THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE STRUCTURES AND FINANCIAL PERFORMANCE OF MANUFACTURING FIRMS IN KENYA

BY

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A RESEARCH PROJECT REPORT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION DEGREE, SCHOOL OF BUSINESS

UNIVERSITY OF NAIROBI.

NOVEMBER, 2014

DECLARATION

Student's Declaration

I declare that this research project report is my original work and has never been previously published or submitted elsewhere for assessment or award of a degree

_____

David Ngera Marikio

D61/75619/2012

Supervisor's Declaration

This research project report has been submitted for examination with my approval as the University Supervisor

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ACKNOWLEDGEMENT

I thank the Almighty God for his grace and favour. For the gift of health and resources that he gave me throughout this academic journey.

My appreciation is to all the dedicated lecturers from the University of Nairobi who always gave us the encouragement during the coursework. In particular, special thanks to my supervisor Mr. Cyrus Iraya, for his expert guidance, constructive criticism and patience when I was doing this research project.

I also wish to express my gratitude to all those who took time to respond and provide information for my project, my colleagues at work for their support, and those special fellow students with whom we started and remained to encourage each other to the end of this journey.

God bless you all.

DEDICATION

This work is dedicated to my entire family.

To my parents Michael and Lydia Marikio who despite not having the opportunity themselves, had hope, and sacrificed to take me to school to ensure I got the best foundation for succeeding in life.

To my beloved wife Evangeline and our children Jesse and Abigail, for their unwavering love and support that enabled me pursue my academic dream.

I will be forever grateful.

ABSTRACT

Corporate governance in business circles is merely understood to mean ensuring that the companies are managed profitably in absence of malfeasances by the management or simply "good governance". Corporate governance structures and their relationship to good governance and hence profitability and financial performance is therefore a higher level understanding of corporate governance. Scholars, investors, top level managers and legal experts are more interested with the structures of corporate governance because they form the engine that determines good governance. In that regard, this study sought to examine the effect of corporate governance structures on the financial performance of the manufacturing firms in Kenya

A correlationship research design was adopted in the study of 43 out of a target of 54 manufacturing firms operating in Kenya between the years 2009 and 2013. Descriptive statistics and inferential statistics were used in the study. Descriptive statistics were used to establish the prevalence of the corporate governance structures. Inferential statistics used Pearsons and Spearman least squares to establish correlation between the corporate governance structures and financial performance and the inter-relationship of the governance structures. ROA was used as the financial performance measure. A regression model was applied to establish the relationship between corporate governance structures of; independent directors, audit committees, board size and CEO duality, and ROA. Firm size as measured by logarithm of assets and the age of the firm were used as control variables.

The results of the study indicated a strong relationship between corporate governance structures and financial performance of manufacturing firms in Kenya. The relationship however varies between the different structures with independent directors had a strong correlation (0.668). Audit committee also had a strong relationship (0.676). Board size had moderate relationship (0.376) and CEO duality had the least correlation among the corporate governance structures studied (0.253). Among the control variables, firm size had a strong correlation (0.881) while age of the firm had a weak one (0.296).

The study has spatial limitations because it was carried out in Kenya and focused to a single sector or industry of manufacturing firms. More broad studies therefore need to be undertaken before generalising the findings of this study.

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ACRONYMS

AGM	**-**	Annual General Meeting
ANOVA	**-**	Analysis of Variance
CBK	**-**	Central Bank of Kenya
CEO	**-**	Chief Executive Officer
CMA	**-**	Capital Markets Authority
GAAP	**-**	Generally Accepted Accounting Procedures
ICPAK	**-**	Institute of Certified Public Accountants
KAM	**-**	Kenya Association of Manufacturers
KCGI	**-**	Kenya Corporate Governance Index
NSE	**-**	Nairobi Stock Exchange
ROA	**-**	Return on Assets
ROE	**-**	Return on Equity
USA	**-**	United States of America

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Governance has acquired a higher level of status and importance in management of organizations today. The need for greater integrity, transparency and availability of information are central to stakeholders in a measure equal to financial performance of an organization. The much publicized financial scandals including Enron, Parmalat and WorldCom were allegedly attributed to unethical behavior of top management of companies especially the directors. Though financial scandals are not new in the history of corporates, there is a renewed urge and concern on how to control managerial discretions over corporate issues whose impact on the interest and welfare of the stakeholders is big. Directors in pursuit of profitability are expected to uphold ethics. The old maxim of "the end justifies the means" has been replaced with accountability of the process. Anderson, Mansi and Reeb (2004) posit that there exists a strong relationship between good corporate governance and firm performance in the long run.

The Corporate governance concept arises from separation of ownership and control of businesses or firms. The shareholders provide investment capital and therefore own the firms. They however entrust management of the firms to directors. This principal-agent relationship as cited by Berle and Means (1932) in their classical thesis "The Modern Corporation and Private Property" forms the backbone of corporate governance today. Naturally, this relationship raises conflict as the directors tend to pursue their own

opportunistic interests at the expense of shareholders objectives. Corporate governance is concerned with how to ensure managers prioritize shareholders' interests and reduce the agency costs. The owners' dilemma is selecting the most capable managers, and deciding which incentives would curtail those managers' opportunism.

Several theories have emerged expounding on corporate governance. The agency theory advanced by Berle and Means (1932) characterizes the relationship between the agent and the principal to be that of mistrust and competing interests. Conversely, the Stewardship theory (Davis, Donaldson and Schoorman ,1997) replaces mistrust with goal congruence. It suggests that managers' need for achievement and success can only be realized when the organization performs well. Good firm performance translates to management gain and individual achievements. Managers can therefore be trusted to pursue shareholders' interests. The Stakeholders theory (Clarkson, 1994) recognizes existence of other stakeholders including suppliers, customers, other organizations, employees and the community. Managers have a moral and professional responsibility of considering interests of other stakeholders together with those of shareholders. The Resource dependence theory (Pfeffer, 1972) introduces organization's accessibility to resources in addition to separation of ownership. Information resource and strategic linkages with other organizations through the Board are considered to be critical resources for a firm's good performance.

Though contextual study of corporate governance reveals uniformity of concept, understanding, and therefore acceptance, there is however a difference in practice depending on the nature of the industry and ownership structure of firms. Ownership

structure of organizations is either concentrated or diluted. Concentrated ownership has few large shareholders exercising strong control and letting managerial discretion (Tricker, 1993). Diluted ownership has many shareholders with little individual control, leaving high managerial discretion and the questions of governance are more pronounced (Datton& Dalton, 2005). Governance on manufacturing organizations concentrates on diverse stakeholders in addition to the owners. Manufacturing firms must take into consideration the interests of their suppliers, customers, and the community who relate directly and indirectly to the organization (Gompers, Ishii and Metrick, 2003).

1.1.1 Corporate Governance Structures

Corporate governance structures determine the way in which power is exercised over corporate entities. Fundamental to any corporate governance structure is establishing the roles of management and the board, with a balance of skills, experience and independence on the board appropriate to the nature and extent of company operations (ASX Council, 2003). Power means the limits of discretion or checks and balances instituted at the board level to ensure fairness, accountability, integrity and transparency in the management of the organizations. Governance structures include; chairman of the board, independent directors, board size, board management, board committees, chief executive officer (CEO) and ownership. The Chairman of the board of directors has the responsibility of ensuring existence and vibrancy of board committees, verification of the organization structure, recruitment and appointment of independent directors (Johannison and Huse, 2000). More importantly, the chairman is required to organize, plan and lead during directors meetings by ensuring board room ethics are observed and that the board draws strategies to guide the organization (John and Senbet, 1998)

The board is composed of both executive and non-executive directors. Executive directors are appointed by the shareholders at Annual General Meeting (AGM). They are referred to as inside directors because they have substantial share in the company. Non-executive directors are appointed by the executive directors to balance or supplement the board in terms of skills, gender, expertise, exposure and networking. The non-executives are independent directors and are noted for their professionalism and impartiality because they have no competing interests. They are persons of integrity, repute and worth whose sole objective is to ensure growth of the organization by upholding rules and requirements of governance (Rosenstein and Wyatt, 1990). Non-executive directors head key committees of audit, nomination and maintain close link with the internal audit department and the CEO for effective monitoring.

Board independence is the degree to which the members of the board make informed decisions without external influence. The external influence to the board arises largely from the ownership of the company or a domineering chairman. Where shareholding in concentrated, persons or institutions having substantial shares in the company exert influence in passing board decisions and resolutions. The block shareholders usually occupy chairman's position in the board from where they project a domineering attitude. They articulate policies and strategies which favour their interest and push for their adoption by the board. The independence or impartiality of the board is therefore lost as it serves to rubber stamp block shareholders' interests (Datton and Dalton, 2005).

Board size is the total composition of the board including the executive and non-executive directors. Board size is surrounded by two contrasting arguments; increase in

agency cost; and skills or experience diversity to enable it offer advice to the company. Hermanlin (2003) posits that agency cost increases out of allowances paid out to many board members and managerial complexities associated with coordinating a large team. A big board is on the other hand noted to have increased capabilities in offering consultancy advice and strategic linkages to the company. Though there is no prescribed board size, a balance between the two contrasting logics guides in not having a too small or too big a board (Shirdasani, 1993).

Board committees are working subsystems of the board system. They are work units or departments of the board that are assigned specialized functions. The committees are headed by directors who have expertise or skills in the respective profession or training. The committees are aligned to the functional structures of the organization so that the boards can exercise effective monitoring and control of the organization. Common committees of the board which form part of the governance include the Board audit committee and the Remuneration committee. Other committees include environment, staff development, recruitment nomination, finance, and production committees. To perform their monitoring and oversight roles effectively, board committees should comprise independent or non-executive directors (Lishenga and Mbaka, 2010).

The CEO is appointed by the board to manage day to day operations of the company ensuring good governance and implementation of the strategies formulated by the board of directors. The CEO's position is double edged; it represents the board at management meetings by articulating board strategies and represents management and employees at the board (McGrath, 2009). CEO's position is the face of the board in governance and

performance of the corporate. Though the CEO reports to the board, he is noted to have an independent field in the day to day operations of the company. The Governance question in CEO arises in the duality concept. Duality arises where the CEO is also the chairman of the board. Conflict in management arises whereby as a chairman with supervisory duty over CEO, he would be supervising his own work similar to a candidate marking their own examination papers. Bias would naturally arise and separation of the two positions is highly advocated to enhance control. A CEO having a dual role is noted to dominate the board because of the mixture in channels of communication (Nicholson and Kiel, 2007). Stewardship theory nevertheless favours duality by arguing that there is congruency of objectives and that agency cost is minimized through reduced cost of monitoring (Abdullah and Valentine, 2009).

Ownership as a structure of governance is viewed from the dimensions of concentration or dispersion of shareholding. Dispersed ownership occurs when the shareholding is spread across several shareholders who hold few shares and hence have minimal individual influence. Concentrated ownership is where large volumes of investment or share blocks are held by individuals or institution. Concentrated or block shareholding exercise a higher degree of control on management and are domineering to the board. Their share of risk in the company is high and hence they seek for control of the board of directors and CEO appointment (Dahya, McConnel and Tavlos, 2002).

1.1.2 Financial Performance of Firms

Performance of a firm can be described as the extent to which the firm is able to achieve its set financial or non-financial objectives over a period of time. Like in any other

industry, the main objective of manufacturing firms is to generate and sustain shareholder value; and in the long term, their survival depends on their performance. Traditionally, financial measures have been used to evaluate the success of a company (Tangen, 2003).Financial performance of firms has several measures depending on the researchers' objectives. This study shall use the following financial performance measures; Return on Equity (ROE), Net Profit Margin, Sales Growth, Tobin's Q, Divided Yield and Return on Assets (ROA).

ROE is a financial measure that gives a ratio of profits before extraordinary items. A high return on equity indicates a better firm performance because it is highly dependent on the bottom line of the company. Net profit margin is the ratio of income before extraordinary items available for common equity and net sales. The ratio indicates contribution of sales to the total income earned. Sales growth is the change in gross sales on a year to year. Tobin's Q is a financial valuation model that indicates the relationship of the value of equity in relation to the total assets. Tobin's Q is based on the maxim that equity prizes are represented by increase in value of assets (Gompers et al, 2003). Dividend yield gives the relationship between dividend per share and the stock prize. Highly prized shares are assumed to have a high dividend yield. Return on assets (ROA) indicates the ration of income earned before tax to the total assets of the firm.

1.1.3 Corporate Governance Structures and Financial Performance

There is an assumed relationship between corporate governance and financial performance of an organization. Good corporate governance structures encourage companies to create value and provide accountability and control systems commensurate

with the risks involved. There is a basic need for integrity among those who can influence a company's strategy and financial performance, together with responsible and ethical decision-making (ASX Council,2003). However, studies done by different researchers have found conflicting results. Similarly, the various financial performance measures do not give similar findings when tested with similar data for different businesses.

Bhagat and Black (2002)did not find Tobin's Q to increase in board independent but Lawrence and Marais (2004) find a positive relationship between boards' independence with increased returns on equity, higher profit margins and larger divided yields. Klein(2002) documents a negative relation between earning management and audit committees. Frankel, Nelson and Johnson (2002) however shows a negative relation between earnings management and auditors independence. Studies taken on the dual role of Chairman also acting as the CEO indicate that there are higher agency problems when the same person holds both positions. Yermach (1996) shows that firms are more valuable when the CEO and board Chairman positions are separated.

1.1.4 Manufacturing Firms in Kenya

Manufacturing is one of the most important contributors for the Kenyan economic development. Apart from being a major source of foreign exchange, manufacturing provides opportunities for economic diversification. Various business and economic review papers indicate that Kenya has earmarked the sector for growth and development because of its potential for wealth creation, employment and poverty eradication. United Nations Development Organization (UNIDO), 1987 classified the Kenya manufacturing sector as a slow growing when compared to the other sectors like Agriculture, Tourism

and Commerce. However, the sector's importance is classified above the other sectors in terms of multiplier effects towards solving macroeconomic challenges of unemployment, unbalanced international trading, and utilization of available raw-materials especially agricultural value addition. As a consequence the Government of Kenya established the Ministry of Industrialization and developed several strategic sessional papers to guide industrialization and development of manufacturing sector. Key strategic papers include: the economic recovery strategy for wealth creation 2003-2007; and Kenya industrialization strategy, 2005.

The Kenya Association of Manufacturers (KAM) indicates that there were over one hundred and fifty manufacturing firms in Kenya as at 2012. This excludes cottage industries which largely operate in the informal sector or "Jua Kali" and whose financial data is difficult to obtain. The manufacturing firms can be classified into the industries or segments of; building construction and mining, chemical and allied, energy and electrical or electronics, food and beverage, leather and footwear, metal and allowed, pharmaceuticals and medical equipment, plastic and rubber, textiles and apparels and timber wood and furniture. (A list of manufacturing firms in Kenya is provided in the appendix I).

The Ownership of manufacturing firms in Kenya is diverse with some being state corporations, private or family businesses or public companies whose shares are listed in Nairobi Securities Exchange (NSE) Governance structures for public companies are largely dictated by NSE and Capital Market Authority (CMA). Most of the private companies have boards of directors but their corporate governance structures are

unregulated. The state owned companies are regulated by the Acts of parliament that formed them. Manufacturing firms in Kenya have KAM as their lobby association. The lobby organization engages the government and public in articulating the interests of the members especially those involving budgets, registration, infrastructure and public relations.

1.2 Research Problem

Governance and control in manufacturing firms presents unique phenomena because the firms are involved with value addition process which has many forward and backward linkages. The linkages reach to several stakeholders and calls for provision of a lot of resources. This requires involvement of various corporate governance theories. The complex nature of manufacturing sector also means that corporate governance and the applicable control mechanisms in this sector may be better understood if the structures of corporate governance are studied separately.

The influence of the corporate governance structures on a firm's financial performance is industry specific. Each structure influences financial performance differently. There is therefore a need to study each of the structures independently. Most manufacturing firms in Kenya are commercial driven with investors keen on effective monitoring and controls to ensure effective utilization of resources and profitability. For this reason, manufacturing firms in Kenya exhibit almost all the various governance structures, namely; board size, CEO duality, ownership control, audit committees, and independent directors. This sector therefore provides an excellent situation in understanding the influence of corporate governance structures on financial performance of a firm.

Corporate governance issues have been a major concern for the manufacturing sector in Kenya. The period from 1980's to 2010 witnessed failure of many companies with governance being cited as the root cause. These companies include; Kenya Co-operative Creameries, Kenya Meat Commission and Rift Valley Textiles. More recent include Uchumi Supermarkets, East Africa Portland Cement and Cooper Motors Corporation. These corporate failures and numerous litigations levelled against management of organizations emphasize the need to objectively evaluate governance in local organizations.

The Kenya Vision 2030 has highlighted industrialization and specifically local manufacturing to be a key component of achieving targeted economic growth. This is because the sector enhances value addition to agricultural products through a business strategy with extensive linkages and a huge economic multiplier effect. The sector is attracting renewed interest from investors and good governance is a major requirement. The researcher's interest arises from this enhanced importance of manufacturing sector and the scholarly duty of contributing to Vision 2030 goals.

Previous studies dwelling on corporate governance and financial performance have not focused on the control efficacy of governance structures in manufacturing firms in Kenya. Aboagye and Otieku (2009) studied on association of corporate governance and microfinance institutions performance in Ghana. Gompers et al (2003) evaluated the relationship between corporate governance and equity prizes. Mayer (1996) studied on corporate governance, competition and performance. Mwangi (2012) focused on corporate governance and performance of Banks in Kenya. The study showed a positive

relationship between corporate governance and banks performance. Although the studies generally indicate a positive relationship between corporate governance and performance, the structures have not been individually evaluated on their influence on financial performance of manufacturing firms.

To the best of researcher's knowledge, there is no known study that has been undertaken on the relationship of corporate governance structures and financial performance of manufacturing firms in Kenya focusing on individual governance structures. The study intends to fill this gap. The researcher seeks to achieve this by investigating and answering the following research question: What is the relationship between corporate governance structures and the financial performance of manufacturing firms in Kenya?

1.3 Research Objective

To establish the relationship between corporate governance structures and the financial performance of manufacturing firms in Kenya.

1.4 Value of the Study

The study is of practical relevance to the investors of various companies who entrust their investment to management. The investors shall use the study to devise or enhance monitoring and control mechanism to management. They will gain insight on the various structures of the governance and hence make practical interpretation in relation to the nature of operations in their organizations.

Regulators like Nairobi Securities Exchange, Capital Market Authority and the government will use the study to enhance their framework of regulations and practices to be used on corporate governance. The Regulations and practices once established and

implemented shall be a step towards in reducing failure of corporates due to poor governance. Reduced failure of corporates leads to increased investor confidence and more investments in the economy.

Academicians will apply the knowledge from the study for further research in developing appropriate theories and principles in corporate governance and financial performance.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter highlights briefly a review of literature on corporate governance theories relevant to this study. It also presents a few empirical studies conducted by other researchers explaining the relationship between corporate governance structures and the financial performance of firms. The purpose of the review is to provide more insight in the research area and to avoid duplication of what has already been researched by others. The chapter concludes with a summary of the empirical studies. The literature reviewed is based on relevant journals, books and recent academic research papers.

2.2 Theoretical Review

Since the preliminary work by Berle and Means (1932), the agency theory forms the basic framework of corporate governance. Subsequently, scholars and practitioners have proposed other theories seeking to provide more insight in study of corporate governance. This section provides a review of the Agency theory and other important corporate governance theories relevant to our study. Among the relevant theories advanced, stewardship theory, resource dependence theory and stakeholders have a higher emphasis on corporate governance structures and firm performance.

2.2.1 The Agency Theory

Berle and Means (1932) discussed the issues surrounding the separation of ownership and control on management of large firms. Their views were later to become more widely acknowledged after Jensen and Meckling (1976) formulated the agency problem. Jensen

and Meckling defined the agency relationship and identified the agency costs. An agency relationship exists when the owners who are the principals engage managers as their agents to perform the services of running the firms on their behalf. The Agency theory suggests that a fundamental problem arises when shareholders, not involved in running the firms, employ professional executives to act on their behalf. The root assumption informing this theory is that the agent is likely to serve their self-interests and opportunistic tendencies at the expense of their principals' objectives.

The primary objective of the shareholders is to maximize their wealth or value of the firm. However, management decisions and actions are not always consistent with this goal. Power struggle and conflict of interests are a common feature of the power sharing relationships in business organizations. Acts of earning management, long term projects, hefty salaries, major constructions deliberate and intentional bringing down of corporate are arsenals of management aimed to shareholders with the objective of prolonging their stay in the corporate against shareholders interest (Gompers et al, 2003).

To counter the agency conflict problems, shareholders or the principal have to incur agency costs. Fama and Jensen (1983) posit that there is increase in agency costs arising from the unhealthy relationship between principal and the agent. The cost includes cost of restructuring contracts to address management's interest, cost of monitoring and controlling the behaviour of the agents or management by the shareholders and loss incurred due to sub-optimal decisions being made by the agents. Such costs have the capacity to influence the financial performance of the firm and hence the need to institute corporate governance mechanisms. Donaldson and Davis (1991) hold that managers will

not act to maximize returns to shareholders unless appropriate governance structures are implemented in the large corporation to safeguard the interest of the shareholders. This is therefore a linkage between corporate governance and corporate's financial performance.

2.2.2 The Stewardship Theory

Stewardship theory is aligned to the Human Relations school of thought (Hung 1998) and organization theory (Clarke, 1998). The theory's basic premise is that directors have a fiduciary duty and that they can be trusted and will act as stewards over the resources of the company (Mason, Kirkbride and Bryde, 2007). Directors as stewards of the corporation work diligently to attain high levels of corporate profits and shareholders return. Thus organizational financial performance and shareholders wealth will be maximized by empowering managers to exercise unencumbered authority and responsibility (Donaldson and Davis, 1994). Davis et al., (1997) posit that directors in stewardship theory are not motivated by individual goals but rather align themselves with the objectives of their principals. According Donaldson and Davis (1991), managers are primarily motivated by their desire for achievement and responsibility. Absence of managerial opportunism in stewardship theory is out of managerial rational thinking that there is a mutual gain for both the managers and the organization. Managers are of the view that improved performance of the company leads to individual managerial benefits of growth, dividends, and personal development.

Stewardship theory addresses relationships of corporate governance structures and firms performance in a variety of ways. It advocates for CEO's quality as a means of reducing agency cost. The CEOs position is bestowed with trust, authority and the prerequisite

discretion in making of decisions (Davis et al, 1997). Stewardship theory is of the view that duality creates harmony between the board of directors, managers and shareholders. Harmony reduces conflicts and mistrust in the board which are counterproductive and negatively affect firm's performance (McGrath, 2009). Convergence of interest and entrenchment by the directors or management in stewardship theory helps to improve performance of the organization (Pergola and Joseph, 2011). Convergence occurs when directors acquire stock ownership of the company incrementally through stock option or direct buying from stock exchange. Due to stock ownership, directors or managers shall consequently align their interests with the stockholders and will therefore make good quality decisions that increase firm performance (Beasley, 1996). Entrenchment of management into ownership reduces acts which may affect cash flow through fraud (Griffith, Fogelberg and Weeks, 2002). Earnings management is also likely to reduce with the stewardship theory. Dechow and Skinner (2000) defines earnings management as a purposeful intervention in the external financial reporting process with intent of seeking some private gain. Earnings management includes fraud and noncompliance with generally accepted accounting principles (GAAP). Trust, loyalty, commitment and convergence of interest which are tenets of stewardship theory drastically reduce earnings management and therefore improve financial performance.

2.2.3 The Stakeholders Theory

The Stakeholders theory takes a pluralistic approach by considering other stakeholders in addition to the shareholders (Clarkson,1994). The term stakeholder includes all individual or groups with a legitimate claim in the firm. They include; customers, suppliers, employees, local community all who interact with the firm in reciprocity. The implicit

and explicit contracts between the firm and stakeholders demand that the directors put structures in place where the stakeholders can state their case, reduce the effects of information asymmetry and enforce systems built to protect the rights of stakeholders (Bonnafous-Boucher, 2005).

The implication of the theory to firm financial performance is on how the board of directors is constituted including its size and diversity of membership. The theory suggests that the Board should be composed of representatives of all stakeholders who are critical to a company's success. Such a board will build consensus and mediate on conflicts that arise out of competing interests of stakeholders (Luoma and Goodstein, 1999). However inclusion of stakeholders may result to a bloated board of directors. Board structure and board size have an implication on financial performance of an organization. Board structure reflects the diversity of board members in terms of gender, age, relevant experience and stakeholder's representation. Too broad a diversity inclusion shall result to a bloated board size. Coordinating a large board is time consuming, resulting to delay in decision making, inflexibility and slow response in picking environmental opportunities and acting on environmental threats. Free riders who are without corresponding impact to relevant decision making by the board may thrive in a large board size, hence increasing the agency cost (Hermanlin et al 2003). Firms with small board size perform better and are more highly valued compared to those with too many members. Small board sizes have a reduced agency cost, are quick in response and in decision making and are effective in monitoring. However, small boards are noted to have deficiencies in lack of experience and expertise and hence may not make quality financial decisions (Datton & Dalton,2005).

2.2.4 Resource Dependency

Resource dependence theory is based on the supposition that board size and composition are not random or independent factors, but are rather, rational organizational responses to the conditions of the external environment (Pfeffer, 1972). The theory emphasizes on the need and ability of the board of directors to offer to management the required resources. Such resources are availed through networking with external environment, development and maintenance of a strong web between organization and technology suppliers, potential investors, vertical integration in the supply chain management and the market. The board plays this role effectively through their sound and professional networks and interlocking directorates (Johannison and Huse 2000). The four types or categories of resources that the boards should provide includes; (i) advice, counsel and know how; (ii) Legitimacy and reputation; (iii) channels for communicating information between external organizations and the firm; (iv) preferential access to commitments or support from important factors outside the firm (Pfeffer and Salncile, 1978).

Resource dependence theory relates to corporate governance through the composition of non – executive or independent directors. Non-executive directors are appointed to the board to supplement the skills and professional deficiencies exhibited by the directors who are appointed by the shareholders in the annual general meeting (AGM). In appointing the non-executive directors, the chairman of the board is guided by the professional deficiency of the board and strategic needs of the organization such as image of the company, reputation and ability of non-executive directors to network. Non-executive directors play a significant role in averting organizations financial crisis by upholding professionalism and challenge the executive management (Tricker, 1993).

Non-executive directors are noted to head the critical board committees of audit and remuneration. The audit committee is directly linked to internal audit function and plays an independent role in monitoring and evaluation of organisation's operations. As head of audit committee, non-executive directors offer expertise advice on finance and governance. They ensure performance of internal control systems and compliance to GAAP. Arthur Andersen (1994) points out that compliance is directly linked to performance of the organization because it ensures cost reduction, disclosure of financial information in the financial statements, reduction of fraudulent activities, safeguarding of assets, fiscal compliance, environmental compliance and transparency in business process. Non-executive directors place a strict control on salaries and remunerations offered to the directors or management when they head of the remuneration committees. They advise on the market trends and challenge the directors on the abuse of salaries and allowances which affect financial performance of the organisation (Podrug and Millic, 2010).

2.3 Determinants of Financial Performance for Manufacturing Firms

Financial performance is an area of primary concern to the shareholders and other stakeholders of any organization, for the reason that, financial performance has implications on the organizations survival and competitiveness. Naser and Mokhtar (2004) describe high performance as reflecting the efficiency and effectiveness which management employs the organizations resources. Manufacturing firms are involved in value addition process through transformation of raw materials to finished products. Thus, measuring their operational performance would equally be appropriate as it would lead to process improvement (Harrington, 1991).Financial performance of a firm is

dependent upon several factors which vary across the firms and the industry. Among the most common factors are; size of the firm, production, sales and corporate governance.

Firm size is represented by book value of the total assets. Total assets represent the ability of the firm to generate revenue and therefore profitability (Sun and Tong, 2003). Larger firms have a financial advantage since they can benefit from wider business relationships. The larger firms have easier access to critical factors of production including human resources and easier and cheaper funding. These benefits have a positive effect on financial performance.

Production affects financial performance in the dimensions of cost efficiency and capacity. Firms that have invested in better, modern production plants and technology have the ability to achieve higher productivity at a lower cost. Cost efficiency, which directly contributes to a firm's profitability, is determined by the technology adopted by the firm while capacity is determined by machine capital investment made by the firm (Tadesse, 2004).

Sales is the revenue flowing into the firm determined by the marketing strategies of the firm as envisaged through advertisement and promotion activities, market share and new product development. Ross, Westerfield and Jaffe (1996) explain that sales turnover of a firm has a direct effect on the profitability of a company. Firms with a larger sales turnover are viewed to be more effective utilization of a firm's assets, higher profitability and therefore higher financial performance.

Corporate governance is however the critical determinant because it ensures that there is no pilferage of finance and that the finances are directed to the areas with the highest

returns. Langat (2013) quoted reports from surveys carried out by consultants McKinsey International, PricewaterhouseCoopers and Kuala Lumpur Securities Exchange on the effects of corporate governance on firms in Malaysia. All the three surveys concluded that Investors present and prospective were willing to pay more for the stocks of firms with superior corporate governance structures in place.

2.4 Empirical Review

Empirical studies on corporate governance have concentrated on separate elements or categories of corporate governance in areas of board independence board size, CEO quality, ownership, audit committee, non-executive directors, and remuneration committee. The studies have resulted to different conclusions depending on the method used or determinant of financial performance applied.

Gompers et al (2003) studied on corporate governance and equity prices fostering the theme of power sharing relationship and the value of the company or equity prices for 1500 large firms in a period of 10 years since 1990 in United States of America (USA). Governance variables used included voting rights and powers of shareholders, compliance with state legislation e.g. anti-greenmail, directors' openness and delays in company's responses. Various multi-regression analysis models were applied to fit each of the governance variables. The firms on the basis of analysis were categorized into democratic portfolio and dictatorship portfolio. Democratic portfolio represented firms where shareholders enjoyed high disclosure, compliance to anti-greenmail laws and could easily remove directors. The results of the study were that democratic firms were associated with good governance experienced higher returns. The firms were noted to be transparent, complainant and directors exercised diligence in their decisions because of

the high accountability expected from them. Democratic firms were found to respect the rights of the minority in shareholding through financial disclosure and compliance to the state regulations and hence increased values of the firm.

Aboagye and Otieku (2009) studied on relationship between microfinance institution performance and corporate governance in Ghana. 30 firms were randomly sampled and were categorized into four groups on the basis of several dimensions of financial performance and corporate governance variables or practice. A chi-squared test of independence between the two groups was performed. Corporate governance variable that were tested were board qualification and experience, board diversity, board committees and CEO duality. The findings were that corporate governance is a predictor of financial performance for firms that were categorized to have excellent corporate governance. However, average score depicted that there is no association between the state of corporate governance and financial performance.

Lishenga and Mbaka (2010) carried studies on the link between compliance with corporate governance disclosure code and firm performance for Kenyan firms. The study focused on the firms listed in the Nairobi Securities Exchange (NSE). Financial performance was related to finance reporting disclosure as required by capital market authority (CMA) and measured against a constructed Kenya Corporate Governance Index (KCGI). The study's main objective was to link the financial performance to disclosure and the value of the shares. A sample of 35 firms from a population of 55 firms listed in NSE was selected. Performance measures of Tobin Q, ROA, and ROE were used. A Multiple regression model was applied to corporate governance variables of board size,

block holding directors, size of the organization and leverage. The model applied is: firm performance = βCG1 + Board size + β_{3lev} + βblock holdings+ $\beta_6$director holding. The study found out that firms with more than 50% outside directors had a higher financial performance and were more highly valued with increasing share process.

Ujunwa (2012) studied on board characteristics and financial performance of Nigeria quoted firms. With a population size of 212 firms the study sampled 122 quoted firms. The study employed the random effects and fixed effects generalized squares (GLS) to test the formulated hypothesis. Corporate governance variables hypothesized and tested in the study included board nationality, ethnic diversity, CEO duality, board gender, board size number of directors with PhD qualifications or board skills, firm size and firm age. The results of the study on board nationality were significant and positive especially where foreign based firms are involved. CEO duality resulted to a negative coefficient of the proxy indicating significance in promoting the firm financial performance. Board gender was found to have positive relationship with the financial performance.

Abels and Martelli (2013) studied on CEO duality. The research concentrated on top 500 selected revenue producing companies in USA as published by Fortune Magazine in 2008. Of the total firm sampled 303 exhibited duality while 197 were non-duality. The study largely concluded that most of the respondents were of the view that directors operating under a dual role contribute to management malfeasance, resulting to failure of CEO's to protect the interest of the shareholders fully. The study provides the splitting process where the duality exists. The process recommended is as follows: (i) Independent directors to lead the board as chairman, (ii) CEO to relinquish both CEO and chairman

title to pave way for new actors, (iii) Clear definition of roles to avoid role overlap, (iv) Appoint the right people, (v) Fostering positive relation.

Nyamongo and Temesgen (2013) studied on the effect of corporate governance on performance of commercial banks in Kenya. The study target was 37 out of a total of 43 commercial banks in operation for the five years period ending 2009. Corporate governance variables of board size, independent directors and CEO duality were studied through a defined bank performance model $Y_{it}= \beta_i+\beta_a GOV_{it} + \beta_2 X_{it} + \Sigma_u$ *where :* $Y_{it}$is composite index of performance, GOV is a vector for governance performance, X is a vector conditioning variable such as asset quality, capital adequacy, liquidity management, market concentration and degree of foreign ownership, β_i is an unobserved bank – specific time invariant that allows for heterogeneity of Y_{it} across the banks and $\Sigma_{it}$is the idiosyncratic error term The study found out that board size and the board of directors quality are critical to the performance of banks because directors have a variety of wide knowledge of the industry and hence can monitor and advice managers efficiently and also ensure absence of conflict of interest between the bank and the CBK. The board takes charge of the links with the regulator, hence ensuring compliance

2.5 Summary of the Literature Review

Theories of corporate governance advanced by different scholars provide a guide to understanding the discipline. They also provide a basis of further research, hence the rapid development of the area. The Agency theory depicts directors and managers as opportunists who are guided by irrational personal motives. This is countered by Stewardship theory which views directors to be trustworthy and work for mutual benefits

with the shareholders. Stakeholders' theory expands the study of corporate governance beyond the shareholders and considers external stakeholders like suppliers, customers and the community. There is a common agreement that good corporate governance structures encourage firms to establish accountability and controls fundamental in ensuring good performance and creating value for shareholders.

A review of the empirical literature shows that there exists a significant relationship between corporate governance structures and financial performance. Based on the method applied during the study, different results have emerged. However and to a good extent, the theories have been found to be applicable and consistent when applied in similar situations. These observations tend to suggest that there is no single model of corporate governance structure that can be adopted to work perfectly in all organizations or industries.

Theoretical and contextual frameworks indicate a wide gap in the understanding of corporate governance. While theoretical framework provides a generalized knowledge to guide in application of corporate governance, contextual framework is specific to the industry and more aligned to a firm. Thus there is no specific theory that can address corporate governance problem in a firm. A combination of more than one theory is required to solve arising governance issues in a firm and variation in application is likely to occur even where the problem is unique to an industry. The gaps in theoretical and contextual framework should however not be interpreted to be a weakness of the theories but a basis of further research towards improvement of governance and performance of organizations.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the research methodology that was used for this study. The chapter explains the research design, the target population for the study, data collection methods and instruments as well as the techniques for data analysis and presentation.

3.2 Research Design

The study used correlation research design. According to Albright *et al*. (2011) a correlation research is a procedure in which subjects' score on two variables are simply measured, without manipulation of any variable, to determine whether there is a relationship. The study also adopted a cross-sectional study in which data was gathered just once over the period 2008 to 2012 and as such, a causal study was undertaken in a non-contrived setting with no researcher interference.

3.3 Target Population

Cooper and Schindler (2008) describe population as the total collection of elements that researcher intends to make inferences about. The target population of the study was108 large manufacturing firms selected from the list obtained from the Kenya Association of Manufactures excluding cottages and 'Jua Kali firms'. The large manufacturing firms were selected due to accessibility of data required for the study. (See Appendix for the list)

3.4 Sample Design

Stratified sampling method was used in the study. The method reduces biasness because it captures the information unique to each population strata (Kothari, 2004) Population

strata shall comprise the various sectors of manufacturing industry. Sample size shall be 50% of the 108 firms yielding a sample size of 54 firms. Mugenda and Mugenda (2003) recommend that 10 percent or more of the population is representative of the population.

3.5 Data Collection

Data was collected from annual reports of manufacturing firms submitted to the NSE , Capital Markets Authority and private firms. All the manufacturing firms that had continually operated between 2009 and 2013 were included to ensure that the sampling frame is current and complete. From the financial statements, the researcher collected information on level of number of independent directors, existence of audit committee, board size, CEO duality, firm size and age of the firm**.**

3.6 Data Analysis Techniques

After data collection, the whole process that immediately follows and ends at the point of interpretation and processing data is data analysis (Cooper and Schindler, 2008). Data analysis for this study will be conducted using descriptive and inferential statistics. The specific descriptive statistics used shall be mean scores and frequencies. The particular inferential statistics used will be regression analysis. Multiple regression analysis will be used to establish the relationship between independent variables and the dependent variables in the study model.

3.6.1 Analytical model

The dependent variable that was used was Return on Assets (ROA). ROA is a ratio of income earned to the assets employed by a firm. It portrays how efficiently management is utilizing the assets to generate earnings. A high ROA indicates that the assets contribution to the sales or profitability is high. A smaller ROA indicates that profit

generated is low compared to the investments in assets by the firm (Pandey, 2010).ROA was selected as a measure of financial performance for this study because of its effectiveness in assessing the contribution of a firm's investments in assets to profitability. The researcher also considered that data required for calculating ROA is more easily accessible for both listed and the unlisted private firms.

The regression model to be empirically tested for this study will be the following:

Return on Assets (ROA) = $\alpha + \beta_1$ Independent Directors + β_2 Board Audit Committee + β_3 Board Size + β_4 CEO Duality + μ+ β_5 Firm Size + β_6 Age of the firm

There are three types of variables in the model: The dependent variable (ROA); Independent variables (independent directors, Board audit committee, Board size, CEO duality); and control variables (Firm size, age of the firm).

The regression equation is therefore;

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \mu$$

Where;

Y = ROA = Net Income divided by Average Total Assets

X_1 = Independent Directors = Non-Executive Directors divided by the Total number of directors in the Board.

X_2 = Audit committee = Dummy variable to be assigned. If audit committee exists (value=1) if none (value =0)

X_3 = Board Size = number of directors serving in the Board

X_4= CEO Duality= Dummy variable to be assigned. If the CEO and Board Chairman are the same person (value =0) different people (value=1)

Control variables:

X_5 = Firm Size = Log (Total Assets)

X_6 = Age of the Firm = Log (Length of time the company has been in operation)

α = the constant term while the coefficient β_i**i= 1….6** will be used to measure the sensitivity of the dependent variable (Y) to unit change in the predictor variables.

μ=the error term which captures the unexplained variations in the model.

3.6.2 Test of significance

The F- test was used to determine the significance of the regression while the coefficient of determination, R2, was used to determine how much variation in Y is explained by X. This was done at 95% confidence level. Pearson correlation coefficients was calculated to determine the level of significance in the relationship between the dependent variable, ROA, and the independent variables in the study model. The Statistical Package for Social Sciences (SPSS) will be used to analyze the data.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the results and findings of the study based on the research objectives. The results are presented in the form of summary tables. In addition a regression analysis is used to analyse the data to answer the research objective. The study used mainly secondary data and targeted a sample of 54 manufacturing firms operating in Kenya comprising of both listed and unlisted firms. Data was received for 43 firms, a response rate of approximately an 80%. Mugenda and Mugenda (1999) suggested that for generalisation, 50% response rate is adequate for analysis and reporting, 60% is good and 70% and over is considered excellent.

Table 4.1 shows the response by the firms;

Table 4.1 Response Rate

Data requested	**Frequency**	**Percentage**
Response	43	79.6
Non-response	11	20.4
Total	54	100

4.2 Descriptive Statistics

Table 4.2 below summarizes the descriptive statistics of the variables included in the regression models as presented. It represents the variables of the 43 manufacturing firms operating in Kenya whose financial results for the 2009-2013 financial years were accessible.

Table 4.2: Descriptive Statistics

	Net Profit (PAT)	IND DIR(X_1)	AUD COMM(X_2)	BD Size(X_3)	CEO DUAL(X_4)	F-SIZE(X_5)	AGE(X_6)
Mean	87,300	0.428	0.8	08	0.1	110,273	21.34235
Std. Devn	25,680	3.1	1.612	2.62	0.00	69,316	4.28226
Skewness	5.9825	1.484	1.358	2.745	1.35	3.32	6.4828
Kurtosis	23.586	10.350	8.439	6.557	50.634	19.830	30.7701
Probability	0.000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000

Source: Calculations Based on Annual Reports of Firms from 2009-2013

Notes: IND DIR– Independent Directors; AUD COMM – Audit Committee; BD Size – Board Size; CEO DUAL –CEO Duality;F-SIZE –Firm Size; AGE – Age of the Firm; PAT-Profit After Tax

The mean value of profitability is significantly positive showing general healthy profitability of manufacturing firms. ROA is obtained as ROA = $\frac{M(PAT)}{M(TA)}$where;

M(PAT)= Mean of total profit after tax; M(TA) is mean of total assets, which represents the firm size.

ROA of manufacturing is calculated at 79.17%. This means that on average, manufacturing firms realized a favourable return on asset, invested. From Table 4.2 the firms are noted to have a high standard deviation on PAT (25,680) and total assets (69,316).This implies that there was significant difference between the firms that recorded the highest profits after tax and lowest profits. The implication is the same for the difference in assets invested described by firm size in the table. A high ROA arises from increased sales revenue of the goods manufactured by the firms. Similarly there is interpreted to a low idle capacity of assets whereby only about 20.13 % of the assets are not contributing to profitability. The mean value for Independent Directors (0.428)was measured by dividing the number of independent directors by total number of directors sitting on the board. The table shows that on average total of 8 directors sit in the boards, and on average firms had 3 independent directors in their boards. The Standard deviation is measured at 3.1 meaning that some of manufacturing firms may not have independent directors. This explains the cases for private companies whose ownership and directorship is mostly family based. The skewness of 1.484 indicates that most firms appreciated the importance of independent directors being included in their boards.

Audit committee was dichotomously measured by establishing whether the firm had established a Board audit committee or none. A value of 1 was assigned to indicate presence of the audit committee while value of zero implies non-existence. The study shows 35 out of the 43 firms studied (mean 0.8 on the table) were found to have audit committees. Since, this was an absolute value; it implies that 20% of the firms studied had not established Board audit committees in their board structure.

Board size was measured considering the number of directors sitting in the board for the period under review. Table 4.2 indicates that the mean board size was 8. The figure is slightly below the common practice for corporate governance whereby a board of nine members is considered appropriate (Shirdasani, 1993).With a standard deviation of 2.62 the board size could be higher or less. The small board size may be explained by the fact that most manufacturing firms in Kenya are privately owned and family businesses and therefore do not have many stake holders requiring to be represented in the Boards.

CEO duality was measured by establishing whether the CEO of the firm and the Board Chairman were the same person. A value of 1 was assigned where CEO and Board Chairman were the same person, and avalueof0 if different persons. With a mean value of 0.1, the study found that CEO duality occurred in only4 out of the 43 firms studied. This implies that the practice is not very prevalent in the manufacturing industry. The skewness (1.35) and standard deviation (0.06) support the view that only few firms have one person doubling as the CEO and Chairman of the Board.

4.3 Inferential Statistics

For quantitative analysis the study used regressions model. This model was used to identify various corporate governance structures and how they influence the financial performance of the firm as measured by return on assets. The model also measured the interrelationship between the various corporate governance structures. The determinants of corporate governance were estimated using pooled least squares and general least squares method with cross section weights. This method was adopted to avoid the problem of heteroskedasticity or unpredictable changes of the values of the variables

when using pooled data. During the regression, the common intercept was calculated for all variables and assigned a weight.

4.3.1 Correlation Coefficient

Pearson and Spearman's correlation coefficient generated from the data is indicated in table 4.3. The coefficient of correlation is analysed to determine the relationship between variables or structures and relationship between variables and outcomes such as those between corporate governance structures and firm performance.

Table 4.3: Correlation Matrix Table (2 tailed Pearson correlations)

Correlations								
		ROA	X_1	X_2	X_3	X_4	X_5	X_6
ROA	Pearson Correlation							
X_1	Pearson Correlation	0.668**						
X_2	Pearson Correlation	0.676**	0.931**					
X_3	Pearson Correlation	0.376*	0.352*	0.400**				
X_4	Pearson Correlation	0.253*	0.212*	0.290*	0.214*			
X_5	Pearson Correlation	0.881**	0.408**	0.419**	0.478**	0.245**		
X_6	Pearson Correlation	0.296*	0.352*	0.190**	0.416**	0.410**	0.243**	
**. Correlation is significant at the 0.01 level (2-tailed).								
*. Correlation is significant at the 0.05 level (2-tailed).								

Notes:–X_1 -Independent Directors; X_2– Audit Committee;X_3– Board Size;X_4– CEO Duality;X_5 –Firm Size; X_6– Age Of The Firm

4.3.3 Independent Directors and Firm Performance

The study set to establish the relationship between independent directors and performance of the firms. Table 4.3 above shows that the Independent director's correlation with the firm performance as measured by ROA is strong at (0.668). This implies that inclusion of independent directors in the firm positively impacts performance of the firm. The findings support the view that presence of independent directors in the board enhances better corporate governance practice and improved firm performance (Rosestein and Wyatt, 1990).A similar strong relationship was found between independent directors and audit committees (0.931) supporting the corporate governance practice view that independent directors should comprise the bulk of the audit committees. There is however a weak correlation between independent directors and CEO duality (0.212). Presence of independent directors has little influence on the CEO duality.

4.3.4 Audit Committee and Financial Performance

The study set to establish the relationship between audit committee as a governance structure and financial performance of manufacturing firms. The results in Table 4.3 shows a strong correlationship between audit committee and ROA (0.676) implying that audit committees contribute to better financial performance of their firms. This could be attributed to the role of the committees in enhancing accountability and prudent utilization of resources. A strong correlationship was also recorded between audit committees and independent directors at0.931, this supports the practice that audit committees comprise of a majority membership of independent directors. Lishenga and Mbaka (2010) are of the view that firms with effective audit committees comprised of

independent directors have favourable financial performance. The correlationship of 0.290 between Audit committee and CEO duality would explain that existence of independent directors and strong audit committees are likely to discourage the practice of CEO duality.

4.3.4 Board Size and Financial Performance

A regression was also run to establish relationship between Board size and firm performance. A moderate correlation of 0.376 was established between Size of the Board and performance of the firm represented by ROA. This implies that the number of directors do not significantly impact on a firms financial performance. Boards have an impact on performance of firms but there is a negative relationship between size of the board and performance. Ujunwa(2012) observed that board size plays an insignificant role in firm performance and is associated with high operational cost; while Nyamongo and Temesgen, (2013) noted that other factors such as qualification, experience, exposure, integrity and commitment are more critical to board performance other than the size.

4.3.5 CEO Duality and Financial Performance

The study sought to establish the relationship between CEO duality and performance. The results from the regression show a correlationship of 0.253 between ROA and CEO duality. This measure indicates that CEO duality has a weak relationship with a firm's financial performance. This is in line with the findings of Abels and Martelli (2013) that directors operating under a dual role contribute to managerial malfeasance resulting to their failure to protect the interest of shareholders fully and therefore poor performance by organisations. CEO duality correlationship with the other variables is also weak:

independent directors (0.212), audit committee (0.290), board size (.214). This indicates the unfavourable view held on CEO duality as a corporate governance practice. This could explain the descriptive statistics why most of the firm's studied had the roles of CEO and Chairman of the Board separated and occupied by different persons.

4.3.6 Firm Size and Financial Performance

The size of the firm was included in the regression model as one of the control variables. From the correlation table, there is a strong correlation,0.881 between the firms performance, ROA and the size of the firm The firm size measured by the logarithm of the total assets indicates that those firms with a high asset base will likely register increased profitability, directly related to their ability to generate high level of revenues. This supports the view expressed by Sun and Tong (2003) that firm size plays a critical role in determining the performance of manufacturing firms. There is however a weak correlationship between farm size with age of the firm (0.256) suggesting that the age of the firm does not necessarily translate to growth in the size of a firm.

4.3.7 Age of the firm and Financial Performance

Age of the firm has a weak correlationship with the firm performance or ROA (0.296).This implies that the age has an insignificant contribution with performance and old firms may not perform well simply because they have been in operation for many years. There is however an improved correlationship with board size (.416) and CEO duality (0.410). This may be explained by the fact that as firms grow in years; they may seek to expand their board size but up o a certain number of directors. Similarly, many firms will want to separate the roles of CEO and chairman after they have been in operation for several years.. Age of the firm was also noted to have a weak

correlationship with firm size. Newly created firms may have more assets compared to the older ones depending on the level of investment in capital expenditure by the owners of the firm.

4.3.8 Regression Analysis

The determinants of return on assets are investigated for all 43 firms. From Table 4.5 below, the established multiple linear regression equation becomes:

$ROA = -202.18590 + 2.9273X_1 + 0.0154X_2 + 0.0103X_3 + 0.0117X_4 - 0.127X_5 + 0.082X_6$

Table 4.4: Model of Coefficient

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		β	Std. Error	Beta		
1	(Constant)	-202.18590	-60.618		-1.436	.157
	X_1	2.9273	.901	0.668	3.249	0.00
	X_2	0.0154	.006	0.676	2.566	0.03
	X_3	0.0103	.005	0.376	2.061	0.05
	X_4	0.0117	.006	0.253	1.949	0.046
	X_5	0.127	.036	.881	2.518	0.00
	X_6	0.082	.390	.296	0.21	0.15

Source: 2009 -2013 survey data, researchers' computation

Notes:–X_1 -Independent Directors;X_2– Audit Committee;X_3– Board Size;X_4– CEO Duality;X_5 –Firm Size; X_6– Age Of The Firm

Ho: (null hypothesis): there is no significant relationship between X_1, X_2..... X_6 and performance of the firm (ROA).

H1: (Alternative hypothesis): There is a significant relationship between X_1, X_2..... X_6 and performance of the firm (ROA).

Reject null hypothesis if P Value (significance) is less than 0.05.

This means X_1, X_2..... X_5 have a significant relationship with (ROA) while X6 have an insignificant relationship with ROA.

This means that the corporate governance structures of independent directors, audit committee and firm size have a big relationship with financial performance of manufacturing firms because their *t* value is less than 0.05 and tends towards 0 or is 0. Board size and CEO duality have less relationship with financial performance because their *t* value is close to 0.05. Age of the firm has little relationship with firm performance because its *p* value is greater than 0.05.

Table 4.5: Model Summary

Model	R	R square	Adj. R^2	SE of estimate
1	0.795	0.632	0.628	0.407

Predictors: (Independent Variables) –X_1 -Independent Directors;X_2– Audit Committee;X_3– Board Size;X_4– CEO Duality;X_5 –Firm Size; X_6– Age Of The Firm
Dependent Variable; ROA

R^2 (Coefficient of determination) it shows the model explanatory power. Results in Table 4.6 shows 63.2% of manufacturing firms performance is explained by the six variables X_1 X_2 .....X_6. The remaining percentage 36.8% explained by other factors not in the model.

Table 4.6: ANOVA

Model		Sum of squares	df	Mean of sum of squares	f	Sig
1	Regression Residual	90.791 17.966	6 36	15.1318 0.499	30. 337	0.00
	Total	108.757	42			

ANOVA tests the model goodness of fit. It tests the Null hypothesis that all the beta are coefficients are zero. Since the F = 30.337; p value = 0.00; p value <0.05) then we can reject the null hypothesis and conclude that at least one of the beta coefficient is non zero.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the key findings, conclusions, limitations of the study, and suggestions for further research. The suggestions for future research are based on the findings of this study.

5.2 Summary

The study investigated the relationship between corporate governance structures and financial performance of manufacturing firms in Kenya. The study used mainly secondary data from 43 manufacturing firms operating in Kenya during the 5 years from 2009 to 2013. The study established a positive correlation between the tested variables of corporate governance structures and financial performance. However the significance of that relationship varied between the different corporate governance structures studied.

The mean value of the firms' profitability is significantly positive resulting in a favourable ROA which was the measure of financial performance used for this study. The firms were also found to have put in place governance structures as a practice of good corporate governance in compliance to stakeholders needs, market and statutory requirements. All the firms were found to have set up boards to oversee the operations of the firms. The study showed that most of the boards had incorporated independent directors and constituted board audit committees. The moderate mean values of independent directors and board size can be explained by the high number of private or family owned manufacturing firms which prefer to maintain small boards comprising

family members and close associates. The number of firms having a CEO duality was also low meaning that most firms preferred separated roles of CEO and Chairman of board in line with the recommended good corporate governance practice. However CEO duality is still present especially in the private and family owned manufacturing firms.

The study found there is a strong correlation between the financial performance and the size of the firm while age of the firm had weak correlation with the financial performance of the firm. The observation indicates that those firms with a high asset base registered increased profitability, due to their ability to generate high levels of revenues through sales, and ability to diversify to different business lines. The time a firm was in operation did not directly influence its growth in size or increased financial performance.

Generally, from the results, there is positive relationship between corporate governance structures and firm performance and the correlations are significant. Therefore we can conclude that the results of the regression from the overall model are consistent with previous studies on corporate governance and financial performance.

5.3 Conclusion

The study confirms that setting up good corporate governance structures is an important factor in financial performance of manufacturing firms in Kenya. From the research findings, the relevance of corporate governance structures is practical because it influences both the managerial practice and financial performance. A better understanding of corporate governance is attained when the governance structures are studied and analysed separately as compared to when the study is done broadly and generalised.

Adoption and adherence to good corporate governance practices can greatly assist the manufacturing firms, irrespective of their size, by introducing better management practices, strong internal control mechanisms and greater opportunities for growth. Corporate governance brings new strategic outlook through external independent directors; and thus enhances firms' competitiveness. Good governance mechanisms increases investors confidence in addition to enhanced performance. Investors would consider investing more where there is a culture of good corporate governance because of reduced risk and a higher assurance of returns on their investment.

5.4 Recommendations for Policy and Practice

The study has shown that establishment of good corporate governance structures positively impacts the financial performance of firms. Manufacturing firms could benefit from the findings of this study and those performed by other scholars to develop an improved code of regulations that would enhance the financial performance of the industry. Board structures such as independent directors, board audit committee and board size should be enhanced.

The ratio of independent directors in the board should be raised since they provide a more objective oversight over the decision making, expertise and links to markets and other stakeholders. The independent members should take the lead role in monitoring activities of the firm's operations. Manufacturing firms should embrace and enhance the roles of the Board Audit Committees as they provide the invaluable of helping the board provide its oversight on matters governance, risk management and controls which have a huge impact on the financial performance especially in the volatile manufacturing industries.

The study showed a moderate relationship between the board size and financial performance. That implies the size of the board matters but other considerations especially on board composition. Manufacturing firms should be concerned more with the quality or value added by members appointed to their boards on top of need for independent directors and observing the best practices of the board size of nine recommended by regulators.

CEO duality was prevalent in only a few of the firms studied yet it is seen to have an impact on financial performance. However CEO duality is not completely abhorred. There is therefore a need to develop practical criteria as a guide when and where separation of the CEO and Board Chairman roles is desirable.

5.5 Limitations of the Study

One of the limitations of the study is that, corporate governance practices may be dictated by the contextual situations or the environment where the firms operate. These interrelations were not investigated in this study. Observations which were not the main objectives of this study show governance structures such as the CEO duality, independent directors and size of the board may be affected by factors such as the ownership type and structure, size of the operation and cross-border territorial dimensions.

Secondly, the research is limited to the sample of Kenyan manufacturing firms. Therefore the findings of this study could only be generalized to firms similar to those that were included in this research. The observations from this and previous studies show that even firms operating in the same industry exhibit varying internal characteristics which may

require adoption of different governance structures. There is no such thing as 'one-size-fits-all' corporate governance structure.

In addition, most of manufacturing firms in Kenya were privately owned and not listed in the stock exchange. This makes it difficult to obtain more detailed and reliable audited financial and other operational information. Only 43 out of the 54 targeted samples had their financial statements available. A more conclusive study can be done when the financial results of a larger population are accessible.

5.6 Suggestions for Further Research

The results of this study should provide a suitable basis for further research in order to arrive at a generalised acceptable practise on corporate governance. Further research should cover governance practices outside Kenya and other elements of corporate governance structures. Emerging organisations and board complexities such as stock ownership by executives and board members, block ownership, financial leverage, anti-takeover mechanisms, and executive compensation should be incorporated in the research on corporate governance structures.

Statutory bodies such as CMA and academic institutions including universities should research more on corporate governance practices with an aim of establishing a code of conduct or governance framework that is applicable across all the industries. Such a code of conduct should be based on scientific research and encompass broad disciplines such as accounting, social sciences and legal profession.

The performance of an organization is considered as much broader than financial success considered in this study. Further research can be done to cover relationship between other aspects of corporate governance and dimensions of firm performance such as growth in market share, operational efficiency and other non-financial indicators.

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Appendix I

Questionnaire

This questionnaire has been designed to collect data on the relationship between corporate governance structures and financial performance of manufacturing firms in Kenya. Information provided will be treated with confidentiality and used for the purpose of this academic research only.

INTRODUCTION

This questionnaire is structured into five sections as follows:

A. General data

B. Board Size

C. Independent directors

D. Audit Committee

E. CEO Duality role

A. GENERAL/ DEMOGRAPHIC DATA

Name of Entity (Optional):_____

1. Gender
   a)Male ☐
   b) Female ☐
2. Current Employment/ Management level
   a)Top Management ☐
   b) Middle Management ☐
   c)Junior Management ☐
3. Highest level of education
   a)Secondary level ☐
   b) College level ☐
   c)Post graduate level ☐

4. For how long have you served the in the management capacity?
   a) 1 – 3 ( )

b) 3 – 5 ( )

c) 5 and above ( )

B. BOARD SIZE

Total number of Directors_____(Please indicate number)

Questions

To what extent do you agree with the following statements as observed in your organization? Please indicate so by marking an (X) or a tick (√) in the column that appropriately fits your assessment.

Key: 5 strongly agree; 4 agree; 3 undecided; 2 disagree; 1 strongly disagree

Statement	Rating Score				
	1	2	3	4	5
The number of directors is adequate for my organization.					
A Smaller board size would enhance my organization's performance.					
Conflicts arise in my organization's Board due to its large size.					
A Larger board would provide more resources / capacity for my organization.					
Larger boards are beneficial since firms they provide effective oversight on management of the organization.					
A Larger board improves board performance by reducing CEO domination of the board.					
A large Board provides enough directors and diversity to form appropriate Board Committees.					
Coordination and communication problems are associated with large board size.					
All Directors of the Board contribute effectively despite the large size.					
A large board size has inefficiency in costs like increase of directors' allowances.					

The appropriate board size for my organization would be? _____ (Please indicate number of directors)

C. INDEPENDENT DIRECTORS

i. The Board consists of both executive and non-executive directors.(YES/ NO) ____

ii. Please state the total number of executive/ non-executive directors

Executive directors	
Non-executive directors (Independent)	

Questions

To what extent do you agree with the following statements observed in your organization? Please indicate so by marking an (X) or a tick (√) in the column that appropriately fits your assessment.

Key: 5 strongly agree; 4 agree; 3 undecided; 2 disagree; 1 strongly disagree

Statement	**Rating Score**				
	1	**2**	**3**	**4**	**5**
The number of non-executive directors in the Board is appropriate for my organizations Board.					
Independent directors have an influence in board decisions and the strategies in my organization.					
Independent Directors conduct themselves in a responsible and ethical manner in their conduct of the organization's business.					
The Independent Directors bring value to the Board through effective networking, business connections and expert capacity.					
Independent directors provide effective monitoring, and oversight to prevent conflict of interest and other malpractices.					
The independent directors act objectively to safeguard the interests of shareholders and other stakeholders.					
Independent directors chair and are the majority members of critical oversight committees such as Audit and Remunerations committees.					
The oversight role provided by the independent directors has contributed in improving the financial performance of the organization.					

D. BOARD AUDIT COMMITTEE

i. The Board has constituted a Board Audit Committee. (YES/ NO)_____

ii. The chairman of the Audit Committee is Non-Executive director. YES/NO)_____

iii. Please indicate the total number of executive/ non-executive directors in the audit committee.

Executive directors	
Non-executive directors (Independent)	

Questions

To what extent do you agree with the following statements observed in your organization? Please indicate so by marking an (X) or a tick (√) in the column that appropriately fits your assessment.

Key: 5 strongly agree; 4 agree; 3 undecided; 2 disagree; 1 strongly disagree

Statement	**Rating Score**				
	1	**2**	**3**	**4**	**5**
Role of the audit committee is clearly defined and includes providing oversight on governance, risk management and financial controls.					
Audit committee members demonstrate professionalism, independence and objectivity individually and as a committee collectively.					
The committee membership collectively provides adequate skills and professional skills and experience for their purpose.					
The audit committee meets regularly to ensure compliance with governance policies, legal and other professional requirements.					
The board audit committee's work has contributed to better organization performance					

E. CEO/ CHAIRMAN DUALITY ROLE

The CEO of my organization is also the Chairman of the Board. Please indicate

(YES/ NO)_____

Questions

To what extent do you agree with the following statements observed in your organization? Please indicate so by marking an (X) or a tick (√) in the column that appropriately fits your assessment.

Key: 5 strongly agree; 4 agree; 3 undecided; 2 disagree; 1 strongly disagree

Statement	Rating Score				
	1	2	3	4	5
The roles of the CEO is clearly defined and separated from the role of chairman of the Board					
The CEO is responsible for day to day management of the firm and does not decide or coordinate the board activities.					
The CEO ensures Board resolutions and corporate strategies are implemented as directed by the Board.					
The chairman of the board has no role in the direct management of the organization whether part time, acting capacity or otherwise.					
The role of the Board Chairman includes coordinating the Board and evaluating performance of the CEO.					
The CEO represents management at the Board meetings.					
Separation of the CEO and Chairman roles has contributed to conflict in the running of the organization.					
Separation of the CEO and Chairman's roles has contributed to improved financial performance of the firm.					

F. FINANCIAL PERFORMANCE

Please provide the following financial information from organization as provided in the table below:

YEAR	Total Assets	Net Profit	Return on Assets
2013			
2012			
2011			
2010			
2009			
2008			

G. OTHER RECOMMENDATIONS

Please give your recommendations on whether and how corporate governance structures can be changed to support good financial performance in your organization.

_____
_____
_____
_____
_____
_____
_____

I sincerely appreciate your time and effort to respond to the questions above. Your responses will be treated in strict

Appendix I: List of Target Manufacturing Firms

S/ No.	Name of Company	S/ No.	Name of Company
A	**BUILDING, CONSTRUCTION & MINING=3**	31	British American Tobacco Kenya Ltd
1	Athi River Mining Ltd	32	Brookside Dairy Ltd
2	Bamburi Cement Ltd	33	Coca Cola East Africa Ltd
3	East Africa Portland Cement Co. Ltd	34	Cadbury Kenya Ltd
B	**CHEMICAL & ALLIED=12**	35	Eastern Produce (K) Ltd.(Kakuzi Ltd).
4	Bayer East Africa Ltd	36	East African Breweries Ltd
5	BOC Kenya Ltd	37	Eastern Produce Kenya Ltd (+ Kakuzi Ltd)
6	Chemicals and Solvents (E.A) Ltd	38	London Distillers Co. Ltd.
7	Colgate Palmolive (E.A.) Ltd	39	Jambo Biscuits (k) Ltd
8	Crown Berger Kenya Ltd	40	Kapa Oil Refineries Ltd
9	Cooper K-Brands Ltd	41	Kenchic Ltd
10	Osho chemicals industries ltd	42	Corn Products Kenya Ltd.
11	Crown Paints Co. Ltd.	43	Kenya Tea Development Agency
12	Vitafoam Co. Ltd.	44	Kenya Wine Agencies Ltd
13	Orbit Chemicals Ltd.	45	Koba Waters Ltd
14	Inter-Consumer Products Ltd.	46	Manji Food Industries Ltd
15	Johnson Diversey East Africa ltd	47	Mastermind Tobacco (k) Ltd
C	**ENERGY, ELECTRICAL AND ELECTRONICS=7**	48	Nairobi Bottlers Ltd
16	PCTL Co. Ltd.	49	Nairobi Flour Mills Ltd
17	East African Cables Ltd	**E**	**LEATHER & FOOTWEAR=2**
18	Optimum Lubricants Ltd.	50	Bata Shoe Co. (K) Ltd
19	Holman Brothers (E.A) Ltd.	51	East Africa Tanners (k) Ltd
20	Kenya Shell Ltd	**F**	**METAL & ALLIED=11**
21	Oilibya (K) Ltd.	52	Reliable Engineering Co. Ltd.

22	Manufactures & Suppliers (k) Ltd	53	East African Foundry Works (k) Ltd
D	**FOOD & BEVERAGE=27**	54	Kens Metal Industries Ltd.
23	Patco Industries Ltd	55	Friendship Container Manufacturers Ltd
24	Nestle Foods Kenya Ltd	56	Pipe Manufacturers Ltd
25	Proctor & Allan (E.A) Ltd.	57	Impala Glass Industries Ltd
26	Unga Group Ltd	58	Mabati Rolling Mills Ltd
27	Pembe Flour Mills Ltd	59	Nails & Steel Products Ltd
28	Aquamist Ltd	60	Orbit Engineering Ltd
29	Premier Flour Mills Co. Ltd	61	Steel makers Ltd
30	Eldoret Grains Ltd.	62	Steelwool (Africa) Ltd
G	**MOTOR VEHICLE & ACCESSORIES=4**	90	Kingsway Tyres &Automart Ltd
63	Associated Battery Manufacturers (E.A) Ltd	91	Plastics & Rubber Industries Ltd
64	General Motors East Africa Ltd	92	Packaging Industries Ltd.
65	Auto Spring Manufacturers Ltd	93	King Plastic Industries Ltd
66	Toyota East Africa Ltd	93	Kenpoly Manufacturers Ltd
H	**PAPER & BOARD=13**	95	Kentainers Ltd
67	Carton Manufacturers Ltd	**K**	**TEXTILES & APPARELS=10**
68	East Africa Packaging Industries Ltd	96	Ken-Knit (Kenya) Ltd
69	CartuboxIndustires (E.A) Ltd	97	Africa Apparels EPZ LTD
70	Colour Print Ltd	98	Alltex EPZ Ltd
71	United Bag Manufacturers Ltd	99	Spin Knit Limited
72	Kartasi Industries Ltd	100	Thika Cloth Mills Ltd
73	Nation Media Group Ltd.	101	Midco Textiles (EA) Ltd
74	The Standard Ltd.	102	Riziki Manufacturers Ltd
75	Tetra Pak Ltd	103	Le-Stud Ltd
76	Modern Lithographic Co. Ltd.	104	Straightline Enterprises Ltd

77	Printpak Multi Packaging Ltd.	105	Spinners & Spinners Ltd.
78	Bag and Envelop Converters Ltd.	**L**	**TIMBER, WOOD & FURNITURE=3**
79	Bags and Bailers Manufactures (K) Ltd.	106	Economic Housing Group Ltd
I	**PHARMACEUTICALS & MEDICAL EQUIPMENT=4**	107	Furniture International Ltd
80	Beta Healthcare International Ltd	108	Timsales Ltd.
81	Cosmos Ltd		
82	GlaxoSmithkline Kenya Ltd		
83	Pharmaceutical Manufacturing Co. (k) Ltd		
J	**PLASTIC & RUBBER=12**		
84	Polythene Industries Ltd		
85	Sameer Africa Ltd		
86	General Plastics Ltd		
87	Haco Industries Kenya Ltd		
88	Nairobi Plastics Ltd		
89	Roto Tanks Ltd		