EFFECTS OF CORPORATE GOVERNANCE ON ORGANIZATIONAL FINANCIAL PERFORMANCE IN KENYA: A CASE OF INSURANCE COMPANIES LISTED IN THE NAIROBI SECURITES EXCHANGE (NSE)

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DECLARATION

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DEDICATION

This work is dedicated to my loving husband Martin Wachira for being a source of strength and showing me that all dreams are achievable. It is also dedicated to my sons Caleb and Chris for giving me hope and strength each day.

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ABBREVIATIONS AND ACRONYMS

ADF	Augmented Dickey-Fuller
AKI	Association of Kenya Insurers
BGD	Board Gender Diversity
BI	Board Independence
BLUE	Best Linear Unbiased Estimators
BOD	Board of Directors
CEO	Chief Executive Officer
CG	Corporate Governance
CMA	Capital Markets Authority
EAC	East African Community
COMESA	Common Market for Eastern and Southern Africa
IRA	Insurance of Kenya Insurers
KPSS	Kwiatkowski-Phillips-Schmidt-Shin
NSE	Nairobi Securities Exchange Limited
OECD	Organization for Economic Cooperation and Development
ROA	Return of Assets
ROE	Return of Equity

ABSTRACT

The purpose of this study was to find out the effect of corporate governance on financial performance of insurance companies listed in the Nairobi Securities Exchange (NSE). The study was guided by four objectives – board size, board independence, board gender diversity and CEO duality – to establish their effect on the performance of insurance companies listed in the NSE. Through the use of descriptive research design, the study targeted all the six insurance companies listed by NSE as at December 2014. The sample size was the secondary data published from audited annual reports and websites for four insurance companies – Pan African Insurance Holding Ltd, Jubilee Holdings Ltd, Kenya Re-Insurance Corporation Ltd and CIC Insurance Group Ltd – for the year 2008 to 2014.The data was analyzed with the help of Eviews and was presented into tables. Regression analysis was used to establish the relationship between financial performance and corporate governance for insurance firms listed in the NSE. The study revealed that all the companies had zero CEO duality in which case the CEO's and chairperson of the BOD were different persons. The study further revealed that there was an inverse relationship between ROA and company board size. The findings also revealed that there was a positive relationship between ROA and board independence. There was also a positive relationship between ROA and gender diversity of the board. The study recommends that the board size, gender diversity and composition of the insurance companies should be considered since it affects the financial performance of the organization. It also recommends that insurance companies should review their policies regarding corporate governance. Another recommendation is that the boards need to be comprised of well-educated people since they are actively involved in shaping the firms strategy. Finally, financial monitoring should be done thoroughly by the board.

CHAPTER ONE

INTRODUCTION

1.1 Introduction

The purpose of the study was to establish the Effect of Corporate Governance to the financial performance of insurance companies listed in the Nairobi Securities Exchange

This chapter presents the background of the study, statement of the problem and research questions. It also gives the significance of the study, scope, and delimitation of the study, conceptual framework and organization of the remainder of the study.

1.2 Background of the Study

1.2.1 Corporate Governance

Corporate Governance is defined as the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account interests of other stakeholders. (CMA Act, 2002). Corporate Governance is also defined as an internal system encompassing policies, processesand people, which serve the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity (Mang'unyi, 2011). Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined (OECD, 2015).

Corporate Governance is the system by which organizations are directed and controlled. It is a set of relationship between company directors, shareholders and other stakeholders as it addresses the powers of directors and of controlling shareholders over minority interest, the rights of employees, rights of creditors and other stakeholders (Murithii, 2009)

Governance refers to the manner in which power is exercised in the management of economicand social resources for sustainable human development initiative (McCord, 2002). Accordingto McCord (2002), corporate governance refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation total portfolio and resources, with an objectiveof obtaining increasing stakeholders value, with a satisfaction of other stakeholderswithin thecontext of individual organizations corporate mission and vision, as spelt out in the strategicplan of an institution.

The concept of corporate governance began being used and spoken of in the 1980s, but it originated in the Nineteenth Century when incorporation was being advocated for as a way of limiting liability (Parker, 1996). The rise of modern corporations led to a separation of control from ownership (Berle & Means, 1967). This separation meant that owners of firms no longer controlled the firms' actions because that was the role of professional managers. This gave rise to the need for corporate governance frameworks to protect owners of firms from the actions of professional managers.

According to Francis (2000) the concept of corporate governance gained prominence in the 1980s because this period was characterized by stock market crashes in different parts of the world and failure of some corporations due to poor governance practices. Corporate collapse was the predominant driver for change to corporate governance codes. As more corporate entities in different parts of the world collapsed in the 1980s, there was a change of attitude with much higher performance expectations being placed on management boards of firms. There was also agrowing realization that managers are to run firms while boards are to ensure that firms are run effectively and in the right direction. Directors and managers require different sets of skills and managers do not necessarily make good directors.The idea of corporate governance was quickly adopted in different parts of the world but with some major variations because circumstances vary from country to country.

There has been renewed interest in the corporate governance practices of modern corporations both in developed and developing countries, particularly in relation to accountability, since the high-profile collapses of a number of large corporations most of which involved accounting fraud e.g. Enron, Lehman Brothers Holdings, WorldCom among others. Corporate scandals of various forms have maintained public and political interest in the regulation of corporate governance. Due to 2007-08 global financial crisis that led to the collapse of the corporate giants, international regulators are at hard work to influence the development and implementation of appropriate regulatory controls.

Corporate governance framework in Kenya is advocated by the Centre for Corporate Governance Kenya which is an affiliate of the Commonwealth Association for Corporate Governance. It is well understood that the first attempt to bring into focus the corporate governance framework in Kenya started in 1999 when the Centre for Corporate Governance Kenya developed a framework, which was voluntary for companies to adopt. The framework developed was further taken up by the Capital Markets Authority (CMA) in 2000 as draft corporate governance practices for listed companies in Kenya. In later years the CMA made it mandatory for the listed companies to adopt those corporate governance practices. These corporate governance practices mainly dealt with such issues as board composition, role of audit committee, separation of the role of Chief Executive Officer (CEO) and the chair. In addition, they focused on the rights of the shareholders. (Lekaram, 2014)

1.2.2 Financial Performance

Financial performance is measuring the results of a firm's policies and operations in monetary terms. Financial performance is a subjective measure of the accountability of an entity for the results of its policies, operations and activities quantified for an identified period in financial terms. In the public sector the nature of financial performance is a function of what the public sector entity is held accountable for accomplishing in financial terms in the identified period.

There are many different ways to measure financial performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or

cash flow from operations can be used, as well as total unit sales. Furthermore, the analyst or investor maywish to look deeper into financial statements and seek out margin growth rates or any decliningdebt.

According to Foladi (2012) empirical researches on corporate governance use either market-based measures or accounting-based measures to assess firm performance. We can measure the operating performance of a firm through the return on assets (ROA) ratio which shows the amount of earnings have generated from an invested capital assets. Managers are directly responsible for the operations of the business and therefore the utilization of the firms' assets. , ROA allows users to assess how well a firms' corporate governance mechanism is in securing and motivating efficient management of the firm. In the present study, ROA is defined as net income before interest expense for the fiscal period divided by total assets for that same period (Foladi, 2012). Return on equity (ROE) is a measure that shows an investor how much profit a company generates from the money invested from its shareholders.

The objectives pursued by the shareholders and the corporate managers tend to be differing and contradictory with regards to their own interests. Hence, this has lead to the looking for approaches and processes that ensure that conflicting interest' spill-over are minimized. One of the compromise that has been given birth to address this divergence is corporate governance. Tricker (2000) and Parum (2005) view that the theoretical platform on which foundations of corporate governance is built is weak and as such finds itself deprived of any theoretical base. They conclude that studies carried out on

corporate governance have not been consistent whether empirically, methodologically, or even theoretically. As such, a vast number of theoretical frameworks have seen the day, stemming from the fields of economics, finance,management or even sociology, so as to serve as a basis for researchers in their analysis of CG. Some researchers, with these piecemeal attempts to understanding CG leave them skeptic about the actual function of the BOD in a company, others have adopted an optimistic position and consider that these differing frameworks share commonalities on a theoretical base.

1.2.3 The Nairobi Securities Exchange

The Nairobi Stock Exchange was official set up in 1953 after the officials of the London Stock Exchange accepted to recognize it as an overseas stock exchange. It mainly dealt with the buying and selling of shares. In 1991, the Nairobi Stock Exchange was registered as a private company limited by shares. Share trading moved from being conducted over a cup of tea, to the floor based open outcry system. In 2011, The Nairobi Stock Exchange Limited changed its name to the Nairobi Securities Exchange Limited (NSE). The change of name was a reflection of the 2010 – 2014 strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange, which supports trading, clearing and settlement of equities, debt, derivatives, and other associated instruments (Nairobi Securities Exchange, 2016). The NSE aids the growth of the Kenyan economy by facilitating idle money and savings to be invested in productive activity (Nairobi Securities Exchange, 2016).

The Capital Markets Authority (CMA) is an independent public agency established by an Act of Parliament, Cap 485. The Authority came into being on December 15, 1989 when the Act was passed and was inaugurated in March 1990. (Capital Market Authority, 2016)

The CMA is a regulating body charged with the prime responsibility of supervising, licensing, and monitoring the activities of market intermediaries, including the stock exchange and the central depository and settlement system and all the other persons licensed under the Capital Markets Act. It plays a critical role in the economy by facilitating mobilization and allocation of capital resources to finance long-term productive investments. (Capital Market Authority, 2016)

There are 656 quoted companies divided into 8 categories depending on the economic activity of each company with the insurance category having six (6) companies. Performance of the market and by extension of each company is monitored through the NSE 20 share index and the NSE all-share index. (Nairobi Securities Exchange, 2016)

The CMA has developed guidelines for good corporate governance practices by public listed companies in Kenya in response to the growing importance of governance issues both in emerging and developing economies and for promoting growth in domestic and regional capital markets. It is also in recognition of the role of good governance in corporate performance, capital formation, and maximization of shareholders value as well as protection of investors' rights.

These guidelines have been developed taking into account the work which has been undertaken extensively by several jurisdictions through many task forces and committees including but not limited to the United Kingdom, Malaysia, South Africa, Organization for Economic Cooperation and Development (OECD) and the Commonwealth Association for Corporate Governance. (Capital Market Authority, 2016). This study examines whether the performance of insurance companies listed in Nairobi Securities Exchange is affected by the corporate governance practices put in place.

1.2.4 The Insurance Industry in Kenya

The insurance industry in Kenya is governed by the Insurance Act (CAP. 487) and regulated by the Insurance Regulatory Authority. The Insurance Regulatory Authority is a statutory government agency established under the Insurance Act (Amendment) 2006, (CAP. 487) of the Laws of Kenya to regulate, supervise and develop the insurance industry.

Insurance companies in Kenya operate under their association called Association of Kenya Insurers (AKI, 2016) . This is the umbrella body, which brings the current 46 Insurance companies together. The membership of the Association is open to any Insurance company duly registered under the Insurance Act to transact business in Kenya. (AKI, 2016)

The insurance industry in Kenya has for almost three decades seen a number of changes being introduced and adopted. It is however, concerning to note that eight insurance firms have either collapsed or have been placed under statutory management; representing an average of one insurance company after every four years. These include: - Kenya National Assurance Company, United Insurance Company, Lake Star Assurance Company, Standard Assurance, Access Insurance Company, Stallion Insurance, Invesco Assurance and Blue Shield Insurance Company. In response to this trend, the government of Kenya responded by establishing IRA which is the prudential regulator of the insurance industry in Kenya.

Kenya's insurance industry leads within the East Africa Community and is a key player in the COMESA region. The industry employs over 10,000 people. It is believed that the industry can grow tremendously if the government brings assets into the industry instead of only playing a regulatory role. The common market protocol of the East African Community (EAC) creates a big market full of opportunities. According to Ndung'u, (2012), the future trend of the insurance and reinsurance market in Africa is to be spread across countries with free movement and with the opportunity to exploit full cross-border growth. The industry should therefore prepare for this eventuality in a timely manner. Insurance Companies must also complywith regulations by the IRA which released Corporate Governance guidelines in 2011 to be observed by Insurance Companies.

1.3 Statement of the Problem

According to Wanyama (2013), many companies have been characterized by scandals. Directors have acted illegally or in bad faith towards their shareholders. Indeed, the Insurance Regulatory Authority identified poor Corporate Governance in insurance Companies as one of the threats to achieving its strategic plan. This is concerning especially since the industry has witnessed in the past, the collapse of firms such as Kenya National Assurance Company, United Insurance Company, Lake Star Assurance Company, Standard Assurance, Access Insurance Company, Stallion Insurance, Invesco Assurance and Blue Shield Insurance Company. It is possible to attribute their collapse to Corporate Governance practices in the insurance industry. Much needs to be done to sort out this mess otherwise, we are likely to see more corporate failures and malfunctions.

Whereas there has been renewed interest in Corporate Governance (CG), relevant data from empirical studies are still few. There are therefore limitations in the depth of our understanding of CG issues. With such an environment in the background, the interest of both the minority shareholders and creditors could be compromised. Consequently, performance of such firms might be compromised. This study sought to bridge this huge gap by investigating the effects of CG on the financial performance of listed insurance firms in Kenya in an attempt to provide more empirical data in the local arena.

This study attempts to establish the effect of corporate governance on financial performance of insurance companies listed in the NSE by measuring corporate governance using the following variables (1) board size; (2) board composition; (3) CEO duality and (4) independent (outside) directors. In addition, a firm's performance is measured by the return on Equity, known as the ROE ratio. This study has examined various research hypotheses based on a sample of listed insurance firms at the NSE for the period of 8 years from 2008 to 2015.

1.4 Research Objectives

The research objectives in this study are:

1. To determine the effect of board size on the financial performance of insurance companies listed in the NSE.
2. To establish the effect of board independence on the financial performance of insurance companies listed in the NSE.
3. To establish the effect of gender diversity on the financial performance of insurance listed in the NSE.
4. To establish the effect of CEO duality on the financial performance of insurance companies listed in the NSE.

1.5 Significance of the Study

The study would be invaluable tothe following groups:

The policy makers would obtain knowledge of the various firm dynamics and the responses that are appropriate; they will therefore obtain guidance from this study in designing appropriate practices that would regulate the shareholders participation in affecting the financial performance of the firms in Kenya.

The treasury would identify how various aspects of corporate governance practices affect the operations of insurance firms in Kenya as well as determine the extent to which this and other factors affect operations of insurance firms. They would also identify the impediments that face insurance firms in approaching various corporate governance practices that affect their financial performance.

Within the context of the current dynamic economic environment, the Kenyan insurance sector must face up to the challenges of globalization in which the inability of firms to adapt to modern business culture may necessarily interfere with their ability to survive. It is imperative therefore for the insurance sector to identify the best corporate practices in other parts of the world and to identify how these could be integrated into insurance industry culture to enhance performance.

In spite of the importance of corporate governance, very little study has been undertaken in this area. It is therefore hoped that this study will fill this gap in our knowledge by providing robust value to the existing useful, though scanty studies on this subject in Kenya. It is hoped that findings of the study will be very useful to policy makers, investors, researchers, insurance managers and other stakeholders involved in an effort to

reshape insurance industry in Kenya by adopting good corporate governance structures. The study will also identify areas for future researchers who would wish to carry on further research in this area.

1.6 Scope and Delimitation of the Study

This study investigated the effect of corporate governance on the financial performance of insurance companies listed in the NSE. The rationale for using insurance firms listed in the NSE is because they are public companies whose data is freely available; it is a statutory requirement for all public companies to provide the information. Corporate governance is the independentvariable while financial performance is the dependent variable. The size and age of the firm are the control variables. The variables that were used to measureCorporate Governance were board size, board composition, CEO duality and independent (outside) directors.

The study was carried out in Nairobi County. This is due to the proximity to Nairobi and the fact that most of the information required being strategic in nature could be located at the head offices of the insurance firms which are located in Nairobi County.

The study focused on the period 2008-2015. The justification for using this period is because the insurance companies in the populationwere listed in the NSE in the chosen years.

1.7 Conceptual Framework

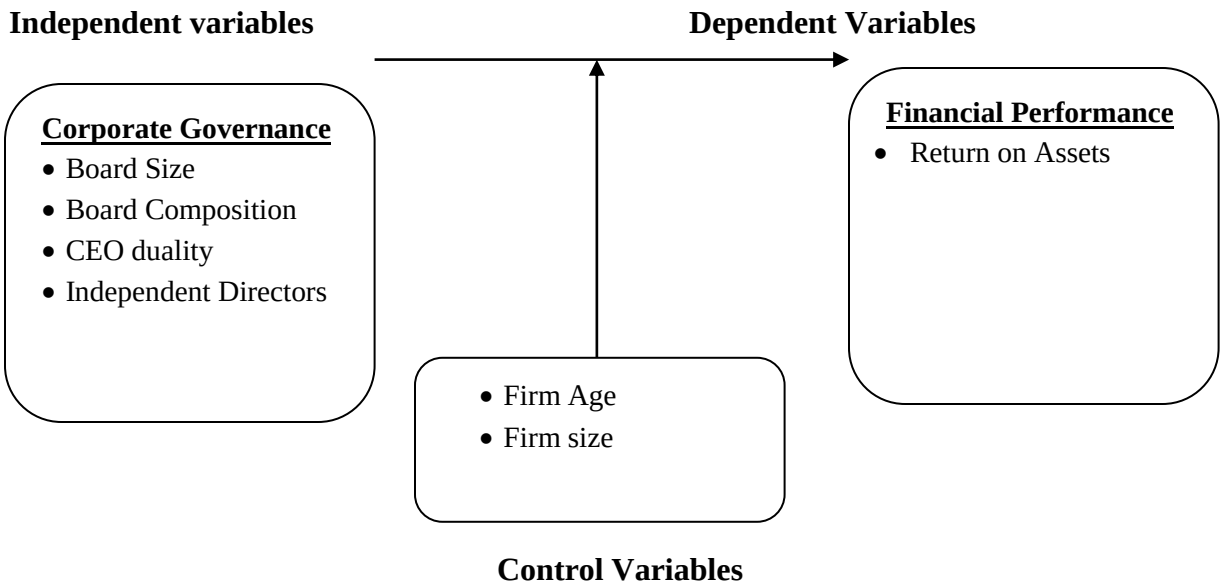


Figure 1.1 Conceptual Framework

The conceptual framework relates to corporate governance mechanisms (board size, board composition, CEO duality and independent directors) on firm financial performance as measured by Return on Equity,Return on Assets, net profit, earnings before interest and tax, Price to earnings ratio amongst other measures, and control variables including the firm size and the age of the firm.

1.8 Organization of the Study

The remainder of the study will be organized into four chapters.Chapter two is the literature review. This chapter provides a discussion of the theoretical and the empirical literature explaining and related to this study. It involves the discussion of the various theories that relate to CG. In addition, other works done by other scholars and researchers were be critiqued and discussed in this chapter.

Chapter three is research and methodology. This chapter discusses the process used to collect the information and data for making decision in the study. This section provides information on the type of research design that was adopted for the study. It gives the population and sample selected for the study. It also show which sample was used in the research.Furthermore, it discusses the data collection, analysis, and presentation techniques that were used in the study.

Chapter four is presentation, discussion and interpretation of empirical findings. This chapter presents analysis and findings of the study as set out in the research methodology. It seeks to achieve three interrelated objectives. First, it attempts to provide a comprehensive description of the data and research methodology used in this study. The second objective of the chapter is to explain the rationale for the various data and methodological choices made at every stage of the study. Finally, it aims to provide an assessment of the robustness of the data.

Chapter five is summary, conclusion and recommendations. The objective of this chapter is to discuss the findings, make a conclusion and make recommendations from all the qualitative and quantitative analysis presented in chapter four. It also recommends areas of further research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter discusses the existing theoretical and empirical literature on corporate governance. Specifically, it attempts to offer a review of the existing theoretical and empirical literature that tries to link CG structure to firm performance. Based on the review of both the theoretical and empirical literature, the chapter will draw existing research gap(s) for this and future studies on this topic.

2.2 Theoretical Review

Corporate governance is concerned with the social political and legal environment in which organization operates.Corporate governance is very vital in every organization, because good corporate governance contribute to better firm performance; it is expected for every organization to enforce corporate governance policy, in order to achieve stated goal.(Alhaji & Yusof, 2012)A number of theoretical frameworks of the effect of corporate governance on organizational performance have stemmed from the fields of economics, finance, management or even sociology, so as to serve as a basis for researchers in their analysis of corporate governance. There are a number of theoretical perspectives which are used in explaining the impact of corporate governance mechanisms on the firm performance. The main theories are agency theory, resource dependancy theory, stakeholders theory and stewardship theory.(Mallin C. A., 2010)

2.2.1 Agency Theory

Agency theory is defined as the relationship between the principals, such as shareholders and agents such as the company executives and managers(Abdullah & Valentine, 2009). Agency theory identifies the agency relationship where one party, the principal, delegates work to another party, the agent. Corporate governance has focused upon the separation of ownership which results in principal-agent problems arising from the dispersed ownership in the modern corporation. CG is regarded as a mechanism where board of directors is a crucial monitoring device to minimize the problems brought about by the principal-agent relationship. In thiscontext, agents are the managers, principals are the owners, and the boards of directors act as the monitoring mechanism (Mallin, 2010).

The disadvantage of the framework is that agent may not work for paramount interest of principal. Agents may misuse their powers for monetary and non-monetary benefits. Agent may not take precautionary risk measures or agent and principals may have different attitude towards risk. It explains the behaviour of persons in firms in their own self-interest, if it is not govern to minimize this behaviour.(Abid, Khan, Zeeshan , & Ahmed, 2014) Agency problem arises because contracts are written and enforced by considering costs. There are agency costs to demoralize agents from benefiting at the expense of principals. Agency costs include the costs of structuring, monitoring, and bonding a set of contracts among agents of divergent interests (Fama & Jensen, 1983)

Advocates of the agency theory are of the opinion that a firm’s top management becomes more powerful when the firm’s stock iswidely held and the board of directors is

composed of people who know little of the firm. The theory suggests that a firm's top management should have a significant ownership of the firm in order to secure a positive relationship between corporate governance and the amount of stock owned by the top management(Mulili & Wong, 2010). According to Wheelen and Hunger (2002)problems arise in corporations because agents (top management) are not willing to bear responsibility for their decisions unless they own a substantial amount of stock in the corporation.

In order to maximize the shareholders' value, agents are controlled by principal-made ruleshence, a more individualistic view is applied in this theory (Clarke, 2004), Indeed, agency theory can be employed to explore the relationship between the ownership and management structure. However, where there is a separation, the agency model can be applied to align the goals of the management with that of the owners. Due to the fact that in a family firm, the management comprises of family members, hence the agency cost would be minimal as any firm's performance does not really affect the firm performance. The model of an employee portrayed in the agency theory is more of a self-interested, individualistic and are bounded rationality where rewards and punishments seem to take priority(Jensen & Meckling, 1976). This theory prescribes that people or employees are held accountable in their tasks and responsibilities. Employees must constitute a good governance structure rather than just providing the need of shareholders, which maybe challenging the governance structure.(Abdullah & Valentine, 2009)

2.2.2 Stakeholder Theory

Stakeholder theory holds that a company owes a responsibility to a wider group of stakeholders, other than just shareholders. A stakeholder is defined as any person/group, which can affect/be affected by the actions of a business. It includes employees, customers, suppliers, creditors and even the wider community and competitors. Many corporations endeavor to maximize shareholder wealth whilst at the same time emphasizing on range of other stakeholders. One rationale for effectively privileging shareholders over other stakeholders is that they are the recipients of the residual free cash flow. This means that the shareholders have a vested interest in trying to ensure that resources are used to maximum effect, which in turn should be to the benefit of society as a whole (Mallin, 2010). The theory is a prominent CG theory because of the accountability of the firm to a wider audience than simply its shareholders. The theory suggests that the performance of corporate cannot be measured only in term of gain to its shareholders (Jensen., 2001)

Stakeholder theory has become more prominent because many researchers have recognized that the activities of a corporate entity impact on the external environment requiring accountability of the organization to a wider audience than simply its shareholders.John and Senbet(1998)have also provided a comprehensive review of the Stakeholders theory of corporate governance. The main issue they raised in the theory is the presence of many parties with competing interests in the operations of the firm. They also emphasized the role of non-market mechanisms such as the size of the board and committee structure as important to firm performance. Jensen (2001) offered a critique of

the Stakeholders theory for assuming a single-valued objective by identifying share and bondholders as the only interest group of a corporate entity necessitating further exploration. An extension of the theory, the enlightened stakeholder theory, was proposed.

2.2.3 Stewardship Theory

Unlike agency theory, stewardship theory presents a different model of management, where managers are considered good stewards who will act in the best interest of the owners. The steward's behaviour is pro-organizational and collectivists, and has higher utility than individualistic self-serving behavior and the steward's behavior will not depart from the interest of the organization because the steward seeks to attain the objectives of the organization (Davis, et al, 1997). According to Smallman (2004) where shareholder wealth is maximized, the steward's utilities are maximised too, because organisational success will serve most requirements and the stewards will have a clear mission. He also states that, stewards balance tensions between different beneficiaries and other interest groups.

Stewardship theory sees a strong relationship between managers and the success of the firm, and therefore the stewards protect and maximize shareholder wealth through firm performance. A steward who improves performance successfully, satisfies most stakeholder groups in an organization, when these groups have interests that are well served by increasing organizational wealth (Davis, et al, 1997). Moreover, stewardship theory suggests unifying the role of the Chief Executive Officer and the chairman, so as

to reduce agency costs and to have greater role as stewards in the organization. Thus, the focus of stewardship theory is on structures that facilitate and empower rather than monitor and control(Alhaji & Yusof, 2012).

2.2.4 Resource Dependancy Theory

The basic proposition of resource dependence theory is the need for environmental linkages between the firm and outside resources. In this perspective, directors serve to connect the firm with external factors by co-opting the resources needed to survive(Alhaji & Yusof, 2012). resource dependancy theoryrecognizes that the administrative body of any firm is the linchpin, among the firm and the resources that are required to accomplish the goals(Tricker, 2012).Whilst, the stakeholder theory focuses on relationships with many groups for individual benefits, resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm. Hillman, et al (2000)contend that resource dependency theory focuses on the role that directors play in providing or securing essential resources to an organization through their linkages to the external environment. Organizations require resources and these leads to the development of exchange relationships or network governance between organizations. Further, the uneven distribution of needed resources results in interdependence in organizational relationships.(Alhaji & Yusof, 2012)

According to the resource dependency rule, the directors bring resources such as information, skills, key constituents (suppliers, buyers, public policy decision makers, social groups) and legitimacy that will reduce uncertainty. This theory supports the

appointment of directors to multiple boards because of their opportunities to gather information and network in various ways.

The implications of this theory are that corporate Boards will reflect the environment of the firm and those 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 resource acquisition potential of its board members (Hillman, Canella, & Paetzold, 2000) from the above discussion unlike the agency theory the resource dependency theory ignores the other board activities like strategizing and providing advice.

2.3 Empirical Review

Earlier studies have measured the firm financial performance using ROA, ROE,Tobin's Q and ROI. These studies remain inconclusive on the measures which are theoretical / or empirically the best measure of firm's financial performance. Hence, studies have employed all or some of these measures of the firm's financial performance.

In her study on the effect of CG on financial performance of companies listed at NSE Mwangi (2013) adopted a descriptive research design. Firm performance was measured using ROA and ROE The study population was all those Companies which were quoted on the NSE as at December 2012 and secondary data were collected usingcompany annual accounts for the period 2008 to 2012. The study found that a strong relationship

exist between the CG practices under study and the firms' financial performance. There was a positive relationship between board composition and firm financial performance, the separation of the role of the CEO and Chair positively influenced the financial performance of listed firms.

In their study Ayako, Kungu, and Githui (2015) they concluded that firms with big board sizes are more likely to report higher ROA compared to firms with small board sizes thus, big board sizes affect ROA positively, this is because big board sizesfacilitate generation of diverse opinions which affects the firm performance positively.

In his study on the impact of internal CG structures on firm performance: Evidence from publicly listed South African companies Tshipa(2013) found that regardless of the financial performance measure used, board size is statistically significant and positively related to ROA. An independent non-executive director is only statistically significant and positively correlated with Tobin's Q. This means that the market perceives independent non-executive directors as a good practice to reduce agency problems. Also board composition, director share-ownership and frequency of board meetings have no impact on firm performance.

Also in his study the effect of CG on the financial performance of insurance companies in Kenya,Mbugua (2013) found that a weak relationship exists between the CG practices under study and the firms' financial performance. The number of Board sub-committee members, number of dependent directors and the age of the company were found to affect the financial performance of insurance companies positively. The financial

performance was however affected negatively by the Board size, number of Board meetings and number of independent directors. He concluded that insurance firms should therefore put in place adequate board, sub committees as well as ensure a higher number of dependent directors in order to enhance financial performance. Board size should also be reduced as much as possible since a larger size reduces the financial performance immensely.

In their studyDominic and Memba (2015) found that a strong relationship exists between the CG practices under study and the firms' financial performance. There was a positive relationship between board members and firm financial performance. Thus the study revealed that generally corporate governance is important in the financial performance of a company.

In her study the effects of Corporate Governance practices on the financial performance of insurance companies in Kenya,Kiragu(2013) board size was found to negatively affect the financial performance of insurance companies as the operations of the companies had to be slowed or halted as the staff had to await final decision because boardmembers took a longer period to agree on major decisions. There was a positive relationship between board composition and firm financial performance. However, the most critical aspect of board composition was the experience, skills and expertise of the board members as opposed to whether they were executive or non-executive directors.On CEO duality, the study found that separation of the role of CEO and Chairman positively influenced the financial performance of insurance firms. The study concluded that insurance companies

that adopt and implement good corporate governance have higher advantage of increasing their performance.

In his study the effect of CG on financial performance of insurance companies in Kenya Makhoha (2014)adopted a descriptive research design, the findings of the study show that while financial performance of insurance companies in Kenya are significantly influenced by board composition the performance is not significantly influenced by board size.The study established that, generally, a weak, negative but statistically significant correlation between financial performance (ROA) of insurance companies in Kenya and corporate governance i.e. board composition and board size.

In another study Coleman (2007) found that large and independent boards enhance firm value and that when a CEO serves as board chair, it has negative effect on performance. He also found that a CEO's tenure in office enhances firms' profitability while board activity intensity has a negative effect on firm profitability. The study also confirmed the widely-held view that board size and its composition are functions of firm and industrial characteristics. Thus, while firm level risk has a positive relationship with board size, CEO tenure correlates negatively with board size and that firms with larger institutional shareholding employ fewer outside directors. Firms in the finance sector were seen to employ smaller board sizes and fewer outside directors partly due to the existence of other regulatory mechanisms in these institutions. More so, it was found that large board sizes enhance shareholders wealth and that both sector and country specific effects impact on shareholders' value. Findings again, suggest that board diversity through the

inclusion of women is important for enhanced performance of microfinance institutions and the independence of corporate boards in particular is important for firm performance.

2.4 Research Gap

The studies cited in the literature mostly concentrate on the developed countries whose strategic approach and corporate governance systems are not similar to that of Kenya. In Kenya, most of the studies done in financial services sector have focused on other companies other than insurance firms in Kenya.Other researchers have examined the relationship between variety of governance mechanisms and firm performance. However, the results are mixed. Some researchers examine only one governance mechanism on performance while others investigate the influence of several mechanisms on performance.

Ashwin(2015) researched on the relationship between Corporate Governance and financial performance of firms listed on the JSE Ltd, while Lekaram (2014) conducted a study on the relationship of Corporate Governance and financial performance of manufacturing firms listed in the NSE, Mwangi(2013) investigated the effect of Corporate Governance on the financial performance of firms listed in the NSE, and Siele(2013) looked into the effect of Corporate Governance on the performance of Micro Finance Instituitons in Kenya. None of the above studies has focused specifically on the relationship between Corporate Governance and financial performance of listed insurance Companies in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

In this chapter, the research methodology used in the study is discussed. This section provides information on the type of research design that was adopted for the study. It gives thepopulation and sample selected for the study. Furthermore, it discusses the data collection, analysis and presentation techniques that were used in the study.

3.2 Research Design

Kumar (2005) defined a research design as a procedural plan that is adopted by the researcher to answer questions validly, objectively, accurately and economically. A research design helps a researcher to conceptualize an operational plan to undertake the various procedures and tasks required to complete the study and to ensure that these procedures are adequate to obtain valid, objective and accurate answers to the research questions.

This study will adopt a descriptive research design. According to Mugenda and Mugenda (2003)descriptive research is a process of collecting data in order to test hypotheses or to answer questions concerning the current status of the subjects in the study. A descriptive study determines and reports the way things are. The choice of the descriptive study design is based on the fact that the research is interested on the state of affairs already

existing in the field and no variable will be manipulated. This study therefore will be able to generalize the findings to a larger population.

3.3 Target Population

Mugenda and Mugenda (2003)define a population as an entire group of individuals, events, or objects having common observable characteristics. The study had targeted to use data for all six insurance firms listed by NSE as at December 2015. However, the published data available was for four listed insurance firms for the year 2008 to 2015indicated in appendix 1. The study investigated the entire study area and as such, there was no sampling undertaken.

3.4 Data Collection Instruments and Procedures

Secondary data was collected from published audited annual reports and websites of the selectedcompaniesfor the period of study 2008 to 2015 financial year. Specifically, the data was collected from the portion expounding on corporate information, statement of corporate governance as well as the directors' profile. Data on financial performance was collected from financial statements such as balance sheets, statements of cash flows, statements of changes in equity and statements of comprehensive incomes provided in the cash flows.

3.5 Data Presentation and Analysis

The study used panel data regression analysis to establish the relationship between financial performance and corporate governance for insurance firms listed in the NSE.

The study will also test for how the model fits into a number of the assumptions of the classical linear regression model. The study will also use visual techniques like tables and graphs to present its findings. The panel regression models that will be used to show the relationship between the dependent and independent variable are:-

$$ROA = C + \beta_1 BS + \beta_2 BI + \beta_3 BGD + \beta_4 CEODUAL + \epsilon$$

Where:-

ROA = Return on assets i.e. the dependent variable, Y

BS = Board size

BI = Board independence

BGD = Board gender diversity

CEODUAL= CEO duality

β_i=Coefficient of independent variable, i= 0,1……4

c = Constant term

ϵ = error term/disturbance term

$$\mathbf{ROA} = \frac{\mathbf{EarningBeforeInterest\&}Tax(EBIT)}{\mathbf{Ave.TotalAssets}}$$

Return on Asset ratio shows how efficiently a company can covert the money used to purchase assets into net income or profits. It is most useful for comparing companies in the same industry as different industries use assets differently

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSION.

4.1 Introduction

This chapter covers the data analysis. The main technique of the analysis was based on regression modelling using secondary data sourced from the listed insurance companies in Kenya. The data analysis section based regression modelling and analysis is generally categorized into three sections. The first two sections (4.2 and 4.3) focus in detail on analyzing the statistical suitability of the developed ordinary least squares (OLS) regression model for prediction, analysis, and decision making. The first section (4.2) analyzes how the model fits into a number of the assumptions of the classical linear regression model (CLRM), through performing the diagnostic tests of heteroskedacity, multicollinearity, autocorrelation, non-normality, suitability of the functional form (linearity) of the model, and test for stationarity of the data series (unit root tests) and the second section (4.3) looks at the overall fit of regression model from the sample data. All these analysis is performed using the versatile econometric software analysis package of EViews. The third section (4.4) focuses on a general summary of the outcomes of the objectives of the research in view of the data analysis.

4.2 The Diagnostic Tests of the Research's Developed Classical Linear Regression Model (CLRM) Assumptions

This section now turns to determine how the developed ordinary least squares (OLS) model best fits within the framework of the assumptions that are supposed to hold for the CLRM to be a useful estimation and prediction model. These tests will include

heteroskedacity, multicollinearity, autocorrelation, non-normality, and linearity or functional form of the model.

4.2.1 The Appropriateness of the Functional Form of the Model: Ramsey RESET Test

An implicit assumption of the linear regression model is that the appropriate functional form is linear. This means that the appropriate model is assumed to be linear in all parameters and that in the bivariate case, the relationship between Y and X can be represented by a straight line. However, this assumption may not always be upheld. Whether the model should be linear, as also assumed in this research, can be formerly tested using the Ramsey RESET test.

Table 4.1:The EViews Ramsey RESET test for the Appropriateness of the Functional Form of the Model: Linearity

Ramsey RESET Test

Equation: UNTITLED

Specification: ROA C BOARD_SIZE BOARD_INDEPENDENCE BOARD_GENDER_DIVERSITY

Omitted Variables: Squares of fitted values

	Value	Df	Probability
t-statistic	4.978154	2	0.0381
F-statistic	24.78202	(1, 2)	0.0381
Likelihood ratio	18.16209	1	0.0000

F-test summary:

	Sum of Sq.	Df	Mean Squares
Test SSR	0.016313	1	0.016313
Restricted SSR	0.017630	3	0.005877
Unrestricted SSR	0.001317	2	0.000658

LR test summary:

	Value	Df
Restricted LogL	11.01174	3
Unrestricted LogL	20.09278	2

Both the t- and F- versions of the test are presented, and it can be seen that there is no apparent non-linearity in the developed research regression equation since the generated similar p-values of 0.038 for both the t-statistic and F-statistic leads to the rejection of the null hypothesis of the presence of non linearity. Therefore it is conclude that the linear model form for the developed research model is appropriate.

Were the results of the test to indicate that the functional form is non-linear, one possibility would have been to switch to a non-linear model but the RESET test does not present a guide to what a better specification may be. However, if the model is

multiplicatively non-linear, a sensible approach according to Brooks (2008) would be to transform the data into logarithms. This will linearize many previously multiplicative models into additive ones.

4.2.2 The EViews Heteroskedasticity White Test

The classical linear regression model (CLRM) assumes that the variance of the errors (error term) is constant or what is referred to as homoskedasticity. If the errors do not have a constant variance, they are said to be heteroskedastic. The assumption of homoscedasticity is central to linear regression models in that if the OLS model is still used in the presence of heteroskedasticity instead of homoscedasticity, the standard errors could be wrong since the OLS regression seeks to minimize the residuals and in time possible standard errors. By definition the OLS regression gives equal weight to all observations, but when heteroskedasticity is present, the cases with larger disturbances (error measurements/terms) leads to inefficient coefficients (β-values for the independent variables and therefore misleading inferences or predications from the model). Therefore testing whether the above assumption is violated by the developed model or not is important because if violated certain remedial measures may need to be considered. An EViews' White Heteroskedasticity test was performed on the OLS model with the below outcome.

Table 4.2: The EViewsHeteroskedasticity White Test

Heteroskedasticity Test: White

F-statistic	1.596821	Prob. F(3,3)	0.3550
Obs*R-squared	4.304396	Prob. Chi-Square(3)	0.2304
Scaled explained SS	0.796714	Prob. Chi-Square(3)	0.8503

Test Equation:
Dependent Variable: RESID^2
Method: Least Squares
Date: 09/26/16 Time: 16:31
Sample: 2008 2014
Included observations: 7

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.490188	0.409488	-1.197074	0.3172
BOARD_SIZE^2	-0.000297	0.000300	-0.990372	0.3950
BOARD_INDEPENDENCE^2	0.603247	0.502444	1.200626	0.3161
BOARD_GENDER_DIVERSITY^2	0.098535	0.115395	0.853893	0.4559

R-squared	0.614914	Mean dependent var	0.002519
Adjusted R-squared	0.229827	S.D. dependent var	0.003862
S.E. of regression	0.003389	Akaike info criterion	-8.240884
Sum squared resid	3.45E-05	Schwarz criterion	-8.271792
Log likelihood	32.84309	Hannan-Quinn criter.	-8.622907
F-statistic	1.596821	Durbin-Watson stat	1.845531
Prob(F-statistic)	0.354986		

EViews has presented three different types of tests for heteroskedasticity and the auxiliary regression as seen in the above table. These test statistics provide the needed information to determine whether the assumption of homoscedasticity is valid or not, and the auxiliary regression in the second table can possibly provide information on the source of heteroskedasticity, if any is present. In the case of the tested model, both F test

and the X (chi-square) test statistic values of 0.36 and 0.23, respectively,give the same conclusion that there is no evidence of heteroskedasticity since thep-values are considerable in excess of 0.05. Therefore, in regard to the developed model, the conclusion is that efficiency of the coefficients of the independent variables are not affected by the phenomenon of heteroskedasticity and subsequently the prediction capability of the model is not affected either.

In the presence of heteroskedasticity, standard econometric packages would have an option usually known as 'robust' which would allow the analyst to employ the standard error estimates that have been modified to account for the heteroskedasticity following the white test (Brook, 2008).

4.2.3 The Eviews Test of Multicollinearity

Muliticollinearity, which is a state of high inter-correlations or inter-associations among the independent variables or a phenomenon in which there are two or more predictor variables in a multiple regression model that are highly correlated (meaning one can be linearly be predicted from the others with a substantially degree of accuracy), can lead to the coefficient estimates of the regression model changing erratically in response to small changes in the model or data. Although multicollinearity will not necessarily reduce the predictive power or reliability of the modelas a whole (at least within the sample data set), it will affect calculations regarding individual predictors. The model may indicate how well the entire bundle predicts the outcome variable, but may not give valid results about any individual predictor, or about which predictors are redundant with respect to

others. The EViews output of the multicollinearity test on the developed model, using a correlation matrix of the independent variables as below.

Table 4.3: The Eviews Test of Multicollinearity with the a Correlation Matrix for the Independent Variables

	BOARD_SIZE	BOARD_INDEPENDENCE	BOARD_GENDER_DIVERSITY
BOARD_SIZE	1.000000	0.760726	0.314748
BOARD_INDEPENDENCE	0.760726	1.000000	0.553944
BOARD_GENDER_DIVERSITY	0.314748	0.553944	1.000000

From the correlation matrix of the independent variables above, the results indicate a somewhat large correlation between the board size of the company and the board-independence (number of independent directors). Therefore this might imply the presence of multicollinearity. According to Brooks (2008), ways of dealing with multicollinearity include; (i) ignoring it, if the model is otherwise statistically adequate in terms of each quotient being of plausible magnitude and having the appropriate sign, because the existence of multicollinearity does not reduce the t-ratios on variables that would have been significant; (ii)dropping one of the collinear variables so that the problem disappears, although this can be unacceptable to the researcher if there were strong apriori theoretical reasons for including both variables in the model or if the removed variable was relevant in the data generating process for y, an omitted variable bias would occur; (iii) transforming the highly correlated variables into a ratio, where again this maybe unacceptable if financial theories suggest that changes in the dependent variable should occur following changes in the individual explanatory variables, and (iv)

near mulitcollinearity is more of a problem with data than with the model, implying that an increase in the sample size will usually lead to an increase in the accuracy of coefficient estimation and consequently to a reduction in the coefficient standard errors, thus enabling the model to better dissect the effects of the various explanatory variables on the explained variable. For the developed model, the sample size may not be adequate (point No (iv)) above, but based on point No (i) above, all the model's independent variables are retained.

4.2.4 The EViews' Breusch-Godfrey Test of Autocorrelation

Another assumption of the classic linear regression model (CLRM) is that the error (disturbance) terms have a covariance over timeof zero, that is the errors are uncorrelated with one other. If the errors are not uncorrelated with one another, it would be stated that they are auto correlated or they are serially correlated. The consequences of ignoring autocorrelation when it is present are similar to those of ignoring heteroskedasticty. The coefficient estimates derived using the OLS, though unbiased, can be said to be inefficient, that is they are not best linear unbiased estimators (BLUE).

A test of this assumption was therefore required, and although the simplest statistical test for autocorrelation is the Durbin-Watson (DW) statistic, it has a limitation in that it is a test for first order correlation, that is, it tests for a relationship between an error and its immediate previous one (a test of whether consecutive errors are related to one another) and therefore it cannot be applied if certain circumstances are not fulfilled and may not be able to detect some forms of serial correlation. Therefore in order to have a joint test

that allows examination of the relationship between the errors in time (μ_t) and several of its lagged values at the same time (all at once), the Breusch-Godfrey test is used as a more general test of autocorrelation up to the r^{th} order. The results of the EViews' Breusch-Godfrey test of autocorrelation on the developed model is as below.

Table 4.4: The EViews Breusch-Godfrey Autocrrelation Test

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	76.91785	Prob. F(2,1)	0.0804
Obs*R-squared	6.954791	Prob. Chi-Square(2)	0.0309

Test Equation:
Dependent Variable: RESID
Method: Least Squares
Date: 09/26/16 Time: 16:54
Sample: 2008 2014
Included observations: 7
Presample missing value lagged residuals set to zero.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-19.22510	3.154408	-6.094677	0.1035
BOARD_SIZE	-0.095841	0.021177	-4.525617	0.1384
BOARD_INDEPENDENCE	21.51868	3.583838	6.004368	0.1051
BOARD_GENDER_DIVERSITY	1.708477	0.196204	8.707669	0.0728
RESID(-1)	-1.721329	0.158787	-10.84050	0.0586
RESID(-2)	-3.445512	0.282068	-12.21519	0.0520

R-squared	0.993542	Mean dependent var	-1.75E-15
Adjusted R-squared	0.961249	S.D. dependent var	0.054206
S.E. of regression	0.010671	Akaike info criterion	-6.474290
Sum squared resid	0.000114	Schwarz criterion	-6.520653
Log likelihood	28.66001	Hannan-Quinn criter.	-7.047324
F-statistic	30.76714	Durbin-Watson stat	2.956788
Prob(F-statistic)	0.135991		

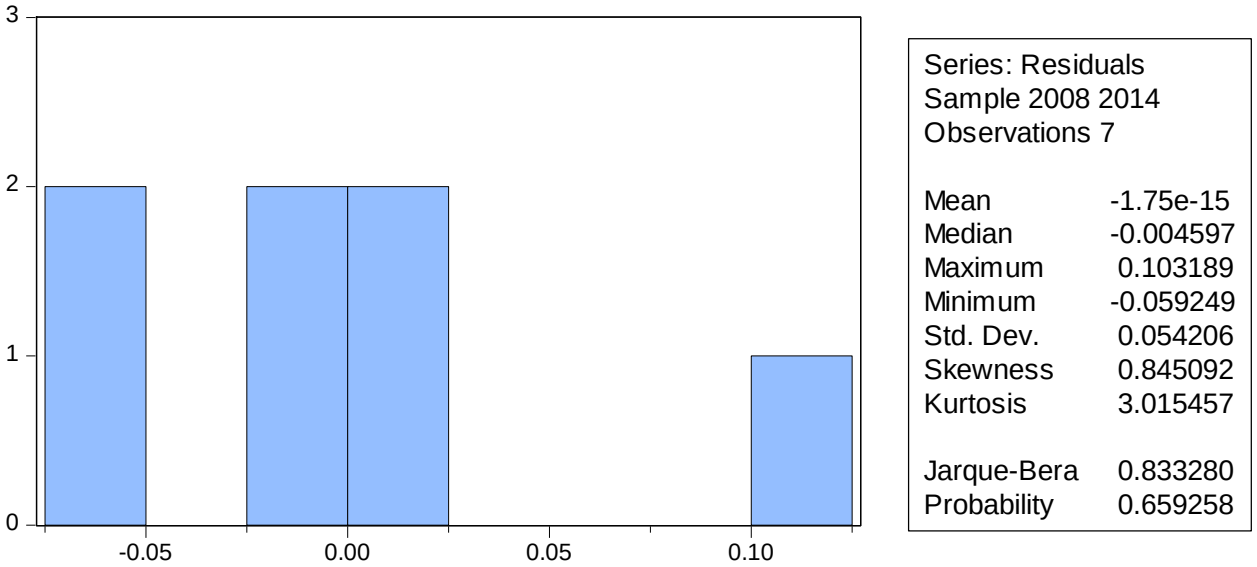
In the above first table of output EViews offers two versions of the test, an F-version and a X^2 (Chi-square) version, while the second table presents estimates from the auxiliary

regression. While the conclusion from the F-statistic with a p-value of 0.08 leads to the rejection of the null hypothesis of no autocorrelation, the conclusion from the Chi-square statistic, with a p-value of 0.03 leads to the acceptance of the null hypothesis of no autocorrelation. Given the Durbin-Watson statistic value of 2.12 provided by EViews output on the regression analysis in Table 1,that also leads to non-rejection of the null hypothesis, this analysis goes with the view that there is no significant evidence of the presence of the autocorrelation phenomenon in the developed model of this research.

4.2.5 Test of Disturbances (Error Terms/Residuals) from Normality

The normality assumption of error terms is also required by the CLRM in order to conduct single or joint hypothesis tests about the model parameters. The Jarque-Bera(JB) is the most commonly used test for normality. A normal distribution is not skewed and is defined to have a coefficient of kurtosis of 3

Table 4.5: The Jarque-Bera Test for Non-Normality of Residuals



Although the histogram does not exactly appear bell-shaped as required of a normal distribution of the residuals, most likely due to the small sample size in use, the Jarque-Bera statistic of 0.83 is not significant and since the p-value of 0.66 is larger than 0.05, the null hypothesis of normality is not rejected at the 5 percent level. The coefficient of kurtosis of 3.02 also supports the existence of normality in the distribution of the error terms.

4.2.6 Stationarity and Unit Root Testing

The stationarity or otherwise of a series can strongly influence its behavior and properties. For instance if the variables in the regression are not stationary, it can lead to what is referred to as spurious regression or valueless/nonsense regression which could suggest relationships even if there are none. Also if two variables are trending over time, a regression of one on the other would have a high R^2 even if the two are totally unrelated. Additionally, if the variables in the regression model are not stationary, then it can be proved that the standard assumptions of the asymptotic analysis will not be valid.

In other words, the usual t-ratios will not follow a t-distribution, and hypothesis tests about the regression parameters cannot be validly undertaken. Due to these reasons, it is important to test the stationarity or otherwise using a unit root test which tests whether a time series variable is non-stationary and possesses a unit root. The nullhypothesis will generally be defined by the presence of a unit root and the alternative is either stationary, trend stationaryor explosive roots depending on the test used. With the large number of options that EViews provides for testing the stationarity/non-stationarity of a series that include the Augmented Dickey-Fuller (ADF) test, Philips-Perron test, Kwiatkowski-

Philips-Schimidt-Shin (KPSS) test, Elliot-Rothenberg-Stock Point Optimal test, and the Ng-Perron test, Two tests, the ADF and KPSS are carried out on each of the data series in this research in order try and return the more supported decision on the situation of stationarity, in the case of no clear outright decision provided by the tests.

Table 4.6: ADF and KPSS Test for Stationarity and Unit Root Testing for Board Size

Null Hypothesis: BOARD_SIZE has a unit root
Exogenous: Constant
Lag Length: 1 (Automatic - based on SIC, maxlag=1)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-3.961774	0.0392
Test critical values:	1% level	-5.604618	
	5% level	-3.694851	
	10% level	-2.982813	

Null Hypothesis: BOARD_SIZE is stationary
Exogenous: Constant
Bandwidth: 1 (Newey-West automatic) using Bartlett kernel

		LM-Stat.
Kwiatkowski-Phillips-Schmidt-Shin test statistic		0.300128
Asymptotic critical values*:	1% level	0.739000
	5% level	0.463000
	10% level	0.347000

From the ADF test above since the test statistic (-3.96) is more negative than the critical values at the 5 percent (-3.69) and the 10 percent (-2.98) levels, the null hypothesis of a unit root in the Board size numbers is rejected and since the test statistic from the KPSS

test of 0.30 is less than the critical values at either 1%, 5%, and 10%, the null hypothesis of stationarity cannot be rejected. Therefore the conclusion is that the board size data series is stationary.

Table 4.7: ADF and KPSS Test for Stationarity and Unit Root Testing for Board Gender Diversity

Null Hypothesis: BOARD_GENDER_DIVERSITY has a unit root

Exogenous: Constant

Lag Length: 1 (Automatic - based on SIC, maxlag=1)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		0.107250	0.9235
Test critical values:	1% level	-5.604618	
	5% level	-3.694851	
	10% level	-2.982813	

Null Hypothesis: BOARD_GENDER_DIVERSITY is stationary

Exogenous: Constant

Bandwidth: 1 (Newey-West automatic) using Bartlett kernel

		LM-Stat.
Kwiatkowski-Phillips-Schmidt-Shin test statistic		0.398872
Asymptotic critical values*:	1% level	0.739000
	5% level	0.463000
	10% level	0.347000

S.E. of regression	0.043925	Akaike info criterion	-3.281111
Sum squared resid	0.011576	Schwarz criterion	-3.288838
Log likelihood	12.48389	Hannan-Quinn criter.	-3.376617
Durbin-Watson stat	0.933612		

From the ADF test on board gender diversity the test statistic (0.107) is not more negative than the critical values at the 1 percent, 5 percent or 10 percent levels, and therefore the

null hypothesis of a unit root in the Board size numbers cannot be rejected but with the KPSS test statistic of 0.398 being lower than the critical values at the 1% and 5% levels, implies that the null hypothesis of stationarity cannot be rejected. Therefore, in the case of gender diversity, the tests return somewhat contradictory results, and this could be due to the size of the sample (small) taken.

Table 4.8: ADF and KPSS Test for Stationarity and Unit Root Testing for Board Independence

Null Hypothesis: BOARD_INDEPENDENCE has a unit root
Exogenous: Constant
Lag Length: 0 (Automatic - based on SIC, maxlag=1)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-3.577709	0.0469
Test critical values:	1% level	-5.119808	
	5% level	-3.519595	
	10% level	-2.898418	

Null Hypothesis: BOARD_INDEPENDENCE is stationary
Exogenous: Constant
Bandwidth: 1 (Newey-West automatic) using Bartlett kernel

		LM-Stat.
Kwiatkowski-Phillips-Schmidt-Shin test statistic		0.434368
Asymptotic critical values*:	1% level	0.739000
	5% level	0.463000
	10% level	0.347000

From the ADF test above since the test statistic (-3.58) is more negative than the critical values at the 5 and 10 percent levels, implying that the null hypothesis of a unit root in

the Board-independence is rejected and since the test statistic from the KPSS test of 0.43 is less than the critical values at 1%, and 5%, , the null hypothesis of stationarity cannot be rejected. Therefore the overall conclusion is that the board-independence data series is stationary.

Null Hypothesis: ROA has a unit root
Exogenous: Constant
Lag Length: 0 (Automatic - based on SIC, maxlag=1)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-2.362831	0.1837
Test critical values:	1% level	-5.119808	
	5% level	-3.519595	
	10% level	-2.898418	

Null Hypothesis: ROA is stationary
Exogenous: Constant
Bandwidth: 0 (Newey-West automatic) using Bartlett kernel

		LM-Stat.
Kwiatkowski-Phillips-Schmidt-Shin test statistic		0.238745
Asymptotic critical values*:	1% level	0.739000
	5% level	0.463000
	10% level	0.347000

From the ADF test above, since the test statistic (-2.36) is not more negative than the critical values and therefore the null hypothesis of a unit root cannot be rejected according to the ADF test. However, with the KPSS test, the test statistic (0.2387) does not exceed critical values and therefore the null hypothesis of stationary series for ROA is not rejected. Again we have mixed results from the two tests on the ROA series, and

which are probably due size of sample, which does not make the outcomes to be definitive.

In recognition of the fact that the sample size may have fallen short of that required for the tests of stationarity (unit root testing) and therefore probably affecting the definitiveness of the test outcomes, and given that for the combined results of the ADF and KPSS tests, the KPSS test results were generally all indicative of stationarity in the data series while the ADF tests returned conclusions of unit root(non-stationarity) in two series (Board size and ROA), the overall conclusion for this research, is that the data series are stationary, and therefore the model will not suffer from the effects of non-stationarity of the series.

From the foregoing conclusion of the presence of stationarity rather than non-stationarity (unit roots) in the data time series, the problem of *cointegration*(a statistically significant relationship between two non-stationary series) was not envisaged for this model and therefore such a test was not carried out.

4.3 Overall Fit of the Model from Sample Data: R^2, F-Test and t-Tests

To determine the relationships between the dependent variable of the model (return on assets-ROA) and the independent variables (board size of the company, independence of board directors, and the board gender diversity in terms of female to male ratio), a pooled ordinary least squares (OLS) regression equation was developed from the panel data using the EViews software package. Table 1 below provides the output.

Table4.9: The EViews Regression Analysis Output

Dependent Variable: ROA
Method: Least Squares
Date: 09/26/16 Time: 16:03
Sample: 2008 2014
Included observations: 7

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-17.82282	18.42007	-0.967576	0.4046
BOARD_SIZE	-0.076588	0.134394	-0.569873	0.0608
BOARD_INDEPENDENCE	20.04039	20.98052	0.955190	0.0409
BOARD_GENDER_DIVERSITY	0.613460	0.872951	0.702743	0.0432

R-squared	0.522866	Mean dependent var	0.109990
Adjusted R-squared	0.573304	S.D. dependent var	0.078474
S.E. of regression	0.076658	Akaike info criterion	-2.003354
Sum squared resid	0.017630	Schwarz criterion	-2.034262
Log likelihood	11.01174	Hannan-Quinn criter.	-2.385377
F-statistic	10.95849	Durbin-Watson stat	2.116315
Prob(F-statistic)	0.047089		

Where ROA = Return on assets that is the dependent variable, Y

BS = Board size

BI = Board independence

BGD = Board gender diversity

CEODUAL= CEO duality

β_1 =Coefficient of independent variable

c = Constant term

ϵ = error term/disturbance term

The regression model in algebraic/general form is:

$$ROA = C + \beta_1 BS + \beta_2 BI + \beta_3 BGD + \beta_4 CEODUAL + \epsilon$$

The specific regression model from the EViews regression analysis is:

$$ROA = -17 - 0.077BS + 20.04BI + 0.061BGD$$

The value of adjusted R^2 (R-squared)= 0.573 indicates that the three independent variables (board size, board independence/independence of board directors, and board gender diversity/ratio of women to men in the board) explains 57.3 percent of the total variation in return on assets. This implies that these variables alone are not very significant in contributing to the performance of the company in terms of performance as measured by return on asset (ROA). About 42.7 percent of the performance is therefore explained by variables not captured in the model analysis.

The p-value associated with the F-statistic of 0.047 is less the critical value of 0.05 leading to the overall F-test rejection of the null hypothesis that none of the independent variables is significant and therefore leading to the conclusion that at least one of the independent variables is significantly related to the dependent variable (performance as measured by ROA).

The test for the significance of the independent variables done using the t-Test for the coefficients of the independent (β_1, β_2, and β_3) to determine whether it can be concluded that any of the β_s,s is equal to 0 , that is, the independent variable is not significant in explaining the dependent variable, the p-values of 0.041 for the board independence and

0.043 for the board gender diversity variables that are less than the critical value of 0.05 indicate that these variables are significant in explaining the dependent variable (performance based on ROA) while the variable board size, with a p-value of 0.061 and > 0.05 implies that the variable is not significant in explaining the dependent variable.

Regarding the relationship between the dependent variable (ROA), and the independent variables, the model shows that ROA is inversely related to the company's board size (BS) as indicated by the negative coefficient of β_1 =-0.077 , implying that a larger board size does not contribute to an increase in return on assets, but rather has the opposite effect (decrease in ROA).

The model also indicates that a higher representation of independent directors on the board (board independence-BI) has a direct positive relationship with return on assets (ROA) as indicated by the positive coefficient of β_2 =20.04. Board gender diversity (BGD) is also positively related to ROA with a coefficient of β_3 =0.061, implying that having a more balanced gender representation (women to men - ratio) in the board has a positive impact on company performance as measured by ROA.

4.4 A Summary of the Statistical Suitability of the Regression Model

From the above statistically analysis of the model in section 4.2 and 4.3 respectively, we can conclude that the model shows an overall medium strength relationship between the dependent variable (ROA) and the independent variables (Board size, Board-Independence, and Board-Gender-Diversity), given that the independent variable is found to account for only about 57 percent of the variation in the dependent variables.

From the developed model it was also determined that while there is an inverse relationship between the dependent variable(ROA) and the company board size (BI), there is a positive relationships between ROA and board independence (BI) and board-gender-diversity(BGD). Therefore, the implications is that a larger board size in terms of membership has a negative impact on the performance of the company whereas inclusion of more independent directors and more women in the board is found to have a positive effect on company performance. It should also be noted that the t-Test for the significant of the independent variables does suggest that board-size is not significant in explaining the performance of the company. This may lead to this variable being dropped from the model or more empirical analysis may need to be carried out to determine its suitability as an explanatory variable in the model.

The diagnostic tests carried out using the EViews software package to determine how well the model fits the assumptions of the classical linear regression model, the White Heteroskedasticity test found noevidence of heteroskedasticity. Therefore, this led to the conclusion that in regard to the developed research model, the efficiency of the coefficients of the independent variables are not affected by the phenomenon of heteroskedasticity and subsequently the prediction capability of the model is not affected either.

The multicollinearity test carried out by creating a correlation matrix of the independent variables indicated a significant correlation between the board size of the company and the board-independence (number of independent directors). Although this implied the

presence of multicollinearity, based on the argument that multicollinearity may be more of a problem with data than with the model, where an increase in the sample size will usually lead to an increase in the accuracy of coefficient estimation and consequently to a reduction in the coefficient standard errors, thus enabling the model to better dissect the effects of the various explanatory variables on the explained variable, the impact of multicollinearity on the developed model was ignored, given that had the sample in this research been larger the problem would not be significant. Therefore the validity of the individual predictors in the model were considered unaffected by multicollinearity.

The Breusch-Godfrey test of autocorrelation combined with the Durbin_Watson test generally led to the conclusion that there was no significant evidence of the presence of the autocorrelation phenomenon in the developed model of this research.The coefficient estimates derived using the OLS, can therefore not be said to be inefficient, and they should generally be considered to be best linear unbiased estimators (BLUE).

The Ramsey RESET test for the appropriateness of the functional form of the modelled to the conclusion that there was no apparent non-linearity in the developed research regression equation. Therefore the linear functional form of the model was found to be appropriate and in accordance with the assumption of the CLRM under which this model was developed.

The Jarque-Bera Test for non-normality of residuals generally supported the existence of normality in the distribution of the error terms. This meant that the normality assumption

of error terms this is required by the CLRM in order to conduct single or joint hypothesis tests about the model parameters, was not violated by the developed research model.Using a combination of the Augmented Dickey-Fuller (ADF) and Kwiatkowski-Philips-Schimidt-Shin (KPSS) tests for stationarity and unit root testing, the tests were generally indicative of stationarity in the data series and therefore the model is not expected to suffer from the effects of non-stationarity of the series. Therefore the conclusion was that the developed regression model was not subject to the problems associated with unit roots (non- stationarity) of a series such as obtaining a spurious regression or valueless/nonsense regression which could suggest relationships even if there are none or having a high adjusted R^2 even if two variables are totally unrelated or the hypothesis tests about the regression parameters not being valid is. From the foregoing conclusion of the presence of stationarity rather than non-stationarity (unit roots) in the data time series, the problem of cointegration(a statistically significant relationship between two non-stationary series) was not envisaged for this model and therefore such a test was not carried out.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary of the study findings, conclusion and recommendations. The objective of this study is to find out the effect of corporate governance on the financial performance of insurance companies listed at the NSE, covering a period 2008-2015.

5.2 Summary of Key Findings

The main objective of the study was to establish the relationship between various board characteristics and financial performance of listed insurance companies. From the statistical analysis it can be concluded that there is a medium strength relationship between board size, board independence, gender diversity and financial performance of insurance companies listed in the NSE. This is because the independent variable was found to account for only 57 percent of the variations in the dependent variable.

According to the findings of the study, all insurance companies studied had zero CEO duality in which case the CEO and chairperson of the board of directors were different persons. This finding is similar to Mbugua (2013) who in his study on the effect of corporate governance on financial performance of insurance companies in Kenya found that all insurance companies in the study had zero CEO duality in that the CEO and chairperson of the board were different persons.

It was found that there is an inverse relationship between ROA and the company board size. This means that a larger board size in terms of members influences negatively the financial performance of insurance companies. The findings are in line with the study carried out byLekaram (2014)that there is a significant relationship between board size and performance of manufacturing firms listed at the NSE. In her study on effect of corporate governance on the performance of Micro Finance Institutions in Kenya Siele (2013) found that size of the board has no significant relationship with the performance of the microfinance institutions.

The study also found that there is a positive relationship between ROA and board independence. This means that inclusion of more independent directors in the board influences positively the financial performance of listed insurance companies.. Increasing the level of the proportion of independent directors should simultaneously increase firm performance, as they are more effective monitors of managers.

Further the study revealed that there is a positive relationship between ROA and gender diversity of the board. This means that inclusion of more females in the board has a positive influence on the financial performance of listed insurance companies. This finding is similar to the study carried out by Wanyama and Olweny (2013) who concluded that the effects of board composition on various aspects of composition of the board affect the financial performance to a greatextent. The study thus, concluded that composition of the board positively influenced the financial performance of insurance companies listed.

5.3 Conclusions

The study concludes that corporate governance has mixed results on its influence on the financial performance of insurance companies in Kenya. From the findings it can be concluded that increase in the board size will influence a decrease in the firm value. Therefore it can be concluded that increase in size of the board will have a negative influence on the financial performance of insurance companies listed in the NSE.

The study also concluded that by having more independent directors it will influence positively the financial performance of insurance companies listed in the NSE. This is because independent directors are more effective in monitoring the management and thus increase the financial performance of the companies.

The study also showed a positive relationship between ROA and board gender diversity hence with the increase of gender diversity in the board then there is an increase in the financial performance of insurance companies listed in the NSE.

The study was not able to measure the effect of CEO duality on the financial performance of insurance companies listed in the NSE. This is because all the insurance companies studied they had zero CEO duality in which case the CEO and chairperson of the board of directors were different persons.

5.4 Recommendations

The study recommends that the board size, gender diversity and composition be considered since theyaffect the financial performance of the insurance companies listed at NSE. The number of non-executivedirectors needs to be selected well since they affect financial performance ofthe firms.

The study recommends that insurance companies should review their policies regarding corporate governance particularly practices influencing board size and the ratio of non-executive directors to executive directors, board gender diversity. Therefore, insurance companies need to consider board size and the number of members during policy formulation in order to improve performance.

The board needs to comprise of well educated people since they are actively involved in shaping firms strategy. The study recommends that non-executive directors be trained on internal corporate governance mechanisms. Ownership concentration needs to be reduced to avoid few people controlling the financial performance of the organization.

The study recommends that financial monitoring should be donethoroughly by the board. A constitution which clearly indicates how to select and replacethe CEO and directors need to be adopted. Listed insurance companies should consider adopting and conducting of regular corporate governance audits and evaluations. Good corporate governancehas a positive economic impact on the institution in question as it saves the organizationfrom various losses e.g. those occasioned by frauds, corruption and similar irregularities.

The study recommends that attention should be taken upon when dealing with the number of board members. The board size should match with firm size so as to avoid instances the board is too small thus will be overburdened with the firm's work which will lead to underperforming, and at the same time boards should not be too large as the inefficiency of large boards will also lead to underperforming of the board members**.**

5.5 Limitations of the Study and Suggested Areas for Further Research

The study was limited by the fact that the financial performance is influenced by other economic variables such as the inflation rate, the interest rate, the level of the stock market and the exchange rate. Therefore, the analysis of the relationship between corporate governance on financial performance of listed insurance companies in the NSE is more comprehensive when the mediation effects of other variables affecting corporate governance and financial performance are included in the study.

The study was also limited to secondary data. The findings may be more comprehensive if primary data is collected to complement the secondary data. This would ensure a more comprehensive evaluation of the relationship between corporate governance on financial performance of listed insurance companies in the NSE.

The time available to conduct the research was limiting. The findings could have been more comprehensive if time was enough to collect primary data through interviews, questionnaires etc.

A similar study to this research could be conducted on all insurance companies in Kenya. A similar study on this research could be conducted but using both primary and secondary data so that the difference (if any) can be established.Another area of further research is on key success factors that would maximize the contribution of corporate governance to financial performance of insurance companies in Kenya.

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APPENDICES

Appendix I: Insurance Firms Listed at the NSE for the Study Period

1. Pan African Insurance Holding Ltd.
2. Jubilee Holdings Ltd.
3. Kenya re- Insurance Corporation Ltd
4. CIC Insurance Group Ltd.

Appendix II: Data Capture Template

	FIRM	ROA	Board size	Board Independence(BI)			CEO Duality	Board Gender Diversity (BGD)		
				No. of Independent Directors	Total No. of Directors	BI		No. of Female Directors	Total No. of Directors	BGD
1	Pan African Insurance Holding									
	2008	0.0412	9	8	9	0.88	0	2	9	0.22
	2009	0.0521	9	8	9	0.88	0	2	9	0.22
	2010	0.0615	9	8	9	0.88	0	2	9	0.22
	2011	0.0560	9	8	9	0.88	0	2	9	0.22
	2012	0.0820	9	8	9	0.88	0	2	9	0.22
	2013	0.0801	9	8	9	0.88	0	2	9	0.22
	2014	0.0504	8	7	8	0.88	0	2	8	0.25
	2015	0.0512	8	7	8	0.88	0	2	8	0.25
2	Jubilee Holdings									
	2008	0.039	8	8	8	1	0	0	8	0
	2009	0.0398	8	8	8	1	0	0	8	0
	2010	0.060	8	8	8	1	0	0	8	0
	2011	0.0306	8	8	8	1	0	0	8	0
	2012	0.0284	8	8	8	1	0	0	8	0
	2013	0.0411	8	8	8	1	0	0	8	0
	2014	0.0371	11	11	11	1	0	1	11	0.1
	2015	0.0528	11	11	11	1	0	1	11	0.1
3	Kenya re-Insurance Corporation									
	2008	0.1321	8	7	8	0.88	0	3	8	0.38
	2009	0.1011	10	9	10	0.90	0	2	10	0.20
	2010	0.1030	10	9	10	0.90	0	2	10	0.20
	2011	0.1121	10	9	10	0.90	0	2	10	0.20
	2012	0.1373	11	10	11	0.91	0	3	11	0.28
	2013	0.1257	11	10	11	0.91	0	2	11	0.18

	2014	0.1311	11	10	11	0.91	0	3	11	0.28
	2015	0.1307	11	10	11	0.91	0	3	11	0.28
4	CIC Insurance Group									
	2008	0.0803	12	11	12	0.93	0	0	12	0
	2009	0.0852	12	11	12	0.93	0	0	12	0
	2010	0.1204	14	13	14	0.93	0	2	14	0.14
	2011	0.0867	14	13	14	0.93	0	2	14	0.14
	2012	0.1317	12	11	12	0.93	0	4	12	0.33
	2013	0.1594	12	11	12	0.93	0	4	12	0.33
	2014	0.0753	11	10	11	0.93	0	3	11	0.27
	2015	0.0550	13	12	13	0.93	0	4	13	0.31