INFLUENCE OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE OF LISTED CORPORATIONS IN KENYA

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DECLARATION

This thesis is my original work and has not been submitted for a degree or any other award in any other university.

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DEDICATION

This thesis is dedicated to my family foremost for unwavering support and encouragement without forgetting those fighting for efficient and effective service delivery in public sector.

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ABSTRACT

Corporations with government shareholding in Kenya have served different purposes in different industries since their establishment during the colonial period. Despite tight regulatory framework, Corporate Governance continues to weaken in Kenya. The purpose of the study was to investigate the influence of corporate governance on financial performance of listed corporations with government shareholding in Kenya. Specifically, the study sought to examine the influence of financial transparency, internal audit standards, internal controls and ownership structure on financial performance of listed corporations with government shareholding in Kenya. The study was anchored on stakeholder theory, stewardship theory, agency theory, and resource dependence theory. This study adopted descriptive survey design. The target population of the study was 98 CEO's, general managers and managers drawn from 12 corporations in Kenya with government shareholding. The study adopted census design where all target corporations were sampled. Primary data was collected using structured questionnaires while secondary data collection sheet was used to collect secondary data. Using collected data, descriptive statistics such as mean, standard deviation and frequency distribution were used to analyze the data. Data presentation was done by the use of charts, percentages and frequency tables Inferential statistics were used in drawing conclusions A t-test was conducted to test the significance of the results at 5% level of significance. Univariate tests were used to provide an insight using both parametric (t-test) and non-parametric test (Pearson correlation coefficient). Statistical Package for Social Science (SPSS) Version 25 was used for data analysis. The results showed that there was a moderate positive correlation between financial transparency, internal audit standards, internal controls, ownership structure and financial performance. Regression analysis results showed that financial transparency, internal audit standards, internal controls, ownership structure explain 71 per cent of variance in the financial performance of corporations. The study established that financial transparency leads to reduced conflicts between shareholders and managers. The corporations voluntarily provide forward looking information and the corporations are mandated by regulations to disclose all financial statements which are accessible to all stakeholders at any time. The study concludes that corporations targeted engage members who have financial knowledge and experience in the committees. The management of sampled corporations enjoys cordial relationships with audit committee and internal auditors observe professional ethics & standards. The study recommends that management of corporations should adhere to laid down regulations on financial disclosure to avoid agency conflicts with shareholders and creditors. The information disclosed by the corporation should be adequate to enable stakeholders to make informed decisions and should be forward looking. The study recommends that the management and regulators of listed corporations should only recruit and select those members who possess financial knowledge and experience to be part of internal audit committees.

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AFC	Agricultural Finance Corporation
ATR	Asset turnover ratio
CBK	Central Bank of Kenya
CEO	Chief Executive Officer
CMA	Capital Markets Authority
CG	Corporate Governance
GDP	Gross Domestic Product
GOK	Government of Kenya
KMC	Kenya Meat Commission
KPLC	Kenya Power Lighting Company
KRC	Kenya Railways Corporation
LSC	Listed State Corporations
NMC	Numerical Machining Complex
NSE	Nairobi Securities Exchange
NSSF	National Social Security Fund
OLS	Linear Regression Analysis
ROA	Return on Assets
ROE	Return on Equity
SOA	Sarbanes- Oxley Act
SPSS	Statistical Package for the Social Sciences

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Globally, financial scandals have been witnessed triggering reaction for tighter regulation and enhanced standards for accounting and corporate governance (Sarbanes & Oxley, 2002). In America, scandals such as World.com and Enron in year 2002 where investors lost over $180 billion led to enactment of Corporate and Auditing Accountability and Responsibility Act (Sarbanes & Oxley, 2002). These major financial scandals were caused by weak corporate governance which the Sarbanes Oxley Act of 2002, tried to address. Corporate Governance is the system by which organizations are directed and controlled. It's a set of relationships between company directors, shareholders and other stakeholder's as it addresses the powers of directors and of controlling shareholders over minority interest, the rights of employees, rights of creditors and other stakeholders (Muriithi, 2016). Corporate governance has evolved over the years with the evolution of the corporate legal personality. Corporate governance essentially arose from the agency problems that were created by the separation of ownership and control which promotes a dominant management team and powerless shareholders.

Corporate governance has evolved over the years with the evolution of the corporate legal personality. Corporate governance essentially arose from the agency problems that were created by the separation of ownership and control which promotes a dominant management team and powerless shareholders (Wells, 2010). This was described by Adam Smith in the *Wealth of Nations* where he identified the divergent interest between managers and owners which would cause a problem for the efficient operation of the corporation. He stated that the manager would not protect the owners' interests as diligently as he would protect his own interests (Smith, 2007). In the mid-nineteenth century, corporate governance practices changed with the changes in shareholder voting from a democratic system which protected minority shareholders to a plutocratic system which favoured majority shareholders (Wells, 2010). These examples laid the backbone to the development of the concept of corporate governance. Therefore, corporate governance allows for a balance between what directors do and what shareholders desire through the creation of mechanisms that incentivize directors to act on behalf of shareholders and shareholders are well informed about their activities (Sale, 2008).

Today good governance is no longer an option but a benchmark to measure the success or failure of any institution. In a study in the US by Gompers, Ishiij, and Metric (2012), it was revealed that investors are willing to commit more money in companies that are managed well because they provide security for their money. In addition, professionals would want to work for organizations that have good reputation and not those that have governance issues. Corporate governance (CG) is therefore concerned with how companies are directed and controlled that influences an organization's growth and development (Clarke, 2009).

Historically, the concept of CG can be traced back to the 19th Century period in the United Kingdom (UK) when the joint stock companies Act (1844) allowed the registration of companies. According to Berle and Means (2004), this registration led to the birth of the modern corporation. The registration of a corporation meant separation of the owner from the business where professional managers are the ones to run the business

(Kiel & Nicholson, 2006). Whereas the birth of corporation reduced the owners' liabilities in the company, it also created conflicts between owners and managers. Consequently, CG framework was necessary to protect owners from the actions of the managers who had the advantage of running the company. In developing countries, (CG) became prominent in the 1980s after the storm of corporate failures sweeping across developed world had calmed down (Francis, 2007). Organizations such as the WorldCom and Enron in the United States of America (USA) and Golden Quadrilateral in India collapsed attributed to bad governance and financial impropriety.

The problems that brought down many organizations in the US and other parts of the world culminated into the formation of codes of conduct for corporate institutions as a way of preventing further corporate failures. Such codes from developed countries include (Cadbury Report UK, 1992, Sarbanes-Oxley SOX**,** 2002**,** Organization for Economic Cooperation and Development OECD, 2004). In developing countries, similar bodies include, Kings Report 11 & 111, and Security Exchange Commission of Ghana, (Nwadioke, 2009), intended to help reinforce corporate ethics in terms of accountability and transparency in the management of a public entities (OECD, 2004). However, there is no universal law due to financial and economic circumstances in different countries (Clarke, 2009).

Berk and DeMarzo (2010) argued that the corporate governance framework aimed to enhance accountability and transparency to facilitate increased efficiency of a firm, in its current form is evidently lacking in a monitoring system to align the interest of the firm owners, board of directors and managers towards wealth creation of the firm and the welfare of all the stakeholders. The financial performance of the firm mostly depends upon the strategic decisions carefully designed and taken by their owners. Corporate governance broadly describes the processes, customs, policies, laws and institutions that direct the corporations in the way they act, administer and control their operations (Khan, 2012). It is viewed from different angles; it can be described as ways in which suppliers of finance to corporations assure themselves of getting a return on their investment, or as governance that determines how the firm's top decision makers (senior management) actually administer contracts. It focuses on managing the relationship among the stakeholders including the board of directors and shareholders in order to achieve the goals of the organization (Khan, 2012).

Corporate governance denotes a system through which corporations are controlled and managed. The governance structure in corporations describes the distribution of rights and responsibilities among the participants (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and also shows the rules and procedures to be followed by the management in making decisions for corporate agendas (Enobakhare, 2010). Effective corporate governance provides a viable structure or system through which corporations can realize their objectives and goals while focusing on the social, regulatory and market context of development within the operational environment (Enobakhare, 2010). Governance is therefore, the process for monitoring, managing the policies, actions, and decisions of operations (Mullins, 2014).

Corporate Governance as an emergent discipline is a framework used by a corporate entity to control and manage its functions. It documents how the entity relates to its stakeholders and may be defined as the stewardship responsibility of corporate directors to provide oversight for the goals and strategies of a Corporation and foster their implementation (Kaufmann, Kraay, & Mastruzzi, 2009). In Kenya, Corporate Governance has been defined in the Capital Markets Act 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 shareholder ultimate value while taking into account the interests of other stakeholders”. It is concerned with striking a balance between the Corporations’ economic and social goals; “between individual and communal goals while encouraging efficient use of resources, accountability in the use of power and stewardship, and as far as possible, aligning the interests of individuals, Corporations and society”.

Corporate governance can influence a firm’s performance whenever a conflict of interest arises between management and shareholders and or between controlling and minority shareholders. In the management-shareholder conflict, the agency problem manifests itself in management’s low effort and unproductive investments, usually known as perquisites. In the controlling-minority shareholder conflict, controlling shareholders use their power to benefit themselves at the expense of the minority shareholders, in what is called expropriation or private benefits of control (Goodstein, 2014). The root of both conflicts is the fact that the manager in the first case, and the controlling shareholders in the second case, receives only a portion of the firm’s net revenue, while they fully appropriate the resources diverted (Organisation for Economic Co-operation and Development [OECD], 2015). Outsiders have two main instruments to counterbalance this power: the enforcement of adequate corporate governance standards and the quality of the regulatory and legal environment, which should discourage detrimental actions by insiders and, once committed, allow affected stakeholders to challenge them through corporate and judicial channels. According to Pfeffer (2012) the principal-agent relationship may be reflected in management pursuing activities which may be detrimental to the interest of the shareholders of the firm.

In the global context, there has been renewed interest in the corporate governance practices of modern corporations, particularly in relation to accountability, since the high-profile collapses of a number of large corporations during 2001–2002, most of which involved accounting fraud. Corporate scandals of various forms have maintained public and political interest in the regulation of corporate governance. In the U.S., these include Enron Corporation and MCI Inc. (formerly WorldCom). Their demise is associated with the U.S. federal government passing the Sarbanes-Oxley Act in 2002, intending to restore public confidence in corporate governance. Comparable failures in Australia (HIH, One.Tel) are associated with the eventual passage of the CLERP 9 reforms. Similar corporate failures in other countries stimulated increased regulatory interest e.g., Parmalat in Italy.

The Asian economic crisis also contributed to raising the profile of Corporate Governance as the crisis has been linked to poor Corporate Governance practices. The Asian financial crisis, which caused so much damage to the global economy, was triggered by poor corporate governance practices just as the recent Enron scandal in the US has shown poor practice undermines investor confidence and affects overall market stability (Reuters, 2008). This scandal led to the reduction of Enron’s market value from US$ 80 billion in August 2000 to less than US$ 1 billion in 2001, when the financial scandal was revealed. Institutional investors rely on the quality of corporate governance regimes in making decisions, and place a financial premium (a cost) where systems are weak. An effective regime that promotes corporate governance contributes positively to the development of both national capital markets and to the promotion of foreign direct investment. Thus, the significance of corporate governance is now widely recognized both for national development, and as part of the international financial architecture. In the words of the President of the World Bank: "The proper governance of companies will become as crucial to the world economy as the proper governance of countries" (Godfrey, 2012).

The world over, it is acknowledged that the Internal Audit practices can possibly provide unparalleled administrations to management in the behavior of their obligations. There has been advance in achieving accord on what audit standards, governments and government offices ought to apply (Spencer, 2008). Internal auditing is a profession that involves prompting organization on the most proficient method to accomplish their objectives through overseeing risks and upgrading internal control (Nagy & Cenker, 2009). According to Bromilow and Berlin (2008) across the world, organizations no longer set up internal control framework as an administrative necessity additionally in light of the fact that it helps in guaranteeing that all administration exercises are fittingly completed. Internal controls are intended primarily to enhance the reliability of financial performance, either directly or indirectly by increasing accountability among information providers in an organization (Jensen & Murpy, 2004). Jiang and He (2015) argue that a typical feature of ownership structure in modern corporate governance is the separation of company ownership and management. In order to better the development of firms, business owners take the companies operating rights to professional managers to manage and only retain the power of the residual value of the company to obtain rights.

The notion of shareholder value, promoted by the conservative governments in the UK and US in the early 1980s, also had a significant impact on Corporate Governance developments (Jensen & Murpy, 2004). Related to these disclosures of alleged gross corporate malfeasance, there was also a more widespread erosion of standards throughout the global markets, with questionable and unethical practices being accepted. The net effect has been to undermine the faith shareholders and investors have in the integrity of the world's capital markets.

Developing countries are now increasingly embracing the concept of corporate governance knowing it leads to sustainable economic growth. The state corporations have tremendous governance problems. Some of the state corporations have folded up partly as a result of governance problems as observed in South Africa (Kyereboah and Biekpe, 2011). In Africa, the corporate governance concept is gradually warming itself to the top of policy agenda like in Ghana and South Africa. Indeed, it is believed that the Asian crisis and the seemingly poor performance of the corporate sector in Africa have made the concept of corporate governance a catch phrase in the development debate (Berglof & Von Thadden, 2014).

The Institute of Directors in Southern Africa (IoDSA) formally introduced the King Code of Governance Principles and the King Report on Governance (King III). The Code and the Report which were unveiled at the Sandton Convention Centre in Sandton, Johannesburg, in 2009 argues that, to maximize financial bottom line of a firm, aspiring and current board members must possess an in-depth understanding of how corporate boards work and what it takes to lead with transparency, accountability, and efficiency. By examining today's corporate governance challenges, prospective female board members, as well as seasoned chairs, committees, and individual directors should be trained to positively influence their company's direction and shareholder performance (Freeman, Wicks and Parmar, 2014). Godfrey (2012) posits that in addition to the South African King Report, there has been a rapid growth in the development of African thinking on corporate governance. New thinking is to attack on the supply side of corruption (company bribes) by complementary anti-corruption measures by the state. The recent initiative of the African Union (AU) to develop an AU Convention on Combating Corruption addresses the importance of declaring public officials' assets, and also breaks ground by targeting unfair and unethical practices in the private sector. Corporate governance is now established as an important component of the international financial architecture, but barely half a decade ago it was little known beyond specialists in a few countries such as the US, the UK, Australia, Canada and South Africa.

Indeed, corporate governance in Kenya is now gaining some level of recognition with very little work in the area even in the well-regulated institutions and sectors. In Kenya, the poor performance of state corporations in 1990's led to outflow from central government to parastatals equivalent to 1 percent of the GDP in 1991. Further, in 1990 – 1992, the direct subsidies to parastatals amounted to Ksh 7.2 billion and as additional indirect subsidies amounted to Ksh. 14.2 billion. By 1994, the subsidies paid to parastatals or organizations were taking 5.5 % of the GDP. The levels of inflation in the country then reflected deficits financed by the Central Bank. Some ways were devised to solve these problems, such as negotiations between state corporations and government in a bid to clarify the former's objectives and set targets, introduction of competition and better accountability to customers, provision of incentives in form of higher salaries and benefits to employees based on performance and increased training of employees. All these measures were not 100% successful. Failure of the above measures made many governments embark on privatization (Kamung'a, 2000).

Since 2003, reforms have been introduced in State Corporations through the push for good Corporate Governance that would enhance delivery of their mandates. The concept of Public Private Partnership was introduced to facilitate investment in infrastructure to ease State Corporations' functions (Muthumbi, 2007). During the period, the Report on Harmonization of Terms and Conditions of Service for Public Officers recommended, *inter alia*: the merging of superfluous State Corporations whose functions overlap; categorizing Corporations into various subsectors; the competitive recruitment of Chief Executive Officers; the proper appointment and dismissals of Directors and setting minimum qualifications for these Directors.

Despite Kenya having very good laws and progressive new constitution with elaborate oversight institutions, the trend in corporate failures is worrying especially in the public sector. State Corporations that have experienced upheavals owing to bad corporate governance are: the Kenya Cooperative Creameries (KCC); National Housing Corporation; Kenya National Assurance Company (KNAC) which was wound up in 2001; Kenya Meat Commission (KMC); Mount Kenya Textiles (Mountex) and Kisumu Cotton Mills (KICOMI) among others (Muthumbi, 2007). An example of the breach of Corporate Governance is in the case of KNAC's senior executives allocating themselves allowances which were way above the ceiling (Standard reporter, 2006). Uchumi Supermarket Limited which collapsed and was revived by the Government was characterized by perfunctory expansion of branches, unsuitable financing, poor resource policy and heavy borrowings which were not channeled to their intended purposes (Wambugu, 2011). The National Bank of Kenya faced liquidity problems due to imprudent loan allocation and interference from politicians who used to impose their cronies on the Board of Directors without following due procedure for their appointment. KMC, a meat supplier in Africa, Europe and the Middle East in the mid 1960 declined due to policy misdirection, high-level corruption and political patronage (Wambugu, 2011). KCC collapsed following political interference and sale of equipment to individuals well connected with the Government (Organic farmer, 2012). A central thread in the collapse and mismanagement of these State Corporations was the non-meritorious appointments of directors of the boards which were not in consonance with sound Corporate Governance principles.

State corporations in Kenya have been through a number of challenges. Perennial losses, debt and misappropriation of funds are some of them. The government has had to bail them out on a number of occasions. All these problems stem from poor management. For any institution to run smoothly, the management team must be well-qualified and committed to the attainment of the institution's objectives. Additionally, the members of these boards serve on many boards which leads to a conflict of interest (Odoyo, Omwonyo & Okinyi, 2014). Corporate governance guidelines are formulated and implemented to correct and prevent the aforementioned issues.

Consequently, in the last two decades, numerous state corporations have failed to discharge their mandate due to mismanagement. The following are instances of Government of Kenya debt restructuring involving commercial state corporations: Agricultural Finance Corporation (AFC) As at June 2002, the indebtedness of AFC to

Government of Kenya was Ksh.8.5 billion comprising Ksh.2.1 billion in principal amount and Ksh.6.4 billion in interests. Cabinet approved a write-off of Ksh.8 billion out of the total amount of Ksh.8.5 billion, with the balance of Ksh.500 million remaining in the books as Government of Kenya loans. Kenya Railways Corporation (KRC) As at June 2010, loans on-lent by Government of Kenya to KRC, inclusive of interest and charges, amounted to Ksh.39.993 billion. KRC had defaulted on the repayment of Ksh.1.5 billion loan on-lent to it by Government of Kenya. Based on a revaluation, the value of KRC assets was Ksh.42.4 billion; hence the conversion to equity of Government of Kenya debt amounting to Ksh.39.993 billion was considered feasible and reasonable. The debt restructuring for the five public sector owned sugar companies including Nzoia, South Nyanza, Chemelil, Muhoroni and Miwani was approved by Government as part of the on-going privatization of the companies.

The Kenya Meat Commission (KMC) collapsed due to mismanagement in the 1990s and was only revived in 2006 by the government injecting it with Kshs 500 million. In 2003, the government came to the aid of Kenya Power and Lighting Company by converting loans to the corporation into non-cumulative shares which means that creditors as the preferential shareholders would recover their money where the company has made a profit; in the event it runs into a loss, it shall skip the dividend in that year (Odoyo et al., 2014). To address the challenges of governance in state corporations, the government developed Mwongozo as a critical building block in entrenching principles and values. However, recently, there have been major scandals in the listed parastatals in spite of strong regulatory from capital market authority and the government mwongozo guidelines (Kiarie, 2018).

Effective corporate governance is critical to firm financial performance and by extension shareholder value, and especially so after the collapses and scandals of the high profile corporates such as Enron, WorldCom and others in the US, serving as an impetus to such recent U.S. regulations as the Sarbanes-Oxley Act of 2002. The Act is considered the most sweeping corporate governance regulation in the past 70 years (Khaled, 2014), with the main objective of the Act being to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and other purposes. Others are Parmalat in Italy, Marcos 10b & Fortune and Baby Doc of Haiti. Back in Kenya, the collapse of Uchumi Supermarkets, Kenya-United Insurance, Lake Star Insurance, Goldenberg, Kenren and Anglo-Leasing scandal clearly point out on the need for good corporate governance. Corporate governance has succeeded in attracting a good deal of public interest because of its apparent importance for the economic health of corporations and society in general. Corporate governance is about the exercise of power over corporate entities. It has become one of the central issues in the running and regulating of modern enterprise today. However, the underlying ideas and concepts of corporate governance have been surprisingly slow to evolve (Enobakhare, 2010).

According to World Bank (2015) corporate governance in developing economies has lately found a lot of research attention. However, the connection between corporate governance and financial performance remains unattested across many sectors of these developing economies. According to Kumudini (2011) there is non-linear association between financial performance and corporate governance practices such as governance training, transparency, and shareholder input in decisions making. On the other hand, large shareholder ownership, state ownership, and the proportion of independent directors are negatively associated with financial performance (Wan and Ong, 2015).

1.1.1 Corporate Governance Concept

Cadbury, (1992) defines Corporate Governance as a system by which corporations are directed and controlled. While the OECD (2004) defines CG as a set of relationships between company's management, its board, shareholders and other stakeholders. However, opinions are divided whether CG definition should include other stakeholders or it should be to specific stakeholders. Miring'u and Muoria (2012) carried out an analysis of the effect of corporate governance on the performance of State Corporations in Kenya and made the observation that the ability of any corporate entity to effectively respond to external factors and changes is heavily dependent on it's governance structures and the effectiveness of it's Board of Directors.

In a study by Love (2011), findings revealed that there exists a relationship between CG and performance with observance of such principles as improved accountability and transparency. Therefore CG is meant to reinforce these principles that influence performance for example: CEO duality; independent non-executive directors; appointment and re-election of directors; availability of information for directors; remuneration of directors; financial reporting; internal controls; audit committee and the relationship with stakeholders (Mullins, 2014). Accountability, transparency, fairness and responsibility provide the assurance to the shareholders that their interests are safe. However, in other instances, researchers had found negative relationship between some aspects of CG practices and organization performance for example (Pham, Surchard and

Zein, 2007). Nevertheless, majority of scholars agree that, good governance enhance firm value where values and principles are adhered to (Eichholtz, Kok & Bauer, 2011).

1.1.2 State Corporations in Kenya

In Kenya, a parastatal is a State Corporation (SC) under State Corporation Act Cap 446 1987. SC has various meanings. First, it may be a corporate body established by or under an Act of parliament. Second, the president may by order establish a SC as a body corporate to perform the functions specified in the order. Third, it also represents a bank or a financial institution licensed under banking Act or other company incorporated under the company Act (Wamalwa, 2014). State corporations are corporate entities that are established and governed by legislation in order to provide a good or service to the public (Odoyo et al., 2014). In Kenya, for desire of sufficient indigenous private entrepreneurship after independence, the government had to use parastatals to fill the existing entrepreneurship gap. Thus, public enterprises served as a means to promote the establishment of private African enterprises (Wamalwa, 2014). The state corporations have tremendous governance problems. Some of the state corporations have folded up partly as a result of governance problems as observed in South Africa (Kyereboah & Biekpe, 2011).

Sessional Paper No.4 (GoK, 2004) on development and employment in Kenya decried the continued deterioration of the performance of SCs. The paper observes that while the creation of SCs through which government participation in economic activities was promoted was perhaps appropriate soon after independence, the objectives for and the circumstances under which most of the state enterprises were created have since changed. The paper underlines the need to implement privatization and divestiture of SCs urgently in view of the managerial problems afflicting the parastatals leading to poor return on government investments, the existence of a larger pool of qualified manpower, availability of more indigenous entrepreneurship to permit private sector led economy and the need for non-tax revenue for the government. The government has made progress in parastatals' reform.

1.2 Statement of the Problem

Despite tight regulatory framework, Corporate Governance continues to weaken in Kenya (Mang'unyi, 2017). According to Muriithi (2016), many companies have been characterized by scandals. In Kenya, cases where managers and directors have been accused of poor corporate governance resulting to corporate scandals include the collapse of Euro Bank in 2004, the placement of Uchumi Supermarkets under receivership in 2004 due to mismanagement, the near collapse of Unga Group, National Bank of Kenya and more recently Board room wrangles and the discovery of secret overseas bank accounts for siphoning company money by some directors at CMC Motors (Kiarie, 2018). The recently publicized huge losses and numerous unresolved disputes resulting to court cases by Kenya Airways and KenolKobil have also thrust corporate governance practices into the spotlight.

Locally, Mang'unyi (2017) conducted a study to explore the ownership structure and Corporate Governance and its effects on performance of firms focusing on selected banks in Kenya and established significant difference between Corporate Governance and financial performance of banks. Muriithi (2016) did a study on the relationship between Corporate Governance mechanisms and performance of firms quoted on the NSE, Wanjiru (2016) did a study on effects of corporate governance on financial performance of companies quoted at the NSE and found that a strong relationship exist between Corporate Governance practices under study and the firms' financial performance. Similarly, leverage was found to positively affect financial performance of insurance firms listed at the NSE. Otieno (2017) researched on impacts of corporate governance and financial performance of commercial banks in Kenya and concluded that corporate governance elements represent 22.4 % of the budgetary execution of commercial banks. Matengo (2015) did a study on the relationship between Corporate Governance practices and commercial banks' performance in Kenya. From the reviewed studies very, few have focused on financial aspects of corporate governance and their influence on financial performance of state corporations. Hence the current study sought to fill the knowledge gap by holistically investigating the influence of corporate governance on financial performance of listed corporations in Kenya with government shareholding.

1.3 General objective

The broad objective of the study was to investigate the influence of corporate governance on financial performance of listed corporations with government shareholding in Kenya.

1.3.1 Specific Objectives

The specific objectives of the study were;

i. To establish the influence of financial transparency on financial performance of listed corporations with government shareholding in Kenya

ii. To determine the influence of internal audit standards on financial performance of listed corporations with government shareholding in Kenya

iii. To examine the influence of internal controls on financial performance of listed with government shareholding corporations in Kenya

iv. To investigate the influence of ownership structure on financial performance of listed corporations with government shareholding in Kenya

1.4 Research Hypothesis

The study was guided by the following null hypotheses;

H_{01}: Financial transparency has no significant influence on financial performance of corporations with government shareholding in Kenya

H_{02}: Internal audit has no significant influence on financial performance of corporations with government shareholding in Kenya

H_{03}: Internal controls has no significant influence on financial performance of corporations with government shareholding in Kenya

H_{04}: Ownership structure has no significant influence on financial performance of corporations with government shareholding in Kenya

1.5 Justification of the Study

The outcomes of the study would be useful in improving the understanding of regulators, Capital market authority, State Corporation Advisory Committee (SCAC), Central Bank among others regarding the importance of corporate governance in parastatals keeping the aspect of listed and non- listed.

This study would be beneficial to management and executives of listed state corporations and other organizations in improving their financial performance and enable them to compete globally.

The study would also open opportunities for future researchers who would want to carry out further research on financial performance of listed companies and especially those with government shareholding. The research is expected to act as a stepping stone to further research in the same area.

1.6 Limitations of the Study

The study and its success may be negatively impacted by the unavailability of adequate time to cover the entire area in focus as well as the time set for filling responses, therefore the researcher made use of research assistants to ensure that the expected scope was covered within the given time limit. The study was also limited by distance of distribution of the various corporations who are distributed across the country. The researcher ensured proper scheduling that enhanced enough time to visit respondents.

1.7 Delimitation of the Study

This study was delimited to state corporations with government shareholding. According to State Corporations Advisory Authority (2018), there are twelve (12) state corporations where the government of Kenya has shareholding. The researcher targeted general managers, managers and CEO's of listed corporations with government shareholding. The study examined target firms' financial statements for the last four years i.e. 2014-2017.

1.8 Assumptions of the Study

The researcher assumed that all the identified respondents were supportive in answering the questions posed and they answered questions correctly and truthfully.

1.9 Operational Definition of Terms

Corporate governance: Structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting (Berglof & Von Thadden, 2014).

Financial performance: General measure of a firm's overall financial profitability over a given period of time (Ulrich, 2008).

Ownership structure: Decision making segment of the firm and is defined by the distribution of equity (Donaldson & Preston, 1995).

Return on Assets: is the total resources owned and controlled by a firm divided by profit before tax (Blair, 1995).

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter discusses essential issues that form the background of the study. It is organized systematically starting from the theoretical literature, empirical review, conceptual framework, and summary.

2.2 Theoretical Framework

A theoretical framework refers to collection of interrelated ideas based on theories (Kothari, 2014). It is a set of prepositions, which are derived and supported by data or evidence. A theoretical framework accounts for or explains a phenomenon (Mugenda & Mugenda, 2012).

2.2.1 Stakeholder Theory

Stakeholders' theory has been popularized since scholars have realized that the tasks of a corporate entity effects on the external environment that requires accountability of the institution to a wider audience than just its shareholders. According to Freeman (2003) companies are no longer the instrument of shareholders alone but they exist within the society and hence it has responsibilities to the society too. In fact, Freeman (2003) pointed out that economic value is created by people who voluntarily come together and cooperate to improve everybody's position. Jenson and Murphy (2004) critiqued stakeholder's theory as assuming single valued objective and hence suggests that the performance of a firm is not measured only by gains to its stakeholders but also other key issues such as flow of information from senior management to lower levels, interpersonal relations, working environment among others.

There are two main theories of stakeholder governance: the abuse of executive power model and the stakeholder model. The Anglo-American corporate governance arrangements offer excessive power in the hands of management who may abuse it to serve their own interest at the expense of shareholders and society as a whole. Supporters of such a view argue that the current institutional restraints on managerial behavior, such as non-executive directors, the audit process, the threat of takeover, are simply inadequate to prevent managers abusing corporate power. Shareholders protected by liquid asset markets are uninterested in all but the most substantial of abuses. Incentive mechanisms, such as share options, are means through which managers can legitimize their abnormal overpayment which is viewed by some as a symptom of the breakdown of governance (Freeman, 2003).

The abuse of executive power is particularly embedded in the problem of executive overpay since executive remuneration has risen far faster than average earnings and there is at best a very weak link between compensation and management performance (Jiang, 2004). The only restraint on executive pay seems to be the modesty of executives themselves, and the creation of so-called independent remuneration committees by large companies is not effective. The supporters of this model do not believe that the main lines of corporate governance reform, such as non-executive directors, shareholder involvement in major decisions and fuller information about corporate affairs, are suitable monitoring mechanisms. Instead, they propose statutory changes in corporate governance, under which hostile takeovers are not possible to effect, since ownership of shares no longer brings the right to appoint executive management.

2.2.2 Agency Theory

Agency theory is a management approach where one individual (the agent) acts on behalf of another (the principal) and is supposed to advance the principal’s goals (Gadi, 2015). The agent therefore advances both the principals’ interests and his own interests in the organization. The theory was propounded by Jensen and Meckling (1976) and views the firm as an artificial construct which serve as a nexus of contracts between individuals. The theory argues that one of the most important contracts a firm engages in is the residual claim (equity) of the shareholders on the firm’s assets and cash flows.

In corporate governance the agency theory offers a solution for the fundamental problem for absent or distant shareholders who need to bring in professional executives to act on their behalf. In line with neo-classical economics, the main assumption of this theory is that the agent is likely to be self-interested and opportunistic. This raises the prospect that the executive, as agent, will serve their own interests rather than those of the owner principal (Gadi, 2015). To counter such problems the principal will have to incur agency costs which are costs that arise from the necessity of creating incentives that align the interests of the executive with those of the shareholder, and costs incurred by the necessity of monitoring executive conduct to prevent the abuse of owner interests (Roberts, 2014).

According to the agency theory, superior information available to professional managers allows them to gain advantage over owners of firms. The reasoning is that a firm’s top managers may be more interested in their personal welfare than in the welfare of the firm's shareholders. Donaldson and Davis (1991) argue that managers will not act to maximize returns to shareholders unless appropriate governance structures are implemented to safeguard the interests of shareholders. Therefore, the agency theory advocates that the purpose of corporate governance is to minimize the potential for managers to act in a manner contrary to the interests of shareholders. Proponents of the agency theory opine that a firm's top management becomes more powerful when the firm's stock is widely held and the board of directors is composed of people who know little of the firm (Gadi, 2015). Therefore, 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.

Agency Theory explains how to best organize relationships in which one party determines the work while another party does the work. In this relationship, the principal hires an agent to do the work, or to perform a task the principal is unable or unwilling to do. For example, in corporations, the principals are the shareholders of a company, delegating to the agent i.e. the management of the company, to perform tasks on their behalf. Agency theory assumes both the principal and the agent are motivated by self-interest. This assumption of self-interest dooms agency theory to inevitable inherent conflicts. Thus, if both parties are motivated by self-interest, agents are likely to pursue self-interested objectives that deviate and even conflict with the goals of the principal. Yet, agents are supposed to act in the sole interest of their principals.

The agency theory therefore works on the assumption that principals and agents act rationally and use contracting to maximize their wealth (Jensen & Meckling, 1976). This theory is applicable to this study simply because internal control is one of many mechanisms used in business to address the agency problem by reducing agency costs that affects the overall performance of the relationship as well as the benefits of the principal (Ray & Kurt, 2011). Internal control enhances the provision of additional information to the principal (shareholder) about the behavior of the agent (management) reduces information asymmetry and lowers investor risk. The relevance of the theory is that it informs the independent variable (internal control). Internal control is all about the board and managers who are entrusted with corporation's resources. Management, being the agents of the state corporations, is expected to act in the interest of the organization.

2.2.3 Stewardship Theory

According to Donaldson and Preston, (1995) stewardship theory, also known as the stakeholders' theory, adopts a different approach from the agency theory. It starts from the premise that organizations serve a broader social purpose than just maximizing the wealth of shareholders. The stakeholders' theory holds that corporations are social entities that affect the welfare of many stakeholders where stakeholders are groups or individuals that interact with a firm and that affect or are affected by the achievement of the firm's objectives. Stakeholders can be instrumental to corporate success and have moral and legal rights (Ulrich, 2008). When stakeholders get what they want from a firm, they return to the firm for more. Therefore, corporate leaders have to consider the claims of stakeholders when making decisions and conduct business responsibly towards the stakeholders. Participation of stakeholders in corporate decision-making can enhance efficiency and reduce conflicts.

In defining ‘Stakeholder Theory’ Donaldson and Preston, (1995) state: '"The firm" is a system of stake holders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm's activities. The purpose of the firm is to create wealth or value for its stake holders by converting their stakes into goods and services'. This view is supported by Blair, (1995) who proposes: the goal of directors and management should be maximizing total wealth creation by the firm. The key to achieving this is to enhance the voice of and provide ownership-like incentives to those participants in the firm who contribute or control critical, specialized inputs (firm specific human capital) and to align the interests of these critical stakeholders with the interests of outside, passive shareholders.

According to Abdi (2015) corporations adopt reactive or proactive approaches when integrating stakeholders’ concerns in decision making. A corporation adopts a reactive approach when it does not integrate stakeholders into its corporate decision making processes thus resulting into a misalignment of organizational goals and stakeholder demands. Some authors attribute scandals such as those of Enron and WorldCom to the failure to consider stakeholder concerns in decision making. Following these scandals, some governments set up new regulations to align the interests of stakeholders with corporate conduct. For example, the Sarbanes-Oxley Act (SOX) was passed as a result of the collapse of Enron and WorldCom. Adams (2010) argues that the stewardship theory remains the theoretical foundation for much regulation and legislation. A proactive approach is used by corporations that integrate stakeholders' concerns into their decision-making processes and that establish necessary governance structures.

Stewardship theory was adopted in this study to enable analyse how different ownership structures have put in place, facilitating and empowering structures rather than monitoring and controls, that are proposed by the agency theory which interferes with the motivation of the steward instead of ensuring that both the principal and the steward interests are aligned to enhance effectiveness of agent in pursuit of improved firms financial performance in the long-term.

2.2.4 Resource Dependence Theory

Resource dependence theory (RDT) by Barney (1986), proposition is based on the premises that a firm's board, and in particular the constitution of the non-executive element of a board, can provide the firm with a vital set of resources. Although agency theory is the predominant theory used in the research on boards of directors (Dalton and Dalton, 2005; Zahra & Pearce, 2003), this is the area of RDT's greatest research influence. Pfeffer and Salancik (2003) asserts that boards enable firms to minimize dependence or gain resources. RDT is less commonly used to study boards than agency theory but empirical evidence to date suggests that it is a more successful lens for understanding boards (Zahra & Pearce, 2003).

Pfeffer and Salancik (2003) suggest that directors bring for benefits to organizations: information in the form of advice and counsel, access to channels of information between the firm and environmental contingencies, preferential access to resources, and legitimacy. Significant empirical evidence supports these proposed benefits and suggests that "resource-rich" directors should be the focus of board composition. Thus, it's not just the number, but the type of directors on the board that matters. Early studies using RDT to examine boards focus on board size and composition as indicators of the board's ability to provide critical resources to the firm.

Zahra and Pearce (2003) advocates that board composition and size are contingent not only on the external environment but also on the firm's current strategy and prior financial performance. Eisenhardt (1989) found a positive relationship between board size and firm financial performance. However, many scholars are quick to question the simplistic answer provided by board size, suggesting that a more complex understanding is necessary.

In summary, resource dependence theory is therefore adopted in this study to creates a background used as basis for analysing and giving an insight on how different ownership structures creates governance structures that enable their management to provide the firm with a vital set of resources in terms of; information in the form of advice and counsel, access to channels of information between the firm and environmental contingencies, preferential access to resources, and legitimacy which in the long-term enhances firms financial performance.

2.3 Empirical Review

This section reviews the existing empirical studies on corporate governance on financial performance.

2.3.1 Financial Transparency and Financial Performance

After many financial scandals of European and American companies in 2000's Enron, Tyco, Parmalat and etc. the issue of voluntarily disclosure and transparency in a financial reporting process led a deep interest from the view of investors. After these scandals many regulations and voluntarily disclosures took a part in today's financial reporting. Today financial reporting is a deep concept beyond the disclosure of financial statements. Attention of investors has turned to not only the effectiveness of corporate governance practices but also to transparency and disclosure of information. Financial transparency entails full disclosure of the financial information to reduce information asymmetry between the companies. The tenet of any corporate governance system is based on the goal of good financial reporting which compliance with the complex accounting standards in conjunction with other regulatory requirements around the world (Fung, 2014). Financial reports full and prompt disclosure help shareholders goal of maximization of wealth to be pursued by managers since any unlawful pursuit is properly scrutinized to limit the top managers' discretion of following their own interest. With more financial transparency, investors are able to invest wisely since they will be well informed as to the right choice of capital which as result reduces cost of financing through the decreased liquidity premium.

Annual reports for companies contain both mandatory and voluntary information. Laws, regulations and accounting standards prescribe mandatory information contained in annual returns whereas voluntary information is dependent on management's judgment on information that need to be included in the annual report (carey, 2008). Financial disclosure aims at introducing and explaining companies' potentials to investors, driving the fluidity of capital market, guaranteeing more effective allocation of capitals, decreasing capital costs, and helps to achieve a more positive communication with investors as perfecting the information disclosed. In other words voluntary financial disclosure is the provision of information by a company's management beyond requirements such as generally accepted accounting principles and Securities and Exchange Commission rules, where the information is believed to be relevant to the decision-making of users of the company's annual reports.

Standard & Poor's has a study that examines the transparency and disclosure (T&D) practices of major public companies around the globe. Since T&D are fundamental components of corporate governance greater transparency and better disclosure keep corporate stakeholders better informed about the way a company is being managed. In addition, studies suggest that better disclosure has a positive impact on the efficient functioning of capital markets. Merkley (2010) examined the relationship between reported financial performance and voluntary disclosure for the period of 12 years from 1996 – 2007. The sample of the study consists of 20990 firm year observation. The fixed effect regression was found to be most appropriated from the results of the Hausman test. The findings revealed that current reported performance is negatively related to voluntary disclosures. However, the study by Merkley (2010) was carried out in a developed country whose regulatory framework is stable unlike those of developing economies.

Agyei-Mensah (2012) conducted an empirical study to investigate the effect of financial performance (proxied with bank size, profitability, debt equity ratio, and liquidity) on voluntary disclosure in annual reports for the year 2009, with respect to 21 rural banks in Ghana. To assess the level of voluntary disclosure the study adopted 27 items checklist developed by other scholars using the un-weighted (dichotomous) scoring method. The study used ordinary least square regression analysis to test the association between the independent variables (bank size, profitability, debt equity ratio, liquidity and audit firm size) and the voluntary disclosure level, the study results indicate that profitability represented by Return on Capital Employed (ROCE) is positively associated with the disclosure level, while debt equity ratio, liquidity (measured by current ratio), bank size (represented by value of net assets) and audit firm size were insignificantly associated to the extent of disclosure.

Hsiu (2006) investigated role of financial information transparency in increased investment in stock exchange. Results showed that all three aspects of transparency including financial information disclosure, ownership structure transparency and transparency of the board structure, affect behavior of investors in stock exchange, and ownership structure had the highest influence. Of course, investors in stock exchange mostly care for financial information disclosure.

Jullobal and Sartmool (2014) evaluated the effect of firm performance on voluntary disclosure in annual reports for the period of 5 years from 2009-2013, a total of 34 companies were studied. Secondary data were collected and analyzed through random effect tobit regression. The results showed that firm performance have significant effect on voluntary disclosure. More also disaggregating the analysis by classifying data into strategic information, non- financial information and financial information revealed that voluntary disclosure of strategic information and non- financial information are influenced by firm performance, while disclosure of financial information is not. The findings of the above study cannot be generalized due to the fact that pre and post diagnostic analysis of the properties of the data were not tested before conducting the regression, this could lead to spurious regression and therefore affect the overall result of the study.

Cunha and Mendes (2017) examined the effect of financial performance on voluntary disclosures between the period of 2005 and 2011 using a sample that comprises of 263 observations. Secondary data was collected from annual reports of the companies for the years 2005 and 2011. The study made use of an ordinal logistics model to explore the financial determinants of voluntary information disclosures. The findings suggest that there is an inverse relationship between voluntary corporate governance disclosures and financial performance, more also that firm size and growth opportunities had a significant and positive effect on voluntary corporate governance disclosures while financial leverage negatively affect voluntary corporate governance disclosures. The limitation of the above findings is that the subjectivity involved in the construction of corporate governance index was not tackled as the perception of users of financial statements was not captured in formulation of the corporate governance index.

Madhani (2007) discusses the role of voluntary disclosure and transparency in financial reporting and highlights risks and costs associated with voluntary disclosure. The study claims that, voluntary disclosure practices increase investor awareness and trust, reducing the uncertainty of the returns to the capital suppliers which is expected to reduce the firm’s cost of external capital to increase its value. Disclosure practices mitigate the political costs of non-compliance and reduce the risk of higher taxes, litigation and too much regulation. Adiloglu and Vuran (2012) investigate the transparency levels of financial information disclosures in corporate governance reports and annual reports are calculated by establishing a transparency checklist for the year 2010. Manova analysis is employed to investigate the relationship between the transparency levels and financial performance indicators. The results indicate that transparency level is statistically significant with return on asset, total debt / total assets, longterm debt / total assets and corporate governance index variables.

Sharif and Lai (2015) examine the effects of disclosure in corporate governance practices on firm performance, bankruptcy risk, leverage and dividend policy in public listed companies. To measure disclosure and transparency more accurately, the recommended practices of the Malaysian Code on Corporate Governance 2012 (MCCG 2012) is used. The results show that corporate disclosure practices have positive effects on company performance and negative effects on company leverage. And also, the paper did not find any significant relationship between corporate transparency levels with bankruptcy risk and dividend payouts.

Musyoka (2017) investigated the effect of voluntary disclosure on financial performance of firms listed in growth and development and research and development disclosure. Correlational research design was adopted and purposive sampling was used to select 43 companies which were actively trading from 2006 to 2015. Regression analysis was used to analyse the data. Results of the study revealed positive and significant relationship between financial, investment, sales growth, research and development and financial performance.

Mutiva (2015) carried out a study on the impact of voluntary disclosures on financial performance with focus on banking, telecommunications and manufacturing companies quoted at the NSE and established that there existed a strong positive association between voluntary disclosure and return on investment. Upon aggregating the voluntary disclosures classes, she obtained a Pearson Product Moment Correlation Coefficient of

0.6235. This indicated that, 38.9% of the variations in financial performance measure ROI can be explained by variations in voluntary disclosure. However, the study focused on commercial public companies which are different from state corporations hence difficult in generalizing the results.

2.3.2 Internal Audit Standards and Financial Performance

Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. Internal audit is an independent, material and consultancy activity, which adds value and improves the functioning of an organisation. It aids the organisation to achieve its aims by means of a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and the management process. It serves as an important link in the business and financial reporting processes of all organizations. Internal auditors play a key role in monitoring a company's risk profile and identifying the areas to improve risk management. Their aim is to improve organizational efficiency and effectiveness through constructive criticism (Goodwin, 2009)

Internal audit function, although it is not compulsory, subsists in majority of private venture or firms' substances, and in public sector are not excluded, state, and nation and city governments. The errand, quality and solid purpose of an inward review capacity might be distinctive broadly inside the approach of top officials and conventions of organizations and associations. By measuring and assessing the viability of firm controls, internal auditing, itself, is an essential administrative control gadget, which is specifically connected to the authoritative structure and the general principles of the business (Cai, 1997).

Public sector must uphold International Auditing standards that guide the internal audits ethics for Risk Based. This is in order to provide good governance in work and sustain professional auditing standards. Current risk management becomes increasingly problematic as organizations grow in size and complexity (Cohen & Hanno, 2008). Previous studies on demand for internal auditing have linked demand to the cost vs. benefit analysis undertaken during monitoring. Investment in fixed costs of internal auditing from a transaction cost perspective means that larger firms have opportunities to gain economies of scale (Carey, 2008). Carcello (2010) emphasizes that companies with complex organizations face a higher risk and must increase their monitoring.

Most internal audit experts contend that a compelling inner review work connects with enhanced money related execution. As indicated by Beyanga (2013), a viable inside review administration can, specifically, decrease overhead, distinguish approaches to enhance effectiveness and expand introduction to conceivable misfortunes from deficiently defended organization resources all of which can significantly affect the execution of an organization. Saren and De Belde (2006) pointed that when an organization seeks after respectability and clear moral qualities reflected in a formal set of principles/morals, the internal audit capacity will take a more noteworthy significance.

Dahir and Omar (2016) in the research paper entitled, "Effects of Internal Audit Practice on Organizational Performance Of Remittance Companies in Mogadishu, Somalia" evaluated the effect of internal audit practice on organizational performance of remittance companies located in Mogadishu, Somalia. The target population of the study was remittance companies located in Bakara market. The sample size was 200 respondents selected by using Slog van's formula. Data was collected through questionnaires set on

Likert scale and analyzed using SPSS version 22. Internal audit independence, internal audit quality, internal control system and audit risk were the variables of internal audit used in the study. The findings indicated that there was a significant positive relationship between internal audit practice drivers and organizational performance of remittance companies in Mogadishu, Somalia.

Hung and Han (2010) in the research paper entitled, "An Empirical Study on Effectiveness of Internal Audit for Listed Firms in Taiwan" tried to identify the factors that affect the effectiveness of internal audit for listed firms in Taiwan. The authors used a sample of 210 listed manufacturing firms. Data was collected through a questionnaire which was mailed to the management, the head of the audited department, and the head of the internal audit department of each company. The findings revealed that management's attitude, controller's attitude, the probability of internal auditors' promotion, the implementation of performance evaluation, the establishment of the job description, and the training and professional abilities of the internal auditor were the factors that affect management's perceiving effectiveness. Moreover, the research highlighted the factors that affect the effectiveness of the head of the audit department. These include internal auditor professional abilities, and the combination of organization formalization and professional abilities. Besides, the study further investigated factors that affect the progress of annual audit plan. These were: management's attitude, controller's attitude, the organization position of internal audit department in a company, the probability of internal auditor's promotion, the implementation of performance evaluation, the establishment of job description, the training and professional abilities of internal auditor, and the combination of organization formalization and the professional abilities.

Ahmad (2007) in the article entitled, “Auditors’ Compliance with International Standards in Audit” examined the degree of compliance of Jordanian auditors with ISA. It was found that Jordanian auditors complied with all audit standards due to strict conditions and requirement of Jordanian Laws wherein the audit profession should be assigned to a Certified Public Accountant (CPA) as well as imposing strict legal liabilities. The study recommended that there should be more attention by auditors and institutions regulating the audit profession in Jordan towards compliance with audit standards, especially those concerning internal audit and imposing on auditor’s responsibility to detect fraud in financial transactions and statements at the appropriate stage.

Kibet (2008) concluded that the internal audit function played a role in corporate governance. The limitations of the study were time constraints, restriction to state owned corporations and having to make prior arrangement in order to meet the heads. Recommendations of further study were effectiveness and contribution of internal audit in promoting corporate governance for companies listed in the NSE. Additionally, a study on the influence of internal audit and financial performance was recommended.

Kibara (2007) conducted a survey of internal auditor’s risk management practices in the banking industry in Kenya. The study sought to establish banks’ internal auditors' perception of their distinct role in the bank wide ERM process, and whether there was any conflict between internal audit and the risk management departments being established to take over the ERM process. Bank internal auditors’ risk assessment practices in Kenya were also probed. To achieve the objectives set, a survey involving all heads of internal audit departments in the banking industry in Kenya was conducted. Data analysis was done, and out of the 27 banks sampled, 14 returned responses and with this response rate of 52%, it was concluded that the outcome of the study fairly represented the banking industry internal auditors' practices and perception of risk management.

2.3.3 Internal Control on Financial Performance

Internal control systems including internal audits are intended primarily to enhance the reliability of financial performance, either directly or indirectly by increasing accountability among information providers in an organization (Jensen & Murphy, 2004). Internal control therefore has a much broader purpose such that the organization level of control problems associated with lower revenues, which explore links between disclosure of material weakness and fraud, earnings management or restatements. Internal controls provide an independent appraisal of the quality of managerial performance in carrying out assigned responsibilities for better revenue generation. There are three major classifications of internal controls; preventive, detective, and corrective. Preventive controls predict potential problems before they occur, make adjustments, and prevent an error, omission or malicious act from occurring. The detective controls are used to detect and report the occurrence of an omission, an error or a malicious act. Finally, the corrective controls help in ensuring that the impact of a threat is minimized, identify the cause of a problem as well as the correct errors arising from the problem. Corrective controls correct problems discovered by detective controls and modify the processing system to minimize future occurrence of the problem (Jensen & Murphy, 2004).

An entity should put in place its own system of controls in order to achieve its objectives. A system of effective internal controls is a critical component of company management and a foundation for the safe and sound operation of organizations. However, ineffective internal controls result in ineffective programs and eventually leading to losses (Olumbe, 2012). Recent incidence of corporate failures and accounting frauds are mostly preceded by failure in companies' internal control structures Internal controls are intended primarily to enhance the reliability of financial performance, either directly or indirectly by increasing accountability among information providers in an organization (Jensen & Murphy, 2004). Internal controls provide an independent appraisal of the quality of managerial performance in carrying out assigned responsibilities for performance.

Internal control also ensures the reliability of financial reporting (all transactions are recorded and that all recorded transactions are real, properly valued, recorded on a timely basis, properly classified, and correctly summarized and posted). An Organization with effective system of internal control is expected to achieve its objective efficiently and effectively. However the overall purpose of the concept is to help an organization achieve its mission, promote orderly, economical, efficient and effective operations and produce quality products and services consistent with the organization's mission, safeguard resources against loss due to waste, abuse, mismanagement, errors and fraud. It also promotes adherence to laws, regulations, contracts and management directives as well as develop and maintain reliable financial and management data, and accurately present that data in timely reports (Magara, 2013).

Ewa and Udoayang (2012) carried out a study to establish the impact of internal control design on banks' ability to investigate staff fraud and staff life style and fraud detection in Nigeria. Data were collected from 13 Nigerian banks using a four point likert Scale questionnaire and analyzed using percentages and ratios. The study found that Internal control design influences staff attitude towards fraud such that a strong internal control mechanism is deterrence to staff fraud while a weak one exposes the system to fraud and creates opportunity for staff to commit fraud.

Mawanda (2008) conducted a research on effects of internal control systems on financial performance in institution of higher learning Uganda. In his study he investigated and sought to establish the relationship between internal control systems and financial performance in an Institution of higher learning in Uganda. Internal controls were looked at from the perspective of Control Environment, Internal Audit and Control Activities whereas Financial performance focused on Liquidity, Accountability and Reporting as the measures of Financial performance. The Researcher set out to establish the causes of persistent poor financial performance from the perspective of internal controls. The study established a significant relationship between internal control system and financial performance. The investigation recommends competence profiling in the Internal Audit department which should be based on what the University expects the internal audit to do and what appropriate number staff would be required to do this job. The study therefore acknowledged role of internal audit department to establish internal controls which have an effect on the financial performance of organizations.

Olumbe (2012) conducted a study to establish the relationship between internal controls and corporate governance in commercial banks in Kenya. The researcher conducted a survey of all the 45 commercial banks in Kenya. It was concluded that most of the banks had incorporated the various parameters which are used for gauging internal controls and corporate governance. This was indicated by the means which were obtained enquiring on the same and this showed that the respondents agreed that their banks had instituted good corporate governance with a strong system of internal controls and that there is a relationship between internal control and corporate governance. A study conducted by Wainaina (2011) examined the internal control function. He established that, other than the prevention and detection of fraud, internal controls should reflect the strength of the overall accounting environment in an organization as well as the accuracy of its financial and operational records.

Mbuti (2014) assessed factors that influence the internal controls in ensuring good corporate governance in financial institutions in developing economies. The research paper assessed how lack of internal controls affected good corporate governance and aimed to bring out elements of good corporate governance. It emerged that failure to effectively implement internal controls contributed significantly to poor corporate governance. The study discovered that internal control system overrides and the issue of "fact cat" directors also contributed to poor corporate governance.

Mwakimasinde, Odhiambo and Byaruhanga (2014) investigated the effect of internal control systems on the financial performance of sugarcane outgrower companies in Kenya. The study adopted a descriptive correlational survey design. All the sugarcane outgrower companies were studied. Both the primary and secondary data was collected. Primary data was collected from the key informants from all the nine outgrower companies in Kenya using questionnaires. Secondary data was extracted from annual reports, publications and document analysis. The key informant's method was used, hence, all the Finance Managers and heads of internal audit for every outgrower company were selected to take part in the study. The data collection instruments were administered to all the nine sugarcane outgrower institutions. The data was analysed using statistical package for social scientists (SPSS) computer software version 19.0 to generate cumulative frequencies and percentages. The study found a positive significant effect of internal control system on the financial performance.

Abdi (2015) investigated the impact of internal control system on financial performance in Mogadishu private banks. The demographic profile of the respondents was age, gender, qualification and experience. The main objectives were to assess the functionality of internal control systems in Mogadishu private banks and to examine financial performance of private banks in Mogadishu. The study was based on 33 target population especially Accountants, finance directors, chief cashiers, internal auditors and managers of private banks in Mogadishu. Descriptive analysis was used. The findings of this study revealed that majority of the private banks in Mogadishu had enough cash to meet its intended goals. Also, there is a clear separation of duties. This study suggests that the internal auditors perform their duties fast, efficient and reliable. However, the study by Abdi (2015) focused on private banks rather than state corporations which is the focus of the current study.

2.3.4 Ownership Structure and Financial Performance

According to Jensen and Meckling (1976), ownership structure is described by the distribution of equity with respect to votes, capital, and also by the equity owners' identity. This was referenced in their study on how the nature of agency costs relates with equity where they aimed at incorporating concepts into the beginnings of a theory of corporate ownership structure. In the recent years, there have been renewed interests on ownership structures due to the increased dynamics of corporate ownership portfolios. Ownership structure, as a mechanism in corporate governance to facilitate increased efficiency of a firm, has been believed to have affected firm performance. In analyzing the relationship between owner's structure and the firm's performance, different aspects of ownership structure are considered, for instance being managerial or non-managerial shareholders, concentration or dispersion of shareholding, whole or retail owners, domestic or foreign shareholders, institutional or individual shareholders. Further, the existence of an owner identity effect is based on the argument that different owners may have different strategic objectives and the owner's objective inclination would influence the firms' decisions such as; investing, financing, and dividend choices thereby influencing firm's performance (Ullah, Attaullah, & Amir, 2011).

Jiang (2015) argue that a typical feature of ownership structure in modern corporate governance is the separation of company ownership and management. In order to better the development of firms, business owners take the companies operating rights to professional managers to manage and only retain the power of the residual value of the company to obtain rights. The disagreement between shareholders and management will lead to manager's selfish behavior of short term profit harming the interest of owners and destroying the contractual relationship. Therefore in addition to incentive pay the shareholdings of managers are also good incentive mechanism as it can help the management and the shareholders to become united to promote the interest of both so that the managers will pay attention to the development of long term interests of the company besides considering themselves, thus contributing to achievement of the contract objectives (Matengo, 2008). Therefore shareholding of managers will make them pay more attention and emphasis on long term development of the firm.

Zhuang (1999) and Lawrence (2010) argue that ownership structure is one of the most important factors in shaping the corporate governance system of any firm. Good ownership structure makes the manager have appropriate and sufficient authority to carry out their duties in the company management (Oman, 2011).This is attributed to the fact that ownership structure is the decision making segment of a firm, which makes and influences the firm's decisions. The main objective of a firm is to maximize the wealth of shareholders, which highly relies on decisions made by the owners. Alipour (2013) and Singh (2014) argued that corporate ownership structures encourage firms to create value in industry in terms of advanced innovations, technology, and skilled workforce development in devising control system that affects the firm's financial performance. According to Shah (2009) the relationship between firm's performance and how managers vie their discretion is systematically related to ownership structure ability to select an effective board and the type of corporate governance structure adopted.

Ownership structure is one dimension of corporate governance which influences firm's performance through its influence on the principal-agent relationships. This is attributed to the fact that the effectiveness of the board is a positive predictor of managerial efficacy and performance. Ndemo (2009) observed that to improve state firms performance through ownership structure, the Kenyan Government has pursued a deliberate policy of divestiture, aimed at reducing state ownership, infusing modern management styles into the public sector by attracting private sector participation in management of the state corporations that would ultimately improve their financial performance. According to

Norman (2010) it is not only the government companies which are changing ownership structure the trend has resulted to private companies converting to public companies to be able to raise more capital while loss-making government owned firms result to privatization to offload the financial burden from the government.

Stanley (2015) assessed the impact of ownership structure on financial performance of listed Chinese banks between the periods 2005-2013. Using correlation analysis, the results revealed that there is no significant difference in performance between the two types of ownership structure (state-owned and joint venture). Mule, Mukras and Oginda (2013) noted also that the NSE as an entity was demutualized in attempt to diversify ownership structure, increase competitiveness, and allow it to raise capital from the public.

Mohamed and Mehdi (2008) analyzed the "impact of ownership structure on corporate performance of listed companies in Tehran Stock Exchange (TSE)". The main hypothesis of this research emphasized the existence of a significant relationship between ownership structure and performance. Statistical method used to test hypotheses in this research was "panel data". In this research, the ownership structure is divided into two institutional and private ownership categories that the private ownership also is divided into three categories including corporate, management, and external shareholders. The findings of this research indicated that there is a negative and meaningful relation between institutional ownership and firm performance and a positive and meaningful relation between the corporate ownership and firm performance. Managerial ownership has a negative meaningful influence on the performance and in the case of private ownership, no information indicating the ownership of external investors was observed in the sample companies. In the private ownership, it is also better that the main part of ownership is held by corporate investors.

Alireza, Ali, and Kazem (2011) examined the effect of ownership structure on firm performance of listed firms in Tehran Stock Exchange between the period of 2001 and 2006. Using regression analysis, the study found that ownership concentration doesn't have any significant effect on firm performance but the effects of two other variables are significant: institutional ownership has positive and significant effect on firm performance whereas concentrated institutional ownership is negative. Abosede and Kajola (2011) investigated the relationship between firms' ownership structure and financial performance of listed companies in Nigeria between 2001 and 2008 respectively. Employing pooled OLS as a method of estimation and after controlling for four firm-specific characteristics, they found negative and significant relationship between ownership structure (director shareholding) and firm financial performance measured by ROE.

Margaritis and Psillaki (2010) using a sample of French manufacturing firms investigated the relationship between capital structure, ownership structure and firm performance and their empirical results showed that listed firms with more dispersed ownership face greater agency costs which lowers their financial performance while listed firms with more concentrated ownership have sound controls which improves financing efficiency and lower agency costs leading to good financial performance. The findings were in line with the study of Bruton, Filatotchen and Chahien (2010) who examined the effects of ownership structure and firm governance on the financial performance and their empirical results showed that higher concentrated ownership have an overall significant impact on firms' financial performance.

Ongore, K'Obonyo and Ogutu (2011) analysed ownership identity of forty-two firms in Kenya based on five elements: government; foreign; institution; diverse; and manager (insider). The study found a significant positive relationship between insider ownership, foreign ownership, institutions ownership, diverse ownership and firm performance. However there was a significant negative relationship between government ownership and firm performance. Alulamusi (2013) supported their findings that Government ownership had a negative relationship with financial performance and attributed this to asset quality and low management efficiency due to laxity in prudent credit management practices and inefficiency of operations and poor returns.

Chege (2013) examined the relationship between ownership structures and financial performance among commercial banks listed in the NSE in Kenya. He found out that there is a positive relationship between profitability and foreign shares ownership and observed that, foreign shares were significant in explaining results as a unit changes in foreign shares were found to be significant in explaining profitability. However local ownership both retail, and corporate, has a negative relationship with profitability. Cespedes, Gonzalez and Molina (2010) evaluated the ownership structure determinants and firms' performance of Latin American firms and concluded that ownership structure has a strong impact on firm's performance is it influences the allocation of resources and control of the firm.

Kirui (2013) researched on the effects of ownership structure on banks profitability in Kenya and found local ownership and foreign ownership had positive and significant effects on the bank's profitability while institutional ownership and state ownership had negative and significant effects on the banks profitability. He concluded that higher ownership concentration and state ownership lead to lower profitability in commercial banks while higher foreign and local ownership lead to higher profitability in commercial banks. However, the study by Kirui (2013) was narrow in scope since it focused on banks' profitability hence the findings cannot be generalized to cover state corporations.

2.3.5 Financial Performance

This study focused on those measures that are strategically important for the success of the company. From reviewed studies many scholars had used various measures to measure financial performance of Firms such as; Return on Asset (ROA) and Return on Equity (ROE) (Peters & Bagshaw, 2014), Return on asset (ROA) while Mujahid and Abdullah (2014) employed accounting terms like ROA and ROE and shareholders wealth measures like EPS and stock price. Flammer (2013) employed Return on Asset (ROA) and Net Profit Margin (NPM).

The current study, therefore, measured the financial performance of the listed companies by looking at profitability (Return on Assets, and Return on Equity). Return on Assets (ROA) refers to the amount of net income returned as a percentage of total assets. Matolcsy and Wright (2011) measured firm performance by using return on assets. It was decomposed as follows: Return on Assets= EBIT / Average total Assets – in book value. Return on Equity (ROE) refers to the amount of net income returned as a percentage of shareholders equity. Yasser, Entambang and Mansor (2011) used return on equity (ROE) and profit margin (PM) for the measurement of firm performance as it measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested. It’s computed as: ROE (Return on Equity=net profit / equity - in book value).

2.4 Conceptual Framework

Conceptual framework is a structure of variables that the researcher operationalizes so as to accomplish the set objectives (Mugenda & Mugenda, 2012). They further define a variable as a measure characteristic that assumes diverse values amongst subjects.

Independent variables **Dependent variable**

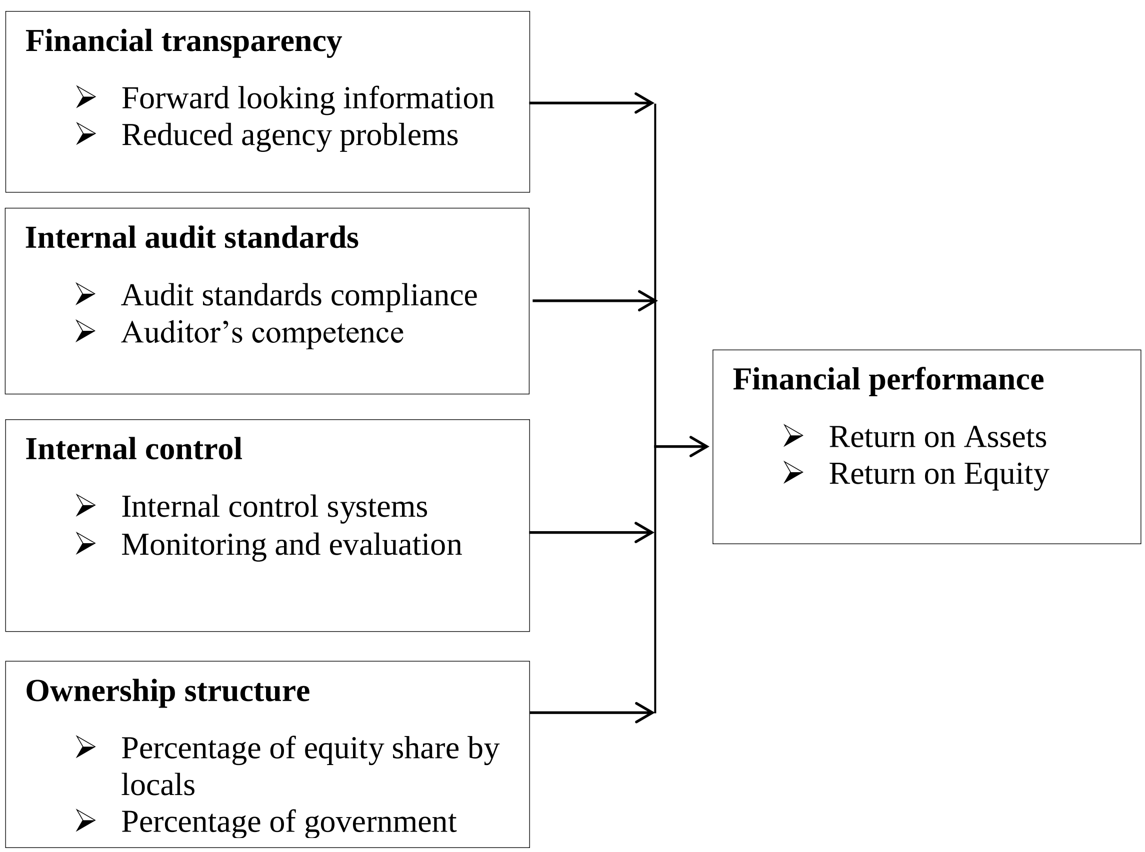

Figure 2.1: Conceptual framework

Figure 2.1 shows the conceptual framework of the study which indicates the independent and dependent variables. For each of the variables, there are selected indicators that were derived from the literature review and are also defined in the subsequent section

The independent variable of this study was corporate governance which was measured by; financial transparency, internal audit standards, internal controls and ownership structure. The dependent variable of the study was financial performance measured by Return on Assets and Return on Equity.

2.8 Summary of Literature Review

The reviewed literature on corporate governance has contradictory findings. Some of the studies indicate that there exists a relationship between corporate governance and financial performance of listed corporations while on the other hand, studies indicates that such a relationship do not exist. Importantly, past researchers have left a gap by lumping up all aspects of corporate governance when investigating their relationship with financial performance a factor that could have resulted into the inconclusivity of the findings noted. This research provides a solution by disaggregating corporate governance in respect to finance field and investigating on the relationship between various aspects of corporate governance and financial performance measured by Return on Assets and Return on Equity.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the methods and procedures that were employed to conduct the study. The chapter discusses the design of the study, sample design, population methods and techniques employed to collect and analyze the collected data.

3.2 Research Design

This study adopted a descriptive survey design which was aimed at describing, explaining, and validating findings. Creative exploration results into description, and assists in organizing the findings so as to fit them with explanations, and consequently validate or test the said explanations (Kothari, 2014). The descriptive survey design is useful since it will help find out the present state of affairs in relation to what extent state corporations adhere to corporate governance practices and how it influences ROE and ROA. The design was also beneficial since it is dependable, valid and generalizable. The advantage of this design over others is that data was collected less expensively and within a short time. The characteristic of variables does not change much in the short period of data collection. It additionally gives answers to inquiries like who, what, when, where and in some cases how.

3.3 Target Population

The population of interest in this study comprised of 98 general managers, managers and CEO's of 12 corporations with government shareholding that existed in Kenya in the financial years 2014 to 2017. The population should have some observable characteristics, to which the researcher intends to generalize the results of the study (Mugenda & Mugenda, 2012). According to State Corporations Advisory Committee (2018) there are 12 corporations with the government shareholding (see Appendix II).

Table 3.1: Target Population

Corporation	CEO's	General/managers	Total
KenGen	1	7	8
National Securities Exchange	1	5	6
Kenya Power	1	8	9
National Bank of Kenya	1	7	8
East African Portland Cement	1	8	9
Kenya Commercial Bank	1	11	12
Kenya Airways	1	6	7
Uchumi	1	4	5
Kenya Re	1	7	8
Mumias Sugar	1	3	4
Safaricom Ltd	1	11	12
Housing Finance	1	9	10
Total	**12**	**86**	**98**

3.4 Sampling Design

Sampling design is the technique or procedure the researcher would adopt in selecting items for the sample (Kothari, 2014). Cooper and Schidler (2013) attest that the ultimate test of a sample design is how well it represents the characteristics of the population it purports to represent. Census design was used in the study. This technique was adopted because the population of study was small and the researcher was able to reach all of them within the research period.

3.5 Data Collection Instruments

The study used primary data which was obtained by use of a questionnaire and secondary financial data from annual reports. Structured questionnaires were used to gather data. The choice of this data collection technique is due to ease in administration, analysis and cost-effectiveness in terms of time and money. Kothari (2014) define a questionnaire as a manuscript that constitutes of a number of questions printed or typed in explicit order on a form or set of forms. The questionnaire comprised of close ended questions. The use of structured questionnaire guarantees reliability of questions and answers from the respondents. Anonymity makes respondents prefer a questionnaire. Obtaining data from participants with different methods and experience helps prevent information bias and thus increasing credibility regarding the information collection. For purposes of this study, close-ended questionnaires using 5 point Likert scale with open spaces for comments on issues were used through distribution on a drop and pick method. Secondary data on the financial performance of state corporations was measured using ROA and ROE for the last 4 years and was collected using a secondary data collection sheet.

3.6 Data Collection Procedure

The data collection procedure involved getting authority letter from the State Corporations that had been identified for the study. The researcher wrote to the CEO of each corporation to request for their participation. The letter entailed the purpose of the study, potential benefits of the results, and a sample of the questionnaire. Managers are envisaged to have better knowledge about the organizations based on their educational level, and years of experience in the corporations. Follow ups was made and the fully completed questionnaires were picked from the respondents later by use of a research assistant and through email.

3.7 Pilot Study

According to Beck, Ross and Norman (2012), a pilot study is a small-scale version, or trial run, done in preparation for a major study. A pilot study was undertaken on 10% of the sample population. The questionnaire was subjected to overall reliability analysis of internal consistency. It is supported by Riel (2010) who recommends that a pilot test of 10% of the population can be used for pilot testing. The findings of the pilot test were not included in the actual study.

3.7.1 Validity of Research Instruments

This study used both construct validity and content validity. For construct validity, the questionnaire was divided into several sections to ensure that each section assesses information for a specific objective, and also ensure that the same closely ties to the conceptual framework for this study (Mugenda & Mugenda, 2012). To ensure content validity, the questionnaire was subjected to thorough examination by two randomly selected top managers. They were asked to evaluate the statements in the questionnaire for relevance and whether they were meaningful, clear and non-offensive. On the basis of the evaluation, the instrument was adjusted appropriately before subjecting it to the final data collection exercise. Their review comments were used to ensure that content validity is enhanced.

3.7.2 Reliability of Research Instruments

In this research, the questionnaire was subjected to overall reliability analysis of internal consistency. This was measured using Cronbach alpha as a coefficient of internal consistency. Internal consistency measures the correlations between different items on the same test (or the same subscale on a larger test) and whether several items that propose to measure the same general construct produce similar scores. Saunders, Lewis and Thornbil (2009) provide the following rules of thumb: >0.9 – Excellent, >0.8 – Good, >0.7 – Acceptable, >0.6 – Questionable, >0.5 – Poor and <0.5 – Unacceptable.

3.8 Data Analysis

Bryman and Bell (2011) define data analysis as a mechanism for reducing and organizing data to produce findings that require interpretation by the researcher. Quantitative methods of data analysis were used to analyze the collected data. Quantitative information was analyzed through statistical procedures. Statistical analyses cover a broad range of techniques, from simple procedures that we all use regularly (e.g., computing an average) to complex and sophisticated methods. Pearson's correlation analysis was used to explore the relationships among the variables. To test the hypotheses, multiple regression analysis was used. Multiple regression analysis was used because it provides estimates of net effects and explanatory power. The statistical package for social sciences, SPSS (version 25.0) was used for data analysis.

The regression model used was as follows:

$$Y=\alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \mathcal{E}$$

Where:

Y is weight for financial performance (ROA or ROE)

α is regression constant

β_1- β_4 is regression coefficients

X_1 is weight for financial disclosure

X_2 is weight for internal audit standards

X_3 is weight for internal control

X_4 is weight for ownership structure

ε is stochastic term

Hypothesis was tested at 95% confidence level ($\alpha = 0.05$). A two tailed test was carried out.

The financial performance of the parastatals was measured in terms of Return on asset (ROA) and Return on Equity (ROE).

ROA was determined as ratio of its net income in a given period to the total value of its assets

ROE was determined as ratio of its net income in a given period to the shareholders equity.

Table 3.2: Hypothesis testing

Hypothesis Statement	Hypothesis Test	Decision Rule
$H_0$1: Financial transparency has no significant influence on financial performance	H0: $\beta 1 = 0$ HA: $\beta 1 \neq 0$ -To conduct F-test to assess overall model significance	Reject $H_0$1 IF P-value $\leq$ 0.05 otherwise fail to reject $H_0$1 if P- value is > 0.05
$H_0$2: Internal audit standards has no significant influence on financial performance	H0: $\beta 2 = 0$ HA: $\beta 2 \neq 0$ -To conduct F-test to assess overall model significance	Reject $H_0$2 IF P-value $\leq$ 0.05 otherwise fail to reject $H_0$2 if P- value is > 0.05
$H_0$3: Internal controls has no significant influence on financial performance	H0: $\beta 3 = 0$ HA: $\beta 3 \neq 0$ -To conduct F-test to assess overall model significance	Reject $H_0$3 IF P-value $\leq$ 0.05 otherwise fail to reject $H_0$3 if P- value is > 0.05
$H_0$4: Ownership structure has no significant influence on financial performance	H0: $\beta 4 = 0$ HA: $\beta 4 \neq 0$ -To conduct F-test to assess overall model significance	Reject $H_0$4 IF P-value $\leq$ 0.05 otherwise fail to reject $H_0$4 if P- value is > 0.05

Using SPSS, the regression model was tested on how well it fits the data. The significance of each independent variable was also tested. Fischer distribution test called F-test was applied. It refers to the ratio between the model mean square divided by the error mean square. F-test was used to test the significance of the overall model at a 5 percent confidence level. The p-value for the F-statistic was applied in determining the robustness of the model. The conclusion was based on the basis of p-value where if the null hypothesis of the beta was rejected then the overall model was significant and if null hypothesis was accepted the overall model was insignificant. In other words, if the p-value was less than 0.05 then it was concluded that the model was significant and had good predictors of the dependent variable and that the results are not based on chance. If the p-value was greater than 0.05 then the model was not significant and was not used to explain the variations in the dependent variable.

Similarly, the t-test statistic was used to test the significance of each individual predictor or independent variable and hypothesis. The p-value for the F-statistic was applied in determining the robustness of the model. The benchmark for this study for failure to reject or failure to accept the null hypothesis was a level of significance of 5 percent. If the p-value was less than 5 percent the null hypothesis failed to be accepted and the alternate hypothesis would fail to be rejected. Also if the p-value was greater than 5 percent the null hypothesis failed to be rejected and the alternate hypothesis failed to be accepted, i.e.

Reject H0: $\beta x = 0$; if $p < 0.05$,

Otherwise fail to reject the H0: $\beta x = 0$

3.9 Ethical Considerations

Ethics is a code of conduct which the researcher is supposed to obey when conducting the study (Mugenda & Mugenda, 2012). Due care was given to strict adherence of research procedures particularly those involving human subjects. Since the study involved human participants, care was taken to ensure that they are not affected negatively in any way and the research was not undertaken for personal gain (Mugenda & Mugenda, 2012). In addition, a research permit was sought before the research study begins. Therefore, approval was sought from Kenya Methodist University and National Council of Science, Technology and Innovation before undertaking the actual research.

The other ethical issues observed throughout the research process include: confidentiality and anonymity, voluntary participation and fairness on the respondents. This means that if any respondent who feels uncomfortable to continue on the research was allowed to step down. The researcher also ensured that the data collected was treated with utmost confidentiality and was used for purposes of the research only.

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter describes the findings and discussion of results of the study on the corporate governance and financial performance of state corporations in Kenya. The data collected in this study was evaluated, discussed and inferences made, in an effort to address the specific objectives of the study. Descriptive and inferential statistics were used to analyze the data on each variable. Data was presented in the form of frequency distribution tables to facilitate description and explanation of the study findings. Data analysis was in line with specific objectives where patterns were investigated, interpreted and implications drawn on them.

4.2 Response Rate

The researcher sought to establish the response rate of the respondents. The results are indicated in table 4.3.

Table 4.3: Response Rate

Respondents	Frequency	Percentage
Respondents	86	87.8
Non-respondents	12	12.2
Total	98	100

Source: Author (2019)

Mugenda and Mugenda, 2003 observed that a 50% response rate is adequate, 60% good and above, while 70% rated very good. Based on this assertion, the response rate of

87.8% in this case is therefore very good and is considered satisfactory to make conclusions for the study.

4.3 Pilot Test Results

For this study a statistical method was used to calculate the Cronbach Alpha Coefficient to assess the internal consistency of the various questions items of the questionnaire

4.3.1 Reliability Analysis

The reliability of a measure is established by testing for both consistency and stability of a research instrument. The reliability of this instrument was assessed with the use of Cronbach's alpha which consists of estimates of how much variation in scores of different is attributable to chance or random error. Table 4.4 presents results on reliability.

Table 4.4: Reliability results

Scale	Cronbach's Alpha	Items
Financial transparency	0.788	4
Internal audit standards	0.716	6
Internal controls	0.759	5
Ownership structure	0.701	5
Financial performance	0.804	4

Source: Author (2019)

The overall Cronbach's alpha for the four categories is 0.75. The findings of the pilot study show that all five scales were reliable as their reliability values exceeded the prescribed threshold of 0.7 (Mugenda & Mugenda, 2012).

4.3.2 Data Validity

Factor analysis was used to check validity of the constructs. Factor analysis attempts to identify underlying variables, or factors, that explain the pattern of correlations within a set of observed variables. Factor analysis was used in data reduction to identify a small number of factors that explain most of the variance observed in a much larger number of manifest variables. In this study the sample size was 86. There is universal agreement that factor analysis is inappropriate when sample size is below 50. Table 4.5 shows the test for sample adequacy in order to conduct factor analysis.

The Kaiser-Meyer-Olkin (KMO) measures the sampling adequacy which should be greater than 0.5 for a satisfactory factor analysis to proceed. If any pair of variables had a value less than .5, one of them was dropped from the analysis. Values between 0 .5 and 0.7 are mediocre, values between 0 .7 and 0.8 are good, values between 0.8 and 0.9 are great and values above 0.9 are superb (Hutcheson & Sofroniou, 2009).

Table 4.5: Factor analysis-KMO and Bartlett

Kaiser-Meyer-Oklin Measure of Sampling Adequacy		.565
	Approx. Chi-square	112.373
Bartlett's Test of Sphericity	Df	10
	Sig.	.000

Source: Author (2019)

From the results in table 4.5, KMO measures of sampling adequacy shows the value of test statistic as 0.565, which is greater than 0.5 hence an acceptable index. Further, Bartlett's test of sphericity shows the value of test statistic as 0.00 which is less than 0.05

acceptable indexes. The results indicate a highly significant relationship among study variables.

4.4 Demographic Information

Demographic data are quantifiable characteristic of a given population. This includes level of experience and level of education. The analyzed results were based on 86 participants who successfully filled and returned questionnaires. The results are presented in the tables below. The highest level of education attained by the respondents and the period the respondent has worked were the aspects of profile variables investigated in this study.

4.4.1 Academic Qualification of the Sampled Respondents

The study intended to establish the participants' academic qualifications. Table 4.6 presents respondents' level of education.

Table 4.6: Academic qualification

Academic qualification	Frequency	Percent
Tertiary college	4	4.7
Undergraduate	35	40.7
Post graduate	47	54.6
Total	**86**	**100.0**

From the results it can be established that 54.6 per cent of the respondents had their highest level of education being post graduate while 40.7 per cent had undergraduate qualification while only 4.7 per cent of the respondents had tertiary college qualification. The level of education was also considered important as it enabled managers to have a greater understanding of Corporate Governance**.**

4.4.2 Experience of respondents

The study sought to establish the work experience of the respondents. The findings are presented in table 4.7.

Table 4 .7: Respondents' Experience

Experience	Frequency	Percent
Less than 5 years	2	2.3
5-10 years	13	15.1
10-15 years	33	38.4
Above 15 years	38	44.2
Total	**86**	**100.0**

Source: Author (2019)

As per the findings in table 4.7, majority of respondents depicted by 44.2 per cent had worked in the corporation for more than 15 years. Further results show that 38.4 per cent of the respondents had worked in the corporation for between 10 to 15 years and the 15.1 per cent of the respondents had worked in the corporation for between 5 to 10 years. 2.3 per cent had worked in the corporation for less than 5 years. The number of years that managers had worked in the organization was considered important, which means that the respondents had adequate working experience with the corporation and therefore possess the necessary knowledge, information and the institutional memory which was considered useful for this study.

4.5 Descriptive Analysis of the Variables

The objective of the study was to establish the influence of corporate governance on financial performance of listed corporations with government shareholding. The section therefore deals with the parameters of performance of corporations.

4.5.1 Financial Transparency and Financial Performance

The study sought to find out the influence of financial transparency on financial performance. A Likert scale data was collected rating the extent of agreement in a scale of 1 to 5 where 1 is the strongly disagree whereas 5 is the strongly agree indicator. The mean score for each item was calculated and the findings are shown in table 4.8.

Table 4 .8: Financial transparency

	N	Minimum	Maximum	Mean	Std. Deviation
There is reduction of agency problems as a result of financial disclosure	86	2	5	4.89	1.158
The institution voluntarily provides forward looking information	86	1	4	4.93	1.150
There is voluntary financial disclosure in the state corporation	8 6	1	5	4.14	.882
The financial and non-financial information is accessible to all stakeholders at any time	86	1	5	4.07	1.101

Source: Author (2019)

From the findings, majority of the respondents agreed that there is reduction of agency problems as a result of financial disclosure having mean score of 4.89 and a standard deviation of 1.158, an implication that financial disclosure leads to reduced conflicts between shareholders and managers. Respondents had agreed that the institution voluntarily provides forward looking information with a mean of 4.93 and standard deviation of 1.150. Majority of the respondents had agreed that there is voluntary financial disclosure in the state corporation with a mean score of 4.14 and standard deviation of 0.882. According to a study by Mutiva (2015) it was established that there existed a strong positive association between voluntary disclosure and return on investment. In the same vein, Merkley (2011) examined the relationship between reported financial performance and voluntary disclosure for the period of 12 years from 1996 – 2007 and revealed that current reported performance is negatively related to voluntary disclosures. Majority of the respondents (mean=4.07; std. deviation=1.101) agreed that the financial and non-financial information is accessible to all stakeholders at any time. Laws, regulations and accounting standards prescribe mandatory information contained in annual returns whereas voluntary information is dependent on management's judgment on information that need to be included in the annual report (carey, 2008).

4.5.2 Internal Audit Standards and Financial Performance

The study sought to find out the extent to which internal audit standards influence financial performance. The following were the findings.

Table 4 .9: Internal audit standards

	N	Minimum	Maximum	Mean	Std. Deviation
Audit committee members possess certain level of financial competency	86	1	5	4.23	.923
The audit committee has effective working relationships with senior management	86	2	4	4.51	.608
Internal auditors observe professional ethics & standards	86	1	5	4.82	1.330
There are full disclosures about compliance risk and risk management	86	1	4	4.78	1.055
The corporation uses International Auditing standards to guide the internal audits ethics	86	1	5	4.21	.897
There is compliance with accepted audit standards	86	1	5	4.22	.980

Source: Author (2019)

From table 4.9, majority of the respondents (mean=4.23; std. deviation=0.923) agreed that audit committee members possess certain level of financial competency thus implying that state corporations engage members who have financial knowledge and experience. Majority of the respondents (mean=4.51; std. deviation=0.608) agreed that the audit committee has effective working relationships with senior management. Most of the respondents (mean=4.82; std. deviation=1.330) agreed that internal auditors observe professional ethics & standards. Saren and De Belde (2006) pointed that when an organization seeks after respectability and clear moral qualities reflected in a formal set of principles/morals, the internal audit capacity will take a more noteworthy significance. Respondents (mean=4.78; std. deviation=1.055) agreed that there is full disclosure about compliance risk and risk management. According to Beyanga (2013), a viable inside review administration can, specifically, decrease overhead, distinguish approaches to enhance effectiveness and expand introduction to conceivable misfortunes from deficiently defended organization resources all of which can significantly affect the execution of an organization. Most of the respondents (mean=4.21; std. deviation=0.897) agreed that the corporation uses International Auditing standards to guide the internal audits ethics. Most of the respondents (mean=4.22; std. deviation=0.980) agreed that there is compliance with accepted audit standards, signifying that the state corporations comply with existing audit standards. The study by Kibet (2012) concluded that the internal audit function played a role in corporate governance.

4.5.3 Internal Controls and Financial Performance

With regard to the influence of internal controls on financial performance of state corporations, data that was collected through the Likert scale measuring the level of agreement of the respondents with respect to the given aspects of internal controls. The results are as presented in table 4.10.

Table 4 .10: Internal controls

	N	Minimum	Maximum	Mean	Std. Deviation
Appropriate measures are taken to correct misfeasance in operation of our Accounting & Finance Management System	86	1	4	4.24	0.860
The corporation performs methodical examination of business processes and connected controls regularly	86	2	5	4.31	1.067
The corporation has an accounting and financial management system	86	1	5	4.25	0.919
Management closely monitors implementation of Internal control systems in the corporation	86	1	5	4.05	0.808
There is provision of independent verification of a sufficient sample of transactions to ensure integrity of the decision-making process	86	1	4	4.18	0.917

Source: Author (2019)

Results in table 4.10 indicate that majority of the respondents (mean=4.24; std. deviation=0.860) agreed that appropriate measures are taken to correct misfeasance in operation of our Accounting & Finance Management System. Respondents agreed that the corporation performs methodical examination of business processes and connected controls regularly as indicated by a mean of 4.31 and std. deviation of 1.067. The corporation has an accounting and financial management system (mean=4.25; std. deviation=0.919). A system of effective internal controls is a critical component of company management and a foundation for the safe and sound operation of organizations (mean=4.05; std. deviation=0.808). However, ineffective internal controls result in ineffective programs and eventually leading to losses (Olumbe, 2012). The results also showed that the management closely monitors implementation of internal control systems in the corporation (mean=4.18; std. deviation=0.917). Internal controls are intended primarily to enhance the reliability of financial performance, either directly or indirectly by increasing accountability among information providers in an organization (Jensen and Murphy, 2004). There is provision of independent verification of a sufficient sample of transactions to ensure integrity of the decision-making process (46%). The findings agreed with Mwakimasinde, Odhiambo and Byaruhanga (2014) who investigated the effect of internal control systems on the financial performance of sugarcane outgrower companies in Kenya and found a positive significant effect of internal control system on the financial performance.

4.5.4 Ownership Structure and Financial Performance

The study sought to determine the effect of procurement transparency. The results are presented in table 4.11.

Table 4 .11: Ownership structure

	N	Minimum	Maximum	Mean	Std. Deviation
The government shareholding influences the stability of the company share prices	86	1	5	4.13	0.940
Local shareholding enables the corporation to get funding from local financial institutions which reduces working capital problems	86	1	5	4.07	0.956
Local shareholding influences the share prices of the corporation	86	2	5	4.41	0.845
Government shareholding gives a positive public image and confidence to investors	86	1	4	4.22	0.869
Government facilitates the corporation to get government tenders	86	2	5	4.27	0.920

Source: Author (2019)

As shown in table 4.11, majority of the respondents (mean=4.13; std. deviation=0.940) agreed that government shareholding influences the stability of the company share prices. A study by Kirui (2013) concluded that state ownership had negative and significant effects on the banks profitability. This contradiction in findings can be attributed to the differing research methodology adopted by the researchers. The results imply that the state corporations enjoy government good will to stabilize their share prices. Further, Alulamusi (2013) established that Government ownership had a negative relationship with financial performance and attributed this to asset quality and low management efficiency due to laxity in prudent credit management practices and inefficiency of operations and poor returns. Jiang (2015) argue that a typical feature of ownership structure in modern corporate governance is the separation of company ownership and management. Majority of the respondents (mean=4.07; std. deviation=0.956) agreed that local shareholding enables the corporation to get funding from local financial institutions which reduces working capital problems and that local shareholding influences the share prices of the corporation as shown by a mean of 4.41 and standard deviation of 0.845). Ongore et al. (2011) analysis of the ownership identity of forty-two firms in Kenya found a significant positive relationship between insider ownership, foreign ownership, institutions ownership, diverse ownership and firm performance. Sampled respondents also indicated that government shareholding gives a positive public image and confidence to investors (mean=4.22; std. deviation=0.869) and the respondents were of the view that the government facilitates the corporation to get government tenders as indicated by a mean of 4.27 and standard deviation of 0.920. The findings confirmed results by Kirui (2013) who researched on the effects of ownership structure on banks profitability in Kenya and found local ownership and foreign ownership had positive and significant effects on the banks profitability.

4.5.5 Normality Test for Financial Performance

Performance measures were subjected to normality test. Unlike the independent variables of the study, Financial Performance being the dependent variable of the study was further subjected to a One-Sample Kolmogorov-Smirnov Test to test its normality. The following null and alternative hypotheses were as used:

H1: The data is normally distributed

H0: The data is not normally distributed

Table 4 .12: One-Sample Kolmogorov-Smirnov Test

		Financial Performance
N		86
Normal parameters	Mean	3.9519
	Std. Deviation	0.76421
	Absolute	0.186
	Positive	0.101
	Negative	-0.182
Kolmogorov-Smirnov Z		2.624
Asymp. Sig. (2-tailed)		0.000

a Test distribution is Normal.
b Calculated from data.

The results obtained in Table 4.12 indicated that Kolmogorov-Smirnov Z is 2.624 (p-value<0.001) the p-value is less than 0.05; we fail to accept the null hypothesis and accept the alternative hypothesis and conclude that the data was normally distributed.

4.6 Relationship Between Corporate Governance and Financial Performance

To establish the relationship between the independent variables and the dependent variable the study conducted correlation analysis.

Table 4 .23: Bivariate Linear Correlation among all Variables

		FT	IAS	IC	OS	FP
Financial transparency (FT)	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	86				
Internal audit standards (IAS)	Pearson Correlation	.499**	1			
	Sig. (2-tailed)	.002				
	N	86	86			
Internal controls (IC)	Pearson Correlation	.562**	.610**	1		
	Sig. (2-tailed)	.037	.000			
	N	86	86	86		
Ownership structure (OS)	Pearson Correlation	.584**	.318**	.415**	1	
	Sig. (2-tailed)	.000	.000	.000		
	N	86	86	86		
Financial Performance (FP)	Pearson Correlation	.490**	.513**	.326**	.274	1
	Sig. (2-tailed)	.000	.000	.000	.000	

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

Key

FT-Financial transparency

IAS-Internal audit standards

IC-Internal controls

OS-Ownership structure

Correlation results in table 4.13 shows that there was a moderate positive correlation between financial transparency and financial performance (r=0.490, P<0.001). Correlation results also indicate a moderate correlation (r=0.513, P<0.001) between internal audit standards and financial performance. Further there was a weak positive correlation (r=0.326, P<0.001) between internal controls and financial performance.

Finally, the correlation results showed that there is a weak correlation ($r=0.274$, $P<0.001$) between ownership structure and financial performance. Alulamusi (2013) observed that Government ownership had a negative relationship with financial performance and attributed this to asset quality and low management efficiency due to laxity in prudent credit management practices and inefficiency of operations and poor returns.

4.7 Influence of Corporate Governance on Financial Performance

The study conducted a multiple linear regression analysis in order to investigate the influence of corporate governance on financial performance of corporations in Kenya. In this model, coefficients of determination explain the extent to which changes in dependent variable can be explained by the changes in the independent variables or percentage of variation in dependent variable that is explained by all four independent variables.

4.7.1 Testing Assumptions of Regression Model – Multi-Collinearity Test

Multicollinearity in the study was tested using Variance Inflation Factor (VIF). A VIF of more than 10 ($VIF \geq 10$) indicate a problem of multicollinearity. According to Montgomery (2001) the cutoff threshold of 10 and above indicate the existence of multicollinearity while tolerance statistic values below 0.1 indicate a serious problem while those below 0.2 indicate a potential problem as shown in Table 4.14.

Table 4 .34: Collinearity Diagnostics

	Collinearity Statistics	
	Tolerance	**VIF**
Financial transparency	0.266	2.438
Internal audit standards	0.318	2.961
Internal controls	0.372	3.274
Ownership structure	0.761	1.509

The results of collinearity diagnosis in table 4.14 indicate that the VIF value for financial transparency was found to be 2.438 while its tolerance statistic was reported to be 0.266, internal audit standards had a VIF value of 2.961 and tolerance value of 0.318, internal controls had a tolerance statistics of 0.372, and a VIF value of 3.274), and ownership structure (tolerance statistics = 0.761, VIF value =1.509). Based on these the assumption of multicollinearity between predictor variables was thus not rejected as the reported VIF and tolerance statistics were within the accepted range.

4.7.2 Model Fit

Analysis of variance was employed to test the overall validity of the regression model. The results are presented in table 4.15.

Table 4 .45: Corporate governance & Financial performance model validity

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	928.392	4	232.098	49.583	.000[b]
	Residual	379.130	81	4.681		
	Total	1307.522	85			

a. Dependent Variable: Financial performance

b. Predictors: (Constant), Financial transparency, Internal audit standards, Internal controls, Ownership structure

Analysis of Variance (ANOVA) was done to establish the fitness of the model used. The ANOVA table shows that the F-ratio (F=49.583, p=.000) was statistically significant. This means that the model used was a good fit. This implies that the predictor variables (financial transparency, internal audit standards, internal controls, ownership structure) explain the variation in the dependent variable which is financial performance.

4.7.3 Model Summary

The results for the model summary are presented in table 4.16.

Table 4 .56: Corporate governance & Financial performance model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.843[a]	.710	.672	2.41036

a. Predictors: (Constant), Financial transparency, Internal audit standards, Internal controls, Ownership structure

According to regression results in table 4.14, the regression equation between corporate governance and financial performance had a strong regression. In the model summary, the R^2 is 0.710. This implies that the four variables studied explain 71% of variance in the financial performance of state corporations. This means that, the other factors not considered in the study contribute 29% of variance in the dependent variable.

4.7.4 Multiple Regression Coefficients

The raw and standardized regression coefficients of the predictors together with their t statistics are as shown in table 4.17.

Table 4 .67: Corporate governance & Financial performance regression weights

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	4.241	1.307		3.245	.000
Financial transparency	.130	.063	.223	2.064	.038
Internal audit standards	.266	.104	.093	2.558	.002
Internal controls	.186	.090	.138	2.067	.027
Ownership structure	.109	.048	.089	2.271	.014

a. Dependent Variable: Financial performance

The estimates of the regression weights, t-statistics and the p-values for the relationship between corporate governance and financial performance are presented in table 4.15.

$Y=4.241 + 0.130X_1 + 0.266X_2 + 0.186X_3 + 0.109X_4$ clearly shows a significant positive relationship between the predictor variables and financial performance. The estimated coefficients show the contribution of each independent variable to the change in the dependent variable. According to the regression equation established, holding all independent factors a constant then financial performance of state corporations will be average (4.241). This constant is significant in the model as it has p=.007 which is less than the 5% level of significance taken for this study.

The coefficients table results further indicate that an increase in the financial transparency by one unit would lead to increase in financial performance by 0.130 units. Results further indicate that an increase in the internal audit standards by one unit would lead to increase in financial performance by 0.266 units. The results also show that an increase in internal controls by one unit would lead to increase in financial performance by 0.186.

Finally, the results indicated that an increase in the ownership structure by one unit would lead to increase in financial performance by 0.109. All the four predictors had significant weights in the model and therefore the four predictor variables were retained in the model.

Regression analysis further formed a basis for testing the hypothesis adopted in this study. This was done by considering the p values corresponding to each variable of interest in the Table 4.15. The benchmark for this study for failure to reject or failure to accept the null hypothesis was a level of significance of 5 percent. If the p-value was less than 5 percent the null hypothesis failed to be accepted and the alternate hypothesis would fail to be rejected. Also, if the p-value was greater than 5 percent the null hypothesis failed to be rejected and the alternate hypothesis failed to be accepted, that is.

Reject H0: $\beta x = 0$; if $p < 0.05$,

Otherwise fail to reject the H0: $\beta x = 0$

The first objective of the study sought to investigate the influence of financial transparency on financial performance of state corporations. This was established by determining Pearson correlations of refined data. The results showed that there was a moderate positive significant correlation between financial transparency and financial performance ($r = 0.490$, $P<0.05$). Regression analysis conducted proved that there was a positively significant influence of financial transparency on financial performance as indicated by the values $\beta_1 = 0.130$, $t = 2.064$, $p<0.05$. Hypothesis testing conducted at 95% confidence level on financial transparency confirmed its significant influence on financial performance hence the null hypothesis is rejected. The study findings, however, disagreed with Merkley (2011) who examined the relationship between reported financial performance and voluntary disclosure for the period of 12 years from 1996 – 2007 and revealed that current reported performance is negatively related to voluntary disclosures.

The second objective was to establish the influence of internal audit standards on financial performance of state corporations in Kenya. Pearson correlation was conducted and the findings indicated that there was a moderate significant correlation between internal audit standards and financial performance ($r=0.513$, $P<0.05$). Regression analysis was also conducted and the results showed a positively significant influence of internal audit standards on financial performance as indicated by the values $\beta_2 = 0.266$, $t = 2.558$, $p<0.05$. Further hypothesis testing conducted at 95% confidence level confirmed that internal audit standards had a statistically significant influence on financial performance hence null hypothesis is rejected.

The study sought to establish the influence of internal controls on financial performance. Pearson correlation was conducted and the findings indicated that there was a moderate significant correlation ($r = 0.326$, $p<0.05$). Regression analysis was also conducted and the results proved that there was positively significant influence of internal controls on financial performance as indicated by the values $\beta_3 = 0.186$, $t = 2.067$, $p<0.05$. Hypothesis testing was also conducted on this variable at 95% confidence level and it was found out that internal controls had a statistical significant influence on financial performance hence null hypothesis is rejected.

Finally, the study sought to examine the influence of ownership structure on financial performance of state corporations. The findings through Pearson correlation analysis concluded that there was a weak significant correlation between ownership structure and financial performance ($r = 0.274$, $p<0.05$). Regression analysis conducted confirmed that there existed a positively significant influence of ownership structure on financial performance as shown by the values $\beta_4 = 0.109$, $t = 2.271$, $p<0.05$. Conducting hypothesis testing on this variable at 95% confidence interval concluded that ownership structure had statistically significant influence on financial performance hence null hypothesis is rejected. The findings were supported by Kirui (2013) who researched on the effects of ownership structure on banks profitability in Kenya and found local ownership and foreign ownership had positive and significant effects on the bank's profitability.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the research findings and provides conclusions and recommendations in line with the topic of study that is to investigate the influence of corporate governance on financial performance of state corporations in Kenya.

5.2 Summary of the Findings

The purpose of the study was to investigate the influence of corporate governance on financial performance of state corporations in Kenya. The study specific objectives were to establish the influence of financial transparency, internal audit standards, internal controls and ownership structure on financial performance as measured by ROA and ROI. The study collected and presented data in chapter four with specific objectives been used as parameters for the analysis. Theoretical and empirical literature played critical role of comparing the results of the study with previous studies done. The study targeted state corporations with highest government shareholding.

5.2.1 Financial Transparency and Financial Performance

The study findings showed that there is reduction of agency problems as a result of financial disclosure and the state corporations voluntarily provide forward looking information and adheres to vvoluntary financial disclosure in the state corporation. The study established that financial and non-financial information is accessible to all stakeholders at all the time.

5.2.2 Internal Audit Standards and Financial Performance

The study established that audit committee members possess certain level of financial competency and this implies that state corporations engage members who have financial knowledge and experience. The study showed that audit committee has effective working relationships with senior management and that internal auditors observe professional ethics & standards. The study established that there is full disclosures about compliance risk and risk management and that the corporation uses International Auditing standards to guide the internal audits ethics. The study found that there is compliance with accepted audit standards signifying that the state corporations complies with existing audit standards.

5.2.3 Internal Controls and Financial Performance

The study established that appropriate measures are taken to correct misfeasance in operation of Accounting & Finance Management System and the corporation performs methodical examination of business processes and connected controls regularly. The study showed that the corporations has an accounting and financial management system and the management closely monitors implementation of Internal control systems in the corporation through provision of independent verification of a sufficient sample of transactions to ensure integrity of the decision-making process.

5.2.4 Ownership Structure and Financial Performance

Based on the study findings, the government shareholding influences the stability of the company share prices implying that state corporations enjoy government good will to stabilize their share prices. The study established that local shareholding enables the corporation to get funding from local financial institutions which reduces working capital problems and local shareholding influences the share prices of the corporation. The results indicated that government shareholding gives a positive public image and confidence to investors and the government facilitates the corporation to get government tenders.

5.3 Conclusions

On financial transparency, the study concludes that financial disclosure leads to reduced conflicts between shareholders and managers. The corporation voluntarily provides forward looking information and the state corporations are mandated by regulations to disclose all financial statements which are accessible to all stakeholders at any time.

On internal audit standards, the study concludes that state corporations targeted engage members who have financial knowledge and experience in the committees. The management of sampled state corporations enjoys cordial relationships with audit committee and internal auditors observe professional ethics & standards. The corporation's practice full disclosures about compliance risk and risk management besides adopting International Auditing Standards to guide the internal audits ethics.

On internal controls, the study concludes that state corporations take appropriate measures to correct misfeasance in operation of Accounting & Finance Management System and further they regularly carry out methodical examination of business processes and connected controls. It is concluded that state corporations' management closely monitors implementation of internal control systems and there is provision of independent verification of a sufficient sample of transactions to ensure integrity of the decision-making process.

On ownership structure, the study concludes that the state corporations' share prices are stabilized by the government shareholding and local shareholding enables the corporation to get funding from local financial institutions which reduces liquidity problems. This implies that the state corporations prioritize local shareholding over foreign shareholding with a view to convey a broader image of 'home grown' perception to the public. Further, government shareholding gives a positive public image and confidence to investors since government will ensure corporation survival irrespective of the prevailing economic challenges hence protection to shareholders.

5.4 Recommendations

The study recommends that management of state corporations should adhere to laid down regulations on financial transparency so as to avoid agency conflicts with shareholders and creditors. The information disclosed by the corporation should be adequate to enable stakeholders to make informed decisions and should be forward looking. The management should develop systems to ensure that all the necessary information concerning the financial performance of the corporation is accessible by all stakeholders at any time.

The study recommends that the management and regulators of state corporations should only recruit and select those members who possess financial knowledge and experience to be part of internal audit committees. The management should strive to maintain good relations with internal audit committee members. The internal auditors should adhere to professional ethics & standards when carrying out their duties in the corporations by adopting International Auditing Standards to guide the internal audits ethics.

The study recommends that the management of state corporations should take appropriate measures to correct misfeasance in operation of Accounting & Finance Management System as well as regularly carry out methodical examination of business processes and connected controls. The state corporations' management should closely monitor implementation of internal control systems.

The study recommends that state corporations should lobby the government to maintain its shares since it was established that government shareholding leads to share price stabilization and promotes the image of the corporation. The management should also float shares to the local public so as to attract local financial institutions' good will.

5.5 Areas for Further Research

This research provides empirical evidence on the influence of corporate governance on financial performance of state corporations in Kenya. The study however concentrated on only four corporate governance aspects namely; financial transparency, internal audit standards, internal controls and ownership structure which accounted for 71% variation in financial performance. This implies that these determinants of corporate governance are not exhaustive hence further research should be undertaken to establish how strategic corporate governance determinants influence financial performance of state corporations.

Secondly, the current study relied solely on data from corporations with the government shareholding and this calls for another study to be carried out on all listed corporations irrespective of the ownership structure. This would provide reliable results for generalization between listed with and without government shareholding.

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APPENDICES

APPENDIX I: Questionnaire

SECTION A: General Information

1. Name of your Parastatal (optional):

   ....

2. For how long have you been a manager in the corporation?
   a) Less than 2 years ( )
   b) 3 to 5 years ( )
   c) 5 to 10 years ( )
   d) Over 10 years ( )

2. What is your highest level of education qualification?

a) Post graduate level ( )

b) University ( )

c) Tertiary College ( )

SECTION B

a) Financial transparency on financial performance

On a scale of 1 to 5 where;

1 – Strongly disagree, 2 – Disagree, 3 – Neither agree nor disagree, 4 – Agree, 5 – Strongly agree. Give the effect of the following statements on financial transparency.

	STATEMENT	**1**	**2**	**3**	**4**	**5**
a	There is reduction of agency problems as a result of financial disclosure					
b	The institution voluntarily provides forward looking information					
c	There is voluntary financial disclosure in the state corporation					
d	The financial and non-financial information is accessible to all stakeholders at any time					

b) Internal audit standards financial performance

On a scale of 1 to 5 where;

1 – Strongly disagree, 2 – Disagree, 3 – Neither agree nor disagree, 4 – Agree, 5 – Strongly agree. Give the effect of the following statements on internal audit standards.

	STATEMENT	**1**	**2**	**3**	**4**	**5**
a	Audit committee members possess certain level of financial competency					
b	The audit committee has effective working relationships with senior management					
c	Internal auditors observe professional ethics & standards					
d	There is full disclosures about compliance risk and risk					

	management					
e	The corporation uses International Auditing standards to guide the internal audits ethics					
f	There is compliance with accepted audit standards					

c) Internal control on financial performance

On a scale of 1 to 5 where;

1 – Strongly disagree, 2 – Disagree, 3 – Neither agree nor disagree, 4 – Agree, 5 – Strongly agree. Give the effect of the following statements on internal control.

	Statement	**1**	**2**	**3**	**4**	**5**
a	Appropriate measures are taken to correct misfeasance in operation of our Accounting & Finance Management System					
b	The corporation performs methodical examination of business processes and connected controls regularly					
c	The corporation has an accounting and financial management system					
d	Management closely monitors implementation of Internal control					

	systems in the corporation					
e	There is provision of independent verification of a sufficient sample of transactions to ensure integrity of the decision making process					

d) Ownership structure on financial performance

On a scale of 1 to 5 where;

1 – Strongly disagree, 2 – Disagree, 3 – Neither agree nor disagree, 4 – Agree, 5 – Strongly agree. Give the effect of the following statements on ownership structure.

	Statement	**1**	**2**	**3**	**4**	**5**
a	Government shareholding influences the stability of the company share prices					
b	Local shareholding enables the corporation to get funding from local financial institutions which reduces working capital problems					
c	Local shareholding influences the share prices of the corporation					
d	Government shareholding gives a positive public image and confidence to investors					
e	Government facilitates the					

	corporation to get government tenders					

e) Financial performance

Secondary data sheet for financial data 2014 to 2017.

	2014	**2015**	**2016**	**2017**
Return on Assets				
Percentage (%)				
Net income				
Total Asset				

	2014	**2015**	**2016**	**2017**
Return on Equity				
Percentage (%)				
Net income				
Share holder equity				

APPENDIX II: State Corporations with Government Shareholding

Corporation	Government shareholding
KenGen	70%
National Securities Exchange	23%
Kenya Power	50.1%
National Bank of Kenya	22.5%
East African Portland Cement	25.3%
Kenya Commercial Bank	17.31%
Kenya Airways	48.9%
Uchumi	14.67%
Kenya Re	60%
Mumias Sugar	71%
Safaricom Ltd	35%
Housing Finance	40%

APPENDIX III: RESEARCH PERMIT

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APPENIX IV: LETTER FROM UNIVERSITY

Kenya Methodist University

P O Box 267 - 60200, Meru, Kenya, Tel: (+254-020) 2118423-7, 064-30301/31229 Fax: (+254-064) 30162 Email: info@kemu.ac.ke , Website: www.kemu

July 30, 2019

Executive Secretary

National Council for Science and Technology

P.O Box 30623 – 00100

NAIROBI

Dear Sir/ Madam,

RE: DAVID GITONGA – MFI-3-0771-3/2015

This is to confirm that the above named is a bona fide student of Kenya Methodi University pursuing a Master of Science in Finance and Investment.

David is undertaking a research study on "**Influence of corporate governance on financi performance of listed corporations in Kenya**". To successfully complete his research wor he requires relevant data in his area of study.

In this regard, we kindly request your office to issue him a research permit to enable h collect the data for his academic research work.

We thank you in advance for your cooperation.

Yours faithfully,

KENYA METHODIST UNIVERSITY
Dean
30 JUL 2019
BOARD OF POSTGRADUATE STUDIES

Dr. Evangeline Gichunge

Associate Dean, Research Development & Board of Postgraduate Studies