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CORPORATE GOVERNANCE, FIRM PERFORMANCE AND FIRM VALUE OF FIRMS LISTED IN NAIROBI STOCK EXCHANGE: A REVIEW OF EXISTING EMPIRICAL EVIDENCE

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Abstract: **This paper aims to revisit the link between corporate governance, firm value, and firm performance by focusing on convergence, understood as the way that listed firms are adopting best practice in terms of corporate governance and the implications of this adoption not only in regard to firm performance but also firm value. A desktop review specifically, Systematic review was utilized. The study focused on listed firms both locally and internationally. We examine theoretical, conceptual and empirical review with an aim of unearthing nexus among these concepts from existing studies. We contribute to the empirical literature by using various studies to show how these concepts relate to each other. There is significant relationship between corporate governance and financial performance. Similarly, there is significant relationship between corporate governance and firm value. However, there were studies that examined nexus of firm value, financial performance and corporate governance. The study adds on the existing debate and widens stock of literature relating to roles of corporate governance in enhancing firm performance and maximizing firms' value. It is substantially of essential policy makers, practitioners, to investors and other stakeholders who are interested with firm's value in particular.**

Keywords: **Corporate Governance, Firm Performance, Firm Value, Listed Firms.**

I. INTRODUCTION

Even though relationship between corporate governance and firm performance has continued to attract attention of scholars, policy and practitioners both in developed and emerging markets, the emergency of firm value among listed firms has given corporate governance new dimension. The mechanism of GCG is become one way to reduce control and ownership problems as it is also related to the increase of firm performance that will result in the increase of firm value. Companies that score high in corporate governance measurements tend to outperform other companies with lower scores (Adams, Hermalin and Weisbach, 2010). The increase in enterprise value is usually marked by the rise of stock prices in the market, as the stock market price of the company reflects the overall investor's valuation for each equity owned by the company.

Corporate governance refers to the procedures and processes according to which an organisation is directed and controlled (Organisation for Economic Co-operation and Development [OECD], 2015). Following the collapse of the Enron Corporation in the United States, in 2001, corporate governance has continuously become a topic of discussion not only in financial markets but in academia as well. Consequently, the corporate governance debate has increasingly attracted great interest from both academic scholars and practitioners across the globe (Ammann, Oesch & Schmid, 2011). In addition, Claessens and Yurtoglu (2013) concur that this lively debate has dominated discussions in corporate boardrooms, academic meetings, as well as policy circles around the world. Furthermore, Bebchuk and Weisback (2010) agree that

interest in corporate governance and its relevance has been rapidly growing, both inside and outside academia. For instance, in academia, the importance of corporate governance is seen in various disciplines as evidenced by many past studies in areas such as, finance, accounting, law and management (Krafft, Qu, Quatraro & Ravix, 2013).

In developed countries, there is vast literature on the investigation of the relationship between corporate governance and firm value, and researchers have made big debates in specific areas (Bhat, Chen, Jebran & Bhutto, 2018). It is also noticed that researchers have contributed to the literature in emerging countries where big discussions are made on the role of corporate governance on firm performance for instance by Gupta and Sharma (2016). The need to discuss corporate governance arises as a result of some scams and collapses in the corporate sector. Anomalies result from having a weak structure of corporate governance, which gives rise to need for reforms to improve the corporate governance system and it can ultimately help in reducing inefficiencies in the corporate sector. Ineffective corporate governance systems play a vital role in the occurrence of accounting scams; thus, corporations having weak governance are more inclined to anomalies (Berkman et al., 2009).

There is a belief that enhancement of firm value is influenced by corporate governance as evidenced by existing studies. In connection, Claessens and Yurtoglu (2013), in a review of corporate governance research in emerging markets indicate that firms with good corporate governance practices benefit from greater access to cheaper financing and higher performance. Besides, Henry (2008) indicates that positive valuation effects from strong corporate governance mechanisms come from risk and cost of capital reduction, effective decision making processes, establishment of suitable incentive structures and lower agency costs. Furthermore, Ammann et al. (2011) established that firms with better corporate governance practices exhibit statistically and economically significant higher values. Similarly, Claessens and Yurtoglu (2013) agree that good corporate governance structures enhance market valuations because better governance practices make firms improve the efficiency of their investment decisions which leads to increased future cash flows distributed to shareholders. Ammann et al. (2011) are of the view that firms should understand corporate governance as an opportunity rather than an obligation.

As a result, countries took steps to improve their corporate governance framework. For example, in Kenya, the important role of corporate governance is recognised in the 2010 constitution (CMA, 2014). In Kenya context, corporate governance has also gained prominence in the Kenyan context (Ekadah & Mboya, 2012). This has been caused partly by corporate failure or poor performance of public and private companies (Barako et al., 2006). In Kenya, corporate failures and regulatory initiatives have also placed corporate governance systems under closer scrutiny than ever for instance, CMC Motors and NHIF (Lekaram, 2014).The challenges of corporate governance in Kenya are yet to be fully addressed. Capital Market Steering Committee report (2014) explained that in the past few years there have been a number of governance scandals and boardroom wars among Kenya's large companies listed in NSE.

Statement of the Problem

Some authors have attributed the emergence of corporate governance to the emergence of major financial problems by international companies (Hamdan et al., 2013). Such companies called for a set of rules and norms of ethical and professional principles to achieve confidence and credibility of the information in the financial statements. In reality, the corporate governance procedures are far from being a reaction of financial crises as corporate governance procedures have been in place since the emergence of public shareholding companies and the agency theory. The procedures that govern the relationship of shareholders with the board of directors, executive management, and other relevant stakeholders have been addressed since old times. Recent financial crisis, followed by subsequent collapse in major international companies have made these rules and laws essential in order to protect the interests of all parties of the company.

There is marked difference on various effects of various practices of corporate governance on both firm performance and firm value. The results are mixed with positive, negative and no correlation for both developed and developing countries for both firm performance and firm value. There is empirical evidence that single practice of corporate governance can have different results when subject to firm performance and firm value yet studies have established relationship between firm value and firm performance when same measure of corporative governance is used. Other empirical studies use a corporate governance index but the results are different when different measures of corporate governance are used.

Due to the few studies regarding corporate governance, firm performance and firm value in developing countries, and specifically in Kenya, compared with developed countries, this paper presents evidence concerning corporate governance, firm performance and firm value. In light of the issues raised above, the main aim of this research is to examine the

perceptions of corporate governance practice in developing countries and the effect of corporate governance on firm performance and consequently the firm performance.

It is expected that this study would add a real contribution to the understanding of such topic both at academic and managerial levels. The study is expected to be significant as it seeks to insightfully research the subject of corporate governance, firm performance and firm value. Studying and analyzing the relationship among these variables of listed firms might reveal new findings in this market not previously researched.

Objectives of The study

The specific objective of this study was to

i. To determine the relationship between corporate governance, financial performance and firm value of firms listed in Nairobi Security Exchange.

II. LITERATURE REVIEW

Theoretical Framework

Agency Theory

Agency theory having its roots in economic theory was exposited by Alchian and Demsetz (1972) and further developed by Jensen and Meckling (1976). Agency theory is defined as "the relationship between the principals, such as shareholders and agents such as the company executives and managers". In this theory, shareholders who are the owners or principals of the company, hires the gents to perform work. Principals delegate the running of business to the directors or managers, who are the shareholder's agents (Clarke, 2004). Indeed, Nyberg, Fulmer, Gerhart and Carpenter (2010) argued that two factors can influence the prominence of agency theory. First, the theory is conceptually and simple theory that reduces the corporation to two participants of managers and shareholders. Second, agency theory suggests that employees or managers in organizations can be self-interested.

The agency theory shareholders expect the agents to act and make decisions in the principal's interest. On the contrary, the agent may not necessarily make decisions in the best interests of the principals (Padilla, 2000). Such a problem was first highlighted by Adam Smith in the 18th century and subsequently explored by Ross (1973) and the first detailed description of agency theory was presented by Jensen and Meckling (1976). Indeed, the notion of problems arising from the separation of ownership and control in agency theory has been confirmed by Davis, Schoorman and Donaldson (1997). In agency theory, the agent may be succumbed to self-interest, opportunistic behavior and falling short of congruence between the aspirations of the principal and the agent's pursuits. Even the understanding of risk defers in its approach. Although with such setbacks, agency theory was introduced basically as a separation of ownership and control (Bhimani, 2008). Holmstrom and Milgrom (1994) argued that instead of providing fluctuating incentive payments, the agents will only focus on projects that have a high return and have a fixed wage without any incentive component.

Stewardship Theory

Stewardship theory has its roots from psychology and sociology and is defined by Davis, Schoorman & Donaldson (1997) as "a steward protects and maximises shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximised". In this perspective, stewards are company executives and managers working for the shareholders, protects and make profits for the shareholders. Unlike agency theory, stewardship theory stresses not on the perspective of individualism (Donaldson & Davis, 1991), but rather on the role of top management being as stewards, integrating their goals as part of the organization. The stewardship perspective suggests that stewards are satisfied and motivated when organizational success is attained.

Agyris (1973) argues agency theory looks at an employee or people as an economic being, which suppresses an individual's own aspirations. However, stewardship theory recognizes the importance of structures that empower the steward and offers maximum autonomy built on trust (Donaldson and Davis, 1991). It stresses on the position of employees or executives to act more autonomously so that the shareholders' returns are maximized. Indeed, this can minimize the costs aimed at monitoring and controlling behaviours (Davis, Schoorman & Donaldson, 1997).

On the other end, Daly et al. (2003) argued that in order to protect their reputations as decision makers in organizations, executives and directors are inclined to operate the firm to maximize financial performance as well as shareholders' profits. In this sense, it is believed that the firm's performance can directly impact perceptions of their individual

performance. Indeed, Fama (1980) contend that executives and directors are also managing their careers in order to be seen as effective stewards of their organization, whilst, Shleifer and Vishny (1997) insists that managers return finance to investors to establish a good reputation so that that can re-enter the market for future finance.

Resource Dependency Theory

Whilst, the stakeholder theory focuses on relationships with many groups for individual benefits, resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm. Hillman, Canella and Paetzold (2000) contend that resource dependency theory focuses on the role that directors play in providing or securing essential resources to an organization through their linkages to the external environment. Indeed, Johnson et al, (1996) concurs that resource dependency theorists provide focus on the appointment of representatives of independent organizations as a means for gaining access in resources critical to firm success. For example, outside directors who are partners to a law firm provide legal advice, either in board meetings or in private communication with the firm executives that may otherwise be more costly for the firm to secure.

It has been argued that the provision of resources enhances organizational functioning, firm's performance and its survival (Daily et al, 2003). According to Hillman, Canella and Paetzold (2000) that directors bring resources to the firm, such as information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy. Directors can be classified into four categories of insiders, business experts, support specialists and community influential. First, the insiders are current and former executives of the firm and they provide expertise in specific areas such as finance and law on the firm itself as well as general strategy and direction. Second, the business experts are current, former senior executives and directors of other large for-profit firms and they provide expertise on business strategy, decision making and problem solving. Third, the support specialists are the lawyers, bankers, insurance company representatives and public relations experts and these specialists provide support in their individual specialized field. Finally, the community influential is the political leaders, university faculty, members of clergy, leaders of social or community organizations.

III. METHODOLOGY

A desktop review specifically, Systematic review was utilized to examine influence corporate governance, financial performance and firm value. The aim of a systematic review is to identify all empirical evidence that fits the pre-specified inclusion criteria to answer a particular research question or hypothesis. The paper summaries review of journals and articles from 1999 and making conclusions on the findings. The study seeks to investigate the key issues associated with corporate governance, firm performance and firm value of listed companies. A range of research methodologies used in previous research and review of empirical literature on corporate governance, financial performance and firm value nationally and internationally will be performed.

IV. FINDINGS AND DISCUSSIONS

4.1 Corporate Governance Concept

Corporate governance is the mechanisms by which corporate managers are held accountable for corporate management and financial performance, and the mechanism by which business is organized, directed, and controlled (Krivogorsky & Dick, 2011). Recently researchers have managed to come up with other definitions of corporate governance. Strine (2010) pointed out that corporate governance is about putting in place the structure, processes and mechanisms that insure that the firm is directed and managed in a way that enhances long-term shareholder value through accountability of manager, which will then enhancing firm financial performance . Currently financial sectors have seen the importance of having good corporate governance practices (Kolk & Pinkse, 2010). IFC (2004) examined the benefits of having good Corporate Governance at different levels. At the company level, well governed companies tend to have better and cheaper access to capital, and tend to outperform their poorly governed peers over the long-term, on the other hand corporate governance reduce financial crisis.

4.2 Financial Performance Variable

It is vital to measure financial performance of a corporation since it is an indicator to determine the annual growth of a corporation. Reports on financial performance can also be used to decide which policy management should take. Studies on financial performance use ROA and ROE as the indicator. Return on Assets (ROA) is key profitability that measures the amount of profit a corporation makes from every asset it has. ROA shows how efficient a company is in utilizing its

total assets to run the company. ROA also provides some information to shareholders how a company convert their investment into profits. In conclusion, ROA is an indicator of a company's profitability to utilize their assets to earn net income. ROA is measured by dividing net income with the total assets. Return on Equity (ROE) is the amount of net income returned as a percentage of shareholders equity. ROE measures a corporation's profitability by revealing how much a company generates with the money shareholders have invested. Brigham and Houston (2011) stated that ROE is ratio of net income after tax divided by shareholders equity. The use of ROE is (1) to measure how efficient a company is based on how much profit it generates from each unit of shareholder equity; (2) ROE shows how well a company uses its investment to generate the growing income; (3) ROE is used to compare profitability rate among companies by comparing different companies in the same industrial sector.

4.3 Firm Value Variable

Firm value is the market value of an enterprise as a whole business that reflects the size of the economy. It is a collection of all holders of securities which are common and preferred equity holders, minority shareholders, debt holders, etc. According to Smithers and Wright (2007) the value of the company is proxied with the value of Tobin's Q given the symbol Q, calculated by using the ratio of Tobin's Q. Modgliani and Miller (1963) explain that firm value is the total amount of debt at market value and stock market value. Meanwhile, Myers et al. (2011) stated that firm value equals to corporation present value or total amount of separated assets. Furthermore, Ross et al. (2008) mention that firm value equals to market value of debt and equity, minus cash and cash equivalents. A goal of a corporation is to maximize shareholders equity not only for the interest of the shareholders, but also people in general (Keown et al., 2011). Every corporation wants to achieve the goal because corporate owners are getting more prosperous when a corporation reaches its maximum firm value (Husnan and Pudjiastuti, 2004).

4.4 Empirical Reviews; Corporate Governance and Firm Performance

Influence of corporate governance and firm performance has continued to gain credence both in public sectors as well as private sector. Al- Haddad, Alzurqan and Al_Sufy (2011) indicated that, profitability of Jordanian firms listed at Amman Stock Exchange (ASE) is influenced by corporate governance. Similar findings were revealed by Muhammad, Anam and Asghar (2018) as corporate governance and firm's financial performance shows positive relationship between each other. However, Paul, Ebelechukwu and Yakubu (2015) did not show significant relationship exists between corporate governance and bank's financial performance of microfinance banks in north central Nigeria. Both studies did not reveal which practices or aspects of corporate governance influence firm performance.

On the hand, Kenga and Nzulwa (2018) were specific on various practices of corporate governance that affects firm performance. The authors indicated that board size and CEO duality had significance on firm performance. Similar findings were found by Madan and Marimuthu (2015) where board ownership and duality are exerting a significant impact on ROA at 5% level of Jordanian firms listed at Amman Stock Exchange. This contradicts Mohan and Chandramohan (2018) who indicated that firms need to separate the post of CEO and Chair in order to ensure optimal performance as CEO duality has negative influence on firm performance in India.

On the other hand, Arifin (2016) failed to establish direct relationship between corporate governance and financial performance of Bank Sector Companies: Indonesia Stock Exchange 2008-2012 although the introduction of intellectual capital resulted to significantly influence financial performance of Indian companies, listed on the BSE. A negative relationship between corporate governance and financial performance was also established by Festo and Nkote (2013) in public universities in Uganda. However, the findings were found to be conflicting with conclusion as the study indicated that corporate governance variable are significant predictors of board roles are significant predictors of board effectiveness. Ahmad and Mensur (2012) found mixed results for board size as a large board size relates to profitability but does not significantly impact on financial performance

Rasul and Mehboob (2018) revealed that in a developing country like Pakistan there are sound codes of corporate governance but, their proper implementation is missing. The results from an empirical study indicated that annual general meeting, managerial ownership, institutional ownership, board size and out-ratio had insignificant influence on financial performance. Interesting findings were revealed by Olayiwola (2018) whereby direct influence of board size results a significant negative correlation with NPM and audit committee size had an insignificant correlation with NPM. However, the joint effect of three variables plus board composition had a significant joint effect on NPM. Thus, smaller board size will increase performance and the board composition should consist more of the non-executive directors while the audit committee also should be reviewed from time to time.

Datta (2018) investigated impact of Corporate Governance on Financial Performance of DSE listed Insurance Companies in Bangladesh. Even though study concluded that corporate governance has an impact on the performance of the insurance sector in Bangladesh, the results provide evidence of a positive relationship between board sizes and ROE as well as board meetings. The result further reveals that a negative relationship between ROE and board composition. The study could not provide any Association between performances of the insurance (ROE) and board audit committee. Rizwan, Asrar, Siddiqui and Usmani (2016) revealed that the inside ownership, board size, presence of independent/non-executive directors, dividend payout ratio and presence of audit committee had significant impact on organization's financial performance while the presence of remuneration committee and board diversity had no impact on firm's financial performance.

4.5 Empirical Reviews; Corporate Governance and Firm Value

Various studies have revealed mixed link between corporate governance and firm value. Pae and Choi (2011) found that cost of equity capital decreases when corporate governance is high and also becomes low for firms with strong commitment to business ethics. The authors suggested for companies to lower their cost of equity and increase value by practicing effective corporate governance and showing commitment to higher standards of business ethics. Caixe and Krauter (2014) confirmed the positive link between corporate governance and market value and also found that firms listed in premium corporate governance segments are priced higher by the market compared to firms listed in the traditional trading segment.

Ammann, Oesch and Schmid (2013) showed that that corporate governance significantly increases firm value in non-competitive industries only. Core, Holthausen, and Larcker (1999) indicated that compensation arising from these characteristics of board and ownership structure has a statistically significant negative relation with subsequent firm operating and stock return performance. Lei and Song (2012) investigated the effects of board structure and internal corporate governance (CG) mechanisms on firm value in an emerging market that have ownership focus and family contribution. They found that firms with independent board structure can have higher firm. They also found that board structure is the most important among the major internal CG mechanisms and can be most valuable to investors in markets with concentrated ownership. They suggested that companies with concentrated ownership should focus on monitoring CG mechanisms with boards of directors to have a greater degree of independence.

Chhaochharia and Grinstein (2007) revealed the announcement of corporate governance rules has a significant effect on firm value. However, the announcement had significant variation between small and large firms; large firms that are less compliant earn positive abnormal returns but small firms that are less compliant earn negative abnormal returns. Gosal, Pangemanan, and Tielung (2018) indicated that although corporate governance influence firm value, only institutional ownership is significantly influenced firm value while managerial ownership, independent board of commissioners and audit committee has no influence on firm value significantly. Kim, Yeo and Zhang (2017) indicated that CEO duality and auditor ownership has significant influence of firm value. Companies in China where the CEO double as Chairman realize high value.

On the other hand, Gherghina (2015) empirically provided support for a lack of any statistically significant relationship between corporate governance measures and firm value. The aspects of corporate governance included first three shareholders, the number of shareholders having holdings over 5%, board size, the number of independent directors, the number of non-executive directors, the number of women on board, and CEO duality. Others were board independence rating, ownership concentration rating, and board diversity rating. Jo and Harjoto (2011) revealed that the board leadership, board independence, blockholders' ownership, and institutional ownership play a relatively weaker role in enhancing firm value.

Siagian, Siregar and Rahadian (2013) revealed that there is a positive association between corporate governance and different proxies of firm value. These findings suggest that firms that implement better corporate governance have higher values. However, negative associations between reporting quality and the proxies for firm value. These findings indicate that lower value firms tend to disclose more information that is consistent with the P3LKE than higher value firms.

4.6 Empirical Reviews; Corporate Governance, Firm Performance and Firm Value

Arifin, Suhadak and Astuti (2012) assessed the influence of corporate governance on financial performance and firm value of bank sector companies and revealed that corporate governance significantly influences financial performance. Corporate governance significantly influences firm value, and financial performance significantly influences firm value. However, the study did not indicate the conceptual relationship between the study variables.

Al Mubarak and Hamdan (2016) showed that market value has increased for those firms which have achieved two conditions of corporate governance that are related to corporate ownership and increase firms' performance in Bahrain Bourse. These two conditions are ownership of the three largest shareholders and property of managers. With regard to the third condition of corporate governance, the ownership of the largest shareholder, the findings reveal that firm's performance increases when one person controls the firm.

Most recently, Bhat, Chen, Jebran and Bhutto (2018) showed connection between the three variables when the study focused on corporate governance, firm value and return on asset a comparative analysis of state and non-state owned companies in the context of Pakistan. The notable findings show that board independence has a significant and positive relationship with firm value only for state-owned companies. Furthermore, the results show that market capitalization and return on assets have a significant and positive association with firm value for both state- and non-state-owned enterprises.

Sayilir (2012) indicated that in regard to corporate governance and firm valuation, CG is not found to have a statistically significant relationship with Tobin's Q. similarly, in regard to corporate governance and profitability, CG is not found to have a statistically significant relationship with ROE or ROA. The findings of the study do not support the hypothesis that better corporate governance is associated with higher firm values and better performance. However, in a non-comparative study conducted in India and South Korea, Gupta and Sharma (2014) revealed that very limited impact of corporate governance should not be seen in isolation of other factors affecting the share price and the financial performance**.**

V. CONCLUSION AND RECOMMENDATION

The theoretical and empirical literature on corporate governance and firm performance relationship is extensive and got much attention. It can be characterized as being unable to reach a consensus regarding the nature of the relationship between the two concepts. Although the empirical evidence is inconclusive, the practical importance of governance in relation to performance is globally acknowledged, especially in aligning the interests of managers and shareholders. The inconclusive results of the empirical studies on this theme can be due to several factors. For measuring corporate governance in some studies only one mechanism of corporate governance is used, while others use an index that captures the influence of several corporate governance mechanisms. Institutional differences among countries lead to different results of the empirical studies mentioned. The studies are conducted in both developed and developing economies, so this raises the variation we consider that good corporate governance is an essential factor in achieving sustainable economic development due to the increase in the access to outside capital.

On the other hand, although there is a large volume of published empirical research examining the relationship between corporate governance and firm value, there is no conclusive evidence documented. This implies that the debate on the corporate governance mechanism that influences firm value is far from over. Furthermore, there are methodological inconsistencies which point to the need for further research in this area. Consequently, arising from the gaps in existing studies, this paper suggests further areas of research. However, few studies have examined the relationship between corporate governance, firm performance and firm value for listed firms. Corporate governance mechanisms that yielded negative influence or non-significant effect on firm performance produced positive and significant effect on firm value and vice versa. This on its own leaves significant conceptual as well as theoretical relationship between the study variables.

Proposed Conceptual Framework

In lieu to continual misconception on the nexus among corporate governance, financial performance and firm value, the study proposes a conceptual framework that would utilize comprehensive measures of corporate governance rather than a single governance mechanism. Further, there must clear delineation of firm performance from firm value and how they affect each other as a result of corporate governance mechanism.

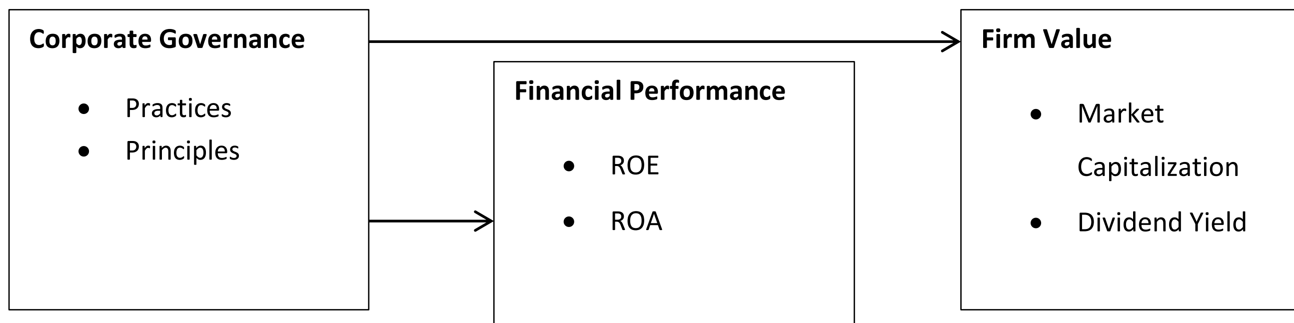

Figure 1

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