

**EFFECT OF CORPORATE GOVERNANCE ON AGENCY COSTS AMONG
LISTED FIRMS IN NAIROBI SECURITY MARKET, KENYA**

By

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DECLARATION

Declaration by the Candidate

I declare that this thesis is my original work and has not been presented for a degree in any other university or institution. No part of this project may be reproduced without prior permission of the author and or Moi University.

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DEDICATION

First and foremost is to thank our Almighty God who has seen me through the thesis writing. I would also like to dedicate this project to my wife and daughter Stephanie, sisters, friends and my able supervisors.

ABSTRACT

In recent times, interest in corporate governance in the African continent has assumed highest proportions. This is probably due to the great push from the developed countries to the African countries to embrace good governance in order to attract foreign investors and to improve shareholders value. The General objective of the study is to investigate the effect of corporate governance on agency costs among listed firms in Kenya. The specific objectives of the study are; effect of board independence on agency cost, effect board size on agency, effect of CEO duality on agency cost, effect of existence of audit committee on agency cost and effect of board tenure on Agency cost. The study adopted explanatory design in order to assess cause –effect relationship. The study used descriptive statistics to analyze data (frequencies, mean, standard deviations and percentages) and inferential statistics (correlation and multiple regression), with a population of 34 listed firms operating consistently in the stock exchange during the period 2004-2010 giving a total of 238 firm year observations. Secondary data was collected through the use of a documentary analysis. The findings revealed that there is negative correlation between agency cost and board independent, there is positive correlation between agency cost and board size, CEO duality was reported to be strongly positively correlated to Agency cost, there is a positive correlation between audit committee and agency cost and Board tenure and agency cost had significant positive relationship. Regression results reveals that there is significant positive relationship between CEO-duality and agency cost ($\beta_2=0.589$, this indicate that, P value =0.000), board independence affect agency cost negatively ($\beta_1=-0.329$), board tenure ($\beta_5=0.289$, P value = 0.000), board size ($\beta_3=0.236$, P value =0.000) and finally existence of audit committee ($\beta_4=0.185$, P value =0.000) these were found to be significant at 95% confident to the study whereas control variables were found to be insignificant. The study concluded that having dual leadership in the firm increases the agency cost, however with more independent directors, agency cost decreases. The study recommends that managers/CEOs should emphasize on board independence, it further recommends that the CEO and chairperson roles should not be exercised by one person.

DEFINITION OF TERMS

Corporate governance-	Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders.
Proxies-	Under U.S. corporate law, stockholders are required to vote on certain matters, such as the election of directors.
Agency cost -	Jensen and Meckling (1976) defined agency costs as the sum of monitoring costs, bonding costs, and residual loss.
CEO Duality-	is the situation when the same person holds both the job of Chief Executive Officer (CEO) and Chairman of the board of a firm
Board Independence-	Refers to director who is not an employee of the company and has not engaged in various types of business dealings with the company
Board Size-	It's the total board number an organization can have as stipulated in the company's act
Board Tenure	the length of time directors serves on a board

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LIST OF ABBREVIATIONS

US	United States
UK	United Kingdom
CEO	Chief Executive Officer
CMA	Capital Market Authority
NSE	Nairobi Stock Exchange

CHAPTER ONE

1.0 INTRODUCTION

1.0 Overview

This chapter outlines the background of the study, statement of the problem, objectives of the study, purpose of the study and significance of the study.

1.1 Background of the Study

Agency problems are increasingly inherent in the modern-day corporation, owing to the widening separation of ownership and control responsibilities, growing business diversification and segmentation across industry and business lines. Agency costs can manifest in various circumstances, including self-serving behaviours on the part of managers focused on empire-building objectives, excessive perquisite consumption, non-optimal investment decision-making or acts of accounting mismanagement or corporate fraud (Henry, 2004).

Good governance recommendations are based on the philosophy of promoting market with “minimum interference” (Hamilton, 2004). The corporate governance is based on broad principles with flexibility. The principles cover the board structure, integrity of corporate reporting, shareholders’ rights, executives and directors’ performance and remuneration, and risk management. The recommendations drive the companies to disclose corporate governance information considered as relevant to investors and the disclosure rule requires companies to explain any departure from the best practice principles (Hamilton, 2004).

According to Maher, & Anderson (1999) “Good corporate governance includes, well-articulated corporate strategy against which the overall success and the contribution of individuals can be measured. The corporate governance sets and enforces clear assignment of responsibilities, decision-making authority and accountabilities that is appropriate for the companies risk profiles. Corporate governance enables strong financial risk management function.

Corporate governance relates to the manner in which the business of the stock market is governed, including setting corporate objectives and risk profile, aligning corporate and behaviors with the expectation that the management will operate in a safe and sound manner, running day-to-day operations within an established risk profile, while protecting the interests of clients and other stakeholders (Mehran, 1995).

Reilly & Brown (1997) states that corporate governance framework can impinge upon the development of capital markets, innovative activity, entrepreneurship, the development of an active SME sector, and resource allocation, which consequently impinge upon the growth of the economy. It impacts upon the behavior and performance of firms. In the current time of growing capital mobility and globalization, corporate governance has become an important framework condition affecting the industrial competitiveness

Following the major corporate collapse and the effect of the crisis, efforts to enhance corporate governance have been undertaken by countries around the world via the establishment of corporate governance guidelines. Insufficient and malfunctioning corporate governance mechanisms are said to be the major factors responsible for the

current issue for causing and accelerating the deteriorating situations of the crisis (Suto, 2003; Sam, 2007). Various internal and external monitoring mechanisms have been suggested, and efforts are undertaken to improve these mechanisms. These mechanisms are claimed to be able to align the interest of agents to be more closely with that of the principals (Sam, 2007). Maijor (2000) claims that corporate governance issues such as monitoring mechanisms are very much related to agency theory.

Mcknight and Weir (2008) in their study found that changes in board structural characteristics have little, or no, effect on agency costs in the UK. They further found out that having a majority of the committee being non-executive directors is also associated with higher costs and that the setting up of a nomination committee is associated with higher, rather than lower, agency costs. This shows that firms had moved to new structures that are consistent with value maximization. In contrast, Karpoff, and Raheja (2007) argued that companies adopt a range of governance mechanisms, each of which is consistent with maximizing firm value. Therefore, they, question the usefulness of moving towards governance systems that identify preferred mechanisms. Such a system may force a firm to move away from a value maximizing structure and to adopt a non-optimal structure.

A report by CMA indicated that due to slump of activities in the Nairobi Stock Exchange due to loss of confidence calls for need to investigate the factors that affect the financial performance of companies listed in the Nairobi Stock Exchange. The potential investors have lost trust in the stock market due to malpractice and professional negligence. To protect investors from losses, the capital regulations were amended to require the

stockbrokers to secure professional indemnity insurance. (Capital Market Authority Annual Report & Accounts 2009).

The purpose of this paper is to examine corporate governance mechanisms in limiting or controlling the magnitude of agency-related costs within these companies. This corporate governance regulation is not legislatively mandated and is centered on a disclosure-based resulting in uncertainty in relation to adherence rates and its overall impact on corporate structure and decision-making. As such, it is foreseeable that Kenya firms, and particularly those of smaller size, may have less-developed corporate governance regimes and be more susceptible to experiencing agency problems.

1.2 Statement of the Problem

Previous studies argue that agency cost findings in western countries have equal impact in African organizations (Ayogu, 2001). Literature also indicates that there is a possibility that given the cultural differences, the typical nature of agents in agency cost may not be the case with regard to non-western countries (Henry, 2004).

According to Chan-Lau (2010) corporate governance plays an important role in determining the agency costs arising from the conflicts of interest between debt holders and shareholders, a role which has not been extensively analyzed previously in the academic literature. He also state in the absence of informational asymmetries, governance structures in which debt holders owning equity stakes in the firm have the right to control it can effectively reduce the agency cost of debt - or underinvestment

problem - providing a rationalization to the existence of such governance structures in the real world.

Listed firms can only achieve their objectives and effectively discharge their responsibilities if they are led by quality and effective leadership which is responsive, transparent and accountable, abide by the highest standards of fiduciary management. listed firms' failures have been attributed to bad corporate governance. The predominant and widely held view is that board characteristics/composition, have a direct bearing on the performance of firms as they guarantee firm control on top management without compromising efficiency.

However, there is hardly any substantive study undertaken on corporate governance on agency cost related to listed firms in Kenya particularly with the focus on board characteristics. Conflicting results are observed in regards to the relationship between firm size and agency costs, although different factors are found to impact on the level of agency costs for small and large firms. This study therefore seeks to establish the effects of corporate governance on agency cost among listed firms in Nairobi Stock Exchange.

1.3 Objectives

1.3.1 General Objectives

The main objective is to analyze how corporate Governance affects Agency cost of a firm.

1.3.2 Specific Objectives

- i. To establish the effect of board independence on agency cost.
- ii. To determine the effect of board size on agency cost.
- iii. To establish the effect of CEO duality on agency cost.
- iv. To establish the effect of existence of an audit committee on agency cost.
- v. To establish the effect of board tenure on agency cost

1.4 Research Hypothesis.

Ho₁. Board independence does not significantly affect agency cost.

Ho₂. Board size does not significantly affect agency cost.

Ho₃. CEO duality does not significantly affect agency cost.

Ho₄. Existence of an audit committee does not significantly affect agency cost.

Ho₅. Board tenure does not significantly affect agency cost.

1.5 Significance of the Study

The benefit of the study goes to the firms' management to use the outcome in improving on its operations and hence performance, provide information to firms operating in Kenyan business environment and investors on how corporate governance operates thus reducing the conflict between the managers and shareholders in the firm. The study also provides information to scholars pursuing, research and students in this field showing the gaps for further studies in this area. From the study scholars were able to evaluate the effect of corporate governance on agency cost. Particularly, the effect of CEO duality and existence of audit committee which increases agency cost.

1.6 Scope of the Study

The study adopted longitudinal study of listed firms in NSE. The sample of the study was selected on the 44 listed firms at NSE in Kenya. This study was limited to companies listed in the Nairobi stock exchange in the entire four categories i.e. agricultural sector, commercial and services, industrial and allied and finance, investment and sectors. Data was obtained from the financial statements of the companies the year 2004 to 2010.

1.7 Ethical considerations

The study was undertaken bearing in mind all the ethical concerns and it attempts to uphold them. Permission to carry out the research was sought from the relevant authorities and from the participants who were involved in the study. The nature and purpose of the study was explained to the listed firms.

During the course of the study, the listed firms were assured of confidentiality, anonymity, and researcher's responsibility (Mugenda and Mugenda 1999). The information was based on the selected listed firms' which marked an informed decision on whether or not to participate in the study.

The study maintained confidentiality of all data collected of the listed firms as it will relate to the operations of the organization that are used to gain competitive advantage.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter presents previous studies undertaken by various scholars on corporate governance and agency cost. The chapter outlines the underlying theory of agency cost, concept of corporate governance, the link between corporate governance and agency cost, board independence, board size, CEO duality, existence of audit committee, board tenure and the conceptual frame work.

2.1 The Concept of Agency Cost

Agency costs arise from the misalignment of the interests of the owners and managers of firms when the separation of ownership and control occurs (Jensen, 1986). Only few studies had directly tackled the measurement issue of the principal variable of interest, namely agency costs. Notable exceptions are Ang *et al.* (2000), Singh and Davidson (2003) and Fleming *et al.* 2005), who investigated the empirical determinants of agency costs and focus on the role of debt and ownership structure in mitigating agency problems. In doing so, they used two alternative proxies for agency costs: the ratio of total sales to total assets (asset turnover) and the ratio of selling, general and administrative expenses to total sales (SG&A). In line with the findings of previous research, they provide evidence that managerial ownership aligns the interests of managers and shareholders and, hence, reduce agency costs.

The agency theory postulates that the separation of ownership and management leading to principal-agent conflicts as the managers may pursue their own interest at the expense of the principals (Ugurlu, 2000; Jensen and Meckling, 1976; Shleifer and Vishny, 1986). This divergence of interest between managers and shareholders may create information asymmetry and result in agency costs (Farrer and Ramsay, 1998).

These agency problems arise because of the impossibility of perfectly contracting for every possible action of an agent whose decisions affect both his own welfare and the welfare of the principal, (Brennan, 1995). Arising from this problem is how to induce the agent to act in the best interests of the principal. Managers bear the entire cost of failing to pursue their own goals, but capture only a fraction of the benefits. Jensen and Meckling (1976) argue that this inefficiency is reduced as managerial incentives to take value maximising decisions are increased.

The second approach taken in the empirical literature has been the evaluation of the association between agency controls mechanisms, with positive performance effects of agency attributes intimated through their contribution to lowering agency costs. Although this strain has spurred extensive research, substantial inconsistency is observed across studies evaluating the impact of individual agency-controlling mechanisms on firm performance.

This approach relates to the expectation that firms offering lower protection for shareholder claims, those with poorer governance practices or firms that are increasingly immune to takeover threat are more likely to experience agency and managerial

entrenchment problems leading to incurrence of agency costs. The evidence in this regard is much more conclusive, with LaPorta, Lopez-de-silanes, Shleifer and Vishny (1998, 2000), Black (2001), Gompers, Ishii and Metrick (2003), Bebchuk, Cohen and Ferrell (2004), Klapper and Love (2004), Black, Jang, Kim and Park (2005), Cremers and Nair (2005) and Black, Jang and Kim (2006) all finding a positive association between measures representative of superior corporate governance quality and stronger shareholder rights.

The final relevant subset of literature, and that which is most closely aligned to this research, involves those studies that have directly attempted to measure the level of agency costs inherent in firms, and then evaluated the factors that significantly impact on the variation in firm agency costs within cross-sectional or longitudinal sample constructs. Ang, Cole and WuhLin (2000) applied this method to a sample of non-listed US small businesses based on measuring agency costs, using operating expense and asset turnover ratios, relative to a zero agency cost base firm represented by a 100% owner-manager firm.

They also provided evidence of non-linear relationships between inside ownership and leverage and the level of agency costs, whereas agency costs are found to be positively associated with the level of institutional ownership. In a similar study of listed UK firms, Doukas, McKnight and Pantzalis (2005) find that greater analyst following only reduces agency costs for small firms. Prior research has focused primarily on ownership structure, and particularly the degree of separation of control and ownership claims, as a key determinant of agency costs.

Although it is not possible to identify the zero-agency-cost case with listed firms, managerial (director) ownership remains a likely candidate as an agency-control mechanism. Such an expectation is consistent with the ‘convergence of interest’ hypothesis proposed by Jensen (1993), where a larger managerial ownership interest should more closely align the decision-making and wealth interests of managers with those of company shareholders, resulting in the minimization of agency problems.

This would suggest a negative relationship between the level of managerial ownership and the extent of agency costs. Beyond a certain level of managerial ownership, however, it is foreseeable that managers may become entrenched in their position, whereby personal wealth consequences are offset by incentives to extract private benefits from incremental or excessive consumption or use of corporate resources. The result of this being growing agency problems as managerial control exceeds this entrenchment level of ownership, and a non-linear relationship between managerial (director) ownership and agency costs.

Outside ownership interests are suggested as providing a watchdog or external monitoring influence on board and managerial decision-making. Institutional investors provide an alternative source of oversight of managerial and firm performance, and they may choose to use their voting rights to influence corporate decision-making and board or management structure. Effective monitoring (or actual activism) from institutional shareholders should help to facilitate the alignment of shareholder and managerial interests and, therefore, lower expected agency costs.

Similarly, other outside substantial corporate shareholders also has an incentive to efficiently monitor firm performance to maximize the value of their shareholdings, which should reduce the extent of agency problems. Identical concerns to those regarding director ownership apply, however, in relation to the potential entrenchment of corporate substantial shareholders if their ownership interest exceeds the level required to obtain effective control of corporations. Achievement of effective ownership and voting control may lead to entrenchment-related agency costs, such as empire-building, underinvestment or the development of excessive financial slack, which cannot be resolved through effective external monitoring or the market for corporate control.

2.2 Agency Theory

The Modern Corporation and Private Property by Berle and Means (1932) stipulates that the principal-agent theory is generally considered the starting point for any debate on the issue of corporate governance. According to them, the fundamental agency problem in modern firms is primarily due to the separation between finance and management. Modern firms are seen to suffer from separation of ownership and control and therefore are run by professional managers (agents) who cannot be held accountable by dispersed shareholders. In this regard, the fundamental question is how to ensure that managers follow the interests of shareholders in order to reduce cost associated with principal-agent theory.

The principals are confronted with two main problems. Apart from facing an adverse selection problem in that they are faced with selecting the most capable managers, they are also confronted with a moral hazard problem: they must give agents (managers) the

right incentives to make decisions aligned with shareholder interests. In further discussion of agency relationships and cost (Jensen and Meckling, 1976) describe agency relationship as a contract under which “one or more persons (principal) engage another person (agent) to perform some service on their behalf, which involves delegating some decision- making authority to the agent”.

In this scenario, there exists a conflict of interests between managers or controlling shareholders, and outside or minority shareholders leading to the tendency that the former may extract “perquisites” (or perks) out of a firm’s resources and be less interested to pursue new profitable ventures. Agency costs include monitoring expenditures by the principal such as auditing, budgeting, control and compensation systems, bonding expenditures by the agent and residual loss due to divergence of interests between the principal and the agent. The share price that shareholders (principal) pay reflects such agency costs. To increase firm value, one must therefore reduce agency costs. The following represent the key issues towards addressing opportunistic behavior from managers within the agency theory:

Composition of board of directors: The board of directors is expected to be made up of more non-executive directors (NEDs) for effective control. It is argued that this reduces conflict of interest and ensures a board’s independence in monitoring and passing fair and unbiased judgment on management.

CEO duality: It is expected also that different individuals occupy the positions of CEO and board chairperson as this reduces the concentration of power in one individual and thus greatly reduces undue influence of particular management and board members.

2.2 The Concept of Corporate Governance

Corporate governance could be defined as “ways of bringing the interests of investors and managers into line and ensuring that firms are run for the benefit of investors (Mayer, 1997). Corporate governance is concerned with the relationship between the internal governance mechanisms of corporations and society’s conception of the scope of corporate accountability (Deakin and Hughes, 1997). It has also been defined by Keasey *et al.* (1997) to include ‘the structures, processes, cultures and systems that engender the successful operation of organizations’. From the foregoing analysis, we argue that corporate governance is represented by the structures and processes laid down by a corporate entity to minimize the extent of agency problems as a result of separation between ownership and control. It should also be noted that different systems of corporate governance will embody what are considered to be legitimate lines of accountability by defining the nature of the relationship between the company and key corporate constituencies.

According to Khan (2011) corporate governance is the broad term that describes the processes, customs, policies, laws and institutions that direct the organizations and corporations in the way they act, administer and control their operations. It works to achieve the goal of the organization and manages the relationship among the stakeholders including the board of directors and the shareholders. It also deals with the accountability of the individuals through a mechanism which reduces the principal-agent problem in the organization. Fine corporate governance is an essential standard for establishing the striking investment environment which is needed by competitive companies to gain

strong position in efficient financial markets. Good corporate governance is fundamental to the economies with extensive business background and also facilitates the success for entrepreneurship.

Zingales (1998) defines corporate governance as “allocation of ownership, capital structure, managerial incentive schemes, takeovers, board of directors, pressure from institutional investors, product market competition, labor market competition, organizational structure, etc., can all be thought of as institutions that affect the process through which quasi-rents are distributed”. Garvey and Swan (1994) assert that “governance determines how the firm’s top decision makers (executives) actually administer such contracts”. Shleifer and Vishny (1997) define corporate governance as “the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment”. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.” Oman (2001) defined corporate governance as a term refers to the private and public institutions that include laws, regulations and the business practices which govern the relationship between the corporate managers and the stakeholders.

Corporate Governance has become a topic of hot debate over the last two decades after the happenings of the corporate scandals and scams like Enron, WorldCom etc. which

shook the corporate world as well as the confidence of the investors. These accounting frauds are related to weak corporate governance (Berkman *et. al.*, 2009). There is a need to induct such standards which can reduce the scope of scams to the minimum. The issue of corporate governance has great importance in the recent times of the corporate world.

2.3 The link between Corporate Governance and Agency Cost

McColgan (2001) gave a very broader view of agency theory and corporate governance. The major interest of his research was to cover the area that where the interests of managers diverge from those of the interests of shareholders. He kept in view the agency relationship and the agency cost which arises from these relationships. He extended the work of Jensen and Meckling (1976) who defined the agency relationship as a type of contract in which the principal keep the agent to carry out the services of the firm on his behalf.

Jensen and Meckling (1976) argued that this delegation authority reduces the value maximizing decisions taking by the manager in the firm. Hubbard and Palia (1999), argued Jenson and Meckling (1976) by saying that principal agent problem are not similar in all firms rather they are different in different firms, different industries and also in different cultures. Himmelberg *et al.* (1999) said that Jenson original theory “nexus of contract’ suggest the same. McColgan (2001) agreeing with the authors said that agency problem can be reduced by the help of effective corporate governance mechanism which can be important in reducing the agency cost and the ownership problems in the firms.

The governance should be design according to the firm environment as one general mechanism can be more important for some firms and less important for other firms.

Okeahalam and Akinboade (2003) conducted the review by studying a contribution on the corporate governance in Africa and said that the modern concepts of separation of management make the corporate governance an important issue for research. The interests of people who control the organizations are differing from those who invest in the company by external finance. Also the principal agent problem and the interest of shareholders can only reduced through the effective corporate governance.

Farinha (2003) argued that major problem in organization arises with the relationship of principal and agent relationships and a different approach of manager than the shareholders. The perspective of the manager remains with the limited cash-flows thus managers focus lies with the short term perspective on investment whereas shareholders stuck with the quick return of cash flows. Risk preference is also a major source of conflict between the principal and the agent.

Shareholders associated with the market risk and the risk of stock returns whereas managers always concerned with the company risk because their survival depends on the firm risk. The area of corporate governance is lacking with the external disciplining devices. The firms through the effective corporate governance can implement these devices which includes the composition of the board of directors, increase number of shareholders, maximize the inside ownership and by providing different financial policies and compensation packages.

2.3.1 Board Independence and Agency Cost

Prior literature, both theoretical and empirical, has focused on one of the many facets of the board of directors as a monitor and/or as an advisor. For several reasons, independent directors have been seen as the most able to assume both roles inside the board.

First, independent directors are not, or are less, subject to potential conflicts of interest that reduce their monitoring capacity. In any firm the ultimate decisions on crucial issues, such as setting executive compensation or searching for replacements of top managers, fall strictly under board authority and, in most cases, are in the hands of independent directors. Second, independent directors typically also serve as experienced professionals in other firms or large organizations, and therefore care about their reputation (Henry, 2008). Fama and Jensen (1983) hypothesize that this reputation effect, rather than large compensation, induces outside directors to monitor. Third, independent directors possess technical expertise both in management and decision making, which allows them to be effective monitors (Fama and Jensen, 1983).

The evidence on the value of independent directors to shareholders is thin. We know little about whether all independent directors are equally good or whether there are other determinants of the value of independent directors. This is partially due to the conflicting evidence in prior studies. Rosenstein and Wyatt (1990) show that Agency cost react positively to the nomination of independent directors to the board, and Core, Holthausen, and Larcker (1999) find a positive relationship between firm value and the fraction of independent directors. Meanwhile McAvoy *et al.* (1983), Bhagat and Black (1999; 2002),

Hermalin and Weisbach (1991), and Klein (1998) show that independent directors are not value-increasing. By contrast, Agrawal and Knoebler (1996) show that independent boards are value-decreasing.

Collier and Gregory (1999) replicate Menon and Williams' study on a UK sample and do not find any significant relationship. It is however claimed that the lack of association is explained by board structure differences between US and UK and that the higher proportion of outside directors in US might lead to stronger influence on the audit committee. In a setting featured by high insider shareholding, it is hypothesized that independent directors may demand more decision control activity, in order to: signal the absence of collusion with controlling shareholders and strong board leaders; and foster their market value as decision control experts.

Independent directors can play a significant role in controlling agency problems, particularly in monitoring executive management (Fama and Jensen, 1983). The inclusion of independent directors generally increases the board's effectiveness in monitoring managers and exercising control on behalf of shareholders (Fama and Jensen, 1983; Weisbach, 1988; Gunasekarage and Reed, 2008). Boards of directors also play an important role in mitigating agency problems between families and minority shareholders because corporate governance mechanisms in family firms are limited. Agency theorists consider the independence from management as a crucial board characteristic from the perspective of board's monitoring role (Fama, 1980; Fama and

Jensen, 1983; Jensen, 1993). The independent directors assume the responsibilities of monitoring and evaluation on management (Jensen and Meckling, 1976). Empirical results of Elloumi and Gueyie' (2001) indicate that boards of financially distressed firms have fewer outside members. Krivogorsky (2006) finds a strong positive relation between the portion of independent directors on the board and profitability ratios in continental Europe companies. Since the independent directors present more or less a constraint power to the management,

Extant research indicates that several conventional corporate governance devices used to control owner-manager agency problems are less effective with family-minority shareholder conflicts. In particular, Gomez-Mejia and Larraza-Kintana (2003), Kole (1997) and Shivdasani (1993) indicate that the takeover market, institutional investors, and incentive compensation are less common corporate governance mechanisms in family firms than in non-family firms. Anderson and Reeb (2004) find that independent director influence, on average, is associated with better performance in large US family firms, and that without the presence of independent directors, firm performance is significantly worse than in non-family firms.

This suggests that independent directors play a significant role in balancing in mitigating agency problems between the share and outside shareholders. Meanwhile, Kaplan and Reishus (1990) and Gilson (1990) find a positive relationship exists between a company's performance and its top executives' service on other boards of directors. According to Agrawal and Knoeber (1996) and Franks *et al.* (2001) boards dominated by non-executive directors are not effective. This rests on the view that non-executive directors

are usually characterized by lack of information about the firm, do not bring the requisite skills to the job and, hence, prefer to play a less confrontational role rather than a more critical monitoring one

2.3.2 Board Size and Agency Cost

Although governance regulations do not typically advocate an optimal board size, it is suggested that smaller boards of directors are more organizationally functional and effective in decision-making and less easily controlled by a dominating influence (such as the CEO or a substantial shareholder). Firms with relatively smaller-sized boards are, therefore, seen as being less susceptible to agency problems and associated agency costs.

Agency costs were found to be negatively related to the manager's ownership interest and the extent of external bank monitoring and positively related to the number of shareholders and the existence of an outside (non owner) manager. Fleming, Heaney and McCosker (2005) identified similar results in an analysis of non-listed Australian firms. Singh and Davidson III (2003) found that larger managerial ownership and smaller-sized boards both enhance asset utilization ratios for larger listed US companies. Doukas, Kim and Pantzalis (2000) examined agency cost determinants for listed US firms and concluded that greater analyst following generally reduces agency costs, but its effect is more prominent for single-segment as opposed to diversified firms.

Jensen (1993) has indicated that a value-relevant attribute of corporate boards is its size. Organizational theory presupposes that larger groups take relatively longer time to make decisions and, therefore, more input time (Steiner, 1972). It is to proposal an appropriate

size of the board it seems to sit in the realms of relativity and subjectivity against the backdrop of unbiased objective measure. However, Lipton and Lorsch (1992) suggest an optimal board size between seven and nine directors. In this respect, empirical studies have shown that the market values firms with relatively small board sizes (Lipton and Lorsch, 1992; Yermack, 1996; Sanda *et al.*, 2005; Eisenberg *et al.*, 1998). Hence, as board size increases board activity is expected to increase to compensate for increasing process losses (Vafeas, 1999). The argument is that large boards are less effective and are easier for a CEO to control. The cost of coordination and processing problems is also high in large boards and this makes decision-taking difficult.

As Pearce and Zahra (1991) point out, large powerful boards help strengthen the link between corporations and their environments, provide counsel and advice regarding strategic options for the firm and play a crucial role in creating corporate identity. Other studies, however, question the effectiveness of large boards and show that small boards are more effective. The premise underlying this argument is that large boards make coordination, communication and decision-making more cumbersome than it is in smaller boards. Recent studies by Yermack (1996), Eisenberg *et al.*, (1998) and Beiner *et al.* (2004) support such a view empirically.

In addition to board size, the effectiveness of a board may also depend on its composition. One hypothesis, for example, is that boards with a significant proportion of non-executive directors are more effective in monitoring management and, therefore, they can limit the exercise of managerial discretion. Consistent with this view, Byrd and

Hickman (1992) and Rosenstein and Wyatt (1990) find a positive relationship between the percentage of non-executive directors on the board and corporate performance.

The Board of directors of an organization is a key mechanism to monitor manager's behavior and to advise them. The largely shared wisdom regarding the optimal board size is that the higher the number of directors sitting on the board the less is performance. This leans on the idea that communication, coordination of tasks, and decision –making effectiveness among a large group of people is harder and costlier than it is in smaller groups (Belkhir, 2006).

Limiting board size to a particular level is widely believed to improve the performance of the firm at all levels. Benefits arising from increased monitoring by larger boards are outweighed by poorer communication and cumbersome decision –making. Empirical studies on board size seem to provide the same conclusion: A big board is likely to be less effective in substantive discussions of major issues among themselves in monitoring management. Large boards are less effective and are easier for CEO to control (Lipton and Lorsch, 1992).

2.3.3 CEO Duality and Agency Cost

CEO duality signals the absence of separation between decision control and decision management (Fama and Jensen, 1983; Finkelstein and D'Aveni, 1994; Lipton and Lorsch, 1992). Concentration of power reduces the board monitoring effectiveness (Finkelstein and D'Aveni, 1994, p. 1079). Powerful CEOs can organize the nomination process, selecting directors under their influence in order to contain the intensity of board

monitoring (Jensen, 1993). Furthermore, strong board leaders can set the board and the committees' agenda, influencing their decision control activity (Carcello *et al.*, 2002; Laksmana, 2008).

The CEO also performing those functions as Chairman of the Board, appears to be of growing concern to shareholder activists who argue that CEO duality increases agency problems and leads to poor firm performance. This position finds support among some academics, Jensen (1993), and law makers who propose splitting the position of CEO and Chairman as a way to control agency problems.

It argue that the agency cost reducing benefits of split positions should therefore depend on the potential agency costs of debt, equity, and free-cash flow determined by the firm's characteristics. It should also depend on the existence of alternative control mechanisms determined by board characteristics, such as composition and ownership structure, and on firm characteristics such as growth opportunities which may induce capital market monitoring. The cost of the splitting mechanism is described by Brickley *et al.*, (1996) as the cost of (incomplete) transfer of information between CEO and Chairman and should also depend on the nature of the firm. Thus, the efficacy of CEO duality cannot be analyzed without considering the characteristics of the firm and its board.

The underlying hypothesis is that the various mechanisms for controlling agency problems interact with each other and with firm characteristics to determine, on the basis of costs and benefits, the optimal leadership structure. A structure with split positions may strengthen the checks and balances on the CEO and decrease the level of agency

problems between the CEO and shareholders, but the marginal effectiveness of having split positions may be small and the costs high if other agency control mechanisms are in place or are cheaper to deploy.

The governance mechanism identified in the UK Combined Code is duality. Consistent with Jensen (1993); the Combined Code regards duality as undesirable because it gives one person too much power potentially over the decision-making process. The incidence of duality has remained much higher in the US relative to the UK. Proponents of CEO duality argue that duality is a logical business model that encourages agency cost reduction through clear responsibility in formulating and implementing business strategies. In making decisions, a dual CEO is privy to a greater level of information that leads to better decision making and board leadership because communications between the CEO and chair are not required. Duality also removes the potential problems of rivalry between the CEO and chair and possible problems from having two public firm spokespersons.

Having a centralized leadership structure connotes to external constituents gives a firm has “strong leadership and a clear sense of direction. Board activists argue that CEO/chair separation is driven by a need to dilute power at the top. Jensen (1993) states that duality makes it “difficult for board to respond early to failure in its top management team.” Jensen also indicates that when the CEO also holds the chair position, internal control systems fail because board members cannot effectively monitor, evaluate, or fire a poorly performing CEO.

Dalton and Kesner point out that the “wearing of multiple hats” by CEO/chair poses a conflict of interest for both the CEO and the board of directors and hence increase agency costs. Given the weakened monitoring system in place under duality, a CEO is more able to push his/her agenda, and is likely to wield more influence over the approval of the initiatives. Board activists point out that shareholders get the short end of the stick because the failure of corporate monitoring systems allows CEOs to engage in trivial and value destructive projects with reduced risk of punishment.

2.3.4 Existence of an Audit Committee and Agency Cost

Audit committee is one of the monitoring devices for which the principals (or their representatives, the board) are prepared to pay to assist the use of financial reports in evaluating managers' performance. Principals have an incentive to choose corporate governance structures, including audit committees, which maximize total surplus.

Menon and Williams (1994) investigated whether the company relies on its audit committee. They found that although firms voluntarily formed audit committees they did not appear to rely on them, implying the committees were formed for other purposes. However, audit committees appear to be used more in larger firms and where there is a higher proportion of non-executive directors.

Other researchers have reported findings consistent with an agency theory framework with respect to resolving disputes and enhancing the quality of financial reporting. Knapp (1987) found that in audit disputes audit committee members tended to support the

auditors rather than management. Haka and Chalos (1990) found evidence of agency conflict between management and the audit committee chair.

Formation of an audit committee can establish a framework for the non-executive director to work within. Higher quality financial reporting should give rise to a lower assessment of audit risk and hence lower sample sizes, etc. It should also give rise to fewer disagreements between the auditor and directors. This should increase audit efficiency and hence reduce fees, which will be particularly evident in risky companies. Thus lower audit fees are likely to be associated with audited complexity and risk in the presence of an audit committee.

Kalbers (1992) found that the importance of audit committees in the financial reporting process varies among companies. Audit committee members rated themselves as effective in all of the above functions, whilst auditors rated them significantly lower. Monroe *et al.*, (1994) found a significant difference between the proportion of companies with an audit committee receiving a qualified audit opinion and those without audit committees. Wild (1994) investigated the relationship between companies' earnings reports and stock returns before and after the formation of an audit committee. He found that earnings are significantly more informative after the formation of an audit committee.

Ho and Wong (2001) find that the extent of voluntary disclosure by listed Hong Kong firms that have an audit committee is significantly higher than for firms that have no such audit committee. Financial reporting quality is at the very foundation of good governance

and a central mechanism for reducing a firm's agency costs. Literature has also shown that audit committees enhance managerial accountability and are an effective component of corporate governance. Since audit committees provide better quality assurance, their usefulness should increase in response to the level of agency problems within a firm. Whereas in most developed markets, audit committees are necessary for stock exchange listing, in China they are optional.

In China, most listed firms have the state as a controlling owner and unlike their private counterparts, state shareholders are government bureaucrats who do not actually own any shares (Chang and Wong 2009). Moreover, state shareholder objectives are frequently dominated by career, societal and political concerns, which can often be in opposition to the standard shareholder wealth maximization paradigm. Audit committees are more likely to be found in companies that have more non-executive directors, more frequent board meetings, a combined chairman-chief executive, and a larger board. However, in contrast to the firm-level findings, audit committees are more common in weak legal environments and substitute for a lack of resilient external governance structures. This would suggest audit committees can be an effective and value relevant signal that a firm has good governance, especially in those environments where external regulatory and governance structures are weak.

2.3.5 Board Tenure and Agency cost

Given the emphasis that policy makers put on director independence, academic evidence on outside director effectiveness is mixed. Studies of specific board level decisions, such

as takeovers and poison pill adoption, generally find that independent directors enhance shareholder wealth (e.g. Byrd and Hickman, 1992; Brickley *et al.*, 1994; Cotter *et al.*, 1997). However, studies looking at the relationship of overall corporate performance and the independence of directors produce inconclusive results (e.g. Bhagat and Black, 1999).

Academic studies typically use biographical information from a company's proxy statement to classify directors as either affiliated (grey) outside directors or independent outside directors. The criteria for classifying directors as independent usually include not being employed by the firm for the past three to five years, not having any type of consulting or retainer agreement with the company, not having family members employed by the company, not being on the board or a manager of a foundation or other organization that receives grants or donations from the company, and, sometimes, no interlocking boards relationships between the company's CEO and other directors. Once a director is categorized as independent, the classification does not generally change unless something unusual occurs.

The typical director categorization scheme ignores the possibility that independence is based on a director's personal profile and the relationships formed in the boardroom over time. Advances in behavioral economics suggest that psychological factors can affect business decisions. In the context of directors, director independence may be affected over time as directors form relationships with each other, the CEO, and other managers. Hence, directors may become less impartial as the desire for group agreement and congeniality among board members and managers increases over time.

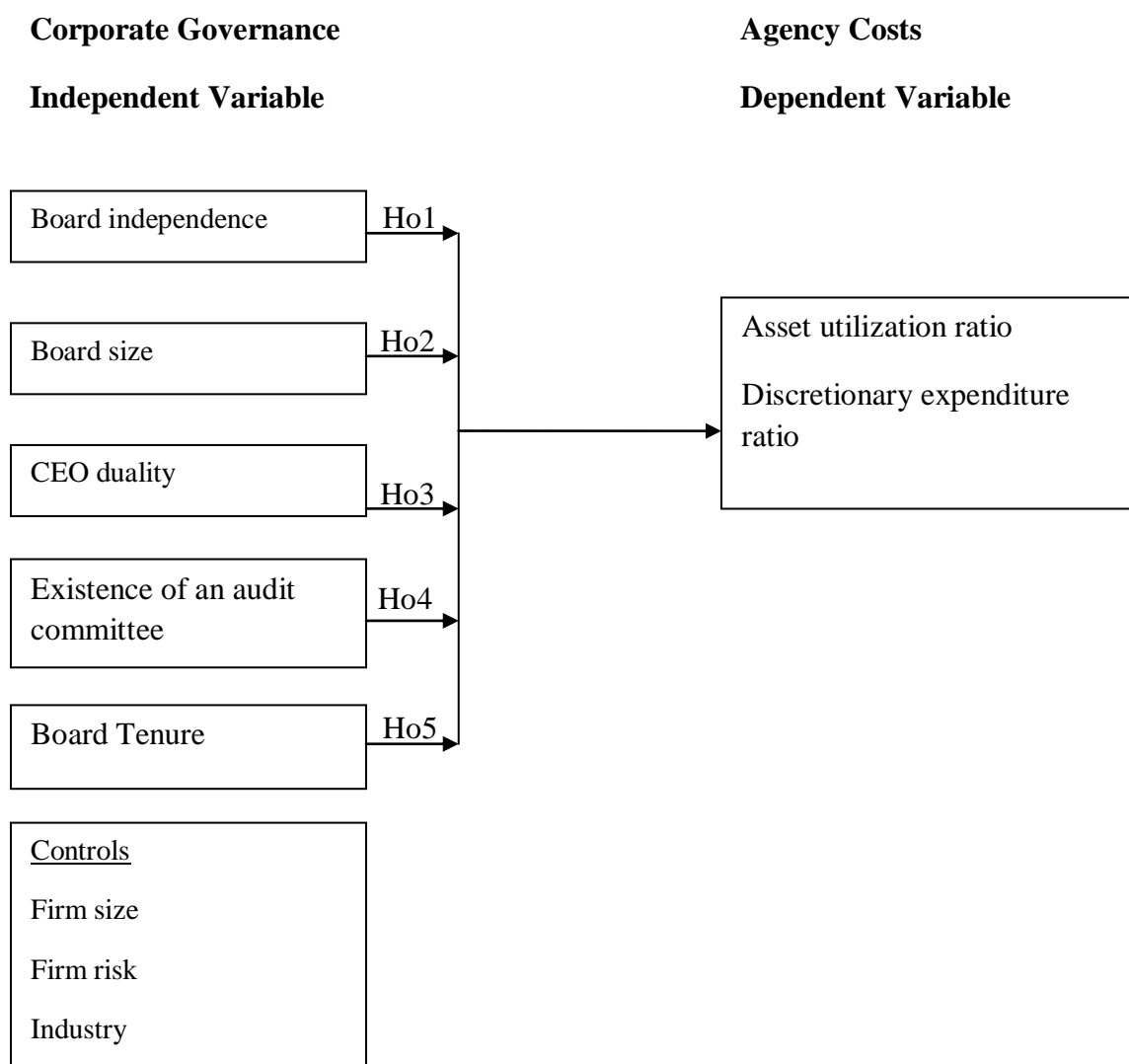
An issue that has been explored only slightly is whether the effective independence of director's changes over time (Vefcas, 2003). While a director's biographical attributes may not change over time, the length of time they serve on a board could nonetheless make them a more or a less effective director, as they develop relationships with other board members and executives. A long-time board member may have a close relationship with the CEO and have a stronger motivation to accommodate the CEO's wishes vs having a stronger loyalty to external shareholders. Bebchuk *et al.*, (2002) also discuss how external perceptions of directors can affect their monitoring of managers. As a director's loyalty shifts towards managers it may take more external outrage before they are willing to confront a CEO.

Hence, board tenure or the length of time directors serves on a board with a CEO can affect the quality of a board's oversight as relationships are formed. Vefcas (2003) develops an 'expertise hypothesis' that suggests greater tenure leads to greater firm and industry knowledge and, thereby, superior monitoring by long-term board members. Bebchuk *et al.*, (2002), argues that a new outside board member may be overly deferential to a CEO and less likely to be critical as compared to board member with longer tenure and so affects agency cost.

The expertise hypothesis implies board members with longer tenure having more expertise and also being more willing to criticize the CEO leading to higher agency costs. Under this hypothesis long-term relationships with executives and other directors reduce incentives to dissent or be critical of managerial proposals.

From this perspective, one area in which reduced director diligence might exhibit itself is recommendations for the compensation of the CEO. If longer tenure implies that director allegiance shifts from shareholders to executives, then we expect a positive relationship between director tenure and CEO pay. An alternative expertise hypothesis predicts superior monitoring of executives by directors with longer tenure. Longer tenured outside directors may have the benefits of greater experience, expertise, and commitment to shareholder interests. If the expertise hypothesis holds we expect to find a non-positive relationship between director tenure and CEO.

2.4 Conceptual Frame Work



CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter outlines on research design, target population, sample size, Data collection, Data analysis and presentation.

3.1 Research Design

Research design is the arrangement of condition for collections and analysis of data in a manner that aims to combine relevance to the research purpose with economy as procedure (Kothari, 2008). This study adopted explanatory design. This is because the research is a cause- effect relationship. The design best for ascertaining the effects of corporate governance on agency cost among listed firms at Nairobi stock exchange in Kenya and it allowed the use of secondary data through documentary guide analysis to facilitate data collection in the listed firms.

3.2 Target Population

The target population of this study was the published financial statements of the listed firms in Kenya, there are 34 listed firms in the NSE being firms which have shown consistency in the market during the period 2004-2010 giving a total of 238 firm year observations therefore target population above is chosen since it provided research information in respect to the study.

3.3 Sampling Size and procedure

The study sampled all firms that have been listed on the Nairobi Stock Exchange (NSE) during the six-year period, 2004 –2010, were sampled. Thirty four firms qualified to be included in the study sample. The sample was selected from the firms which had been listed for a consistent of 6 years.

3.4 Data Collection

This study utilized secondary data which was obtained through hand book, magazine articles, sales analysis summaries and investor annual reports, for the researcher to get systematic information it used a designed documentary analysis guide. This guide is used to find out the information concerning board independence, board size, CEO duality, the existence of an audit committee, board tenure, asset utilization ratio and discretionary expenditure.

3.5.2 Measurement of Variables

Dependent Variable: Agency cost was measured using two proxies: Asset utilization which was measured as the ratio of annual total revenue to annual total assets as used by Ang, Cole and Wuh Lin (2000) and Singh and Davidson III (2003). This provides the relative quantitative measure of the effectiveness of firm investment decisions and the ability of the firm's management to direct assets to their most productive use and the second proxy was discretionary expenditure ratio measured as annual selling, general and administrative expenditure divided by annual total revenue to establish relative expenditure on items over which management have discretionary authority which is

Similar to Singh and Davison (2003). Further, a composite measure of the two variables was computed to measure the overall agency cost.

Independent variable: A number of corporate governance attributes were used in the study: Board independence was measured using the procedure used by Henry (2010) as the proportion of the total board composed of independent directors, Board size measured as the total number of directors (Henry, 2010), CEO- duality was given a value of 1 if the CEO is also the chairperson of the board of directors, otherwise 0. This is consistent with other studies (Henry, 2010)., existence of an audit committee is also defined by dummy variable coded 1 if there is a board audit committee during the period was coded 1; otherwise 0 and board tenure is measured average tenure of the entire board (see Henry 2010 for a similar procedure).

Control Variables : Firm size is measured as the natural log of total revenue, industry is rated 1 for industrial and allied 2 for commercial 3 for financial 4 is Agricultural sectors and Firm risk measured as the standard deviation of share returns (Henry, 2010) .

3.5 Data Analysis

The study utilized quantitative technique to analyze data; Quantitative data was analyzed using descriptive statistical method, the statistical tools such as frequency distribution. Measures of central tendency and dispersal such as mean and standard deviation were used.

The data collected was analyzed using multiple regression and correlation analysis, the significant of each independent variable was tested at a confidence level of 95%. The regression equation of the form below was applied.

3.5.1 Model Specification

$$y_{it} = \alpha_{it} + \beta_1 x_{1it} + \beta_2 x_{2it} + \beta_3 x_{3it} + \beta_4 x_{4it} + \beta_5 x_{5it} + \varepsilon_{it}$$

Where, Y =agency cost of the firm measured by asset utilization ratio and

Discretionary expenditure ratio, which is the dependent variable.

α = Constant

$\beta_1 \dots \beta_5$ =the slope which represents the degree in which agency cost of the firm

Changes as the independent variable change by one unit variables.

X_1 = the board independence

X_2 = Board size

X_3 =CEO-chairperson duality

X_4 =Existence of Audit Committee

X_5 =Board Tenure

ε = error term

i = measure of firms

t = measure of time

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION

4.1 Introduction

This chapter presents results of this study based on the formulated objectives and hypotheses as presented in chapter one. The study investigated the effect of corporate governance on agency cost among listed firms in Kenya. Key variables investigated were Board Independent, CEO Duality, Board Size, Audit Committee, Board Tenure, Asset Utilization, Discretion expenditure. The quantitative data obtained was analysed using both descriptive (means, standard deviations and illustrations) and inferential statistics (T- test for testing significant differences and multiple regression for determining relationships).

4.2 Descriptive Analysis

The influence of board independent, CEO duality, board size, audit committee, board tenure and on asset utilization and asset discretion of firms are studied through calculating maximum, minimum, mean, median and standard deviation. This analysis helped in determining the basic features of the data that are used in this study, because it is provided simple summaries about the sample and the measures. Board independent was the measure of total non-executives board members divided by board size. Board size was total board members in the firm, CEO duality used dummy values (if CEO was the same as Chairman = 1, otherwise = 0). Audit committee was constructed as binary (if Firm had internal audit committee = 1, otherwise = 0). Board tenure was total board tenure divided by board size; Agency Cost was the additional mean of asset discretion

and asset utilization. Firm size was logarithm of total asset, Industry constructed as a categorical variable (= 1 if firm belong in agriculture sector, 2 if firm belong in finance and services sector, 3 if firm belong in commercial sector, 4 if firm belong in alternative investments sector. Firm Risk was measure of standard deviation of total share returns

4.2.1 Descriptive Statistics for Board Independence

Table 4.1 below illustrates the means and standard deviations for board independence among the sectors (agriculture sector, commercial sector, finance and investment sector and alternative investment). From the table results alternative investment sectors had the highest board independency of 86.67 percent, followed closely by agriculture sector with 81.71 percent non executive board members. Commercial sectors and finance investment sector had 78.96 and 79.31 percent board independency respectively.

Table 4.1 Descriptive Statistics for Board Independence

	Mean	Std. Deviation
Agriculture sector	0.8171	0.11118
Commercial Sector	0.7896	0.10835
Finance and investment sector	0.7931	0.11695
Alternative Investment	0.8667	0.09709
Total	0.7969	0.11402

Source survey study (2012)

4.2.2 Descriptive Statistics for CEO Duality

Analysis for means and standard deviation for CEO duality in agriculture sector, commercial sector, finance and investment sector and alternative investment sector were

depicted in table 4.2 below. Study from the table reported that alternative investment sector had the highest number of firms with CEO duality as recorded by mean of 0.667(66.7%), while agriculture sectors had 11.5% of firms with CEO duality. Commercial sector had 0.16(16.07) percent of firms with CEO duality and finance and investment sectors had 26.71 percent of firms with CEO duality.

Table 4.2 Descriptive Statistics for CEO Duality

	Mean	Std. Deviation
Agriculture sector	0.1154	0.32581
Commercial Sector	0.1607	0.37059
Finance and investment sector	0.2671	0.44398
Alternative Investment	0.6667	0.5164
Total	0.235	0.42493

Source survey study (2012)

4.2.3 Descriptive Statistics for Board Size

Board size was total numbers of board numbers including non executive members; table 4.3 shows the means and standard deviations for board size for Agriculture sector, Commercial Sector, Finance and investment sector and Alternative Investment. Study findings from table 4.2.3 below indicate that alternative investment sectors had the highest number of board members as reported by mean of 11.66, followed by finance and

investment sector with mean of 9.5 board members. Commercial sector and agriculture sectors recorded means of 9.05 and 8.5 board members in that order.

Table 4.3 Descriptive Statistics for Board Size

	Mean	Std. Deviation
Agriculture sector	8.5357	3.13265
Commercial Sector	9.0526	2.57336
Finance and investment sector	9.5137	2.14069
Alternative Investment	11.6667	4.4572
Total	9.3418	2.48667

Source survey study (2012)

4.2.4 Descriptive Statistics for Audit Committee

Audit committee was measured by dummy values (existence of audit committee = 1 otherwise =0). The study established means and standard deviation of audit committee among the sectors as depicted in table 4.4 below, results of analysis from the table shows that finance and investment sector had the highest audit committee of 26.81 percent. Commercial sector, agriculture sector and alternative sector had 18.87 percent, 17.86 percent and 16.67 percent respectively.

Table 4.4 Descriptive Statistics for Audit Committee

	Mean	Std. Deviation
Agriculture sector	0.1786	0.39002
Commercial Sector	0.1887	0.395
Finance and investment sector	0.2681	0.44459
Alternative Investment	0.1667	0.40825
Total	0.2356	0.42529

Source survey study (2012)

4.2.5 Descriptive Statistics for Board Tenure

Board tenure was measured as the average board tenures for all board members. As established from table 4.5 below alternative investment recorded that the highest board tenure of 8.3 years, while agriculture sector had recorded board tenure of 6.9 years. Commercial sector had board tenure of 5.3 years and financial and investment had board tenure of 4.6 years.

Table 4.5 Descriptive Statistics for Board Tenure

	Mean	Std. Deviation
Agriculture sector	6.9518	3.68536
Commercial Sector	5.3744	2.91041
Finance and investment sector	4.6044	2.5669
Alternative Investment	8.3583	0.80425
Total	5.1596	2.909

Source survey study (2012)

4.2.6 Descriptive Statistics for Firm Size

Figure size was measured as the log of total asset, the higher the log the higher the firm size. Table 4.6 below illustrates means and standard deviation for firm size in . Study findings from the table reveals that finance & investment sector and alternative investment had highest firm size of 7.08 each. Commercial sector had firm size of mean 6.78 and agriculture sector had mean of 6.49.

Table 4.6 Descriptive Statistics for Firm Size

	Mean	Std. Deviation
Agriculture sector	6.4979	0.32672
Commercial Sector	6.7831	0.64652
Finance and investment sector	7.087	0.64992
Alternative Investment	7.0819	0.16683
Total	6.9448	0.64392

Source survey study (2012)

4.2.7 Descriptive Statistics for Firm Risk

Firm risk was standards deviation of total revenue, the higher the standard deviation of total revenue the higher the firm risk. Table 4.7 present means and standard deviations of firm risk. Results from the table reported that agriculture sector was more risky as evident of mean firm risk of 7.14. Commercial sector and finance & investment sector reported a mean firm risk of 7.0 each. Moreover alternative investment was less risk as shown by firm risk mean of 6.99

Table 4.7 Descriptive Statistics for Firm Risk

	Mean	Std. Deviation
Agriculture sector	7.1427	0.01535
Commercial Sector	7.0764	0.03934
Finance and investment sector	7.0267	0.05345
Alternative Investment	6.9956	0.23948
Total	7.0515	0.0704

Source survey study (2012)

4.2.8 Descriptive Statistics for All the Variables in the Entire Sample

Results from table 4.8 indicated that board independent had mean (= 0.7969), this implies that on average firm in our sample had board composition consisted of 79.6% non executives board member. CEO duality had mean of 0.235 suggesting that 23.5 percent of the sampled firms had CEO as the chairman this also shown by the minimum value of 0.

Board size had mean of 0.93418 This shows that most of the firms in our sample had board comprising of 9 board members, however the largest board size had 17 board members and the smallest board had 4 board members. Similar to CEO duality, audit committee had mean of 0.2356, suggesting 23.56 percent that in our had no internal committee.

Board tenure had mean of 5.1596 meaning that most of the board members serves the company up to period of 5 years and the highest number of years that board members serve in our sample are 15.21 years, and the least years served by board members are 7

months. Agency cost which is our independent variable had mean of 1.1388, while firm size had mean of 6.9448 which is the control variable. Kolmogorov-Smirnova test the normality of the data since the P values of the variables are less than 0.05 (level of significance) the data is thus regarded as deviating normal with exception of firm size which is normal.

Table 4.8 Descriptive Statistics for all the variables in the entire Sample

	Mean	Std. Deviation	Minimum	Maximum	Kolmogorov-Smirnova Statistic	Sig.
Board						
Independent	0.7969	0.11402	0.43	1	0.167	0.000
CEO Duality	0.235	0.42493	0	1	0.476	0.000
Board Size	9.3418	2.48667	4	17	0.133	0.000
Audit Committee	0.2356	0.42529	0	1	0.479	0.000
Board Tenure	5.1596	2.909	0.763	15.21	0.125	0.000
Agency Cost	1.1388	0.84164	0.06	4.02	0.102	0.000
Firm Size	6.9448	0.64392	5.35	8.46	0.051	.200*
Industry	2.5504	0.73173	1	4	0.373	0.000
Firm Risk	7.0515	0.0704	6.64	7.19	0.061	0.045

Source survey study (2012)

4.3 Correlation Results

In order to examine the possible degree of multi-co linearity among the among the independent variables and dependents variables correlation matrixes of the variables for listed firms are shown below. Correlation analysis is a statistical tool that could be used

in this study to describe the degree to which one variable is linearly related to another. Through conducting correlation analysis this study shall be able to identify the degree of association among the variables.

Table 4.9 Correlation Analysis

	Agency cost	Asset Utilization	Discretionary Expenditure	Board independence	CEO Duality	Board Size	Audit Committee	Board Tenure
Agency cost	1							
	0							
Asset Utilization	.749**	1						
Discretionary Expenditure	.680**	0.024	1					
Board independence	-.295**	-.128*	-.305**	1				
CEO Duality	.576**	.592**	.213**	0.037	1			
Board Size	.254**	-0.022	.408**	-0.051	0.101	1		
Audit Committee	.224**	.370**	-0.075	-0.058	0.063	-0.07	1	
Board Tenure	.169**	-0.004	.260**	.136*	-0.054	-.141*	0.032	1

**Significant at the 0.01 level (2-tailed).

* Significant at the 0.05 level (2-tailed).

N=238

Source survey study (2012)

The study of analysis from table 4.9 reported some interesting association between the dependent variable (agency cost) and independent variables (board independent, board size, CEO duality, board tenure, audit committee. Board independents was indicated to be negatively and significantly correlated to agency cost (Pearson correlation ratio = -.295

with a p value = 0.00). CEO duality was reported to be strongly-positively correlated to Agency cost (Pearson correlations = 0.576), since the probability ratio (0.00) was significant at 0.05 this suggest that there is 57.6% dependency between agency cost and CEO duality.

Other study findings shows that CEO duality was also correlated to industry (control variable) as indicated by Pearson correlation of .181 and P value of 0.005, nevertheless this relationship was very weak (18.1%). The incidence of duality has remained much higher in the US relative to the UK. Brickley, Coles, and Jarrell (1997) reported that 80.94% of their sample had the same person as CEO and chairman. Over the period, 1994–2000, Linck, Netter, and Yang (2007) found the figure to be 58.3%. The separation of the posts of CEO and chairman should lead to lower agency costs.

Results from table 4.9 reported positive correlation (Pearson correlation = .254) between agency cost and board size, the correlation between agency cost and board size was significant at $p = 0.05$. Explanations based on agency theory depend on efficiency propositions and the fact that governance structures are designed to mitigate against agency cost. There is evidence to show that variations in governance structures between firms could be due partly to firm specific variables. Strategic agency models consider the linkage between factors that determine company performance and the composition of corporate boards (Pearce and Zahra, 1992). Board size was also significantly positively correlated to firm size and industry (Pearson correlations values, 0.258 and 0.176 respectively).

Board tenure and agency cost had significant positive correlation (Pearson correlation = 0.169 significant at 0.01). Board tenure was also significantly positively correlated to board independent (Pearson correlation = 0.136 significant at 0.05). Surprisingly, board tenure was significantly negatively correlated to board size (Pearson correlation = -0.141, significant at 0.05).

In relation to our other measures of board effectiveness, we find that there is no association between the length of board & tenure and agency costs. Thus the potential costs associated with longer serving CEOs is offset by the potential benefits gained by greater experience. The result is consistent with firms choosing the tenure of their CEO according to how effective the CEO is perceived to be. This supports the Coles *et al.*, (2008) argument that firms choose their governance structures to maximize value and that this is achieved by means of a range of governance mechanisms. We also find no evidence that sitting on additional boards; BUSYCEO is associated with higher agency costs. This suggests that CEOs are not spending too much time on outside activities and is also consistent with a value-maximizing position.

Board Independent reported to have significant negative relationship with agency cost (Pearson correlation = -.295 significant at $P = 0.01$), asset utilization (Pearson Correlation = .128 significant at $P = 0.05$) and discretionary expenses (Pearson Correlation = .305, significant at $P = 0.01$). CEO duality was significantly positively correlated to agency cost (Pearson correlation = .576 significant at $P = 0.0$), asset utilization (Pearson correlation 0.592 significant at $P = 0.01$) and Discretionary expenses (Pearson correlation = .213 significant at $P = 0.01$). Board size had positive significant relationship with agency cost

(Pearson correlation = .254 significant at $P=0.0$) and discretionary expenditure (Pearson correlation = .408 significant at $P =0.01$).

Audit committee was positively correlated to agency cost (Pearson correlation = .224 significant at $P=0.01$) and asset utilization (Pearson correlation = .370 significant at $P=0.01$). Board tenure had positive relationship with agency cost (Pearson correlation = .169 significant at $P=0.01$) and discretionary expenditure (Pearson correlation = .260 significant at $P =0.01$) which shows that board tenure had more strong correlation on discretionary expenditure than agency cost.

Firm size had a negative correlation with asset utilization (Pearson correlation = -0.280 significant at $P =0.01$) and positively correlated with discretionary expenditure (Pearson correlation = .328 significant at $P=0.01$).industry had positive correlation with agency cost (Pearson correlation = .186 significant at $P=0.01$ and discretionary expenditure (Pearson correlation = .161 significant at $P=0.05$).firm risk had negative correlation with agency cost (Pearson correlation = -0.127 significant at $P=0.05$) and asset utilization (Pearson correlation = -0.160 significant at $P=0.05$).

4.4 Regression analysis

For the purpose of identifying the important variables among the independent variables (board independent, CEO duality, board size, audit committee, board tenure) and control variables (firm size, firm risk and industry) influencing the dependent variable (Agency coast) the results of our two regression models (Control and with control variables) are shown below.

Table 4.10 Regression analysis for control variables; firm risk, firm size and industry

R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
0.037	0.025	0.83107	1.356

Source survey study (2012)

Control variables: (Constant), industry, Firm size, firm risk

Dependent Variable: Agency cost

The regression results from table 4.10 shows that the study regression model had a coefficient of determination (R^2) of about 0.037. This means that Firm size, Firm risk and industry explain 3.7 percent of the variations in agency cost of the firms. Durbin–Watson statistic is substantially less than 2, there is evidence of positive serial correlation, although positive serial correlation does not affect the consistency of the estimated regression coefficients, it does affect our ability to conduct valid statistical tests, as such we conclude that the significant statistics are valid.

Table 4.11 Analysis of Variance (ANOVA) results

	Sum of Squares	df	Mean Square	F	Sig.
Regression	6.264	3	2.088	3.023	.030
Residual	161.617	234	0.691		
Total	167.881	237			

Control variables: (Constant), industry, Firm size, Firm risk

Dependent Variable: Agency cost

Table 4.11 reveals that the F-value of 3.023 with a p value of 0.03 at 5% significance level is significant indicating that the overall regression model is significant, hence, the joint contribution of the control variables (Firm size, firm risk and industry) was significant in predicting the dependent variable (agency cost).

Table 4.12 Regression Coefficients of Controls (Model 1)

	Standardized Coefficients		
	Beta	T	Sig.
(Constant)	2.999	0.447	0.655
Firm Size	-0.048	-0.695	0.488
Firm Risk	-0.023	-0.297	0.767
Industry	0.188	2.259	0.025

a. Dependent Variable: Agency cost

Source survey study (2012)

Regression_Model 1

$$\text{Agency Cost} = 2.999 - 0.048^{\text{FS}} - 0.023^{\text{FR}} + 0.188^{\text{I}}$$

Where; FS = Firm Size

FR = Firm Risk

I = Industry

Coefficients estimates for firm size and firm risk are insignificants as evident of coefficient estimate = -0.048 and -0.023 for firm size and firm risk with p values of 0.488 and 0.767 which are greater than $P=0.05$ respectively, hence we accept null hypothesis that both firm size and firm risk had no effect on agency cost, nevertheless industry had coefficient estimate = 0.188 and P value of 0.025 which are less than 0.05 hence we conclude industry had influence agency cost.

Table 4.13 reveals that audit committee, CEO duality, board independent, board tenure and board size explains 61.9% (coefficient of determination R squared = 0.619) of asset utilization which was higher than 52.5% of total variation of the discretionary expenses that is explained by Audit Committee, CEO Duality, Board Independent, Board Tenure and Board Size. Suggesting that in agency cost, independents variables predict more of asset utilization than discretionary expenses.

In table 4.13 and table 4.14 results in ANOVAs reported that in both asset utilization and discretionary expenses the F ratios (F ratios = 42.916 and 29.112 respectively) were significant as shown by p values = 0.00 and 0.00 respectively. Hence the study suggests that the two models are fit.

Board independence was indicated to have negative effect on discretionary expenditure (coefficient of estimate (β_1)=-0.335) than asset utilization (coefficient of estimate = -0.159), this show that despite our model showing more prediction on asset utilization than discretionary expenses, board independent on its own explains more in discretionary expenses than asset utilization. CEO duality had more positive impact on asset utilization (coefficient of estimate (β_2) = 0.588) than discretionary expenses (coefficient of estimate = 0.203).

More interesting results shows that board size had positive effect on discretionary expenses (coefficient of estimate (β_3) = 0.365), nevertheless board size had no effect on asset utilization. Audit committee had small negative effect on discretionary expenditure (coefficient of estimate (β_4) = -0.103) and very positive effect on asset utilization (coefficient of estimate = 0.336). Board tenure had positive effect on both asset

utilization and discretionary expenses (coefficients of estimates (β_5) = 0.018 and 0.432 respectively), however, board tenure was affecting discretionary expenses more than asset utilization.

Table 4.13 Regression results using asset utilization as the dependent variable (Model 2 and Model 3)

Variable	standardized Coefficients			
	B	Std. Error	T	Sig.
(Constant)	15.476	6.552	2.362	0.019
Board independent(β_1)	-0.159	0.477	-3.663	0.000
CEO duality(β_2)	0.588	0.13	13.448	0.000
Board size(β_3)	0.012	0.023	0.272	0.786
Audit committee(β_4)	0.336	0.13	7.778	0.000
Board tenure(β_5)	0.018	0.019	0.412	0.681
Controls				
Firm size(β_6)	-0.344	0.093	-7.263	0.000
Industry(β_7)	0.037	0.096	0.67	0.504
Firm risk(β_8)	-0.073	0.93	-1.379	0.169
R Square	0.619			
Adjusted R squared	0.605			
ANOVA (F Ratio)	42.916			
ANOVA (Prob)	0.000			

Source survey study (2012)

Table 4.14 Regression Results Using Discretionary Expenses as the Dependent Variable

Variable	B	Std. Error	T	Sig.
(Constant)	-4.709	6.587	-0.715	0.475
Board independent(β_1)	-0.335	0.479	-6.888	0.000
CEO duality(β_2)	0.203	0.131	4.166	0.000
Board size(β_3)	0.365	0.023	7.189	0.000
Audit committee(β_4)	-0.103	0.13	-2.133	0.034
Board tenure(β_5)	0.432	0.019	8.721	0.000
Controls				
Firm size(β_6)	0.221	0.094	4.165	0.000
Industry(β_7)	0.081	0.096	1.303	0.194
Firm risk(β_8)	0.026	0.934	0.436	0.663
R Square	0.525			
Adjusted R squared	0.507			
ANOVA (F Ratio)	29.112			
ANOVA (Prob)	0.000			

Source survey study (2012)

4.4.7 Overall Regression Statistics for Corporate Governance and Agency cost

Contrary to the R squared (0.037) obtained in the regression model of dependent Variable (agency) against the control variables (firm size, firm risk and industry) the overall model inclusive of all the variables, R squared obtained in the regression analysis of the same dependent and independent variables with the intervention of control variables (industry and firm size) was 0.63, suggesting that with the introduction of control variables in the model the agency cost was predicted by the joint contribution of CEO duality, Board independent, Board Size, Board tenure and Audit committee and control variables. To

find out the significance of the model the researcher found it paramount to perform analysis of variance (ANOVA) test to validate the significance of the following model.

The results in table 4.15 indicated that the overall model was significant as shown by F test ratio 44.386 and probability ratio of 0.000 which is less than study confidence level of 0.5 implying that we shall reject our null hypothesis and accept that the study regression model 4 is significance to show the prediction of the independent variables on agency cost.

Collinearity Statistics test the existence of multicollinearity of the data. Multicollinearity exists when Tolerance is below .1; and Variance Inflation Factor is greater than 10 or an average much greater than 1. In this case, there is no multicollinearity but Multicollinearity exists in industry and firm risk.

Table4.15 illustrates the coefficient estimates of the board independent, CEO duality, board size, audit committee and board tenure after introduction of control variables (firm size, industry and firm risk). Before the introduction of the control variables in the model the coefficient estimates of board independent was reported to be 0.329 but after introduction the coefficient estimates increased to -0.341 with p value of 0.000 which less than $p=0.05$, hence we fail to accept null hypothesis that there is no significant relationship between board independence and agency cost, we therefore conclude that there is significant negative relationship between board independence and agency cost suggesting that increase in board independents with one units will automatically reduce agency cost with 0.341 units.

Other variables which indicated increase in their effect on agency cost were board size and board tenure, board size recorded coefficient estimate of 0.252 with a p value of 0.00 significant at 0.05, this implies that there is significant positive relationship between board size and agency cost. Increase of number of board members with one unit will yield 0.252 units to agency cost. Similarly board tenure had coefficient of estimate of 0.301 with p value (0.000) significant at 0.05, hence infer that there is positive significant relationship between board tenure and Agency, this implies that increase of board tenure with one unit increases agency cost with 0.301 units.

Nevertheless, CEO duality and Audit committee influence on agency cost was reduced after the introduction of firm risk, industry and firm size. CEO duality coefficient estimates before the introduction of control variables was 0.589 with p value (0.00) less than $P=0.05$, hence we conclude there is significant relationship between CEO duality and agency cost, this suggest that increase of CEO duality with one unit increases agency cost with 0.589 units .Audit Committee reported a coefficient estimates of 0.180 with p value of 0.000, this suggest that we shall fail to accept null hypothesis that significant positive relationship between the existence of an audit committee and agency cost. This show that increase in audit committee increase agency cost with 0.180.

Table 4.15 Overall Regression Statistics for Corporate Governance and Agency cost (Model 4)

	Standardized Coefficients				Collinearity Statistics	
	Beta	Std. Error	T- Test	P Value	Tolerance	VIF
(Constant)	5.384	4.378	1.23	0.220		
Board independent(β_1)	-0.341	0.318	-7.923	0.000	0.954	1.048
CEO duality(β_2)	0.571	0.087	13.197	0.000	0.944	1.059
Board size(β_3)	0.252	0.015	5.611	0.000	0.875	1.142
Audit committee(β_4)	0.180	0.087	4.216	0.000	0.966	1.035
Board tenure(β_5)	0.301	0.013	6.868	0.000	0.919	1.088
Firm size(β_6)	-0.108	0.062	-2.302	0.022	0.803	1.245
Industry(β_7)	0.082	0.064	1.482	0.14	0.577	1.733
Firm risk(β_8)	-0.037	0.621	-0.704	0.482	0.646	1.547
R Squared	0.63					
Adjusted R squared	0.0613					
ANOVA (F Value)	44.386					
ANOVA (P Value)	0.000					

Predictors: (Constant), Firm Risk, Audit Committee, Firm Size, CEO Duality, Board Independent, Board Tenure, Board Size, Industry

Dependent Variable: Agency Cost

Source survey study (2012)

Regression Model 4

AgencyCost=5.384-0.341B.I+0.571C.O+0.252B.S+0.180A.C+0.301B.T-

0.108F.S+0.082I-0.037FR

Table 4.16 Stepwise Regression Analysis for Hypothesis Testing (Model 5)

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Beta	t test	Beta	t test	Beta	t test	Beta	t test	Beta	t test
constant	0.856	16.382	2.691	9.106	2.51	8.987	1.736	5.595	1.537	5.089
Predictors										
CEO Duality	0.606	11.242	0.623	12.517	0.632	13.531	0.603	13.444	0.589	13.606
Board Independence			-0.313	-6.295	-0.35	-7.424	-0.342	-7.62	-0.329	-7.607
board tenure					0.26	5.518	0.293	6.465	0.289	6.624
board size							0.219	4.832	0.236	5.378
Audit committee									0.185	4.31
R squared	0.367		0.465		0.531		0.577		0.611	
R adjusted	0.364		0.46		0.524		0.569		0.602	
F test	126.386		94.202		81.474		73.263		67.118	
P value	0.000		0.000		0.000		0.000		0.000	

Source survey study (2012)

R squared obtained in the stepwise regression analysis of the same dependent and independent variables with the intervention of control variables (industry and firm size) was 0.61, suggesting that with the introduction of control variables in the model the agency cost was predicted by the joint contribution of CEO duality, Board independent, Board Size, Board tenure and Audit committee and control variables.

To find out the significance of the model the researcher found it paramount to perform analysis of variance (ANOVA) test to validate the significance of the following model. The results in table 4.16 indicated that the overall model was significant as shown by F test ratio 67.118 and probability ratio of 0.000 which is less than study confidence level of 0.5

Regression Model 5

$$\text{Agency Cost} = 1.537 - 0.329^{B.I} + 0.589^{C.O} + 0.236^{B.S} + 0.185^{A.C} + 0.289^{B.T}$$

4.4.1 Ho₁. Board independence does not significantly affect agency cost.

Hypothesis 1 stipulates that board independence does not significantly affect agency cost. Results from model 2 in Table 4.16 illustrates the coefficient estimates of the board independent to be -0.313 significant at 0.05 level of significance, hence we fail to accept null hypothesis that board independence does not significantly affect agency cost, we therefore conclude that board independence significantly affect agency cost, suggesting that increase in board independence with one units will automatically reduce agency cost with 0.313 units. This results contradicts with Hickman (1992) and Rosenstein and Wyatt (1990) who found a positive relationship between the percentage of non-executive directors on the board and corporate performance.

4.4.2 Ho₂. Board size does not significantly affect agency cost.

Hypothesis 2 suggests that board size does not significantly affect agency cost. Results from model 4 in table 4.16 above reveals that Board size recorded coefficient estimate of 0.219 with a p value of 0.00 significant at 0.05, hence the results does not support the hypothesis, the study therefore inferred that board size significantly affect agency cost. Increase of number of board members with one unit will yield 0.236 units to agency cost. Vafeas (1999) asserted that as board size increases board activity is expected to increase to compensate for increasing process losses. Moreover, Pearce and Zahra (1991) pointed out, large powerful boards help strengthen the link between corporations and their

environments, provide counsel and advice regarding strategic options for the firm and play a crucial role in creating corporate identity.

4.4.3 H₀₃. CEO duality does not significantly affect agency cost.

Hypothesis 3 suggests that CEO duality does not significantly affect agency cost. CEO duality coefficient estimates was 0.606 with $p < 0.05$ as depicted in model 1, hence we conclude CEO duality significantly affect agency cost, this suggest that increase of CEO duality with one unit increases agency cost with 0.606 units . According Jensen (1993), law makers proposes splitting the position of CEO and Chairman as a way to control agency problems. He further concluded a structure with split positions may strengthen the checks and balances on the CEO and decrease the level of agency problems between the CEO and shareholders, but the marginal effectiveness of having split positions may be small and the costs high if other agency control mechanisms are in place or are cheaper to deploy. Jensen also indicates that when the CEO also holds the chair position, internal control systems fail because board members cannot effectively monitor, evaluate, or fire a poorly performing CEO. His suggestion were supported by Dalton and Kesner (2001) who pointed out that the “wearing of multiple hats” by CEO/chair poses a conflict of interest for both the CEO and the board of directors and hence increase agency costs.

H₀₄. Existence of an Audit Committee does not significantly affect Agency Cost.

Hypothesis 4 suggests that existence of an audit committee does not significantly affect agency cost. Study of analysis results from model 5 in table 4.16 shows that Audit Committee reported a coefficient estimates of 0.185 with $p < 0.05$, this suggest that we shall fail to accept null hypothesis that existence of an audit committee does not

significantly affect agency cost. This shows that an increase in audit committee increases agency cost with 0.185. This contradicts Menon and Williams (1994) who found that although firms voluntarily formed audit committees they did not appear to rely on them, implying the committees were formed for other purposes. However, audit committees appear to be used more in larger firms and where there is a higher proportion of non-executive directors. Haka and Chalos (1990) found evidence of agency conflict between management and the audit committee chair. Wild (1994) investigated the relationship between companies' earnings reports and stock returns before and after the formation of an audit committee. He found that earnings are significantly more informative after the formation of an audit committee.

4.4.3 Ho₅. Board tenure does not significantly affect agency cost.

Hypothesis 5 suggests that board tenure does not significantly affect agency cost. Results in model 3 in table 4.16 indicated that board tenure had a coefficient estimate of 0.26 with a p value of 0.000 significant at 0.05, hence infer that board tenure does not significantly affect agency cost, this implies that an increase of board tenure with one unit increases agency cost with 0.26 units. Vefas (2003) reported that board tenure or the length of time directors serve on a board with a CEO can affect the quality of a board's oversight as relationships are formed, develops an 'expertise hypothesis' that suggests greater tenure leads to greater firm and industry knowledge and, thereby, superior monitoring by long-term board members

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes and presents the research findings, from the study. It has been organized to provide a concise summary of the study findings, conclusions and areas suggested for further research.

5.2 Summary of Findings

The purpose of this study was to determine the effect of corporate governance on agency cost among listed firms in Kenya. The study was carried out in Kenya and 34 companies listed in Nairobi Stock Exchange which have shown consistency over the year of study were selected. This section presents the findings from the study in comparison to what other scholars have said about influence of board independent, CEO duality, board size, audit committee and board tenure on agency as noted under literature review.

H₀₁: There is no effect of Board Independence on Agency Cost

From the study findings Pearson correlation findings shows that, there exist a relationship between board independent (Pearson correlation = $-.295$). Regression results revealed that there is negative significant influence of board independence on agency cost suggesting that increase in board independents will reduce agency cost ($\beta = -.329$). Anderson and Reeb (2004) found that that existing board structures represent an optimal outcome given the costs and benefits associated with different types of director.

Raheja (2005) argued that executive directors benefit the company because of the extent of their firm specific information. Numerous studies support the view that non-executive directors have a positive effect and find that boards dominated by non-executive directors are more likely to act in shareholders' best interests (for example, Borokhovich, Parrino, & Trapani, 1996; Hermalin & Weisbach, 1988; Byrd & Hickman, 1992; Brickley, Coles, & Terry, 1994). In addition, Fama (1980), Fama and Jensen (1983) and Kaplan and Reishus (1990) showed that reputation concerns, fear of lawsuits and the market for their services motivate non-executive directors to be effective monitors of the board's decisions.

Brickley, Coles, and Linck (1999) find evidence that boards take account of ability, based on previous performance, when appointing outside directors. Gilson (1990) reports that directors that resign following a firm's bankruptcy achieve fewer directorships in the future than other directors. Coles and Hoi (2003) further support the importance of reputation by finding that non-executive directors that limit managerial discretion, by means of rejecting anti-takeover provisions, are rewarded by gaining additional directorships.

However, the findings of these study coincide Anderson and Reeb's finding that there exist a relationship between board independence (Pearson correlation = -.0295) but it disagrees with their findings that firms that without the presence of independent directors, firm performance is significantly worse than in non-family firms because from the study findings board independence was found to have a negative influence on agency cost (coefficient of estimate = -.0329).

5.2.2 H₀₂: There is no effect of Board size on Agency Cost

Study findings show that Board Size was positively and significantly correlated to agency cost (Pearson correlation of .254). Board size further recorded coefficient estimate of 0.236 this implying that there is significant positive relationship between board size and agency cost. Increase of number of board members with one unit will increase units to agency cost this coincide with Jasens' findings that Firms with relatively smaller-sized boards are, therefore, seen as being less susceptible to agency problems and associated agency costs (Jasen, 1999). He further has indicated that a value-relevant attribute of corporate boards is its size.

5.2.3 H₀₃: There is no effect of CEO Duality on Agency Cost

From the findings firms CEO duality was found to be positively correlated to agency cost (Pearson correlation = 0.576), further findings from the regression analysis showed that without control variables (industry, firm risk and firm size) CEO duality positively predicted Agency cost with 0.589 units but after the introduction of control variables in the model the units reduced up to 0.589 units. This high influence can be related to Jensen (1993) suggestion that in making decisions, a dual CEO is privy to a greater level of information that leads to better decision making and board leadership because communications between the CEO and chair are not required. Duality also removes the potential problems of rivalry between the CEO and chair and possible problems from having two public firm spokespersons.

5.2.4 H₀₄: There is no effect of Audit Committee on Agency Cost

Literature has also shown that audit committees enhance managerial accountability and are an effective component of corporate governance. Since audit committees provide better quality assurance, their usefulness should increase in response to the level of agency problems within a firm; this was found to be true in this study where audit committee was found to have positive relationships with agency cost (0.224). Audit committee influences the agency cost with 0.185 units.

5.2.5 H₀₅: There is no effect of between Board Tenure on Agency Cost

Board tenure was found to have a positive relationship with agency cost (Pearson correlation 0.169). According to regression analysis after the introduction of control variable in the study, board tenure influence agency cost positively (coefficient of estimate = 0.289). This influence, however, reduces after the introduction of control variables in the model.

After performing regression separately on agency cost (average of asset utilization and discretionary expenses), asset utilization and discretionary expenses the study found out that independent variables together with controlling variables (firm risk, audit committee, firm size, CEO duality, board independent, board tenure, board size and industry) predicts more of asset utilization in agency cost as compared to discretionary expenses. More results indicated that independent variables will have a significant relationship with agency cost as long they have significant relationship in either asset utilization or discretionary expenses.

5.3 Conclusion

The purpose of this research is to examine the influence of board independent, CEO duality, board size, and audit committee and board tenure on agency. The show that CEO duality, board size, audit committee and board tenure all predicted the outcome of agency, however, this outcome depended highly on magnitude and strength of the predictor, as such the study conclude that positive agency cost relied heavily on CEO duality and Board tenure the study further contradicts many studies in the literature that the ability of the CEO/Chairperson to exercise independent self-evaluation is questionable and conclude that that when the chairman is also active as the CEO in the daily activities of the firm, he will try to invest as much as possible to increase the size of the firm or to boost his personal status, also the longer the board member stays/survive in the firm the higher it influence on the agency cost.

From study findings board independence had negative effect on agency cost, thus increase in number of independent directors in the board will reduce agency cost. Board size had positive effect on agency cost, suggesting that increasing the number of board will increase agency cost. CEO duality was positively affecting agency cost. Audit committee had positive effect on agency cost, thus existence of audit committee in a firm will improve agency cost. in addition based on the above results increasing board tenure increase agency cost.

Moreover, our results indicated that “Audits committee” also had influence on agency cost suggesting that audit committees can be an effective and value relevant signal that a firm has good governance, especially in those environments where external regulatory

and governance structures are weak. In addition, our results indicate that “board size” is a significant determinant of the level of agency costs within a firm. With board independent showing a negative influence on agency cost, this would only infer that increasing the number of outside directors would not improve agency cost but on the contrary it will reduce it, this maybe because Inside directors are conflicted but well informed. Independent directors are not conflicted, but are relatively ignorant about the company. Perhaps independent directors will be quicker to act if something goes wrong, but more likely, in their ignorance, to do the wrong thing, especially if their deliberations are not leavened by the information available to fellow inside directors

5.4 Recommendations

Most of the effects of agency cost are felt in shareholder wealth and wider impacts on other corporate stakeholders, such as debt providers, employees and society in general. As such the research recommends that firms should formulate policies that will oversee efficient and effective CEO who also serves as the chairman for enforcement of codes of corporate governance practice to enhance director and management oversight and create desirable incentive structures within firms.

Since audit committee influence agency cost positively as thus the study recommends establishment of internal audit committee in firms, it also recommends that the CEO and chairperson roles should be exercised by one person. The board or appropriate board committee should establish policies on risk oversight and management.

The results imply that the benefits of split positions may be firm specific and a policy of split positions is not appropriate for all firms. For firms with high block ownership, low CEO ownership, low debt holdings and high levels of agency problems, the benefits of splitting are high. Nevertheless, despite its limitations, this study does contribute towards the understanding of corporate governance issues with particular reference to board of directors and percentage of executives in Kenya listed firms. Notwithstanding the results, this study also contributes to the limited existing literature on the association between board tenure and corporate governance in Kenya.

5.5 Recommendations for Further Research

The research recommends a comparative study between Kenya and other countries especially countries with the same economic growth rate. More importantly, the empirical literature indicates a sample selection bias in favor of very big firms listed at NSE. It is hereby suggested that attention should be devoted to the study of small and medium scale firms in Kenya. It would also be interesting to investigate the effect of these factors on a firm's performance and audit committees and board tenure.

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LETTER OF INTRODUCTION TO LISTED FIRMS

Ayabei K Ezekiel,
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P.O BOX 3900,
ELDORET.

Dear Sir/Madam,

I am a student at Moi University, School of Business and Economics pursuing Masters in Business Management and carrying out a research study on “Effects of Corporate governance on Agency cost among listed firms at NSE”.

You have been selected as a participant in this study and your co-operation will be highly appreciated. Attached herein is a Documentary guide, you are requested to give your honest opinion about the research study. The information will be used for the purpose of this research only and shall be accorded all the confidentiality.

Thank you.

Yours faithfully,

Ayabei k Ezekiel.

