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DOES CORPORATE GOVERNANCE, OPERATING ENVIRONMENT AND TOP MANAGEMENT TEAM CHARACTERISTICS JOINTLY INFLUENCE THE PERFORMANCE OF COMPANIES LISTED AT NAIROBI SECURITIES EXCHANGE IN KENYA?

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Abstract

The general objective of the study was to determine whether corporate governance, operating environment and top management characteristics influence the performance of companies listed at the Nairobi Securities Exchange (NSE). The study aims to add value to decision making by creating a framework that can be adopted by the Nairobi Securities Exchange and other regulatory agencies like capital market authority in designing guidelines for corporate governance practices considering other critical factors on out how firms should be governed to counter the arising challenges that continues to hinder them from registering better performance consistent to the expectations of the shareholders. The study was guided by three theoretical foundations; Agency Theory, the Environmental Dependence Theory and the Upper Echelons

Theory. A cross sectional research design targeting 66 firms listed at the Nairobi Securities Exchange was employed. The study used both primary and secondary data. Descriptive and inferential statistics (multiple linear regression) were used in data analysis. The findings revealed that corporate governance, operating environment and top management team characteristics jointly and significantly influence performance of firms listed at NSE. The implication is that firms should consider to critically analyze their governance practices, management characteristics when considering maximizing shareholders interest through corporate governance practices. This will provide an opportunity for organizations to deliver to the expectations of shareholder's interest through proper formulated strategies employed in sound business environment.

Keywords: Corporate Governance, Operating Environment, Top Management Team Characteristics, Firm Performance

INTRODUCTION

Corporate governance regulations ensure transparent management of companies for efficient accountability to stakeholders. According to Gregory Zabri, Ahmadand Wah (2016), the principal characteristics of effective corporate governance include transparency which is reflected in the disclosures made by the firm. It includes the disclosure of relevant financial and operational information and internal processes of management oversight and control; protection and enforceability of the rights and prerogatives of all shareholders; and directors capable of independently approving the corporation's strategy and major business plans and decisions, and of independently hiring management, monitoring management's performance and integrity, and replacing management when necessary. The firms with weaker governance structures have to face more agency problems and managers of such firms gain more private benefits (Brunninge, Nordqvist & Wiklund, 2015). It has been noted that good corporate governance simply means good business (OEDC, 1999). Corporate governance provides a structure for directing and controlling the business with a higher level of efficiency, transparency, accountability and fairness. In addition, corporate governance practices include the decision-making and controlling processes for a business. It offers an understanding of the managerial structure of business firms, as such, top management team characteristics. The various attributes of corporate governance structure, including a board of directors, an audit committee, independent directors, various other administrative committees within a board, are factors influencing the firms' decision-making process and thus play an important role in controlling manager's discretionary power hence driving the firm to higher performance.

Empirical studies have suggested that the success of an organization seldom depends upon a single factor but rather it largely stems from the ability to reach and maintain a viable balance among a combination of different factors (Kariuki, Awino & Ogutu, 2011).Environment refers to a set of conditions defined by the surroundings that dictates how the firm adjusts to survive in relation to its competitors (Ombaka,Muindi & Machuki, 2015). Organizations in a certain operating environment work to outwit, outsmart, outmaneuver as well as outperform their rivals (Lefort, McMurray& Tesvic, 2015). Accurate information from the environment enables the firm undertake efficient governance practices to achieve their goals. Top management team characteristics refer to unique personal traits ascribed to members of top management team that are innate or learned, observable or cognitive. They are indicators of the worth that the top management team members bring to administrative situations in managing their organizations(Kinuu, 2014).Furtherwith better and sound top management, communication and reporting, inefficiencies in corporate governance practices will decrease while increasing the investor confidence in an organization and therefore enhanced overall firm performance.

The listed companies are diverse covering a range of economic activities such as agriculture commercial and services, telecommunication and technology, automobiles and accessories, banking, insurance, investment, manufacturing, construction, energy, and petroleum. They provide a suitable profile of Kenya’s economy. Following the Capital Market Authority (2015) report, issues in the corporate governance coupled with poor performance associated with delisting of some companies listed at the Nairobi Securities Exchange have resulted in much attention. Surfacing of crises including ineffective oversight by the board, inconsistence in auditing and accounting standards, weak regulatory and legal systems and wrong application of governance practices has been conspicuous in the post millennium era in Kenya. These comparisons in the performance of the listed firms provided an opportunity for this study. It is thus argued that variation in performance of firms listed at NSE can be explained by their unique integration of corporate governance mechanisms, their selection of top management team and how they respond to ever changing business environment. This study was done to test the hypothesis that there is no significant joint effect of corporate governance, operating environment and Top Management Team (TMT) characteristics on performance of companies listed at NSE.

LITERATURE

The study reviewed various theories pertinent to corporate governance, business environment and top management team characteristics and performance. These include; Agency theory (Jensen & Meckling, 1976; Eisenhardt, 1989), Environment dependency theory (Ansoff &

Survillan, 1993) and the upper echelons theory (Hambrick & Mason, 1984). Agency theory which is also the overarching is based on the assumptions and philosophy that separating ownership and management leads to corporate governance issues. And it’s the most discussed theory in strategic management as far as corporate governance is concerned (Shukeri, Shin & Shaari, 2012). The theory is based on the argument that board of directors as an example of corporate governance minimizes the problems that may arise due to principal who are the owners and stakeholders of the firm and the agent who are the management is because CEOs seek to increase their utility at the expense of firms by withholding effort or increasing their own compensation through self-dealing (Hendry, 2002).

The environment dependency theory presents the assumptions on the notion that organizations should continuously analyze, scan and evaluate the environmental context in which they operate with the objective of detecting any trends at early state before affecting the performance. This means that as top managers develop strategies, they will be subject to macro-environment influences and will need to continuously ensure that strategic decisions take cognizance of risks being span by the environment within which the organization operates (Ansoff & McDonnell, 1990).The theory helps the study with the argument that scanning environmental conditions and forces enhances performance of listed companies at the Nairobi Securities Exchange. On the other hand, the key assumptions of the Upper Echelon theory are the argument that top management team characteristics are closely related to the cognitive and psychological elements of the executives’ (Cannella, Park & Lee, 2008). This gives an organization an upper hand in developing, adapting and execution those strategies that maximize the organizational power over other competing firms. The principle of the UET recognizes that top managers’ different characteristics such as age or career experiences affect their decisions on strategy and structure and it will directly affect firm’s strategic choice and organizational performance (Nielsen 2010). The theory enables the study understands the role of top management team characteristics and how their potential can be harnessed to improve organizational performance.

Performance realization has become a critical function for top management and corporate governance principles as firm environments become increasingly turbulent and complex. The literature concerning how operating environment and tom management teams’ characteristics plays a role in corporate governance and performance relationship have been documented with varied conclusions. In a study by Manini and Abdillahi (2015) based on data from Kenyan banks found that size of the audit committee, diversity associated with gender and capital in the bank do not at any point significantly affect or rather influence profits in the associated sample with also size of the board negatively having impact on profits whereas the size of the bank giving positive effects. In another study by Goodman, Ravlin, and Schminke (2018) indicated that the turbulence of an organization's environment moderates the association between top team size and firm performance. The more turbulent the environment, the more varied and fragmented the nature of managerial work and the greater the information-processing demands on the top team. The greater the task uncertainty, the greater the amount of information that must be processed among decision makers during task execution in order to achieve a given level of performance. Turbulent environments increase information-processing needs by creating new opportunities and crises that often necessitate strategic and structural adaptations. Hence, as an environment grows more turbulent and a firm's decision- making tasks grow more difficult, managers have greater information processing requirements.

On the other hand, Abebe (2010) empirically examine the effect of top management team (TMT) characteristics on corporate turnaround performance in declining firms under conditions of environmental stability and turbulence. Theoretical hypotheses were developed and tested using data collected from 98 US manufacturing firms that experienced performance decline and turnaround during the periods 1990-1994 and 1995-2000 respectively. Data were collected from the COMPUSTAT database and annual filings and analyzed using a moderated regression analysis. The results of moderated regression analysis indicate an adverse effect of long organizational tenure on corporate turnaround, especially in turbulent environments. In a similar study, Lester (2006) conducted an examination of top management team prestige and environmental uncertainty. Relying on one of the more notable entrepreneurial settings, an initial public offering (IPO), this study extended prior work on top management team (TMT) characteristics. The study examined whether or not prestigious TMTs at the time of an IPO enhance organizational legitimacy and thereby provide a signal to potential investors. Because an IPO represents an entrepreneurial context characterized by high levels of uncertainty, the study also considers the impact of environmental uncertainty on the TMT prestige/investor valuation relationship. The findings show that both an element of TMT prestige and environmental uncertainty influence investor valuations. However, the influence of prestige does not assuage investors when analyzing IPOs in different environmental conditions.

METHODOLOGY

This study used a cross sectional survey design. The target population for the study was drawn 66 firms listed at the Nairobi Securities Exchange. Census methods was used whereby all firms were considered. Only firms which did not have adequate data were left out. Also, firms that have not been listed for more than 2 years were left out. This led to a total of 53 firms. Both primary and secondary data as collected via questionnaires, interviews and desk review were used in analysis.

The questionnaire was self-designed according to the study objective hence enabling the researcher to collect views of respondents on the manifestations of corporate governance, operating environment, Top Management Team characteristics and performance. The questionnaire adopted a 5-point Likert scale. This made made it possible to quantify the qualitative data, and therefore, enable the attainment of more objective results regarding the views of respondents on the different manifestations. Before administering the data collection instrument, respondents were assured of complete confidentiality and anonymity regarding their responses. The questionnaire was administered using the ‘drop and pick up later’ method so as to allow the respondents sufficient time to respond to the questions, thereby enhancing accuracy in responses and improve response rate. Validity and reliability analyses were considered and consequently attained via pilot testing of the instruments.

The study applied both descriptive and inferential statistic (mean scores, standard deviations, percentages and frequency distribution) were used. The regression model was tested to depict the relationship between the dependent (performance of listed companies at NSE) and independent factors (corporate governance, operating environment and Top Management Team characteristics). The following Multiple Regression model was tested;

$Y_i = \alpha + \beta_1 X_{1.} + B_2 X_2 + \beta_3 X_{3.} + \varepsilon$

Y= firm performance where i=1, 2 with 1 for non-financial performance (model 1) and 2= financial performance (model 2)

α= constant (intercept)

X_1= Is the composite index of corporate governance

X_{2-}=Is the composite index of operating environment

X_3= Is the composite index of Tom Management Team characteristics

$\beta_{1,}\ \beta_2,\ \beta_{3-}$ are the coefficients whereas ε -is the error term

The joint significance of these factors was tested via Analysis of Variance (ANOVA) examining the overall P-value, F-ratio and the coefficient of determination.

RESULTS AND DISCUSSIONS

Data analyzed was obtained from 53 NSE firms listed out of the targeted 66 companies sampled. Three of the questionnaires returned were not complete. Only 50 questionnaires were analyzable. This represented 75.76% of the firms sampled. Nachmias and Nachmias (2004) in their view presented 50% as satisfactory especially where challenges become inevitable to some extent. The firm profile demographics that were considered include year’s organization has been in existence, sector of operation, scope of operation and the size of organization. These firm characteristics established in the study are all summarized in the table 1.

Table 1. Organization Demographic Profiles

Years Organization has been in the Industry	**Frequency**	**Percentage (%)**
Less than 5 years	1	2.0
11 to 15 years	3	6.0
16 – 20 years	8	16.0
Over 20 years	38	76.0
Sector in which Organization operates in		
Agriculture	5	10.0
Telecommunication & Technology	2	4.0
Banking	9	18.0
Investment Services	4	8.0
Construction & Allied	4	8.0
Commercial Services	5	10.0
Automobile & Accessories	4	8.0
Insurance, Investment	7	14.0
Energy & Petroleum	5	10.0
Manufacturing & Allied	5	10.0
Scope of Organization		
National (Only Within Kenya)	13	26.0
Regional (Only within East Africa)	15	30.0
Continental (only in Africa)	15	30.0
Globe (Africa and other Continents)	7	14.0
Size of Organization in terms of personnel		
Between 101-200	**7**	14.0
Between 201-300	**7**	14.0
Between 301-400	10	20.0
Over 400	26	52.0
Total	**50**	**100**

Results of the findings indicate that most of the surveyed organizations that were listed in the NSE had been in operation for more than 20 years at 76%. Other firm had been operation for 16-20 years at 16%, 11- 15 years at 6% and less than five years at 2%. These findings indicate that majority of the organizations have been in service for a long time hence domineering in the respective sectors realizing great profits therefore were listed in the NSE. Another reason would be presence of good corporate governance that increased efficiency and profitability in the organizations. The study further sought to establish the sector of operation of the surveyed companies. Results generally indicate firms were evenly distributed across all the sectors. Additionally, it indicated that 18% of the firms in the study were in Banking industry, 14% of the firms were insurance and investment, 10% of them were in agriculture, commercial services, Energy & Petroleum, Manufacturing & Allied and Agriculture, 8% were in Investment Services, Construction & Allied and Automobile & Accessories and finally 4% of the firms were in Telecommunication & Technology.

In addition, the study sought to establish scope of operation and size of the organizations listed in the NSE. Scope of operation is a long-term capacity decision which involves a long-term commitment on the geographical static factors that affect a firm, and therefore an important strategic level decision which influence firm performance. Moreover, the study also looked at how firm size influenced a firm's performance. Generally, large firms can generate stronger competitive capability than their small rivals due to their superior access to resources, greater market power as well as economies of scale. Results of the finding indicate that majority of the organizations operated regionally (only within East Africa) and continental (only in Africa) at 30% each. Other organizations' scope of operation was nationally (only within Kenya) at 26% and globally (Africa and other continents) at 14%. The results indicate that most firms listed in the NSE serve a wide range of clients who are distributed throughout the country; hence they do not only limit themselves in serving clients that are close to their location. Generally, a firm that serves a wide range of clients can make huge profits as opposed to a firm that is only limited to clients within its geographic location. Additionally, firms with a wide scope of operation can have a better competitive advantage in obtaining clients and therefore realize great profits.

In determining the size of the organizations in terms of personnel, the findings indicate that majority of the organizations had employees over 400 at 52%. Other organizations had employees between 301 and 400 at 20%, and finally the rest had employees between 201 and 300 and between 101 and 200 at 14% each. These findings indicated that majority of the firms were large hence realized enormous profits. Additionally, corporate governance in the firms played a key role in steering the firms to achieve its objectives and goals hence profitability.

The study also sought to further establish top management team characteristics and hence the respondents were asked to indicate their demographic characteristics which include age, highest level of education and the number of years they had served in the organization. These Top Management Team characteristics were important as it would be used to assess performance of the firms as well indicate the level respondents would also be in a position to give organizational memory on the firm's activities hence response would be credible. Table 2 shows the results.

Table 2: Top Management Team Characteristics

Age Group	**Frequency**	**Percentage (%)**
20 to 30 years	2	4.0
31 to 40 years	18	36.0
41 to 50 years	18	36.0
51 to 60 years	10	20.0
More than 60 years	2	4.0
Highest Education Level		
Diploma/Certificate	1	2.0
Degree	17	34.0
Master's degree	25	50.0
Doctorate	7	14.0
Work Experience		
0 to 5 years	15	30.0
6 to 10 years	18	36.0
11 to 15 years	13	26.0
Over 15 years	4	8.0
Total	**50**	**100**

Table 2 shows that majority of the TMT's were in the age bracket 31-40 years and 41-50 years with response of 36% each. Others were in age bracket of 51-60 a 20%. The findings also indicated that few TMT's were in the age bracket of above 60 years and 20-30 years at 4% each. Age plays a milestone of roles where the experience related to an individual is manifested especially where he has utilized the age in the working endeavors. It is also through age that teams in the management can get different views in terms of ideas, innovation and creativity thereby having the best group that champion performance in entirety.

On the level of education, results indicated that majority of the respondents 50% had master's degree as their highest level of education, 34% had bachelor's degree, 14% had Doctorate and 2% had diploma as their highest level of education. High level of education among the Top Management Team could reflect high organization performance as the duties are conducted with great skill and competency. The results of the study could also be attributed to the recruitment policies of top management team that require the leaders to attain minimum qualification of a degree.

On the years of service in the organization, the researcher observed that majority of the respondents had 6-10 years of experience at the current workstation at 36%, followed closely with those having 0-5 years of experience at 30%. Other respondents had 11-15 years of experience a 26% while 8% of the respondents had over 15 years of experience. Functional backgrounds of the TMT's such as years of service aid in building competence as well as bring together diverse knowledge domains. Managers that are well acquitted with their experience backgrounds are able to develop denser connections to stimulate organization performance.

Since the study was assessing both non-financial and financial performance, two sub hypotheses were derived from the hypothesis. The first sub hypothesis aimed at testing the joint influence of corporate governance, operating environment and top management team characteristics on the non-financial performance of companies listed at NSE while the second sub hypothesis aimed at testing the joint influence of corporate governance, operating environment and top management team characteristics on the financial performance of companies listed at NSE. The key results of hypothesis testing for non-financial performance are displayed Table 3.

Table 3: Model One (Dependent Variable: Non-Financial Performance)

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.706a	.498	.488	.55956

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	15.482	3	5.161	16.420	.000b
	Residual	14.457	46	.314		
	Total	29.939	49			

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.731	.573		1.275	.009
	Corporate governance	.361	.101	.359	3.574	.001
	Operating Environment	.162	.150	.119	1.083	.084
	Top Management	.106	.106	.112	-1.007	.019

a. *Dependent Variable: Non-Financial Performance*

b. *Predictors: (Constant), Corporate Governance,* The model on overall was significant. Results on joint effect indicated that 51.7 percent of the variation in non-financial performance was explained by the changes in corporate governance, operating environment and top management team characteristics. The model was generally significant (*F=16.42, p<.05*). The hypothesis that corporate governance, operating environment and top management team characteristics don't have significant joint effect on the non-financial performance of companies listed at NSE was rejected.

The second sub hypothesis aimed at testing the joint effect of corporate governance, operating environment and top management team characteristics on financial performance (Return on Assets) of companies listed in NSE. The findings are as shown in table 4.

Table 4: Model 2 (Dependent Variable: Financial Performance)

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.706a	.498	.488	.55956

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	12.606	3	4.202	15.11	.000[b]
	Residual	12.790	46	.278		
	Total	25.396	49			

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.258	.539		.478	.635
	Corporate Governance	.558	.116	.549	4.811	.000
	Operating Environment	.058	.141	.046	.413	.682
	Top Management Characteristics	.236	.099	.269	2.373	.022

a. Dependent Variable: Financial Performance
b. Predictors: (Constant), Corporate Governance, Operating Environment, Top Management Characteristics

The findings indicate that corporate governance, operating environment and top management team characteristics jointly explain 49.8% of the variations in financial performance. The model was generally significant (*F=15.113, p<.05*). The hypothesis that corporate governance, operating environment and top management team characteristics don't have significant joint effect on the financial performance of listed companies at NSE was rejected. The study show that, in both models, the F statistic were significant. The above findings concur with Yang and Wang (2014) who argues that gender, age and work experiences of the top managers' leads to better corporate governance practices identification resulting to superior financial performance. Firms should base on management characteristics when considering maximizing shareholders interest through corporate governance practices. This will provide an opportunity for organizations to deliver to the expectations of shareholders interest through proper formulated strategies associated with best principles of corporate governance. Theoretically, external environment is deemed to affect firm performance in the perspective of the emerging and traditional measures. From the literature, uncertainties are caused by variations of legal, political and other competitive environments (Pearce & Robinson, 2002). Therefore, the ability of the firm to counter and engage responsive strategies that may include technology in improving customer service may lead to improved performance of the firms in question. The findings were further supported by Julian et al. (2009) who indicated that quality of decisions that influence performance is derived from diverse information from top management, better analysis of the environment in operation and openness of governance principles. This was as well in line with the study by Shukeri, Shin and Shaari (2012) in their analysis pertaining characteristics of the board. They argued that TMT characteristics traits chiefly including value principle and insights and cognitive basis is reflected entirely and effectively by the characteristics of top management.

CONCLUSIONS

The study sought to establish if there is joint effect of governance at corporate level, characteristics of teams at management and environment especially operating relate to performance. The study revealed that the joint effect of governance at corporate level, operating environment and team characteristics at management on firm performance was statistically significant. This implies that quality of decisions that influence performance is derived from diverse information from top management, better analysis of the environment in operation and openness of governance principles. Additionally, TMT characteristics traits chiefly including value principle and insights and cognitive basis is reflected entirely and effectively by the characteristics of top management. This eventually results to better knowledge of the environment, enhanced decision making and positive implications on firm performance.

Further, strategic choice perspective posits that the characteristics of the TMT through corporate governance practices play an important role in influencing a firm's strategic choices and overall performance. The study suggests to policy makers and management of organizations to consider proper application of decision-making prospects arising from managerial angle with well-considered environmental factors that are dynamic, munificence and complexity in nature. There is need of hiring of managers at the top considering matching their profiles of management in existence in order for firms to attain the best performance. Corporate governance that are best needed to be incorporated with boards that are independent and specialized where possible. Organizations should mitigate the challenges of external environment to stimulate higher performance.

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