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Research Paper

Effect of Corporate Governance Practices On Financial Sustainability of Listed Manufacturing Companies in Nairobi Securities Exchanges

Gacheru Michael Mutugi[1] Wanjau Boniface Muriithi [2]
[1] Jomo Kenyatta University of Agriculture and Technology [2] Catholic University of Eastern Africa
Corresponding author:

Abstract
All business enterprises are guided on the desire to remain sustainable. Likelihood of sustainability is guided on the quality of corporate governance practices in place. Hence, the current study examined the effect of corporate governance practices on financial sustainability of manufacturing companies listed in Nairobi securities exchanges. Specifically, the study examined the effect of board independence, gender diversity and board tenure on financial sustainability of listed manufacturing companies in Nairobi securities exchanges. The study was based on stewardship theory. Correlation research design was applied and census used to select nine manufacturing companies from 2015 to 2022. Correlation and regression analysis analyzed the data. Results of the study depicted that there was a statistically significant effect of board independence, gender diversity and board tenure on financial sustainability of listed manufacturing companies in Nairobi securities exchanges.
Key words: Corporate governance practices, Board independence, board tenure, gender diversity, financial sustainability.

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I. Introduction

According to Agyris (1973) the key difference between agency and stewardship theory is that, the former considers individuals as economic beings and the later cements on the need for an organization to embrace organization structure in achievement of corporate goals. In a profit-making entity, it is deemed that employees are more motivated in achievement of optimal returns. Moreover, the primary goal for management is minimization of operational costs (Davis, Schoorman & Donaldson, 1997). On the other hand, Daly, Dalton and Cannella (2003) argued that managerial and executive teams are geared towards protection of corporate reputation therefore they act to amplify financial performance. This will be achieved if they perceive organizational performance to have impact on them. This is in tandem with Fama (1980) who argued that corporate managers have tendencies to continuously upgrade their careers to be perceived as effective stewards of their specific organization. Consequently, they take ownership of their jobs so as to amplify achievement of their corporate roles.

Okoye et al. (2020) indicated that board independence and gender diversity has inverse statistically significant effect on financial sustainability while board size had positive statistically significant effect on financial sustainability. Tatiana et al. (2021) depicted that corporate governance has statistically significant effect on financial performance of companies in Romania. Magoma and Ernest (2023) indicated that there was a statistically significant effect of gender diversity on financial performance of listed companies in Tanzania. Iren (2016) depicted that there was statistically significant effect of gender diversity in the board on firm financial performance. Since these studies have methodological, conceptual and contextual issues there was need for subsequent study to elucidate the effect of corporate governance practices on financial sustainability of listed manufacturing companies in Nairobi Securities Exchanges (NSE). Specifically, the study was guided by the following research questions:

i. What is the effect of board independence on financial sustainability of listed manufacturing companies in NSE?
ii. What is the effect of gender diversity on financial sustainability of listed manufacturing companies in NSE?

iii. What is the effect of board tenure on financial sustainability of listed manufacturing companies in NSE?

Theoretical Review

Stewardship theory was brought forth by Davis and Donaldson (1997). The theory argues that a steward ought to not only protect shareholders wealth but also maximize shareholders wealth. This will be in congruence with stewards' utility maximization. In this study stewards will be county management which is bestowed with the responsibility of protecting and providing amenities to county stakeholders. The theory complements agency theory since it departs from individual interests and considers top managers as pace setters in individual and organization role integration (Donaldson & Davis, 1991). Satisfaction and motivation of stewards is achieved when an organization succeeds. The theory is relevant for the study since there is need for provision of stewardship through board independence, gender diversity and board tenure so as to enhance financial sustainability of listed companies.

Empirical Review

Okoye et al. (2020) studied the effect of corporate governance on financial sustainability of micro finance institutions in Nigeria. Correlation research design was applied and board independence, board size and gender diversity were applied as proxies for corporate governance. Through regression analysis results of the study indicated that board independence and gender diversity has inverse statistically significant effect on financial sustainability while board size had positive statistically significant effect on financial sustainability. Since the study was carried out amongst micro finance institutions the findings may not be generalized amongst manufacturing companies due to differences of industry specific characteristics.

Tatiana et al. (2021) explored the effect of corporate governance mechanism on financial performance of companies in Romania. Corporate governance was operationalized as independent directors, members of the board, shareholders structure and independent directorship. Descriptive research design was applied and secondary panel data was sourced from annual financial statements. Results of the study depicted that corporate governance has statistically significant effect on financial performance of companies in Romania. The study may have considered carrying out simultaneous system of equations rather than running independent regression analysis on the three predictors.

Magoma and Ernest (2023) studied the impact of gender diversity on financial performance of listed companies in Tanzania. Correlation research design was applied and secondary data collected of 15 firms from 2016 to 2021. Regression analysis findings indicated that there was a statistically significant effect of gender diversity on financial performance of listed companies in Tanzania. The study was in support of agency and resources dependence theory. The study has conceptual gap since it considered only effect of gender diversity unlike currently board independence, gender diversity and board tenure on financial sustainability.

Iren (2016) studied the effect of gender diversity in the board room and firm financial performance. The study applied correlational research design and sourced data amongst 60 listed companies in Abu Dhabi and Dubai securities exchanges. Results of the study depicted that there was statistically significant effect of gender diversity in the board on firm financial performance. The study presents contextual gap since there are country specific characteristics in Dubai that may differ from Kenya thus the need for a localized study.

II. Methodology

The current study applied correlational research design and sourced secondary data from annual financial statements of listed manufacturing companies. A census approach was used to select eight manufacturing listed companies for the period 2015 to 2022. The population for the study was BOC Kenya limited, British American Tobacco Kenya limited, Carbacid Investment limited, East Africa Breweries limited, Eveready East Africa limited, Kenya Orchards limited, Mumias Sugar company limited and Unga group limited. The study applied unbalanced panel data. Collected data was cleaned and analyzed using correlation and multiple regression analysis. The regression model for the study was of the form:

$Yit = \beta_0 it + \beta_1 x_{1it} + \beta_2 x_{2it} + \beta_3 x_{3it} + e$

Y = dependent variable (financial sustainability)

β_0 = Constant Term

$\beta_1\beta_2\beta_3$= coefficient of determination

x_1= Board independence

x_2= Gender diversity

x_3= Board tenure

e = Error Term

III. Findings and Discussions

Correlation Analysis

Product moment correlation coefficient was applied to evaluate the strength of the relationship between corporate governance practices and financial sustainability of listed manufacturing companies in NSE. Findings in Table 4.1 depicts that there was a positive statistically significant relationship between board independence and financial sustainability (rho= 0.671, p value < 0.05). Secondly, there was a positive statistically significant between gender diversity and financial sustainability of listed manufacturing companies in NSE (rho = 0.546, p value < 0.05). Further, board tenure has positive statistically significant effect on financial sustainability (rho = 0.604, p value < 0.05). Correlation coefficient among predictor variables was not exceeding 0.7, thus there were odds of multicollinearity.

Table 4.1 Correlation Analysis

	1	2	3	4
(1) Financial Sustainability	1			
(2) Board independence	0.671	1		
	0.000			
(3) Gender diversity	0.546	0.034	1	
	0.000	0.109		
(4) Board tenure	0.604	0.096	0.041	1
	0.000	0.425	0.647	

Diagnostic Tests

Before fitting regression model to examine the effect of corporate governance practices on financial sustainability of manufacturing listed companies. Panel data diagnostic tests were executed and study findings are reported below.

Normality Test

Normality test of the error term was examined with the assumption that the error term of the data was normally distributed against an alternative that it was not. Findings in Table 4.2 has a p value of 0.5426 and Jarque Berra coefficient of 1.3561. This indicates that the error was normally distributed thus there was no need for data transformation.

Table 4.2 Normality Test

	Financial sustainability
Jarque-Bera	1.3561
Probability	0.5426

Lagragian Multiplier Test

Lagragian multiplier test was carried to examine the null hypothesis that there were no panel effects against an alternative that there were panel effects. Results in Table 4.3 depicts that there was enough evidence for rejection of the null hypothesis and conclusion that there were panel effects thus pooled effects model was not the most appropriate for examination on effect of corporate governance practices on financial sustainability of listed manufacturing companies in Kenya.

Table 4.3 Lagragian Multiplier Test

	Var	Sd=sqrt (var)
Creative accounting	7.5826	2.7537
e	3.4258	1.8509
u	0.6423	0.9125
Chi square =12.256, p value <0.0002		

Serial Correlation Test

Serial correlation test was carried to examine the relationship between current period and past period error terms. Results in Table 4.4 depicts that there was no first order serial correlation since the p value was less than 0.05 thus the null hypothesis that stated that there was no first order serial correlation was rejected.

Table 4.4 Serial Correlation Test

	F (1,5)	P value
Wooldridge test for autocorrelation	14.25	0.0013

Heteroskedasticity Test

Heteroskedasticity test was carried to examine the uniformity of variance of error term of variables under examination. Results in Table 4.5 depicts that there was enough evidence to support rejection of the null hypothesis and conclusion that there was no uniformity of variance of error term since the p value was less than 0.05. Hence, the model fitted in the study had robust standard errors.

Table 4.5 Heteroskedasticity Test

	Chi square	P value
Modified Wald test	132.241	0.0000

Multicollinearity

Multicollinearity is a condition in which there is a high correlation amongst predictor variables. It was examined using variance inflation factors. Results in Table 4.6 depicts that none of the variables had variance inflation factors greater than 4. Thus, these variables were not highly correlated.

Table 4.6 Multicollinearity

	VIF
Board independence	1.02
Gender diversity	1.21
Board tenure	1.32

Hausman Test

Hausman test was carried to examine the most appropriate model to fit between fixed and random effects model. Results in Table 4.7 depicts that the most appropriate model to fit was fixed effects since the p values was greater than 0.05. Thus, the study adopted random effects model while examining the effect of corporate governance practices on financial sustainability.

Table 4.7 Hausman Test

Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
20.21	3	0.425

Regression Analysis

Regression analysis results in Table 4.8 depicts that 71.2% of changes in financial sustainability of listed manufacturing companies can be accounted for by board independence, gender diversity and board tenure while the remaining portion is attributed to others issues excluded in the model. Since F statistics has p value less than 0.05 then at least one of the slope coefficients is none zero. Board independence has positive statistically significant effect on financial sustainability of listed agricultural companies in Nairobi securities exchanges (β= 0.724, p value < 0.05). Thus, it can be concluded that while holding constant gender diversity and board tenure unit increase in Board independence increased financial sustainability by 0.724 units. Gender diversity has positive statistically significant effect on financial sustainability of listed agricultural companies in Nairobi securities exchanges (β= 0.542, p value < 0.05). Thus, it can be concluded that while holding constant board independence and board tenure unit increase in gender diversity increased financial sustainability by 0.542 units. Board tenure has positive statistically significant effect on financial sustainability of listed agricultural companies in Nairobi securities exchanges (β= 0.612, p value < 0.05). Thus, it can be concluded that while holding constant gender diversity and board independence unit increase in board tenure increased financial sustainability by 0.612 units.

Table 4.8 Regression Analysis

Financial Sustainability	Coef.	St. Err.	t-value	p-value
Board independence	0.724	0.223	3.245	0.001
Gender diversity	0.542	0.213	2.541	0.000

Board tenure	0.612	0.158	3.875	0.000
Constant	0.214	0.052	4.123	0.000
R-squared	0.712			
F-test	28.412	Prob > F	0.000	

IV. Conclusion and Recommendations

From the foregoing findings there is need for consideration of corporate governance practices so as to enhance the likelihood of achieving desired financial sustainability levels. Since board independence, gender diversity and board tenure all had positive statistically significant effect on financial sustainability then an increase in each of these practices enhanced shareholders wealth creation.

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