

**CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF COMMERCIAL
AND SERVICE FIRMS LISTED AT THE NAIROBI SECURITY EXCHANGE**

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DECLARATION

I declare that this project is my original work and has not been submitted for an award of a degree in any other University for examination purpose.

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DEDICATION

I dedicate this work to my wife Miriam Gathoni and my daughter Mitchel Njoki Murangiri for their unwavering moral and financial support.



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ABBREVIATIONS OF KEY TERMS

AC	Audit Charges
ACR	Audit Company Rotation
CMA	Capital Market Authority
GLS	Generalized Least Square
GMM	Generalized Method of Moments
IDX	Indonesia Stock Exchange
KSE-100	Stock Exchange 100
NSE	Nairobi Security Exchange
OLS	Ordinary Least Square
PSX	Pakistan Stock Exchange
ROA	Return on Assets
ROE	Return on Equity
ROI	Return on Investment
SSE	Shanghai Stock Exchange



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ABSTRACT

Commercial and service firms play a crucial role in modern economies, and their significance can be recognized in multiple ways. Enterprises play a pivotal role in both society and the economy by providing goods and services, creating job opportunities, and fostering economic growth and development. Commercial and service organizations have encountered many problems during their operations over time. Corporate governance has greatly improved industry firms' financial performance. This study examines how corporate governance affects NSE-listed commercial and service companies' financial performance. The present study examined how independent board, external audit quality, board size, and institutional ownership affect businesses' financial performance. The study was anchored on agency, steward and stakeholder theories. Data was collected from secondary sources, such as company papers and financial reports for the period 2018 to 2022, for the study. This study targeted the twelve NSE-listed commercial and service companies. Diagnostic testing preceded multiple regression analysis of the obtained data. The research followed ethical principles and receive consent from the appropriate regulating organization. Disclosed by the study, board independence significant affect these listed firms' financial performance positively thus reaching the conclusion that businesses that have a larger percentage of independent board members are more likely to experience improved profitability and overall performance. External audit quality unveiled a favorable but irrelevant effect on these listed firms' financial performance thus concluding that although higher quality audits might aid in enhancing financial performance, their influence is not substantial enough to be considered significant. Board size disclosed a noteworthy inverse effect on these listed firms' financial performance reaching a conclusion that larger boards may hinder effective decision-making and governance, leading to poorer financial outcomes. Furthermore, the outcome uncovered that institutional ownership inversely affects listed commercial and service firms' financial performance in Kenya prompting the conclusion that the presence of institutional investors does not play a crucial part in influencing the financial outcomes of these businesses. The study recommends that the Nairobi Securities Exchange regulatory bodies should establish guidelines that promote a higher proportion of independent directors on corporate boards. This could involve setting a minimum threshold for independent board members to ensure that firms benefit from diverse perspectives and objective oversight. By increasing the presence of independent directors, companies can enhance governance practices, leading to improved decision-making and strategic direction. The potential users of the study outcomes include capital market authority, investors, corporate managers and board members, academicians and the general public.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Over the past few decades, there has been a significant transformation in the worldwide business landscape, brought about by the emergence of developing nations, market liberalization, and advancements in information and communication technologies. Consequently, the global economy has witnessed a rapid expansion in the professional services sector, among other sectors (Bello, Radulovich, Javalgi, Scherer & Taylor, 2016). The performance of commercial firms is influenced by various worldwide patterns, such as heightened rivalry, alterations in managerial frameworks, efficient customer service management, and even escalating fuel costs, which are decreasing the profits generated by airline companies (Klynveld Peat Marwick Goerdeler (KPMG), 2018). Also, in the realm of revenue generation, digital platforms have emerged as the preferred mode of customer relationship management. This is evident in the increasing trend of online air ticket purchases and retail consumer transactions through e-commerce giants like Amazon and Alibaba (Yan & Wei, 2017).

The rise of digital platforms for customer relationship management and e-commerce giants showcases the increasing importance of technology-driven interactions and transactions (Gil-Gomez, Guerola-Navarro, Oltra-Badenes & Lozano-Quilis, 2020). This global trend in the service sector also highlights the need for efficient corporate governance to ensure sustainable growth and financial performance. Companies need to adapt to changing consumer behaviors, market dynamics, and technological disruptions to remain competitive and maintain investor confidence (Ahmed, 2023). Particularly in light of the recent US regulations, including the Sarbanes-Oxley Act of 2002, which were prompted by the collapses and scandals of prominent corporations like Enron, WorldCom, and others, effective corporate governance is essential to business success and, consequently, value for shareholders (Scrimgeour & Duppati, 2014; Mishra & Kiranmai, 2022).

The concepts of communication and cooperation are fundamental in various academic disciplines and professional settings. These concepts entail the exchange of information, ideas, and perspectives among

individuals or groups. The ability to engage in critical thinking and problem-solving is a valuable skill set in several academic and professional contexts. The concept of imagination is a cognitive process that involves the ability to generate mental images and ideas. In this communication, the user has provided a single word without any additional context or information. A significant proportion of the population residing in sub-Saharan Africa has limited access to essential services, such as financial services, due to the inadequate financial infrastructure present in the region. According to Awaworyi (2019), business organizations should progress and expand their operations by transitioning from one stage to the next. In spite of the proliferation of countless new enterprises, a substantial proportion of African nations persistently grapple with a pronounced incidence of company failure, predominantly attributable to deficient management methodologies. The need for efficient management strategies for decision-making and practical knowledge is a strong impediment to the expansion of service firms in Somalia, alongside the difficulties in enhancing their performance (Ali & Isak, 2019). In order to harness the full potential of their service sectors and stimulate economic growth, African nations must confront and tackle the prevailing obstacles they face. The examination of the achievements and difficulties encountered by companies listed on the NSE (NSE) can offer significant scholarly perspectives for neighboring nations grappling with comparable obstacles.

Enterprises working in the commerce and amenity sectors, which have been registered on the Nairobi Stock Exchange (NSE), have experienced varying degrees of success. While some companies, such as TPS Eastern Africa, have achieved positive outcomes, others, like Kenya Airways, have encountered challenges as a result of their operational environment (Njoroge, 2019). The difficulties encountered by organizations, such as Airways serve as a testament to the influence of operational obstacles, competitive forces, and economic circumstances on their financial success. According to Onsongo, Muathe, and Mwangi (2020), the Capital Markets Authority has seen NSE-listed businesses' financial performance worsen in recent years. A considerable number of NSE business and service enterprises had poor financial performance and were at risk of failure

between 2013 and 2017. Uchumi stores, Hutchings Biemer, Kenya Airways, Atlas Development (ADSS), Deacons, Eveready, and Express Limited, a Logistics company, were industry players.

1.1.1 Corporate Governance

Corporate governance encompasses the establishment of a cohesive and balanced rapport among diverse stakeholders within a commercial entity, including investors, executives, consumers, suppliers, creditors, authorities, and the general public. According to Mallin (2020), the principal objective of corporate management is to foster transparency, accountability, and ethical conduct in order to augment the value over the extended duration of the enterprise for its stakeholders. The organizational structure and duties of the board of governors, the implementation of executive compensation and incentives, the significance of auditing and accounting procedures, the management of risks, and the link amongst the corporation and its shareholders are just a few of the frameworks and strategies utilized to ensure effective governance (Yermack, 2016).

Hermuningsih, Kusuma, and Cahyarifida (2020) argued that the composition of the board consists of independent individuals who do not possess any affiliations with other directors, controlling shareholders, banks, or commissioners in the areas of finance, administration, shareholding, or kinship. This lack of connections is crucial to ensure their ability to make objective decisions. The positive influence on corporate performance can be ascribed to the magnitude of autonomous commissioners, who are assigned with conducting unbiased evaluations of a business's plans, resources, and success (Melawati & Muharam, 2016). In an effort to lessen the occurrence of exploitation and the influence of administrative self-interest, the formulation of monetary statements is subject to oversight by an autonomous committee.

Board independence is the capacity of the board to decide without being influenced by those with inside knowledge of the company. Mungai and Wanjohi (2023) essentially proposed that a company benefits from the independence of the board of directors because it gives the board more responsibility, allows it to make judgments about self-governance, expands the board's business network connections with executives, and limits the power of the CEO and board chairman. One non-executive director for every two executive board members

is the most recommended board composition for optimal independence, according to CMA's (2015) code of corporate practices review; non-executive directors should make up one-third of the total number of directors. Accordingly, boards with more outside directors have higher levels of independence.

The concept of external audit quality pertains to the process of ensuring the accuracy and adherence to accepted accounting principles in an entity's financial statements, the effective implementation of the control framework, the conduction of internal audits in accordance with accepted standards, and the management's appropriate response to audit findings. The performance of a corporation is influenced by an independent audit due to its role in examining the financial reporting system (Hermuningsih et al., 2020). The confidence of auditors in reporting errors is linked with their level of independence, and their ability to identify errors is linked with their competence, both of which inherently impact the audit's quality. Audit quality is by definition the description of the jointly calculated market probability that an auditor in particular would discover and reveal infractions within clients' accounting systems (Suleiman, Abdullahi, Mainoma & Olotu, 2024).

One way to gauge an audit's quality is to see how well auditors are able to determine whether the information that companies' management provide to investors is accurate. The ability of auditors to spot and eliminate window-dressed indicators and earnings manipulations in business financial statements is another technique to measure it (Erasmus, & Akani, 2021). Notably, a framework for evaluating the quality of the audit may be provided by evaluating the auditor's ability to recognize and detect problems in the company's financial statements. One common method of manipulating financial statements is by means of optional accruals, which are always accruals under management control to create outcomes that show stronger demand or income (Ideh, Jeroh & Ebiaghan, 2021). Due to the fact that reporting standards are founded on principles, corporate management exploits any perceived shortcomings or gaps in them to sway corporate reporting in their favor. This present investigation gauged audit quality from several perspectives, including 0 denoting the top 4 audit companies and 1 denoting audit firms outside of the top 4.

The board of directors holds exclusive jurisdiction over all operational and administrative decisions inside a company. Melawati et al. (2016) stated that a corporation's success hinges on the size of its board of directors, which sets policies and strategies for short- and long-term resource allocation. Arora and Sharma (2016) noted that board size improves corporate governance and financial effectiveness. A large board can serve as a safeguard against manipulation and offer access to a wide range of external resources, thereby enhancing a company's performance. Additionally, a diverse board possesses a range of competencies, expertise, and abilities. A corporation's attainment of favorable financial outcomes has the potential to engender a heightened level of confidence and reliance among investors.

Regarding a business's financial performance, one of the key elements is the size of its board. It alludes to a board's total number of directors. There are differing opinions and conclusions among academics regarding the impact of a board's size. First, in order to preserve the effectiveness of communication and decision-making, the Capital Markets Authority recommends small board sizes (Gatehi & Nasieku, 2022). Notably, the CMA observes that lengthy deliberations and conflicts are common on large boards. Bach and Mwenda (2024) however, argue that more substantial boards are suitable since they increase the diversity of viewpoints, knowledge, and ultimately, decision-making. Large board sizes should be preferred by business owners since they allow for specialization, which affects efficient monitoring and advising functions.

In the realm of corporate governance, institutional ownership is the cumulative number of shares held by a company's executives, board members, and proprietors. Reddy, Wellalage, and Wang (2017), motivation plays a decisive part in influencing a firm's performance by encouraging management to prioritize efforts toward improving the company's productivity. Susanti and Mildawati (2014), as cited by Hermuningsih, Kusuma, and Cahyarifida (2020), an increase in institutional ownership percentage leads to heightened institutional investor monitoring, which serves as a deterrent to exploitative managerial actions. A significant proportion of institutional stockholders enhances a firm's worth and enhances its economic output.

According to Otieno (2022), institutional ownership is the percentage of ownership that is under the control of businesses like fund managers, underwriters, and commercial banks. An organization's culture and management practices are likely to shift when these owners are present. Because of their experience and knowledge, institutional owners are better able to monitor and advise shareholders. Tanui (2021) asserts that because institutional owners typically own larger interests than other common shareholders, they are more motivated to keep an eye on the organizations' operations. Due to their substantial interests in the business, these investors are typically more exposed.

1.1.2 Financial Performance

The measurement of a business's efficiency in generating revenues through its available resources is known as financial performance. This provides a basis for making decisions about future business expansion, asset acquisitions, and managerial oversight (Momanyi, 2018). The effectiveness of a corporation in utilizing its resources to carry out its core operations and generate revenue is the key factor that determines its financial success. Moreover, it encompasses the general financial state of the company. Financial achievement can also serve as a means of measuring the financial well-being of companies operating within the same sector or across different sectors. Ultimately, it is a crucial objective that organizations, particularly those that prioritize profitability, aim to attain (Chepkwony, 2018).

The ability of a business to make enough money to keep running is a measure of its financial performance. Given that it demonstrates the effectiveness of the board and the business's financial health, financial success is important to investors, shareholders, and the nation as a whole (Kenton, 2024). The outcomes and results that show a company's overall financial health throughout time are highlighted by its financial performance. Because it directly contributes to the growth of shareholders' wealth, it is one of the primary markers of a company's performance (Ali, 2023). In this sense, it's critical to assess listed firms' financial success in order to determine how effective the qualities of their boards are. But measuring financial performance is the most important factor.

Companies have different methods for measuring financial performance because every company is different in terms of its operations, management styles, board, and goals (Stobierski, 2020).

There are several methods for measuring financial success, such as calculating ratios and assessing explanatory factors. Namanya, Musiime, and Muganga (2021) specifically used growth as an explanatory variable to group financial assessment methodologies into measures of profitability and liquidity. Thus, the best indicators of a business's financial performance are ratios like return on equity (ROE), Return on Sales (ROS), return on investment (ROI), and return on assets (ROA). Return on assets is one of the best metrics for assessing financial performance. ROI is represented as a percentage and quantifies the impact on a company's wealth. As a result, it displays the performance and financial efficiency of an organization (Ozegbe & Jeroh 2022). Gatehi and Nasieku (2022), however, contend that ROE is a useful indicator for assessing financial performance. According to the authors, analysts divide net income by total shareholders' equity.

Financial performance primarily emphasizes elements that have a direct bearing on a business's financial reports. The performance analysis may encompass various subjects, such as the asset base, capital employed, dividend growth, and sales turnover. The achievement of defined goals and objectives is a crucial sign of success for many economic entities. The stakeholders are particularly concerned with the performance of the company's finances (Nyamita, 2014). The measurement of financial performance holds significant relevance for companies since it provides a more accurate depiction of the organization's growth and progress. Also, it is relevant in helping organizations know their area of strength and weaknesses and help them come up with policies and plans that are geared towards bettering the overall performance.

Financial performance can be demonstrated by the utilization of several metrics, including efficiency indicators, solvency indicators, leverage indicators, and profitability indicators. The evaluation of a subject matter can be approached from multiple aspects, such as liquidity, profitability, and financial stability (Mwangi & Angima, 2016). Financial indicators are commonly employed to assess the financial well-being of an organization.

Financial ratios offer a quantitative assessment of a firm's financial success and are employed by investors, analysts, and management to make well-informed judgments regarding the company's prospects. As an enterprise amasses a greater quantity of assets, it has the capacity to generate increased sales and prospective profits. According to Hayes (2023), compared to assets, using economies of scale can help reduce costs and boost margins, which could result in a faster growth in returns. This could potentially enhance the financial performance of the firms.

1.1.4 Commerce and Services Listed Firms on the Nairobi Stock Exchange

Enterprises working within the commercial and services sector are entities that participate in the exchange of goods and services within their specific areas of specialization. These companies exhibit unique characteristics, such as functioning as intermediaries. One further attribute exhibited by the enterprises falling within this classification is their lack of involvement in how raw resources are converted into final goods, in contrast to manufacturing firms that engage in such conversion activities (Armstrong, 2017). In contrast, their operations primarily focus on business objectives, serving as intermediaries between manufacturers and end consumers to facilitate transactions. These firms fulfill the role of intermediaries by offering a range of services including warehousing, transportation, distribution, and retailing of products and services (Onsongo, Muathe & Mwangi, 2020).

The establishment of the Nairobi Security Exchange (NSE) occurred in 1954, with its primary function being the registration of companies and the issuance of securities that are traded by individuals and institutions worldwide, facilitated by brokers or dealers (Mburugu, 2020). The NSE serves as the principal stock exchange, encompassing the biggest marketplace for stocks within the East African region. Momanyi (2018) asserts that the National Stock Exchange (NSE) comprises exclusively authorized stock brokers. The NSE is an officially acknowledged corporate entity operating in compliance with the stipulations of the Companies Act (CAP 486). In 1988, the privatization of the Securities Exchange (NSE) was initiated by the government, which involved the sale of 20% of its stake.

1.2 Statement of the Problem

The commercial and services sector is a key driver of Kenya's economy, contributing 62.72% to the country's Gross Domestic Product (GDP) in the quarter ending September 2024, with service industries such as transport, real estate, and financial services generating KES 1.65 trillion during this period (Owino, 2025; Capital Wealth Management, 2025). This sustained growth has seen the sector outpace traditional contributors like agriculture and construction, highlighting its central role in national economic development. Despite this significant contribution, commercial and service firms listed on the Nairobi Securities Exchange (NSE) have faced persistent challenges, including declining financial performance, frequent suspensions, and even delisting from the exchange (Sawe, 2022). These issues are often attributed to poor corporate governance practices, weak financial management, and inadequate oversight, which undermine investor confidence and the sector's ability to sustain its economic impact (Aluoch, 2023). Efforts to reverse these trends have included the implementation of stricter corporate governance guidelines by regulatory bodies such as the Capital Markets Authority and the Central Bank of Kenya, as well as the adoption of improved financial management practices within firms. However, the effectiveness of these interventions remains questionable, as financial underperformance and governance lapses continue to be reported.

Previous research has delved into the link between corporate governance and financial success. Arora and Sharma's (2016) research analyzed how corporate governance affected the productiveness of key Indian manufacturing sectors. The research showed that the indices of corporate governance have no meaningful relationship with either return on equity or profitability. The study filled a knowledge void, but only in the manufacturing sector. Research by Momanyi (2018) examined how debt financing affected the bottom lines of companies providing goods and services traded on NSE. Debt finance and corporate governance were found to have no appreciable effect on the financial results of these firms. The critical elements of corporate governance could not be accurately measured in this study. Hermuningsiha, (2020) explored how corporate governance affect operational efficiency within industrial businesses that are listed on the Indonesia Stock Exchange

(IDX) from 2014-2016. Good corporate governance has been shown to increase an organization's efficiency, according to their study. However, the study focused on Indonesia.

Most of the literature that has attempted to discuss the subject matter have either captured just a segment or the implications are limited to a particular region. Considering the existing gap in focused research regarding the influence of corporate governance on the financial performance of commercial and service firms listed in NSE, Kenya, and this study is both timely and pertinent.

1.3 Purpose of the study

This study explored the effect of corporate governance on financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya.

1.4 Objectives of the Study

The below listed objectives guided the investigation;

- i. To scrutinize the effect of board independence on financial performance of commercial and service firms listed at the NSE.
- ii. To analyse the influence of external audit quality on financial performance of commercial and service firms listed at the NSE
- iii. To establish the effect of board size on financial performance of commercial and service firms listed at the NSE.
- iv. To determine the influence of institutional ownership on financial performance of commercial and service firms listed at the NSE.

1.5 Hypotheses

H0₁: There is no significant effect of board independence on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya.

H0₂: There is no significant influence of external audit quality on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya.

H0₃: There is no significant effect of board size on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya.

H0₄: There is no significant impact of institutional ownership on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya.

1.6 Significance of the study

This study will supplement existing research and theories that have been previously investigated by other scholars. Hence offering additional proof of how corporate governance affects the financial success of commercial and service organizations. The evidence presented here will aid in gaining a deeper comprehension of corporate governance. Additionally, the study will assist future researchers in focusing on other variables or performing fresh research on the same research. In the real world, the study will assist commercial and service companies by providing them with recommendations on how to handle corporate governance in order to influence their companies' financial success. In this manner, businesses and service providers will be able to boost their earnings while lowering potential risks and, at the same time, please their clients and staff. The Treasury would ascertain the degree to which this and other factors impact business operations, as well as how different facets of corporate governance standards impact the operations of different firms in Kenya. They would also pinpoint the challenges businesses encounter when attempting to implement different corporate governance procedures that impact their bottom line.

The study has a wide range of applications. The results could be used by the government and other policymakers to improve the performance of the industry as a whole. The outcome also has the potential to assist the industry's key players by providing them with a fresh perspective on how to use corporate governance to boost performance. The outcome of this investigation will assist stakeholders and policymakers in making decisions that will benefit commercial and service businesses. As a result, choosing a plan to reward and penalize companies that don't want to improve corporate governance. However, the stakeholders can keep an eye on the

risks that the companies incur and how they are managed. In order to design appropriate practices that would regulate the participation of shareholders in influencing the financial performance of Kenyan firms, policy makers would benefit from this study's knowledge of the various firm dynamics and appropriate responses.

1.7 Scope of the Study

This investigation examined the effects of corporate governance on the bottom lines of commercial and service enterprises traded on NSE. The research was on businesses in Nairobi. The investigation utilized a descriptive research strategy. Similarly, the research would limit itself to NSE-listed companies and considered the period 2018 to 2022.

1.8 Limitation of the Study

Several companies listed on the Nairobi Securities Exchange (NSE) exhibited data inconsistencies due to factors such as delisting, suspension, or new market entry within the study period. Consequently, firms with incomplete or irregular data were excluded to ensure the analysis focused exclusively on entities demonstrating consistent financial records from 2018 to 2022. Additionally, variations in the presentation formats of financial statements posed challenges in data extraction; thus, the researcher meticulously examined these documents to accurately retrieve the required information. The study relied solely on secondary data which may be confronted with variation issues across different sources however, the study made use of data sourced from the NSE and Capital Markets Authority (CMA) websites to obtain reliable and relevant information for the research.

1.9 Delimitations of the Study

Data collection was confined to the period 2018 to 2022. This timeframe was chosen to analyze recent trends and developments in corporate governance and financial performance reflecting the current business environment.

1.10 Assumptions of the Study

For the success of this inquiry, it is imperative to operate under the assumption that the collected data pertaining to corporate governance practices and financial success is accurate and reliable.

1.11 Operational Definitions of Terms

Board Independence: entails when the directors' board is independent enough from management and other stakeholders to make objective decisions for the benefit of the business and its investors.

Board Size is the total number of directors serving an organization, which might vary depending on criteria such as its size and complexity, the industry it operates in, and the board's own aims and priorities.

Corporate Governance is the set of rules, customs, and procedures used to run a business. This includes connections among the CEO, shareholders, board of directors, other interested parties, as well as the norms and laws that govern responsibility and business decisions.

External Audit Quality refers to how well an independent auditor does their job in accordance with accepted standards of the profession and how quickly they provide their findings to those who need them.

Institutional ownership: refers to how well an independent auditor does their job in accordance with accepted standards of the profession and how quickly they provide their findings to those who need them.

Financial Performance: entails the state of financial well-being of a company which is often evaluated by means of financial metrics such as revenue, income, ROI, and EPS.

Return on Asset is a financial ratio used to determine how profitable a business is by comparing net income to total assets.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This section examines Agency and Balanced Scorecard, the theoretical framework for this research. The paper reviews empirical material, analyzes the conceptual framework, and discusses hypotheses.

2.2 Empirical Review

2.2.1 Board Independence and Performance of Commercial and Services Sector

Almaqtari (2020) examined how board dynamics affect Indian company performance. This research explores how corporate governance frameworks affect 391 CNX 500 companies on the Indian National Stock Exchange. Tobin's Q and ROA are market- and accounting-based corporate performance indicators. The research implies that board autonomy affects the company's bottom line. The study was peculiar to India which is better emerging than Kenya hence making the finding unapplicable within the Kenyan context. This research examined size, institutional ownership, board independence, and the caliber of external audits.

The study by Aidoo, Nombare, and Boamah (2024) investigated the relationship between board characteristics specifically board size, independence, and expertise—and the financial performance of listed manufacturing firms in Ghana, with a focus on the moderating role of board commitment. Using panel regression analysis on the data covering 2010 to 2022, the research disclosed that while board size has an insignificant effect on financial performance, board independence and expertise significantly enhance financial performance. Board commitment further strengthens the positive impact of board independence and expertise on financial performance. Although the study was conducted on board features, it was particular to the manufacturing sector in Ghana which makes generalization of these findings unrealistic with the context of commercial and service listed firms in Kenya hence a gap which this study covered.

Wambui (2021) assessed board independence effect on Kenyan banks' performance. The investigator utilized a descriptive survey, and questionnaires were utilized to gather data. Additionally, 40 commercial banks were the focus of the inquiry, and census data was utilized to get this data. Data from the participants was estimated using descriptive statistics. The outcome revealed a favourable correlation amongst organizational effectiveness and board independence. The investigation deduces that the observed improvements in organizational performance are strongly predicted by board independence suggesting that increased board independence is the reason for banks' improved performance. The aforementioned study was focused on 40 Kenyan commercial banks while the recent study will focus financial success of commercial and service businesses.

Namanya, Musiime, and Muganga (2021) investigated the effect of board independence on the financial effectiveness of East African Community (EAC) listed businesses. In a quantitative investigation, 42 EAC listed firms were chosen utilizing a positivist paradigm and non-probability sampling. Regression, correlation, and descriptive statistics were utilized. The outcome of the investigation indicated that board independence positively and significantly impacted the financial success of the company as gauged by ROA, TBQ, and ROE, but not PER. The previous study utilized positivist design and based on financial performance of East African Community (EAC) listed businesses while the recent study utilize descriptive research design and based on commercial and service firms.

Mungai and Wanjohi (2023) explored the link amongst board independence and banks financial success that are listed on the Kenyan Stock Exchange. Using a census selection technique, twelve banks that were active on the NSE from 2015 to 2021 were chosen, and a descriptive study methodology was used for analysis. Panel regression estimation techniques were utilized for the study's estimations. The findings indicated that banks financial success is significantly affected by board independence. The outcome also indicated a favorable link between improved financial outcomes and a larger and more independent board. Hence, the performance of commercial banks seemed to be very diverse. The study deduced that in order to get the best possible financial

performance, NSE-listed financial organizations will profit from strengthening the independence of their board of directors. The previous study utilized financial success of banks from 2015-2022 while the recent study will utilize financial effectiveness commercial and service businesses from 2018-2022.

The influence that board independence exerts on the financial effectiveness of service and commercial listed companies at the Kenyan NSE was examined by Oboo and Aluoch (2024). In this study, an ex-post research approach was applied. To find out how these board structure factors affect listed organizations' financial performance between 2015 and 2022, eleven (11) listed commercial and service firms were employed. The outcome of the investigation stated that board independence considerably and favorably affects the performance of Kenyan listed companies. Thus, the inference made from this data is that board independence is essential to the success of Kenyan listed commercial and service companies in terms of financial performance. This investigation is distinct from Oboo and Aluoch studies since it focused on financial effectiveness of Kenyan commercial and service businesses.

2.2.2 External Quality Audit and Performance of Commercial and Services Sector

Naseem, Sun, Sulman & Rehman (2017) examined the effect of board structure on Pakistan Stock Exchange businesses' financial outcomes. The analysis examined data from six important economic sectors represented by Pakistan Stock Exchange-listed companies. Researchers collected 1074 samples of yearly data from a selection of firms from 2009 to 2015. Audited annual reports, balance sheets, and publications from the State Bank of Pakistan were utilized to evaluate the board's membership and financial performance. Accounting and market indicators monitored financial success, whereas board qualities explained it. Panel data regression demonstrates a favorable link between a firm's financial outcomes and its external audit thoroughness. This study compares social and economic conditions in Pakistan.

Iliemena and Okolocha (2019) investigated if an organization's external audit quality affected its financial outcomes as a Nigerian industrial products maker. The retrospective, descriptive study covers 2012-2018. A

sample of 24 industrial product enterprises listed on the NSE as of September 4, 2019, was studied. This study primarily adopted a descriptive research approach. It aimed to offer a thorough examination of the topic being studied by utilizing various data collection methods, applying rigorous statistical analysis, and addressing potential limitations. This study should encompass a thorough explanation of the data collection methods utilized, a comprehensive description of the statistical techniques employed for analysis, and a candid discussion of any potential limitations encountered during the research. Such an elaboration would provide a deeper and more transparent insight into our research methods and findings.

Alsmady (2022) conducted an examination of the six Gulf Cooperation Council (GCC) regimes with Arab origins, comprising Saudi Arabia, Qatar, Bahrain, Oman, the UAE and Kuwait. The research examined how external audit and financial reporting quality affects firm performance in different nations. To assess a company's performance, accounting metrics like M/B and ROA, market indicators like Tobin's Q and EPS are needed. This study employs Estimated Generalized Least Square (EGLS) Panel Data regression analysis to analyze 191 businesses and 1337 company-years of observations from 2013 to 2017 before COVID-19. The research suggests that autonomous audits improve firm finances. The study uses market book value, ROA, Tobin's Q, and EPS. These measurements are commonly used, although their complexity may limit their representation of a company's financial success. Adding financial metrics may improve the image.

Dattijo, Ibrahim, and Adamu (2022) investigate how audit quality affects the value and usefulness of accounting data during a five-year period (2015-2019). 74 listed non-financial service companies on the NSE comprise the study's population. Based on census sampling, the investigation's sample entailed of all 74 businesses. BVP and EPS were used as stand-ins for accounting data. To estimate the data, OLS regression was employed. The outcome demonstrates that the value and relevancy of the accounting information are significantly and favorably impacted by audit quality. According to the investigation's outcome, there is a higher chance that non-financial service companies' accounting information will become more valuable and relevant when audit quality is good.

While financial success of Kenyan commercial and services sector will be used for the current study, value and usefulness of accounting data of non-financial service companies in Nigerian were adopted for the research

The impact of audit quality on Kenyan commercial banks' financial effectiveness was investigated by Edward and Joseph (2022). The estimation technique utilized in the investigation is descriptive. All eleven of the commercial banks registered on the NSE make up the study population. The information was extracted from 2014–2019 financial filings. Statistical analysis that is both descriptive and inferential was utilized. The outcome of the investigation indicated that when size, capital structure, and audit quality are properly linked, they will all lead to successful performance. Based on the investigation's outcomes, it was deduced that commercial banks listed on the NSE have better financial results as a result of high-quality audits, which can thus be applied to the entire banking sector. The prior inquiry was carried out on Kenyan commercial banks while the present investigation will be focus on commercial and services sector in Kenya.

The qualities of audit quality were investigated by Ozegbe and Jeroh (2022) as potential predictors of business financial performance. The study drew conclusions from quoted Nigerian firms using data collected over a ten-year period (2011–2020). Mandatory audit services, audit firm size, independence, and tenure were used as proxies for audit quality, while ROA was utilized to measure firm performance. The Panel Least Squares method was used in the investigation. Although the study indicated that audit independence significantly lowers ROA, it also found that audit tenure and firm size had a favorable, albeit irrelevant, link with ROA. However, corporate performance (ROA) is notably impacted by statutory audit services alone. Overall, audit quality criteria have a big influence on ROA. The investigation deduced that the independence of auditors and the caliber of audit work expressly dedicated to statutory audit are key factors that explain profitability, with particular reference to variations in ROA between businesses. This differs contextually to the aims of this study as it examines potential predictors of business financial success of Nigerian quoted corporations while this study will evaluate financial effectiveness of commercial and services sector in Kenya.

The effect of audit quality on the financial success of Nigerian quoted money deposit banks was investigated by Ayeni-Agbaje and Oluyori (2024). ROA was utilized as a stand-in for financial success, and audit quality metrics include auditor independence, audit committee size, and audit firm size. An ex-post factor research approach was employed in the inquiry. 12 Nigerian quoted money deposit banks on the NGX as of 2023 make up the study's population. A census sampling technique was utilized to select the sample size of 12 banks. The time frame for the study is 2014–2023. Descriptive and inferential statistics were utilized to evaluate the data, and pooled least squares was utilized to test the hypotheses. The outcome indicated that financial performance is negatively and negligibly impacted by auditor quality. The study concluded that before hiring an auditor, the size of the audit firm is an imperative consideration. The latest inquiry will be done on commercial and services sector in Kenya, whereas the previous investigation was completed on quoted Nigerian money deposit banks.

2.2.3 Board Size and Performance of Commercial and Services Sector

Yasser et al. (2017) examined board size effect on Karachi Stock Exchange performance. This study assessed corporate performance using accounting metrics including Tobin's Q, economic profit, and ROA. According to the research, a bigger board, underrepresented groups, and family directors help a firm succeed.

This research assessed corporate performance using accounting metrics including Tobin's Q, economic profit, and ROA. Such measures are widely used, however accounting procedures may weaken their trustworthiness. Discussing constraints and how altering performance metrics may impact outcomes is beneficial.

Kaur and Vij (2017) studied whether board quality affects firm effectiveness. This article investigates the impact of corporate governance principles on bank profitability, utilizing panel data from Indian National Stock Exchange listed institutions over the period from 2008 to 2014. The study measured financial performance using Tobin's Q, Net Interest Income, Returns on Assets, and Returns on Equity. The link between governance and bank performance was examined using pooled OLS and GLS estimates. The performance-governance relationship was examined using the GMM Estimator. Smaller boards are more competent, which benefits the

organizations they oversee. The studies of Yasser et al. (2017) and Kaur and Vij (2017) focused on financial institutions, while this study concentrated on enterprises and service providers.

Oyedokun (2019) examined publicly listed Nigerian commercial banks from 2013 to 2017 to see how board quality affected financial performance. The commercial bank annual reports provided the data. Our whole data set was evaluated using "multiple panel regression. The study showed board size does not affect corporate success. This investigation fills a vacuum in the literature by concentrating on Nigerian commercial banks.

Board size's effect on non-financial firms' NSE-listed financial performance was investigated by Gatehi and Nasieku (2022). 26 randomly chosen non-financial companies listed on the NSE were utilized. ROE was utilized as the dependent variable in a correlational and panel regression study that was carried out utilizing past financial information from the financial accounts of businesses. The outcome demonstrated that board size's effect on non-financial firms' NSE-listed financial performance was statistically insignificant. The investigation came to the conclusion that board size should not be disregarded because its features are crucial for promoting greater diversity on boards. In contrary to this study, the present study will focus on Kenyan commercial and services sector.

Waithigi, Kenyanya, and Oluoch (2022) evaluated board size influence on the financial success of Kenyan listed manufacturing businesses. The explanatory survey research approach was utilized in this investigation. All 16 manufacturing businesses listed on the NSE throughout the six-year period 2015–2020 were the investigation's target population. Thirteen enterprises with complete data over the whole study period were chosen using the census approach to provide 78 observations. Descriptive and multiple regression estimation techniques were utilized to estimate the data. According to the investigation, board size improves financial success. The study came to the conclusion that the size of the board significantly improves the financial success of manufacturing companies that are listed on the NSE. The investigation was however based on data Kenyan listed manufacturing companies which differs from commercial and services sector which is the focus of this investigation.

The impact of board size on manufacturing's tax preparation and related companies listed on the NSE was investigated by Ochola, Mungai, and Jagongo (2022). The causal study approach was utilized. The 9 companies listed in the manufacturing and related sectors were the target population, and the audited financial reports provided secondary data. The outcome of the investigation demonstrated that among manufacturing and related companies listed on the NSE, board size had no discernible impact on tax planning. The study concluded that among manufacturing and related companies listed on the NSE, Kenya, board size had a negligible favorable impact on tax planning. In Kenyan manufacturing and related industries listed on the NSE, bureaucratic conditions across enterprises may have a negligible impact on tax planning. Tax planning by manufacturing and related companies in Kenya served as the study base for the previous study. Financial effectiveness of Kenyan commercial and services sector will serve as the study base for this current study

From 2016 to 2020, Bach and Mwenda (2024) explored how board size affects the financial effectiveness of money deposit banks that were listed on the NSE. Both descriptive and inferential statistics were applied in estimating the data, and Stata 16 was used to examine the Panel Data Regression Model. According to the study, Kenyan commercial banks' financial performance and board size are positively correlated. According to the study's findings, a change in the board's size is favorably linked with changes in the performance of Kenya's registered, profitable banks. Board committees' size enables them to supervise, monitor, and counsel top management as needed by the regulator. The investigation was carried out on financial effectiveness of Kenyan money deposit banks. This present investigation focused on financial success of commercial and services sector in Kenya.

The impact of board size on the financial success of service and commercial listed companies at the Kenyan NSE was examined by Oboo and Aluoch (2024). In this study, an ex-post research approach was applied. To find out how these board structure factors affect listed organizations' financial performance between 2015 and 2022, eleven (11) listed commercial and service firms were employed. The financial success of Kenyan listed

commercial and service enterprises was established to be negatively impacted by board size, but this effect was negligible. The study deduced that the financial success of these businesses would not be notably impacted by changes in board size. The aforementioned investigation was based on the period 2015-2022 while the present investigation will base on the year 2018-2022.

2.2.4 Institutional Ownership and Financial Performance of Commercial and Services Sector

Kabir and Thai (2017) examined how corporate governance affects financial performance. Researchers examined a variety of Vietnamese firms. Data was analyzed using robust regression analysis and three models: fixed-effects, two-stage least squares, and ordinary least squares. Findings revealed that foreign or government ownership improves financial performance. Since the previous research solely covered Vietnam, the applications of the findings are unique to Vietnam. This study focused on Nairobi County to address that gap.

Ali, Sial, Brugni, Hwang, Khuong, and Khanh (2019) investigated how effective corporate governance affects financial performance. Panel regression was performed on 3400 Shanghai Stock Exchange (SSE) companies. The relationship between corporate governance and financial performance was examined using 2009-2018 annual data. Institutional ownership correlated positively with corporate financial success. The report suggests the researchers focused on one aspect of corporate governance. This study focused on board independence, institutional ownership, size, and the caliber of external audits.

Sakawa and Watanabe (2020) examined how ownership structure affects institution performance. The study sampled Japan's most famous publicly listed corporations, the TOPIX 500, from 2010 to 2016. This study examined institutional investors' stakeholder-focused corporate governance function. The study examined the effect of institutional investors on business performance using 2924 firm-year data. Institutional ownership improves business governance and financial sustainability, the study found.

Tanui (2021) explored the moderating effect of capital structure in the indirect link amongst institutional ownership and financial success through the corporate diversification of listed firms at the NSE. The study,

which comprised 35 listed companies from 2003 to 2017, was driven by the post-positivist research paradigm and an explanatory research methodology. Outcomes demonstrated that corporate diversity, capital structure and institutional ownership have a strong interaction effect on financial success. According to the report, the financial success of NSE-listed companies is significantly and favorably impacted by institutional ownership. The study established that institutional ownership is seen as a source of market power that is utilized to improve the firm's performance. Although, institutional ownership was a moderating variable in the prior investigation, the present investigation considers institutional ownership as an independent variable.

Otieno (2022) investigated how the institutional ownership structure affected the NSE-listed non-financial companies' earnings management. During the five years 2014–2018, a census research was conducted that included all 38 listed non-financial enterprises. Regression analysis, correlation, and descriptive statistics were utilized in the investigation's data analysis. The investigation discovered a detrimental and statistically negligible link between earnings management and institutional ownership. Therefore, it has been discovered that institution ownership improves the caliber of financial reporting. Thus, the investigation concluded that the bank's owners are long-term investors who care about the company's long-term success. Through their duty as monitors, these investors possess the ability and desire to enhance the caliber of financial reports. The study however was based on realities of Kenyan non-financial companies' earnings management which differs from the realities of Kenyan commercial and services sector which is the primary focus of this study.

Buigut (2023) explored how institutional ownership affected Kenyan listed companies' dividend payout policies. 40 Kenyan listed companies were selected for the inquiry from public audited financial statements between 2009 and 2019. Panel regression estimation was utilized in the study. The result showed that institutional ownership, both local and international, is significant and strongly correlated with dividend distribution policies. According to the study's findings, foreign institutional investors use the active monitoring hypothesis to keep an eye on businesses and allocate resources to keeping an eye on and forcing investee companies to pay dividends. The

study's main focus was on dividend payout policies of 40 Kenyan companies. Financial performance of Kenyan commercial and services sector will be the subject of this investigation.

The moderating effect of institutional ownership on cash holdings and the factors influencing non-financial firms listed on the NSE was examined by Ongwae (2024). In this investigation, a longitudinal research strategy was employed. In this investigation, 44 non-financial firms that were listed on the NSE were utilized, which ran from 2011 to 2022. Thirty-one of the 44 businesses were involved in the investigation. The study's population included trusts in the following sectors: investment and services, manufacturing, real estate, energy and petroleum, construction and associated industries, commercial and services, agricultural, and automobiles and accessories. Financial statements and annual reports served as secondary sources of data. Utilizing Arellano dynamic panel analysis, the study discovered that the impact of cash holding variables on non-financial enterprises listed on the NSE is moderated by institutional ownership. Additionally, the paper suggests enforcing disclosure laws that require businesses to report on how institutional ownership affects financial choices, particularly cash management. The previous investigation focus on only 44 non-financial companies listed on the NSE from 2011-2022 while the present investigation focus on Kenyan commercial and services sector from 2018-2022.

2.3 Research Gaps

The extant empirical literature has rigorously examined the effects of corporate governance elements—such as board independence, external audit quality, board size, and institutional ownership—on firm financial performance across diverse international contexts. However, persistent gaps remain evident: a significant proportion of prior research, including studies by Almaqtari (2020) and Naseem et al. (2017), concentrated in jurisdictions like India, Pakistan, and GCC states, whose economic structures and regulatory frameworks diverge markedly from those of Kenya, thereby limiting the transferability of findings. Moreover, investigations such as those by Mkabane et al. (2020) and Wambui (2021) have predominantly targeted specific sectors (e.g., SACCOs and commercial banks), constraining the generalizability of results to the broader commercial and service

sectors, while methodological heterogeneity—including outdated data periods and reliance on alternative performance metrics such as Tobin’s Q and ROE—further underscores the absence of focused, contextually relevant analyses using ROA for Kenyan firms.

2.4 Recap of Literature

In summary the literature revealed inconsistent and sometimes contradictory evidence regarding the nexus between governance practices and firm performance, with some studies reporting significant associations and others finding insignificant or adverse effects—highlighting both contextual and methodological limitations. This study directly addressed these lacunae by centering on commercial and service firms listed on the Nairobi Securities Exchange during 2018–2022, employing ROA as a standardized indicator of financial performance and integrating Kenya-specific governance dynamics, thereby furnishing a better and contemporaneous contribution to the scholarly discourse.

2.5 Theoretical Review

2.5.1 Agency Theory

The agency theory was advanced by Ross and Mitnick (1973). The theory states that in relationships where one party (the principal) delegates decision-making authority to another (the agent), conflicts of interest and information asymmetry can arise because both parties are assumed to act in their own self-interest. Smith (1773) prophesied that there is a likelihood that the executives of an establishment may not function in the proprietors' utmost interests if they are not the real proprietors of the enterprise. Research by Jensen and Meckling (1976) supported the idea that stockholders in a company with share capital represent the legal proprietors of the business. These shareholders (the principals) act as agents by delegating management responsibilities to the company's executives. An important point that this study raises is whether or not the leaders of a company with share capital put the needs of the owners ahead of their own. The theory of agency delves into and concentrates on the predicaments that crop up in enterprises due to the dissociation of proprietors and administration. This

theory facilitates the execution of diverse regulatory measures to manage the conduct of performers in co-owned companies (Panda & Leepsa, 2017).

According to the hypothesis, managers who are employed to oversee the organization's operations are more inclined to prioritize their own interests over maximizing the organization's wealth. The following presumptions are made by the theory: that the ownership of the business is distinct from the organization's management (Fama & Jensen, 1983). Additionally, the idea makes the assumption that people are naturally sluggish and unwilling to complete tasks without sufficient supervision (Fama, 1980). The theory also assumes that the company's owners have informed senior managers of their goals and are aware of what they hope to accomplish (wealth maximization). According to the notion, managers' personal interests conflict with the owners' in order to maximize their own fortune.

Accordingly, when ownership and management are separated, modern organizations produce conflict areas. The innate human traits of greed and laziness are what fuel these disputes. It is assumed that people are inherently lazy and will not always desire to put up their best effort when assigned tasks (Ferrell, Fraedrich & Ferrell, 2014). Additionally, managers would rather profit themselves than choose options that will optimize the owners' wealth. Lastly, managers are likely to mislead about their abilities to run the company, which results in adverse selection by the shareholders. It is unlikely that shareholders will accurately assess a manager's competence and capacity to faithfully carry out their responsibilities (Jensen & Meckling, 1976).

The aforementioned goal incongruence encourages managers to fabricate financial reports in order to fulfill their contractual obligations. Teshima and Shuto (2008) assert that if the compensation of senior team managers is dependent on specific performance matrices, agency issues will be made worse. As a result, managers are inclined to choose accounting estimates and procedures that will maximize bonuses received during that accounting period. As a result, the hypothesis suggests closer observation of managers. The owners' active oversight is probably going to guarantee that the agreement between the managers and the owners is upheld. It

lowers the likelihood of misreporting by increasing the likelihood that the agent will act as anticipated. Financial statements that accurately reflect the occurrence of economic substance as it occurred within the company are eventually produced as a result of these monitoring efforts (Roodposhti & Chashmi, 2011).

Larger audit operations typically employ a workforce with a variety of skills intended to lessen the vast spectrum of information asymmetry issues. The agency notion is seen as the fundamental idea that underpins the need for corporate governance and contributes to the growing relevance of internal audit monitoring in contemporary corporate governance (Brickley, Coles & Jarrell, 1997). From the foregoing, it is clear that agency theory explains both the necessity of internal audit and the extent of its role. In this study, the primary agent relationship was between the external auditors and the organization's governance.

Furthermore, Jensen and Meckling (1976) depicted the organization as a self-contained entity that solely operates to enhance its value and earnings. A proficient collaboration and a shared sense of teamwork between the parties engaged in the enterprise could result in the optimization of riches. However, if there is a clash of interests due to their diverging objectives, it can only be settled by the authority and management of the company.

The self-interested groups also acknowledged that the company's presence was crucial for their interests to be fulfilled. As a consequence, they work efficiently to guarantee the organization's endurance. Hermalin and Weisbach's 2012 paper posits that conflicts of interest exist between different stakeholders in a corporation. A principal-agent link is established when shareholders give managers the power to make decisions. The central challenge is to align the interests of these two parties.

Information disclosure plays a decisive role in this context as it aids in bridging the informational divide between principals (shareholders) and agents (managers). They suggested exploring the nuances of different types of information disclosure and their effects on specific aspects of corporate governance. From this study, a concern may be raised on whether the sample is representative and whether selection biases are adequately addressed.

2.5.2 Stewardship Theory

Stewardship theory is believed to have emanated from the work of Davis, Schoolman and Donaldson (1997) that reported that supporting the organization and working as a team is more advantageous than prioritizing individual interests is the foundation of the man model. A steward will always choose pro-organizational conduct over selfish actions that may harm the organization. While outlining the major tenets of stewardship theory, Chrisman (2019) submitted that the theory of stewardship is rooted in a model of human nature that depicts individuals as altruistic and oriented towards the greater good rather than self-serving. According to the Smallman (2004), independent company managers are more prone to be prudent with the resources of the stakeholders. Managers are seen by the notion as moral curators who will boost a company's profitability in a sincere and fair manner. Managers act as responsible guardians of the organization if they are allowed to do so, according to the belief. The theory explains why managers are crucial to the management of operations in listed firms by making sure that assets are used effectively to produce profits for stakeholders and that important good corporate governance practices are followed to reduce agency costs and mitigate corporate risks.

The theory states that directors who aspire to be effective corporate stewards must behave morally and collaborate with all parties involved in order to accomplish the shared goal of achieving the overall company aims. According to this theory, managers act as stewards, protecting and overseeing shareholder capital through business operations in order to further their own efficacy goals. Therefore, the idea of stewardship argues that dependable and devoted connections between stewards and leaders directly affect the operation of the company (Tonui & Olweny, 2018). The stewardship theory states that since internal executives rationally aim to maximize owner profits, having more of them will be linked to improved corporate performance. The ability to obtain data and conduct a comprehensive inquiry is taken into account while making decisions (Hassan & Lukong, 2012). Those who oppose stewardship theory claim that boards may no longer be required if the majority owner is a family or a government agency. Some boards are established out of a sense of edifying tradition and an

unwavering faith in their effectiveness, or to give government-run organizations a more corporate aspect (Tonui & Olweny, 2018).

Moreover, according to this theory, individuals who embrace these principles are more likely to prioritize the goals of the organization over their personal objectives, thereby sacrificing their own interests for the benefit of the principal. Stewardship theory also posits that formal mechanisms such as monitoring and financial incentives are redundant and may even have adverse effects, as it assumes that people's objectives are inherently aligned with those of the owners and/or the enterprise. Based on the stewardship principle of administration, executives must handle the resources that have been confided to them by investors and other invested parties to guarantee the corporation's sustained success.

Stewardship theorists contend that senior executives will not annoy shareholders out of concern for their reputation. The top executive's reputation is crucial in this situation because acting against the interests of the company reduces their usefulness. Stewardship theory proponents argue that higher business performance is linked to the majority of internal directors working to enhance shareholder profits. This is based on the idea that internal directors rule more effectively than external directors and have more and more significant decision-making authority because they have a better understanding of the organization's operations. The fundamental idea here is that since managers are basically reliable, there will not be any substantial agency expenses. This is the exact reverse of what the agency theory predicts (Donaldson & Davis, 1991).

The stewardship theory has come under fire as scholars like Dicke (2002) observed that the implementation of stewardship theory as a substitute for administrative principles, which rely on principal-agent theory, is unlikely to be established as a means to improve the efficiency of large organizations and uphold ethical standards. This is because the commitment to uphold public service values in order to benefit wider stakeholders is overly idealistic and cannot be put into practice under stringent external regulations.

Williamson (1975) further argues that stewardship-like conduct is untenable because it runs counter to natural human opportunism. In practical terms, the bureaucratic style of administration rooted in agency theory stands as the norm. The theory of stewardship needs to address how asymmetry of information and limited rationality impact the stewards' ability to understand the principals' objectives.

2.5.3 Stakeholder Theory

The groundbreaking study by Freeman (1984) emphasized the concept of organizations having stakeholders and the imperative of devising a management framework that takes this into account, forming the basis for a plethora of subsequent publications on stakeholder theory in management. The theory was seen as an alternative to the conventional input-out model that had been invoked. For Freeman and Evan 1990, stakeholders are people or entities with legitimate concerns in the material and/or procedural aspects of commercial operations. Regardless of whether the company has a functional stake in them, interested parties can be recognized by their investment in the organization, and every interested party's concerns hold inherent importance. This implies that each set of interested parties should be considered for their own benefit and not solely because it can benefit another group, such as the shareholders.

The theory asserts that the primary watchdog over the business's approach and procedures is the interests of its stakeholders. It implied that when the management is developing the organization's plans, they should consider the interests of the parties involved. It is based on the premise that a number of groups both affect and are influenced by the choices and actions of the businesses. In this sense, stakeholders are people and organizations that profit from or suffer harm from the conduct of corporate entities, as well as those whose rights are upheld or infringed. Along with shareholders, these stakeholders span a number of groups, including workers, creditors, suppliers, consumers, and the environment (community) as a whole (Donaldson & Davis, 1991). According to the theory, businesses must fulfill their social obligations in order to make sure that the varied and combined interests of all the groups impacted by their choices and actions are taken into account (Mbalwa, 2015). This is because the company's objective is to maximize performance while meeting the needs of all the major

stakeholders. Therefore, it is crucial to emphasize that shareholders are still only one of the many stakeholder groups that influence and are influenced by a company's operations (Aganyo, 2014).

Donaldson and Preston's foundational work from 1995 argued that the stakeholder concept had broad applicability for management. That the literature in question does more than only describe the here and now or provide forecasts based on cause and effect linkages is implied by this phrase. Stakeholder management is advocated, along with the usage of the associated techniques, protocols, and frameworks. He said that he had learned that developing organizational structures and general policies and making judgments required rigorous evaluation of the genuine concerns of all key stakeholders.

In a corporation's surroundings, a lot of associations seem to be vibrant and diverse, according to Gray, Owen, and Adams (1996). Therefore, in order to fulfill the establishment's aims, it is necessary to comprehend the power of the stakeholders and address their concerns. A collection of stakeholders working together to manage their needs, interests, and viewpoints is referred to as an organization. According to stakeholder theory, businesses can benefit from keeping in mind the needs of multiple stakeholder groups (Franco et al., 2020). Explaining and providing a roadmap for the development of a business's operations and structure are the two main objectives of stakeholder theory. Three viewpoints can be used to approach stakeholder theory: normative, instrumental, and descriptive.

The instrumental approach discusses the possible outcomes of stakeholder interactions and emphasizes the link amongst stakeholder approach and achieving financial aims, while the descriptive approach describes the traits and actions of a particular organization. On the other side, the normative approach is used to comprehend and interpret how businesses operate. It is predicated on the idea that the business's connections with stakeholders are founded on ethical pledges as opposed to seeing stakeholders as a way to increase profits (Jones, Harrison and Felps, 2018). The idea of the stakeholder connection—that is, businesses having a link with stakeholders that involves both influence and impact from stakeholders—is the fundamental tenet of stakeholder theory for

all three methods (Freeman, 1984). Businesses must consider how their actions affect other people because of this interconnectedness, which means understanding stakeholders' social environment, values, and actions by being explicit about what the company stands for (Freeman, 2004).

Donaldson and Preston (2001) asserts that the theory has been criticized for being mostly descriptive and having inadequate practical applications. According to Antoconacopulou and Méric (2005), stakeholder theory is sometimes portrayed as a philosophy rather than a scientific approach to examining contractual interactions amongst players. The fundamental premise is that actors' relationships and interactions are being shaped by control. However, Clarkson (1995) contended that due to the potential lack of responsibility for meeting the needs of all stakeholders, there could be a deficiency in accountability among companies. This could allow organizations to prioritize the interests of certain stakeholders over others without facing consequences. Additionally, prioritizing the interests of stakeholders over shareholders could negatively impact a company's profitability. The fact that the study was published in 1995, while it might still be relevant, it's crucial to consider whether it aligns with current business and economic contexts. This is because the business landscape has evolved significantly in the past few decades, which could impact the relevance and applicability of Clarkson's argument today.

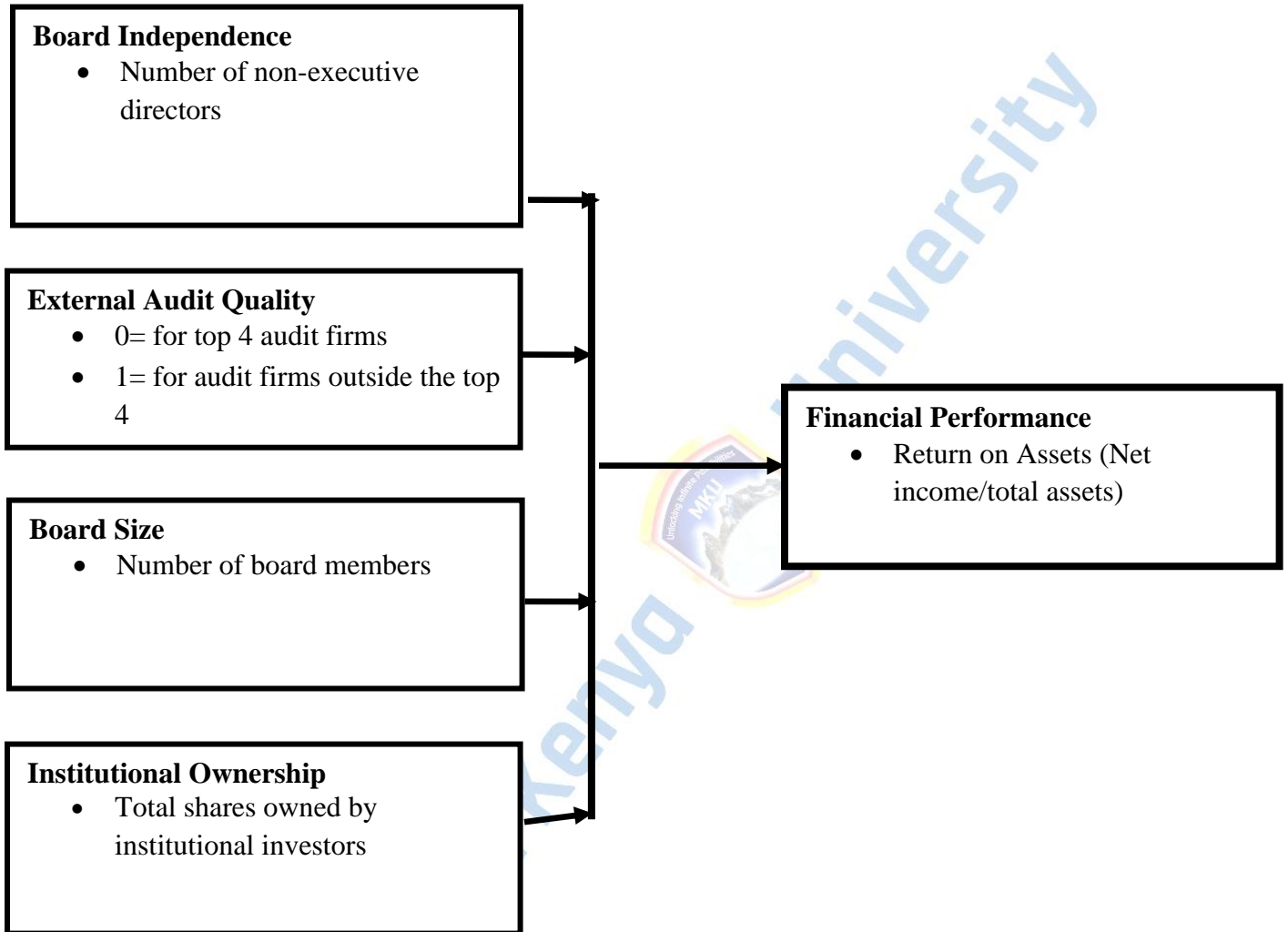
2.6 Conceptual Framework

A conceptual framework is a tool that structures and organizes key concepts, variables, and their relationships to guide a research study, providing a clear lens through which the research problem is understood and investigated. The conceptual framework underpinning this study mapped the relationship between corporate governance mechanisms and the financial performance of listed NSE commercial and service firms. It positions board independence, external audit quality, board size, and institutional ownership as pivotal governance levers—each serving as an independent variable—while designating financial performance, quantified by Return on Assets (ROA), as the dependent variable. Through this structured framework, the research offers a

focused analytical lens to discern how distinct governance practices affect these firms' financial performance.

The framework is illustrated in figure 2.1.

Independent Variables



Source: Researcher (2025)

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The research approach pertained to the various techniques or procedures that a researcher utilized in carrying out research. The target population, experimental plan, data collection instruments, selection process, analytical methods, and ethics were included.

3.2 Study Research Design

A descriptive research approach was utilized for this investigation. A research plan serves as a comprehensive framework for a proposed research project, encompassing all essential elements and strategies necessary for its successful execution. This research design was used because it collects data using a variety of qualitative and quantitative methods in order to produce precise predictions regarding a certain issue or hypothesis (Dulocks, 1993). The research focused on the target demographic comprising the commercial and service organization listed in the NSE.

3.3 Target Population

In the context of research, the term "target group" is used to denote any entity that displays the specific qualities that are being examined or investigated. This implies that the group includes all individuals or subjects that the researcher considers deserving of attention. The research focused on the target demographic comprising of all the 12 commercial and service firms that are listed in the NSE. The study used census survey since the population is small and is less than 200, hence, the population size is taken as the sample size (Israel 2012). This category has been identified for the study as a category of interest from the thirteen categories of firms listed at NSE.

3.4 Instruments of data collection

The collection and compilation of data for an investigation are commonly known as data-gathering techniques, which encompass a researcher's methodical procedures. This study relied on secondary sources of data, specifically financial records, to extract information pertaining to financial success. The records are obtained

from these firms' financial statements that made available the firms' total assets and net income. The audited financial statements were utilized to gather data on the tangibility and liquidity of assets throughout examining their economic impact. The annual reports serve as a reliable source for obtaining precise information regarding corporate governance.

3.5 Method of Data collection

The process of acquiring information for scholarly investigation is often known as data collection. The Capital Market Authority (CMA) and company financial accounts for the period year 2018 to 2022 provided secondary data for this investigation. Respective websites(nse.co.ke/listed-companies) were used to get data on board of directors.

3.6 Diagnostic Tests

The study applied diagnostic tests to ensure no assumptions inherent to the least squares regression method were violated. The tests are significant in confirming the validity and reliability of the results generated by the survey. Kerlinger (1998) suggests that any violation of the inherent assumptions of classical linear regression raises questions about the reliability of the conclusions drawn. A range of diagnostic methods, such as normality, serial correlation, multicollinearity, and heteroscedasticity tests, were used to examine critical considerations in this study.

3.6.1 Multicollinearity Test

Multicollinearity arises when there is a high correlation between explanatory variables in a regression model, and it can lead to estimation problems (Gujarati & Porter, 2009). Even mild multicollinearity can lead to inflated standard errors, thus making coefficient estimates inaccurate and reducing the statistical power of hypothesis testing (Wooldridge, 2016). The effects of such repercussions can hinder the distinctive effects of single variables, thereby making incorrect conclusions about their significance. Such impacts can also make confidence

intervals expand and t-statistics reduce, thus making it more likely for one to fail to reject null hypotheses even if there are real relationships (Gujarati & Porter, 2009). While a variance inflation factor (VIF) value of 10 was utilized in the study, any VIF value above 10 is considered severe multicollinearity otherwise it is not thus, considered less or no collinearity.

3.6.2 Normality Test

The test of normality decides if a given dataset is normally distributed, which is a necessary assumption in many statistical tests, including ordinary least squares (OLS) regression (White, Redford & Macdonald, 2020). The Shapiro-Wilk test was utilized to test normality; the test is reported to be normal if the associated p-value is greater than 0.05 (de Souza, Toebe, Mello & Bittencourt, 2023). In cases of violated normality, while the estimates of the coefficients can remain unbiased, t-distribution based hypothesis tests and F-tests could be unreliable and produce incorrect levels of significance and confidence intervals (Studenmund, 2017). In addition, non-normal residuals may reduce the efficiency of estimators, especially with small samples, thus increasing the likelihood of committing Type I or Type II errors when testing hypotheses. While higher sample sizes may mitigate normality problems in compliance with the rules of the central limit theorem, it is also important for researchers to check for the distribution of residuals to ensure the validity of statistical inferences (Wooldridge, 2016).

3.6.3 Autocorrelation Test

Autocorrelation occurs when residuals in a regression model are correlated across observations, violating the independent errors assumption underlying ordinary least squares (OLS) regression (Akpan & Moffat, 2018). The Breusch-Godfrey test was utilized to detecting autocorrelation based on a null hypothesis that assumes no autocorrelation. The null hypothesis is violated if the p-value is below the critical level of 0.05, thus providing evidence for the presence of autocorrelation, leading to inefficient coefficient estimates, understatement of

standard errors, and unreliable hypothesis testing (Wooldridge, 2016). Such inefficiency results in biased inferences because the distortion in standard errors negatively affects t-statistics and confidence intervals (Ulrich, Miller & Erdfelder, 2018). Consequently, researchers can reject or fail to reject hypotheses incorrectly, leading to potentially misleading conclusions. Correcting autocorrelation generally requires standard errors to be adjusted by applying heteroscedasticity and autocorrelation-consistent (HAC) estimators or by using generalized least squares (GLS) methods to improve estimation accuracy (Mignon, 2024).

3.6.4 Heteroscedasticity Test

Heteroscedasticity is a situation where the variance of error terms in a regression analysis is not homogenous across different observations, thus violating one of the key assumptions of ordinary least squares (OLS) estimation (Hayes & Cai, 2007). The presence of this issue might lead to coefficient estimates that are inefficient and unreliable, as it biases the standard errors, thus compromising the validity of hypothesis testing (Saccenti, Hendriks & Smilde, 2020). Under heteroscedasticity, the resulting standard errors obtained may be either underestimated or overestimated, resulting in misleading significance tests, inaccurate confidence intervals, and inefficient inferences (Sun, Yuan & Liu, 2017). To counteract the effects of heteroscedasticity, researchers often use robust standard errors or generalized least squares (GLS) to obtain more reliable estimates (Agunbiade & Adeboye, 2012). Detection of heteroscedasticity was through the application of Breusch-Pagan using 0.05 p-value significance.

3.6.5 Stationarity Test

Stationarity testing assesses if a time series variable sustains a constant mean and variance over its course, which is essential for the validity of statistical inferences drawn from regression estimates (Racine, 2019). The Fisher-type test was used as a panel unit root test that combines individual unit root tests over cross-sectional units to determine stationarity (Maddala & Wu, 1999). If a time series is found to be non-stationary, the estimates

obtained from regression analysis could be ruined by spurious correlations, leading to misleading interpretations of coefficients and unstable results in hypothesis testing (Wooldridge, 2016). Non-stationary variables can generate deceptively high R-squared measures and biased standard errors, thereby increasing the probability of Type I errors in hypothesis testing (Baltagi, 2021). To avoid problems associated with non-stationarity, the study adopted differencing procedures to ensure statistical relations reflect actual conditions.

3.6.6 Hausman Test

The Hausman test is a statistical test for the most suitable model specification to use in panel data analysis, specifically for the distinction between a fixed effects (FE) and a random effects (RE) model (Hausman, 1978). The null hypothesis is that the RE model is appropriate, which means that individual-specific effects are not correlated with the explanatory variables. The fixed effects model is more suitable, as shown by a statistically significant p-value (typically <0.05), whereas a non-significant p-value accords with the adoption of the random effects model (Baltagi, 2021). The fixed effects model addresses unobserved heterogeneity by permitting individual-specific intercepts, hence being very effective for the estimation of time-invariant characteristics. The random effects model makes the assumption that unobserved individual effects are random and uncorrelated with the regressors and, therefore, provides higher efficiency, provided the assumption holds (Wooldridge, 2016). The study adopted a p-value of 0.5 for judging between the FE and RE model.

3.7 Data Analysis and Presentation

Data analysis is seen as the methodical technique of scrutinizing, modifying, and simulating data utilizing statistical methods in order to get significant insights that facilitate the process of making well-informed decisions. The data was analyzed using a panel regression model. The outcomes were presented in a tabular format. Based on the aforementioned study, a comprehensive conclusion was derived, and a set of recommendations was put forth. The panel regression model was represented in the following manner:

$$FN_{it} = \beta_0 + \beta_1 BI_{it} + \beta_2 EQ_{it} + \beta_3 BS_{it} + \beta_4 IN_{it} + \varepsilon$$

Where

FN = Financial Performance

BI = Board Independence

EQ = External Audit Quality

BS = Board Size

IN = Institutional Ownership

β_0 = Intercept

i= Firm

t= Time Period

$\beta_1, \beta_2, \beta_3, \beta_4$ = Estimated Parameters

ε = Error Term



3.8 Operationalization and Measurement of Variables

The operationalization of the factors utilized in the study is provided in Table 3.1. This displayed the measurement of the variables, indicators that captured both the dependent and independent variables.

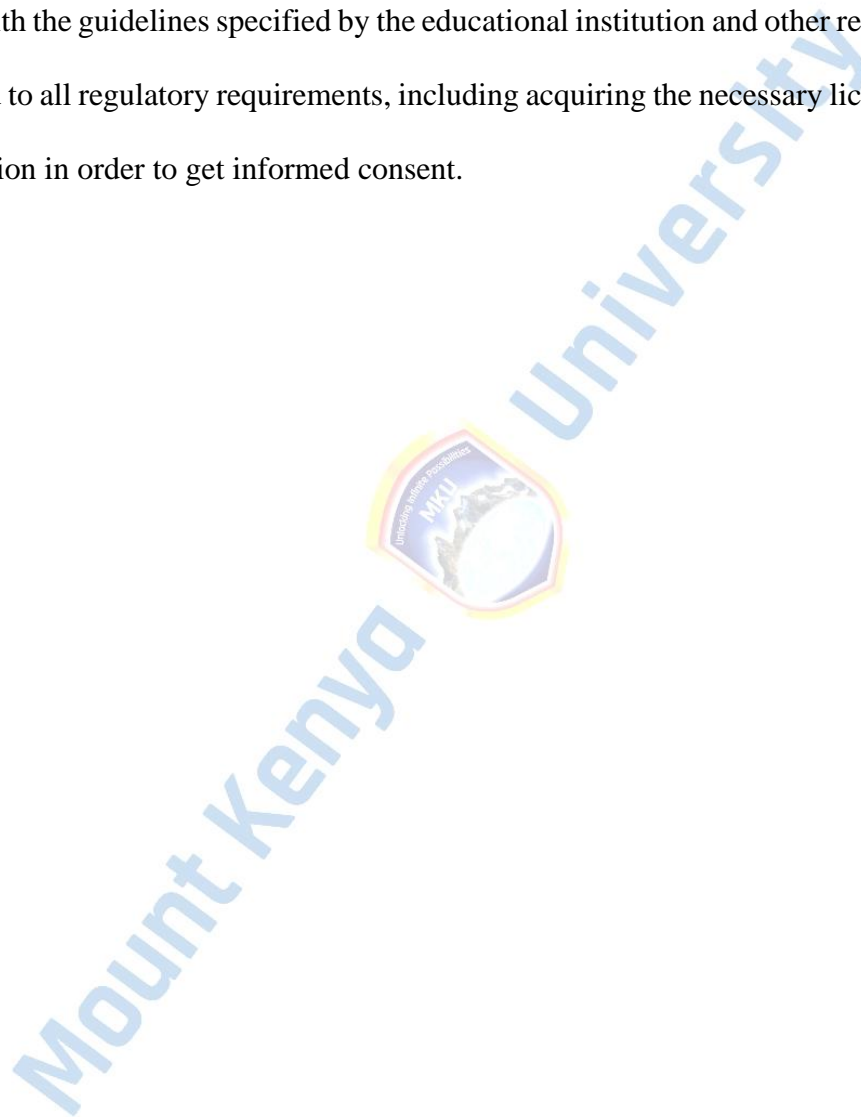
Table 3.1: Variable Operationalisation and Measurement

Variable Type	Variable	Operationalisation/Measurement	Data Source
Dependent Variable	Financial performance metric	Revenue, net income, earnings per share, return on equity	Annual reports of listed firms, Financial databases
Independent Variable	Board independence	Composition of the board (independent directors vs non-independent directors)	Annual reports of listed firms
	External audit quality	Name of the external firm, audit fees, audit report opinion (e.g qualified), audit tenure	Annual reports, audit reports
	Board size	Total number of board members, including executive and non-executive directors.	Annual reports of listed firms
	Institutional ownership	Percentage of shares owned by institutional investors(e.g., mutual funds, pension funds)	Annual reports, shareholder information

Source: Researcher (2025)

3.9 Ethical Considerations

In the process of conducting a research inquiry, adherence to ethical concerns is of paramount importance. Ethical considerations encompass a collection of rules and norms that the researcher must follow. It is imperative to ascertain the suitable methodologies to utilize throughout the course of the study investigation. The researcher rigorously complied with the guidelines specified by the educational institution and other research organizations. The researcher adhered to all regulatory requirements, including acquiring the necessary license and permit from the appropriate institution in order to get informed consent.



CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION

4.1 Introduction

This chapter presents the results of the data analysis, including descriptive statistics, diagnostic tests, and regression analysis, to examine the relationship between corporate governance and financial performance of listed commercial and service firms in Kenya. The chapter concludes with a discussion of the key findings in relation to the research hypotheses.

4.2 Descriptive Analysis

Descriptive analysis plays a crucial role in data exploration by offering a detailed overview of the essential features of the dataset being examined. This includes various statistical indicators such as means, standard deviations, and ranges, which help illuminate the central tendencies and variability present in the data. By utilizing these metrics to summarize the information, the patterns, trends, and anomalies of the data are identified, as illustrated in Table 4.1.

As obtained in table 4.1, financial performance exhibited a mean value of 1.549395, with a standard deviation of 4.271787. This showed the considerable variability across firms. The minimum value of -11.2868 was also disclosed. This suggests that some firms are experiencing significant financial distress, while the maximum value of 15.04297 reflects strong performance by others. This wide range highlights the uneven financial health of firms in the NSE, which could impact market confidence. Investors may perceive the market as risky due to the high volatility in performance, potentially deterring investment in underperforming firms. However, the presence of high-performing firms could also attract investors seeking high returns. The practical implication is that regulators and firm management need to address the factors driving poor performance in some firms while promoting best practices among high performers. This finding aligns with studies such as Muriu (2014), who

noted similar disparities in financial performance among Kenyan firms, attributing them to differences in governance and operational efficiency.

The mean board independence score of 4.425, with a standard deviation of 1.412172 were discovered. The outcome suggests that most firms have a moderate level of independent directors on their boards. The range between the minimum (2) and maximum (7) values were disclosed. This connotes variability in governance practices, with some firms having fewer independent directors than recommended. Higher board independence is generally associated with better governance and oversight, which can enhance market confidence by reducing agency conflicts and improving decision-making (Jensen & Meckling, 1976). However, the observed variability suggests that some firms may not be fully leveraging the benefits of independent oversight, potentially undermining investor trust. This finding is consistent with studies such as Jafeel, Chu and Abdalla (2024), who found that moderate levels of board independence are common in emerging markets but emphasized the need for stronger governance frameworks to maximize performance.

The mean external audit quality score of 0.75, with a standard deviation of 0.438529 were unveiled in table 4.1. This outcome indicates that a majority of firms engage high-quality auditors, as the variable is binary (0 for low quality and 1 for high quality). However, the presence of firms with low audit quality (minimum value of 0) raises concerns about the reliability of financial reporting for these firms. High audit quality enhances market confidence by ensuring the accuracy and credibility of financial statements, which are critical for investor decision-making (Zhang, Ge & Su, 2018). This implies that regulators should enforce stricter compliance with audit standards to ensure uniformity in financial reporting quality. This finding aligns with studies such as Bagonza, Chen and Rech (2024), who highlighted the positive impact of audit quality on investor confidence in emerging markets.

As contained in table 4.1, the mean of board size is 9.6, with a standard deviation of 3.256552. The findings suggest that most firms have relatively large boards, ranging from a minimum of 4 to a maximum of 16 members. While larger boards can bring diverse expertise and resources, they may also face challenges in coordination and decision-making efficiency (Vaidya, 2019). The variability in board size indicates that firms adopt different governance structures, which could impact their effectiveness. This demonstrates that investors may prefer firms with optimally sized boards that balance diversity and efficiency. The practical implication is that firms should evaluate their board structures to ensure they are neither too large to be effective nor too small to provide adequate oversight. This finding contrasts with studies such as Dalton et al. (1999), who found no consistent relationship between board size and performance, but aligns with Yan, Hui and Xin (2021), who argued that smaller boards are often more effective.

The mean institutional ownership value of 1502.738, with a high standard deviation of 1827.367 was revealed. This reflects significant variability in the level of institutional investment across firms. The minimum value of -2358.463, which is unusual and may indicate data anomalies or specific cases of disinvestment, contrasts sharply with the maximum value of 5404.743, representing substantial institutional involvement. Higher institutional ownership is generally associated with improved governance and performance due to active monitoring by institutional investors (Sakawa & Watanabel, 2020). However, the observed variability suggests that some firms may not be attracting sufficient institutional interest, potentially due to perceived risks or poor performance. This could undermine market confidence, as institutional investors are often seen as stabilizers and enhancers of governance. The practical implication is that firms should work on improving their governance and transparency to attract more institutional investment. This finding aligns with studies such as Franks (2020), who noted that institutional ownership patterns vary widely across markets, but contradicts He, Huang and Zhao (2019), who emphasized the universal benefits of institutional involvement.

Table 4.1: Descriptive Results

Variable	Obs	Mean	Std. Dev.	Min	Max
Financial Performance	40	1.549395	4.271787	-11.2868	15.04297
Board Independence	40	4.425	1.412172	2	7
External Audit Quality	40	.75	.438529	0	1
Board Size	40	9.6	3.256552	4	16
Institutional Ownership	40	1502.738	1827.367	-2358.463	5404.743

Source: Study Data (2025)

4.3 Correlation Analysis

The direction and strength of the corporate governance factors (board size, institutional ownership, external audit quality and board independence) were examined on the financial performance of the listed firms in Kenya. This was performance using Pairwise correlation technique of analysis. The outcome accredited to this study is illustrated in Table 4.2.

Table 4.2 disclosed that board independence exhibited a significant positive relationship (0.5747) with financial performance. This demonstrates that higher levels of board independence are associated with improved financial outcomes of these firms. This finding aligns with agency theory, which suggests that independent boards enhance governance by reducing managerial opportunism and ensuring alignment with shareholder interests (Jensen & Meckling, 1976). Similar results have been reported by Reguera-Alvarado and Bravo (2017), who found that board independence positively influences firm performance in developed markets. Conversely, external audit quality showed a significant negative correlation (-0.5039) with financial performance. This suggests that higher audit quality is associated with lower financial performance. This result contradicts studies such as Zekaj (2018), who found that audit quality positively impacts financial performance by reducing information asymmetry and enhancing credibility. The unique market conditions and the differing technique utilized in these studies could be linked to these outcomes.

Board size, while not significantly correlated with financial performance (-0.0726), showed a weak negative correlation. This suggests that the size of the board, in itself, does not have a substantial direct impact on financial

outcomes. This finding aligns with studies such as Croci (2018), who found that smaller boards tend to be more effective in improving firm performance due to better coordination and reduced free-rider problems. Institutional ownership demonstrated a significant negative correlation (-0.4260) with financial performance. This signifies that higher institutional ownership is associated with lower financial outcomes. This finding contradicts the conventional view that institutional investors enhance performance through active monitoring and governance (Sakawa & Watanabel, 2020). However, it aligns with studies such as Cremers, Pareek and Sautner (2019), who argued that institutional investors might prioritize short-term gains or engage in passive ownership, potentially undermining long-term performance. The conflicting outcomes may reflect the unique contextual differences in the Kenyan market.

Table 4.2: Correlation Results

Variable	Financial Performance	Board Independence	External Audit Quality	Board Size	Institutional Ownership
Financial Performance	1.0000				
Board Independence	0.5747*	1.0000			
External Audit Quality	-0.5039*	-0.2381	1.0000		
Board Size	-0.0726	0.2331	0.5925*	1.0000	
Institutional Ownership	-0.4260*	0.1677	0.5893*	0.1304	1.0000

Source: Study Data (2025)

4.4 Diagnostic Test Results

Diagnostic tests are crucial for confirming the assumptions that underpin the regression model and for ensuring the results' reliability. These tests are vital for evaluating the model's adequacy and strength. They assess various factors, such as the normality of residuals, the presence of multicollinearity, heteroskedasticity, and autocorrelation, all of which can significantly impact the accuracy of regression coefficients and the validity of statistical conclusions derived from the model (Huang & Yang, 2015; Vatcheva, 2016; Rocha, Shamarova & Simas, 2016). The normality of residuals test ensures that residuals follow a normal distribution, which is crucial for valid p-values and confidence intervals in small samples; the multicollinearity test detects high correlations

among independent variables, as it can inflate standard errors, destabilize regression coefficients, and obscure the individual effects of predictors; the heteroskedasticity test checks for constant variance of residuals, since violations can bias standard errors and lead to unreliable hypothesis tests; and the autocorrelation test identifies dependencies among residuals, which can invalidate the assumption of independent errors and result in misleading inferences in time-series data (Dong & Giles, 2004; Oscar & Bruno, 2019; Shresther, 2020; Uyanto, 2020).

4.4.1 Multicollinearity Test Results

Multicollinearity arises when regressor in a regression model exhibit a strong correlation with one another, potentially skewing the estimation of coefficients and resulting in unreliable outcomes (Vatcheva, 2016). To assess this issue, the Variance Inflation Factor (VIF) of 10 was employed, and the findings are obtained in Table 4.3. O'Brien (2007) argued that a VIF exceeding 10 indicates a significant level of multicollinearity, which can distort the estimation of regression coefficients and lead to unreliable statistical inferences. Kutner *et al.* (2004) also supported the use of 10 as a critical threshold for VIF, noting that values above this limit can indicate problematic levels of multicollinearity that warrant further investigation. Hair *et al.* (2019) reiterates the importance of monitoring VIF values in regression models and reinforces the threshold of 10 as a standard guideline. Even moderate levels of multicollinearity, indicated by variance inflation factor (VIF) values below the threshold of 10 but higher than 1, can increase the variance of coefficient estimates, making them sensitive to small changes in data or model specification, which leads to inflated standard errors, unstable regression coefficients, and reduced reliability of hypothesis tests by producing insignificant p-values for variables that may actually be significant predictors (Daoud, 2017).

With a mean VIF of 3.77, which is well below the threshold of 10, it indicates that multicollinearity is not a significant problem within this model. Specifically, board independence shows a VIF of 2.49, suggesting that its correlation with other variables is low and unlikely to distort coefficient estimates. External audit quality has

a VIF of 6.02, indicating a moderate level of correlation but still below the critical threshold, implying that it retains its reliability in assessing financial performance. Similarly, board size and institutional ownership exhibit VIFs of 3.45 and 3.12, respectively, both indicating acceptable levels of correlation that should not compromise the integrity of the regression analysis. These results suggest that the independent variables can be considered stable and reliable for evaluating their effect on financial performance without significant concerns regarding multicollinearity.

Table 4.3: VIF Results

Variable	VIF	1/VIF
Board Independence	2.49	0.402300
External Audit Quality	6.02	0.165992
Board Size	3.45	0.290203
Institutional Ownership	3.12	0.320163
Mean VIF	3.77	

Source: Study Data (2025)

4.4.2 Normality Test Results

The normality assumption is crucial for making valid statistical inferences and accurately estimating regression coefficients. The Shapiro-Wilk test serves as a statistical tool to assess whether a sample comes from a normally distributed population, which is a fundamental assumption in various statistical analyses, including regression modeling. The Shapiro-Wilk test outcome is disclosed in Table 4.4.

The outcome unveiled that board independence and board size had p-values higher compared to the 0.05 significance threshold, indicating that it adheres to the normality assumption, as the p-value exceeds the threshold, suggesting they can be appropriately included in subsequent analyses without concern for non-normality issues. Contrarily, the variable financial performance, external audit quality and institutional ownership showed p-value lower compared to the 0.05 threshold utilized, indicating a significant deviation from normality; this suggests that the financial performance data is not normally distributed. Given that the sample

used in the study is more than 30, that is, 40 observations, normality is said to be attained and the any deviation from normality does not affect the outcome of the study. As sample size grows, the sampling distribution of the sample mean would typically be normally distributed, regardless of the population distribution, typically when the sample size is greater than 30 (McClave & Sincich, 2017). This implies that even if some variables do not meet the normality assumption, using a sample size above 30 as it is the case in this study can lead to reliable estimates of the mean and standard error, allowing for valid statistical inferences. The findings resonated with that of Razali and Wah (2011) who noted that while a p-value below 0.05 suggests rejecting the null hypothesis of normality, it does not necessarily imply that the data is fundamentally non-normal, especially in large samples where even minor deviations from normality can lead to significant p-values. Ghasemi and Zahediasl (2012) further highlighted that a significant p-value in the Shapiro-Wilk test may not always reflect practical significance or meaningful deviations from normality.

Table 4.4: Shapiro-Wilk Test Results

Variable	Obs	W	V	z	Prob>z
Financial Performance	40	0.65326	13.706	5.509	0.00000
Board Independence	40	0.98159	0.728	-0.669	0.74820
External Audit Quality	40	0.92801	2.846	2.201	0.01388
Board Size	40	0.96440	1.407	0.719	0.23602
Institutional Ownership	40	0.92914	2.801	2.167	0.01510

Source: Study Data (2025)

4.4.3 Autocorrelation Test Results

Serial correlation come into play when the residuals from a regression model are correlated across different observations through time, which violates the independence assumption and can lead to inaccurate and ineffective estimations (Chen, 2022). The Breusch-Godfrey test is a commonly employed technique for identifying serial correlation within the residuals was adopted with the outcome recorded in Table 4.5.

The F-statistic of 0.737700, with a corresponding p-value of 0.4859 as obtained, indicates that there is no significant evidence of serial correlation at the 0.05 significance level, suggesting that the residuals are independent across observations. These findings imply that the assumptions underlying the regression analysis are upheld, allowing for reliable estimation of coefficients and valid statistical inferences regarding financial performance. The absence of serial correlation enhances the credibility of the results, indicating that any patterns observed in the data are less likely to be influenced by unaccounted correlations among residuals, thereby supporting robust conclusions about the factors affecting financial performance.

Table 4.5: Breusch-Godfrey test Results

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	0.737700	Prob. F(2,23)	0.4859
Obs*R-squared	1.711830	Prob. Chi-Square(2)	0.4249

Source: Study Data (2025)

4.4.4 Heteroscedasticity Test Results

Heteroskedasticity emanates from when the error variance varies across different levels of the regressors, potentially resulting in inefficient estimates and skewed statistical conclusions (Morgan, 2013). Although the regression coefficients may remain unbiased, the standard errors can be affected, which in turn can compromise hypothesis testing and the reliability of confidence intervals (Tofighi & Kelley, 2020). The occurrence of heteroskedasticity was assessed via the Breusch-Pagan test with the outcome summarized in Table 4.6.

The chi-squared statistic of 0.72, accompanied by a p-value of 0.3962 was unveiled, revealing that the study failed to reject the null hypothesis of constant variance. This implies that there is no any solid proof of heteroscedasticity, suggesting that the residuals' variance stays constant at various fitted value levels for financial success. Consequently, this finding reinforces the reliability of the regression estimates, as the absence of heteroskedasticity indicates that the standard errors are not biased, which supports accurate hypothesis testing and confidence interval calculations. The absence of heteroscedasticity, confirmed by failing to reject the null

hypothesis of constant variance, ensures that the standard errors of the regression estimates are unbiased, thereby supporting accurate hypothesis testing and confidence interval calculations, whereas evidence of heteroscedasticity would have implied biased standard errors, potentially leading to incorrect inferences and unreliable statistical conclusions which would have been corrected using robust standard estimation.

Table 4.6: Breusch-Pagan Test Results

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
Ho: Constant variance
Variables: fitted values of Financial Performance
chi2(1) = 0.72
Prob > chi2 = 0.3962
Source: Study Data (2025)

4.4.5 Stationarity Test Results

Stationarity is vital in assessing properties of time variables, signifying that a variable's mean and variance, among other statistical characteristics, do not change with time. This is because they ensure that the data's mean and variance remain constant over time, which is essential for the validity of many econometric models; if data is not stationary, it can lead to spurious regression results and incorrect inferences, therefore, handling non-stationarity typically involves differencing or transforming the data to achieve stationarity (Rao et al 2010). In the context of panel data utilized for this study, Fisher-Type tests was used to assess stationarity, accommodating structural breaks and heterogeneous variances across units. The Fisher-Type assessment technique was applied with the outcome unfolded in Table 4.7.

The outcome produce unveiled that all variables tested, including financial performance, institutional ownership, board (independence, and size), and external audit quality exhibited p-values well below the 0.05 significance threshold, indicating that they are stationary. Specifically, financial performance has a statistic of 146.5464 with a p-value of 0.0000, confirming its stationarity; equally, board independence indicates a statistic of 32.5771 and a p-value of 0.0084, establishing its stability over time. External audit quality also demonstrates stationarity with

a statistic of 62.5906 and a p-value of 0.0042, while board size has a statistic of 133.4324 and a p-value of 0.0000, reinforcing its consistent behavior across periods. Institutional ownership presents a statistic of 80.2450 with a p-value of 0.0020, further confirming its stationarity. With this, the statistical properties of these variables do not change over time, allowing for reliable regression analysis and valid interpretations.

Table 4.7: Fisher-Type Test Results

Variable	Statistic	P-value	Comment
Financial Performance	146.5464	0.0000	Stationary
Board Independence	32.5771	0.0084	Stationary
External Audit Quality	62.5906	0.0042	Stationary
Board Size	133.4324	0.0000	Stationary
Institutional Ownership	80.2450	0.0020	Stationary

Source: Study Data (2025)

4.4.6 Model Specification Results

Model specification entails selecting the appropriate framework and variables to accurately depict the relationship between the regressand and the regressors in a panel dataset. The Hausman test was adopted to assess whether the unique errors, or unobserved effects, are correlated with the model's regressors, which affects the decision between two estimation methods. The test outcomes are detailed in Table 4.8.

The test yielded a chi-squared statistic of 3.83 with a p-value of 0.4292, which is significantly above the 0.05 significance threshold. This reveals that there is no statistically noteworthy difference between the fixed and random effects estimates for the variables tested, suggesting that the choice between these two modeling approaches does not significantly impact the results. The fixed effects model treats unobserved differences between individuals as fixed parameters, controlling for time-invariant variables but precluding their estimation, whereas the random effects model assumes unobserved variables are randomly distributed and uncorrelated with observed variables, allowing for the estimation of time-invariant effects and generalization beyond the sample (Nwakuya & Ijomah, 2017). Based on the results, the random effects model is more suitable for the analysis.

The random effects model was chosen for its ability to include time-invariant variables and provide more efficient estimates when assumptions are met, though its limitations include potential bias if unobserved variables are correlated with observed ones, which can lead to inconsistent estimates although it remained the most preferred for this study. This means that the assumptions underlying the random effects model are valid, meaning that the unobserved individual effects are not correlated with the regressors in the model thus allowing for greater efficiency in providing more generalizable results by utilizing both within and between variations in the data. Thus, given these results, the random effects model is preferred for this analysis.

Table 4.8: Hausman Test Results

	(b) Fixed	(B) Random	(b-B) Difference	$\sqrt{\text{diag}(V_b - V_B)}$ S.E
Board Independence	1.086381	2.30869	-1.222309	.8017174
External Audit Quality	.0315398	.0411366	-.0095968	.0038602
Board Size	.6214133	-.3639797	.2574336	.0662721
Institutional Ownership	-.002192	-.0016713	-.0005207	.0005766
Chi (4)	3.83			
Prob>chi2	0.4292			

Source: Study Data (2025)

4.4 Regression Results

Regression analysis facilitates the measurement of how regressors—such as board independence, external audit quality, board size and institutional ownership—affect the regressand of financial performance. This section concentrated on the outcomes from the regression analysis, a vital statistical technique used to explore how corporate governance affects the financial success of commercial and service Kenyan listed businesses. The analysis outcomes are documented in Table 4.9.

The outcome unveiled a negative (-4.7559) and insignificant (0.104) intercept denoting that without the inclusion of the regressors in the model financial performance would be negative (losses). The R-squared value of 0.6542 was indicated noting that 65.42% of the changes in financial performance is explained by the independent

variables, such as board size, external audit quality institutional ownership, and board independence. This means that more than half of the changes in financial performance can be attributed to these governance factors, suggesting a moderate to strong relationship between corporate governance and financial outcomes. An R-squared of 65.42% is generally considered moderate to high, as it indicates that the model provides a good fit to the data, though it leaves about 34.58% of the variability unexplained. However, using R-squared to assess model fit has limitations, as it does not account for potential biases in coefficient estimates or the presence of multicollinearity among independent variables. Additionally, a high R-squared does not always imply a good model, especially if it results from overfitting or if the model includes irrelevant variables that artificially inflate the R-squared value (Frost, 2024; Fernando, 2024; Taylor, 2024). The Wald chi-squared statistic of 28.33 with a p-value of 0.0000 confirms the overall significance of the regression model, demonstrating a strong link amongst at least one predictor and the financial effectiveness of Kenyan listed commercial and service businesses.

Board independence has a positive coefficient of 2.30869 and a significant p-value of 0.000. This implies that for every unit increase in independence, financial performance would increase by 2.30869 units. The magnitude of this effect is considerable, suggesting that for every unit increase in board independence, financial performance increases by a substantial amount, specifically by 2.30869 units. This effect is not only statistically significant but also practically significant, as it implies a meaningful improvement in financial outcomes when board independence is enhanced. In contrast, external audit quality showed a positive coefficient of 2.448158 but an insignificant p-value of 0.444. The magnitude of the effect, as indicated by the coefficient, suggests that for every unit increase in external audit quality, financial performance would increase by 2.448158 units, but this increase is not reliable due to the lack of statistical significance. Consequently, the effect is not practically significant, as it cannot be confidently attributed to external audit quality rather than random variation. This

means that despite the positive coefficient, there is insufficient evidence to conclude that external audit quality has a meaningful impact on financial performance in this context.

Board Size presents a negative coefficient of -0.3369977 and a p-value of 0.310 which is insignificant. This means that for every unit increase in board size, financial performance would decrease by 0.3369977 amounts, but this decrease is not reliable due to the lack of statistical significance. The result suggests that the magnitude of the effect is small and not practically significant for commercial and service firms listed at the Nairobi Securities Exchange. This implies that larger boards do not have a visible impact on financial outcomes in this context. The variable institutional ownership has a negative coefficient of -0.0016713 with a corresponding significant p-value of 0.002. However, the magnitude of this effect is small, suggesting that for every unit increase in institutional ownership, financial performance decreases by 0.0016713 amounts. While this effect is statistically significant, its practical significance may be limited due to the small coefficient, implying that the impact of institutional ownership on financial performance, although reliable, is not substantial in terms of actual financial outcomes.

Table 4.9: Regression Results

Financial Performance	Coef.	Std. Err.	Z	P>z	[95% Conf.	Interval]
Board Independence	2.30869	.632592	3.65	0.000	1.068833	3.548548
External Audit Quality	2.448158	3.196751	0.77	0.444	-3.817359	8.713675
Board Size	-.3369977	.3321556	-1.01	0.310	-.9880108	.3140154
Institutional Ownership	-.0016713	.0005315	-3.14	0.002	-.0027131	-.0006296
_cons	-4.755903	2.926394	-1.63	0.104	-10.49153	.9797237
R-Square	0.6542					
Wald chi2(5)	28.33					
Prob > chi2	0.0000					

Source: Study Data (2025)

4.5 Hypothesis Testing and Discussion of Findings

This segment concentrated on hypothesis testing that corresponded with the study’s specific objectives. The hypotheses which analyzed whether board independence, external audit quality, board size and institutional

ownership have noteworthy effect on these listed firms financial performance in Kenya are judged using 0.05 threshold verge.

4.5.1 Board Independence and Financial Performance of Listed Commercial and Service in Kenya

The null hypothesis stated that there is no significant effect of board independence on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya. Using a significance threshold of 0.05, the result revealed that board independence has a p-value of 0.000 less compared to 0.05 as contained in Table 4.8. This outcome led to the rejection of the null hypothesis of board independence insignificant on the firms' financial performance implying that board independence has a significant effect on the financial performance of the firms. This outcome underscores the importance of having independent directors on corporate boards as independent board members are typically not affiliated with the company, which allows them to provide unbiased oversight and make decisions that prioritize shareholder interests. This leads to better governance practices, enhanced strategic decision-making, and increased accountability, all of which contribute to improved financial outcomes. Therefore, independent directors often bring diverse perspectives and expertise to the boardroom, which fosters innovation and adaptability in a competitive market. Their ability to challenge management decisions constructively also mitigates risks associated with poor governance, ultimately leading to stronger financial performance. The outcome aligns with Almaqtari *et al.* (2020) who unveiled that the independence of the board significantly affects companies' performance in India.

4.5.2 External Audit Quality and Financial Performance of Listed Commercial and Service in Kenya

The null hypothesis states that there is no significant influence of external audit quality on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya. The outcome unveiled in Table 4.8 indicated that external audit quality had a 0.444 p-value which is higher and above the significance level of 0.05. This outcome implies that this study failed to reject the null hypothesis indicating that

external audit quality has insignificant effect on the firms' financial performance. This implies that while higher audit quality may be beneficial, it does not significantly influence these firms' profitability. This result could be attributed to the inadequate compliance to regulatory framework governing audits in Kenya which might not sufficiently enforce high standards, leading to a situation where even high-quality audits do not significantly enhance financial performance. Also, the effectiveness of external audits could be overshadowed by internal management practices where there exist underlying inefficiencies within the organization, thus limiting the potential benefits of high audit quality. The outcome disagrees with Naseem *et al.* (2017) who demonstrated a noteworthy link amongst a business's financial outcomes and its external audit thoroughness.

4.5.3 Board Size and Financial Performance of Listed Commercial and Service in Kenya

Null hypothesis states that there is no significant effect of board size on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya. Noting from the outcome, board size insignificantly affects the listed firms' financial performance as noted by the p-value of 0.310 higher when compared to 0.05 as contained in Table 4.8. The outcome agrees with the null hypothesis indicating that board size has an insignificant effect on the financial performance of commercial and service firms listed at the Nairobi securities Exchange. This suggests that simply increasing or decreasing the number of board members does not significantly influence the performance of the firms financially. The outcome could be linked to the fact that larger boards may lead to diminishing returns in terms of decision-making efficiency. As the size of the board increases, it becomes more challenging to reach consensus, resulting in slower decision-making processes and potential conflicts among members, which could hinder effective governance that would enhance financial performance. The findings align with Yasser *et al.* (2017) who noted that board size significantly affect the success of firms. Kaur and Vij (2017) also unveiled that board size play a significant role in the performance of firms. The outcome conflicted with Oyedokun (2019) demonstrated that board size does not significant affects

the success of firms. The varying outcomes could be attributed to the contextual framework in which these studies were conducted hence the incompatibility in the outcomes.

4.5.4 Institutional Ownership and Financial Performance of Listed Commercial and Service in Kenya

The null hypothesis states that there is no significant impact of institutional ownership on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya. The outcome attributing to this demonstrates significant effect on the firms' financial performance as displayed by 0.002 p-value when compared with 0.05 significance threshold as contained in Table 4.8. The findings resulted in the null hypothesis rejection implying that institutional ownership significantly affects the firms' financial performance. This signifies that higher levels of ownership by institutional investors may correlate with reduced performance of the firms financially. The findings could be credited to the different objectives institutional investors have from individual shareholders, leading to conflicts of interest which could result in decisions that are not aligned with maximizing immediate financial performance. Furthermore, the institutional investors might exert pressure on management to focus on short-term financial results to meet quarterly performance targets or benchmarks that detract from long-term strategic investments that are essential for sustainable growth, ultimately harming overall financial performance. The finding is inconsistent with Kabir and Thai (2017) who noted that foreign or government ownership improves financial performance. Ali, Sial, Brugni, Hwang, Khuong, and Khanh (2019) also uncovered that institutional ownership correlated significantly with corporate financial success. Sakawa and Watanabe (2020) further disclosed that institutional ownership improves business governance and financial sustainability. The differences in the outcome could be linked to the unique contexts in which these studies were performed leading to divergence in the outcomes.

4.6 Summary of Hypotheses Testing Outcomes

The summary of hypotheses testing outcomes reveals that corporate governance exerts a positive and statistically significant influence on the financial performance of firms, as evidenced by accepted hypotheses linking governance mechanisms to improved firm value and financial metrics. The breakdown is noted in Table 4.

Table 4.10 Summary of Hypotheses Testing Outcomes

Hypotheses	Test results	Sign
H0 ₁ : There is no significant effect of board independence on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya.	Rejected H0 ₁ ($p < 0.05$)	Positive (+)
H0 ₂ : There is no significant influence of external audit quality on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya.	Accepted H0 ₂ ($p > 0.05$)	Positive (+)
H0 ₃ : There is no significant effect of board size on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya.	Accepted H0 ₃ ($p < 0.05$)	Negative (-)
H0 ₄ : There is no significant impact of institutional ownership on the financial performance of commercial and service firms listed at the Nairobi Securities Exchange, Kenya	Rejected H0 ₄ ($p < 0.05$)	Negative (-)

Source: Researcher (2025)

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provided a comprehensive overview of the survey in relation to its specific objectives. It encapsulated the findings derived from the various factors examined throughout the study. The results led to conclusions regarding these variables, which subsequently informed recommendations that align with the survey's aims. The chapter also enhanced the existing body of knowledge in the field and suggests avenues for further research.

5.2 Summary of Findings

The survey investigated the influence of corporate governance on the financial performance of listed commercial and service firms in Kenya. Explicitly, it assessed the effect of factors such as board independence, external audit quality, board size, and institutional ownership on the financial outcomes of these firms. To accomplish these objectives, a panel regression method was employed, and the results of the survey are summarized subsequently.

The research investigates the impact of board independence on financial performance of listed firms. At first, it was hypothesized that board independence would not significantly affect financial outcomes. Contrary to this assumption, the findings demonstrated a significant and positive effect of board independence on the financial performance of these firms. This implies that firms with a higher proportion of independent directors on their boards tend to experience better financial outcomes.

This analysis aimed to investigate the influence of external audit quality on the financial performance of listed firms in Kenya. Based on this goal, the initial hypothesis proposed that external audit quality would not significantly impact the financial performance of the companies. The findings indicated that external audit

quality insignificant and positively affect these listed firms' financial performance in Kenya. This implies that the presence of female directors on the boards of these institutions is linked with lower profitability levels.

This analysis explored the impact of board size on the financial performance of listed firms in Kenya. The theoretical hypothesis suggested that board size would not have a significant effect on the firms' financial outcomes. However, the outcome indicated that while board size negatively influences financial performance with the effect being statistically significant. This suggests that larger boards can lead to slower decision-making processes due to increased complexity and potential conflicts among members.

The aim of this survey was to investigate the effect of institutional ownership on the financial performance of listed firms in Kenya. The hypothesis formulated in line with this objective suggested that institutional ownership would not significantly influence the financial outcomes of these firms. However, the results revealed that institutional ownership has an insignificant negative effect on the financial performance of the listed companies. The result suggests that institutional investors may not exert strong pressure on management to focus on immediate financial returns at the expense of long-term strategies.

5.3 Conclusion

The survey aimed to exploring how corporate governance affect the financial performance of listed commercial and service firms in Kenya as its primary objective. Exclusively, it focused on how factors such as board independence, external audit quality, board size, and institutional ownership influence the financial outcomes of these firms. In line with this objective, particularly regarding the influence of board independence, the study revealed that board independence has a significant and positive effect on the financial effectiveness of these listed firms. The survey concludes that independent directors play a critical role in enhancing corporate governance and driving financial success. This conclusion suggests that firms with a greater percentage of independent board members are probably going to have improved profitability and overall performance.

Independent directors contribute a range of viewpoints, knowledge, and impartiality, which can lead to better decision-making and strategic oversight. Consequently, this result highlights the importance of fostering board independence as a strategic priority for firms aiming to enhance their financial outcomes.

Exploring the objective of the influence of external audit quality on the financial performance of Kenyan listed firms, the results revealed an insignificantly positive effect on their financial outcomes. Consequently, the survey concludes that quality of external audits does not play a significant role in enhancing financial outcomes for these firms. The lack of significance in this context may indicate that other factors, such as corporate governance practices or market conditions, have a more substantial impact on financial performance. Therefore, relying on high-quality audits may not be sufficient for firms seeking to improve their financial performance. Companies might need to focus on integrating other governance practices to achieve better financial results.

This analysis examined the effects of board size on the financial performance of listed firms in Kenya. As a result of this investigation, the outcome indicated that the financial success of these companies is insignificantly impacted by board size. The investigation concludes that other factors, such as board composition or external governance mechanisms, play a more critical role in determining financial performance for commercial and service firms. The lack of significance highlights the complexity of how corporate governance structures influence financial performance.

The effect of institutional ownership on the financial performance of listed firms in Kenya was examined. In line with this objective, the findings revealed that institutional ownership exerts an insignificant negative effect on these businesses' financial performance. Regarding this, the survey concludes that the presence of institutional investors plays a crucial role in shaping financial outcomes. This conclusion aligns with the theoretical framework of agency theory, which posits that institutional investors, due to their substantial equity stakes and expertise, play a critical role in monitoring and disciplining firm management, thereby enhancing operational

efficiency and financial outcomes. The significant effect of institutional ownership underscores its importance as a governance mechanism in mitigating agency conflicts and fostering better decision-making, which ultimately translates into improved financial performance.

5.4 Recommendations

Drawing from the survey findings, recommendations were crafted to correspond with these outcomes, emphasizing the factors that notably influence the financial performance of these listed firms in Kenya.

The Nairobi Securities Exchange regulatory bodies should establish guidelines that promote a higher proportion of independent directors on corporate boards. These guidelines should mandate a minimum threshold for independent board members to ensure that firms benefit from diverse perspectives and objective oversight. The implementation of these guidelines should involve a multi-step process, starting with the development of a comprehensive regulatory framework that outlines the criteria for independent directors, including their tenure limits and roles, to ensure consistency across listed firms. By taking these actions, regulatory bodies can promote better governance practices, leading to improved decision-making and strategic direction for commercial and service firms listed on the Nairobi Securities Exchange, ultimately enhancing financial performance.

The regulatory bodies should focus on other governance aspects that have been shown to impact financial performance more significantly. Specifically, they should prioritize enhancing board independence and composition, as these factors have been found to positively influence financial outcomes. To implement these guidelines, regulatory bodies could establish minimum thresholds for independent directors on boards and provide training programs to enhance their effectiveness. Additionally, they should ensure that firms disclose detailed information about their board composition and governance practices to improve transparency and accountability. This approach will help create a robust governance framework that supports better financial outcomes for listed firms.

The capital market authority should focus on other governance aspects that have been shown to impact financial performance more significantly. Particularly, they should prioritize enhancing board composition and independence, as these factors have been found to positively influence financial outcomes. To implement these guidelines, regulatory bodies could establish minimum thresholds for independent directors on boards and provide training programs to enhance their effectiveness. Additionally, they should ensure that firms disclose detailed information about their board composition and governance practices to improve transparency and accountability. This approach will help create a robust governance framework that supports better financial outcomes for listed firms. Implementation should involve a multi-step process, including the development of a comprehensive regulatory framework, robust enforcement mechanisms, and ongoing monitoring to ensure compliance with these guidelines.

The regulatory bodies should take specific actions to ensure that institutional investors' interests align with those of other stakeholders. The bodies should establish guidelines that promote transparency and accountability in institutional ownership structures. These guidelines should require firms to disclose detailed information about their ownership composition and the roles of institutional investors, enabling better oversight and alignment of interests. Implementation should involve a multi-step process, including the development of a comprehensive regulatory framework, ongoing monitoring to ensure compliance, and regular reviews to assess the effectiveness of these measures in improving financial performance and governance practices. Additionally, regulatory bodies should engage with institutional investors to understand their investment strategies and goals, ensuring that these align with the long-term financial health of the firms they invest in. This approach will help create a more balanced and effective governance environment for commercial and service firms listed on the Nairobi Securities Exchange.

5.5 Contribution to Knowledge

This study contributes to the existing literature by providing new insights into the relationship between corporate governance factors and financial performance of commercial and service firms listed on the Nairobi Securities Exchange in Kenya. Specifically, it highlights the significant positive impact of board independence on financial performance, reinforcing previous findings that emphasize the importance of independent directors in enhancing governance practices and financial outcomes. The study also builds upon existing research by underscoring the insignificance of external audit quality and board size in influencing financial performance, contrasting with some studies that suggest these factors can be important in other contexts. Furthermore, the negative effect of institutional ownership on financial performance offers an understanding of how ownership structures can impact firm performance, suggesting potential conflicts between institutional investors and other stakeholders. Theoretically, these findings support agency theory by highlighting the role of governance mechanisms in mitigating agency problems. Practically, they imply that firms should prioritize board independence and consider the implications of institutional ownership when designing their governance structures to improve financial performance.

5.6 Suggestions for Further Studies

This survey explored the effect of corporate governance on the financial performance of listed commercial and service firms in Kenya. Future research could investigate the impact of corporate governance on financial performance in specific sectors, such as manufacturing and agriculture, to explore potential sector-specific variations. Also, qualitative study could be applied to explore the perspectives of managers and institutional investors on the challenges and opportunities of implementing different corporate governance mechanisms in Kenyan firms.

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