

BOARD STRUCTURE AND FINANCIAL PERFORMANCE OF LISTED FIRMS IN NAIROBI SECURITIES EXCHANGE. THE MODERATING EFFECT OF CHIEF EXECUTIVE OFFICER'S POWER

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Abstract—*The general objective of the study was to establish the moderating effect of Chief executive officers' power on relationship between board structure and financial performance of listed firms in Nairobi Securities Exchange. This study made use of two theories namely; agency theory and stewardship theory. An exploratory research design was used in this study. The target population consisted of 68 companies for the period 2011- 2015. The research employed both descriptive statistics and inferential statistics. The sample size was 58 firms which were listed for the entire period of study and had complete data. The study used secondary data which was obtained from financial annual reports. Data was analyzed using both descriptive and inferential statistics. Specifically, multiple regression was used to test the hypotheses. The results showed that CEO power had a positive and significant moderation effects on board age ($\beta=2.582$; $p<0.005$) board independence ($\beta=2.681$; $p<0.05$ and financial expertise ($\beta=2.874$; $p<0.05$). The results provide evidence on new theoretical insight into factors influencing financial performance by incorporating the role of CEO Power. This study adds value on the understanding of the effect of board diversity on financial performance in listed firms and how CEO power influences this relationship in decision making in the context of a developing economy country like Kenya, where CEO power is more superficial due to the ownership structure and the role of family and founders in firm management. The findings of this study will provide a basis for further studies on board diversity and financial performance. Furthermore, the study provides empirical evidence which will be used by the policy makers with regard to board corporate governance of listed firms. The study recommends that the board should employ independent directors as they are found to effectively exercise their mandate.*

Keywords—*Board Structure, Chief Executive Power, Financial Performance, Global Financial Crisis, Nairobi Securities Exchange.*

INTRODUCTION

Financial performance is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Nath, Islam & Saha, 2015). They reasoned that financial performance of a firm can be used to determine its operating performance that means that the firm's performance is in quantifiable metrics.

Dibra, (2016) stated that the global financial crisis, triggered by bankruptcy of poorly governed companies such as Enron, AIG, Lehman Brothers and Merrill Lynch led the developed countries as well as developing nations to introduce stricter corporate governance rules and regulations in order to protect the interests of stakeholder so as to improve the overall firm performance. Ferreira (2010) contends that the inclusion of outside directors on the corporate board is vital for prosperity of the firm because they have connection which could bring resources to the firm. Zafar et al., (2014) finds that the board structure emphatically impacts the firm performance as a strong board structure cultivates a disciplined atmosphere.

In South Africa Meyer & de Wet (2016) found that the proportion of independent non-executive directors had a significant positive effect on firm performance as measured by earnings per share and enterprise value, but had no significant effect on Tobin's Q ratio. The number of directors serving on the corporate board had a significant positive effect on firm performance as measured by earnings per share, enterprise value and Tobin's Q ratio. In developing countries such as Nigeria study by Edem et al (2014) indicated that board size and board education are positively and significantly related to company performance. While there is no relationship between boards equity, board independence, and board age. Also, this study evidences a negative significant between board women and turnover.

In Kenya, corporate boards including those of benefits assets are said to be dominated by men. The system allows male directors to acquaint their companions with boards before they resign. The Institute of Directors of Kenya discredits that this arrangement procedure prevents larger part from claiming the ladies the opportunity to be chosen to the corporate boards thus denying the association this essential asset. In Kenya board composition is prescribed under Section 11(3) and 12 of the Capital Markets Authority Act (CMA Act, 2000) that empowers the Capital Markets Authority to make rules and regulations to govern capital markets in Kenya

STATEMENT OF THE PROBLEM

In Kenya the number of corporations going into receivership and others collapsing remains in dilemma. Muchoki, Iraya & Mwangi, (2015) reported the collapse of Euro Bank, Imperial Bank, mismanagement in Uchumi Supermarkets, the near collapses of Chase Bank, Unga Group, National Bank of Kenya among others. The devastating impact that the collapse of Enron, Worldcom, Barings Bank, Imarbank and others had on the global economy supports the argument about the plethora of interested parties affected by corporate failure (Mizruchi, 2004; Brick, 2006).

Corporate financial fluctuation is enhanced by different scenarios for instance, Fama and Jensen (1983) asserts that the board of directors is one of the central institutions to ensure firms act in the interest of their stakeholders and mitigate the agency problem between management and shareholders. Meyer and de Wet (2016) in their studies in South Africa found that the number of directors serving on the corporate board had a significant positive effect on firm performance as measured by earnings per share, enterprise value and Tobin's Q ratio.

There are inadequate studies as to whether the composition of boards of directors can meet responsibilities in the same ways in differing market contexts and jurisdictions in which they operate (Krause *et al.*, 2014). This therefore underpins the need to investigate the moderating role of CEO power on the relationship between board structure and financial performance of the listed firms in NSE, Kenya.

GENERAL OBJECTIVE

The objective of the study was to establish the moderating role of Chief executive officers' power on relationship between board structure and financial performance of listed firms in NSE.

THEORETICAL FRAMEWORK

Agency Theory

The first scholars to propose, explicitly that a theory of agency be created and to actually begin its creation were Stephen Ross and Barry Mitnick, independently and roughly concurrently. Ross introduced the study of the agency in terms of the problem of compensation contracting. Agency was seen, in essence as an incentive problem. Mitnick introduced the now common insight that institutions forms around agency, and evolve to deal with agency, in response to the essential imperfection of agency relationship.

Agency theory can be defined as a supposition that explains the relationship between principals and agents in business. It is concerned with resolving problems that can exist in agency relationship due to unaligned goals or different aversion levels to risk. The assumption of agency theory is a pragmatic contribution to the social sciences, incorporating central ideas about how human-machine interaction affects every day social life, including the mental structures of human agents, as machine becomes more complex in their application and behavior.

Agency theory is based on the relationship between the principal and the agent. The separation of ownership from management in modern corporations provides the context for the functioning of the agency theory. The theory of agency relationship mirrors the basic structure of a principal and an agent who are engaged in cooperative behavior, but have differing goals and attitudes towards risk. The theory further assumes that principals because of information asymmetry cannot adequately observe actions that agents are taking in their benefit (Barac & Klepo, 2006). According to Stolowy & Breton (2003), if the theory of creative accounting can be constructed, it will not refer to the techniques used to manipulate, but rather to the needs, opportunities and relationships existing between categories of market participants.

Davidson, (2005) argues that when management provides inaccurate financial reporting information, it introduces creative accounting as a type of agency cost. The agency theory provides a basis for the governance of firms through various internal and external frameworks Roberts, (2005). The most important basis of agency theory is that the managers are usually motivated by their own personal gains and work to exploit their own personal interests rather than considering shareholders' interests and maximizing shareholder value (Weir *et al.*, 2002).

Agency theory is relevant in this study since it is used to understand the relationship between the agent and the principal. The agent (executive management) represents the principal (the shareholders) in a particular business transaction and is expected to represent the best interests of the principal without regard for self-interest.

Stewardship Theory

Stewardship Theory, developed by Donaldson and Davis (1991 & 1993) is a new perspective to understand the existing relationships between ownership and management of the company. This theory arises as an important counterweight to Agency Theory. This is a theory that managers, left on their own, will act as responsible stewards of the assets they control. This theory is an alternative view of agency theory, in which managers are assumed to act in their own self-interests at the expense of shareholders.

Stewardship theory adopts a psychological and sociological perspective of human behavior and rejects the premise that all decisions are driven by economic considerations (Psaros, 2009). Stewardship theory stresses not on the perspective of individualism (Donaldson and Davis, 1991), but rather on the role of top management being as stewards, integrating their goals as part of the organization. The stewardship perspective suggests that stewards are satisfied and motivated when organizational success is attained. Their premise is that individuals are motivated by noneconomic means such as acceptance, recognition, personal growth, and the need to gain satisfaction through their performance (Psaros, 2009).

Stewardship theory considers that performance is enhanced through good stewardship and the empowerment of managers (Royae & Dehkordi, 2013). Stewardship theory holds that performance variations may arise due to structural constraints and not because of insufficient rewards (Psaros, 2009). It adopts the view that independence of director representation should be minimized and asserts that the duality of the chief executive officer and board chair roles should be unified to provide a strong relationship (Psaros, 2009). Advocates of stewardship theory argue that authoritative decision-making under the leadership of a single individual (as both chairman and CEO) leads to an increase in the firm's performance (Jackling & Johl, 2009).

This theory proposes that managers do have similar interests to the corporation, in that the careers of each are linked to the attainment of organizational objectives, and their reputations are interwoven with the firm's performance and shareholder returns (Young & Thyll, 2008). Managers are seen as good stewards who are unlikely to misappropriate company resources for self-interest because they are motivated by non-financial values (Van den Bergh & Levrau 2004). Stewardship theory advocates the value of self-motivation towards what is good, assuming that managers, or the board of a firm, are self-motivated to serve the best interests of the firm and its owners.

Accordingly, the focus is on the inside directors' ability to promote shareholders' value through their superior knowledge of the company (Beasley *et al.*, 2009). Daily *et al.* (2003) argued that in order to protect their reputations as decision makers in organizations, executives and directors are inclined to operate the firm to maximize financial performance as well as shareholders' profits. In this sense, it is believed that the firm's performance can directly impact perceptions of their individual performance. Having control empowers managers to maximize corporate goals. Stewardship theory is therefore not favored in modern corporate governance practices where CEO duality is frowned upon. The stewardship theory considers composition of board of directors, position of the chief executive officer (CEO) and board size as essential elements for ensuring effective corporate governance within any organization (Coleman *et al.*, 2007).

EFFECT OF BOARD GENDER ON FINANCIAL PERFORMANCE

Gender representation on corporate boards of directors refers to the proportion of men and women who occupy board member positions. Adams & Ferreira (2009) find that more gender-diverse boards are tougher monitors; however, in firms with weak shareholder rights, the relationship between firm performance and female representation on boards is negative. A greater female representation on boards not only increases the size of the human capital pool from which directors can be drawn, but also provides some additional skills and perspectives that may not be possible with all-male boards.

Carter, Simkins & Simpson (2010) examine the relationship between board diversity and firm value for Fortune 1000 firms. They find a statistically significant positive relationship between the fraction of women or minorities on the board and firm value. Similarly, Jurkus, Park & Woodard (2008) investigate gender diversity in the top management of Fortune 500 firms and find that gender diversity is positively associated with both performance and stock valuation. Carter et al. (2010) and Bonn (2014) provide empirical evidence to support the view that increased gender diversity has a positive relationship with firm value.

Shrader, Blackburn & Iles (1997) investigated the relationship between the percentage of female board members and financial performance (using ROA and ROE) for a sample of approximately 200 Fortune 500 firms. They find a significant negative relationship between the percentage of women on the board and firm value in some tests. Carter et al. (2013) report a positive relationship between board diversity (measured by the presence of women and minorities) and firm value. Using a sample of 638 Fortune 1000 firms, the results of this study suggest that a higher percentage of women and minorities on the board of directors can increase firm value. The study also suggests that the proportion of women on boards is a significant determinant of the fraction of minority directors on boards.

EFFECT OF FINANCIAL EXPERTISE ON FINANCIAL PERFORMANCE

Knowledge and experience in accounting and finance are viewed as being among the important elements for financial expertise effectiveness (Engel et al., 2010). Experience in accounting, auditing and finance, and professionally qualified or certified accountants, are the important characteristics to be considered as an expert (Carcello et al., 2002). Additionally, these characteristics are essential to further enhance the effectiveness of the financial expertise. Accounting certification and audit committee experience are among the characteristics that are valued positively by the Board of Directors when designating an audit committee member as a financial expert (Iyer et al., 2013). Defond et al. (2005) noted that accounting expertise contributes to greater monitoring by the members of the audit committee, which, in turn, enhances multiple attributes of the financial reporting quality.

Nelson (2010) proposed academic qualification, i.e. postgraduate qualifications, as one of the characteristics of financial expertise that can enhance its effectiveness. Kim et al. (2006) suggested that formal education allows individuals to gain knowledge and skills, and earn credentials valued by others in the business community. Plus, postgraduate qualifications might help to sustain the effectiveness of the financial expertise through higher audit quality. Kor (2003) documented that past managerial experience contributes to the competence of the top management team. Carcello et al. (2006) noted that repetition to exposure and the extensive effects of experience increases the knowledge and skills of experts. Further, DeZoort et al. (2002) implied that audit committee members' oversight experience and knowledge in accounting, auditing and finance make judgments more similar to external auditors than less experienced audit committee members.

Felo, (2009) find that expertise and size are positively related to financial reporting quality. They state that given the prior evidence of a negative relationship between financial reporting quality and cost of capital, firms could improve their reporting quality by appropriately structuring their financial expertise, thus reducing their cost of capital. The presence of financial expertise in public corporate entities has a positive effect on reducing agency cost when measured by cost to revenue (Reddy et al., 2010). Furthermore, an effective nomination committee should ensure the appointment of non-executive directors whose interests are aligned with those of the shareholders and reduce any agency problems.

EFFECT OF BOARD INDEPENDENCE ON FINANCIAL PERFORMANCE

An independent board is a corporate board that has a majority of outside directors who are not affiliated with the top executives of the firm and have minimal or no business dealings with the company to avoid potential conflicts of interests

Coles, Daniel & Naveen (2008) re-examine the ideal number for a board by classifying firms into complex or simple firm and they find complex firms have larger boards than simple firms. There are some perspectives on how big a firm's board size should be. From an agency perspective, it can be argued that a larger board is more likely to be vigilant for agency problems simply because a greater number of people will be reviewing management actions. From a resource dependence theory perspective, it can be similarly argued that a larger board brings greater opportunity for more links and hence access to resources. From a stewardship theory perspective, it is the ratio of inside to outside directors that is of relevance, since inside directors can bring superior information to the board for decision-making. Larger boards are likely to have more knowledge and skills at their disposal, and the abundance perspectives they assemble are likely to enhance cognitive conflict.

Reddy et al. (2008) also find similar results for New Zealand listed-firms. Furthermore, the median board size for New Zealand firms is six members which is less than what Jensen suggests for firms in the U.S. However, the smaller board size in New Zealand firms fits with its small market characteristic. Though the result is inconclusive, it is assumed that

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larger boards provide more expertise, greater management oversight and access to a wider range of resources; therefore, to balance the skills required in the board room, New Zealand firms may require larger boards.

Using secondary data of quoted companies in the NSE, Mululu (2005) suggests that board activity, as measured by the frequency of board meetings, is positively related to the financial performance of firms. The results suggest that board meetings are an important dimension in board operations and particularly in the board's ability to effectively monitor management and improve firm's performance. Aosa, Machuki & Letting (2012) examined the relationship between board diversity and financial performance of 40 firms listed in the NSE. The results indicate a statistically not significant effect of board diversity on financial performance.

Mandu, (2012) examined the relationship between measures of board independence and the financial performance of commercial banks in Kenya. Data for the period 2004 through 2008 for 36 banks were obtained from the annual financial reports of commercial banks in Kenya. The study concluded that board composition has a significant negative correlation with performance of smaller firms and not for larger firms.

Mbugua, (2012) examined the relationship between board diversity and financial performance of commercial banks registered and domiciled in Kenya. Data on Boards' gender, educational qualifications, study specialization, and board specialization as well as the companies' financial performance were obtained from CBK's supervisory department where a total of 33 banks reports were sampled. The results show that there is very minimal association between board diversity and financial performance. A number of empirical studies on the effect of board size have been conducted in Kenya and globally with mixed results.

CEO POWER

Argote & Miron-Spektor (2011) suggest that the experiential learning on the individual level have to be embedded in some supraindividual arrangement to enable the learning to occur on higher level. Similarly, Canella et al. (2008) point out that the executive characteristics need to be converted into implemented strategic choices to achieve organizational outcome. CEOs with power from the founder identity and board control may be able to overcome such constraints and insert their positive impact into the organization routine Hambrick (2007). First, the power enhances the CEO's ability to mold the strategic choice at his or her will and thus strengthen his or her influence on the firm (Hambrick & Finkelstein, 1987). Second, the power facilitates deeper understanding of the firm-specific culture and politics and shields the implementation of innovation strategies from barriers originated from these factors (Groysberg, Lee, & Nanda, 2008; Huckman & Pisano, 2006).

Findings from relevant empirical works are largely consistent with the proposition that the power of the executives to make decisions shifts the impact on performance. Haleblian & Finkelstein (1993) propose that the TMT characteristics are significantly associated with performance only when executives have high managerial discretion. In their study on CEO turnover and innovation, Bereskin & Hsu (2011) report that internal CEOs who are supposed to have more power than outsiders may lead to inventions of higher quality and quantity. On the opposite end, the presence of predecessor executive, as a potential suppression force on the power of the incumbent CEO, is found to dampen the new CEO's chance to make significant gains in performance (Quigley & Hambrick, 2012).

H₀₁ *There is no Moderating effect of CEO power on the relationship between Board gender and financial performance of listed firms in Kenya*

H₀₂ *There is no Moderating effect of CEO power on the relationship between Board Financial Expertise and financial performance of listed firms in Kenya*

H₀₃ *There is no Moderating effect of CEO power on the relationship between Board independence and financial performance of listed firms in Kenya*

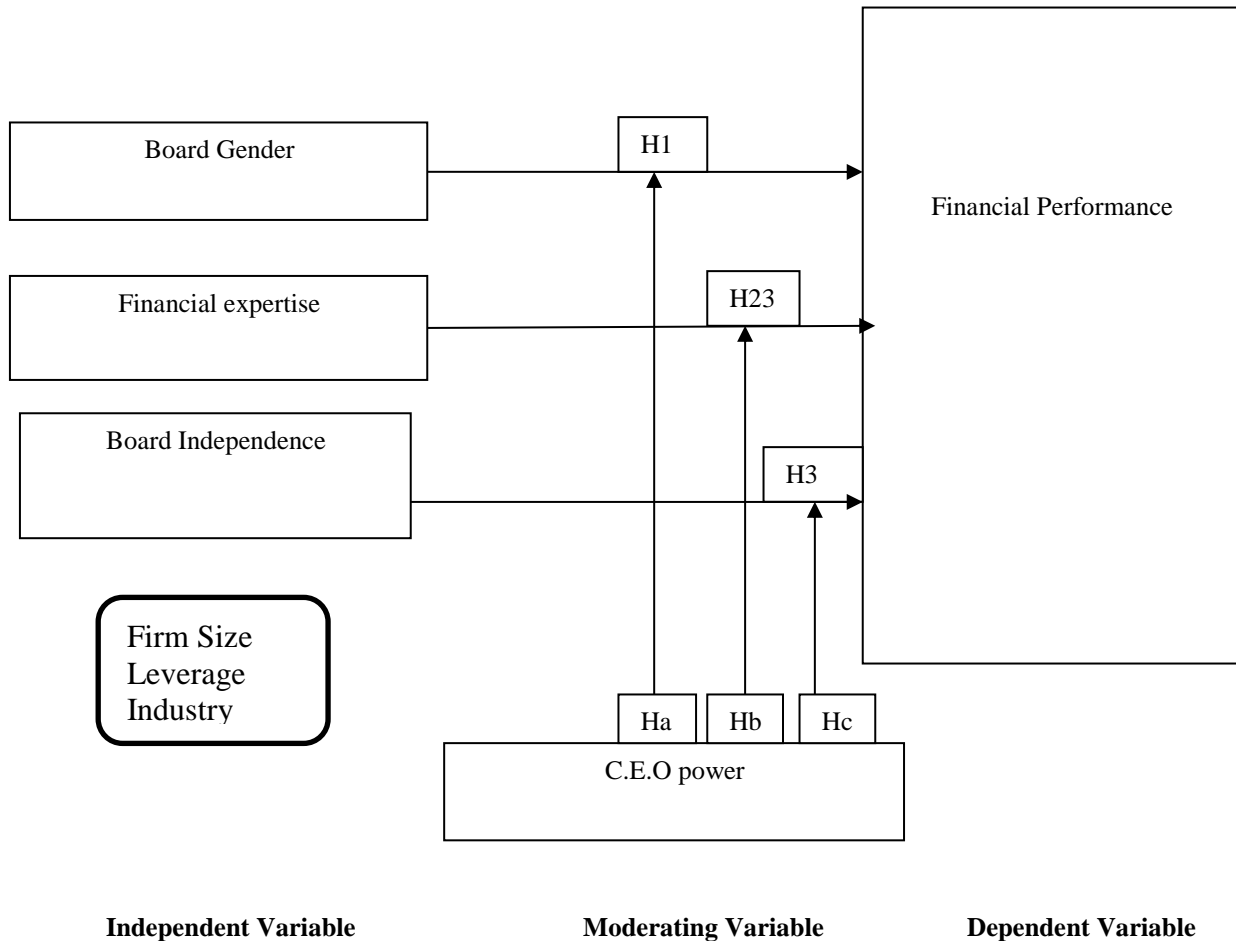


Figure 1.1: Conceptual Framework

METHODS AND DATA

Exploratory research design was used in this study. Panel data was used in this study which was derived from publicly listed firms in Kenya during the period 2011-2015. The total number of firms listed on the Nairobi Securities exchange (NSE), as at the end of 2015, was 58: these firms fall under different sectors of the economy, such as agricultural, commercial and services industry, telecommunications and technology, automobile and accessories, investment, manufacturing and allied, and construction. We considered only those firms that traded throughout the period under study: thus, firms that were first listed after 2011 and those that were suspended during the period were excluded.

For the purpose of this study, companies were excluded if the relevant financial information was not available either in the company annual financial reports or on company websites. Therefore, total number of firms used in the study was 58, yielding a total of 290 firm year observations.

An exploratory research design was used in this study. The major purpose of descriptive research design was to provide information on characteristics of a population or phenomenon (Mugenda & Mugenda, 2003). Descriptive research was

used as a pre-cursor to quantitative research designs as it provides the general overview giving some valuable pointers as to what variables are worth testing quantitatively.

MEASUREMENTS OF VARIABLES

Dependent Variable

Firm performance was measured using ROA as measured by (Sanda *et al.*, 2011; Taghizadeh and Saremi, 2013).

Independent Variable

The first set of test variables captures director monitoring and incentives as discussed under agency theory that is independent directors. Director independence was measured as the percentage of membership held by the outside independent directors, which has been considered in prior studies (Zahra and Stanton, 1988). The other set of test variables reflects the provision of resources by directors under resource dependence theory and includes board age, board gender, audit committee and board independence. Following prior studies (Agrawal & Knoeber, 2001; Kassinis & Vafeas, 2002; Rivas *et al.*, 2009; Maere *et al.*, 2014) board age was measured by composing age groups and then measure the percentage of board members in each age group. This will be done by dividing per age group the amount of people in all sample companies in that group by the total amount of board members in all sample companies. This method is also used by Siciliano (1996) and Engelen *et al.* (2012), and board gender as the average number of years the firm's directors have participated on the board was calculated by dividing the total number of years directors served on the board (starting from the year of appointment until the year of resignation or the focal year) by the number of directors on the board (Finkelstein & Hambrick, 1990; Hambrick & D'Aveni, 1992).

Financial expertise of the directors the study followed studies by Güner *et al.*, (2008) the study classifies a director as a financial expert if he or she (i) has worked within a banking institution, (ii) currently works at a non-bank financial institution, (iii) has a finance-related role within a non-financial firm (CFO, accountant, treasurer, or finance) or (iv) academic institution (professor in finance, accounting, economics or business), (v) is a professional investor (hedge fund, private equity).

Control Variables

Factors that have a possibility of affecting the financial performance are controlled. *Firm size* is defined and measured as natural log of total value of firm assets (Back, 2005; Boyd *et al.*, 2005; Agarwal and Taffler, 2008; Brad *et al.*, 2015; Doumpou *et al.*, 2015) for firm *i* in year *t*.

Industry differences refer to attributes common to an industry (Mauri and Michael, 1998; Lieu and Ching-Wen, 2006; Short *et al.*, 2007). Following this observation, and consistent with the approach used by Barroso *et al.*, (2011) and Plambeck and Weber (2010) this study assigned "1" to firms in the manufacturing sector and "0" to the rest.

Financial leverage was measured as the equity-to-debt ratio (equity/debt) as measured by (Haynes *et al.*, 2007; Sirtaine, 2005; Maere, 2014).

Moderating Variable

The Chief executive officer's power was used as a moderating role in order to determine how the CEO tenure affects the financial performance of the firms. These include looking at the time period the officer was running the operations of the organization.

Model Specification

The following equation was used;

$$ROA = \beta_0 + \beta_1 C1_{it} + \beta_2 C2_{it} + \beta_3 C3_{it} + \epsilon_{it} \dots \dots \dots \text{Model 1}$$

$$ROA = \beta_0 + \beta_1 C1_{it} + \beta_2 C2_{it} + \beta_3 C3_{it} + \beta_4 BA_{it} + \beta_5 BG_{it} + \beta_6 FE_{it} + \beta_7 BI_{it} + \epsilon_{it} \dots \dots \dots \text{Model 2}$$

$$ROA = \beta_0 + \beta_1 C1_{it} + \beta_2 C2_{it} + \beta_3 C3_{it} + \beta_4 BA_{it} + \beta_5 BG_{it} + \beta_6 FE_{it} + \beta_7 BI_{it} + \beta_8 BA * CP_{it} + \beta_9 BG * CP_{it} + \beta_{10} FE * CP_{it} + \beta_{11} BI * CP_{it} + \epsilon_{it} \dots \dots \dots \text{Model 3}$$

Where

ROA/ROE= Firm financial performance of firm *i* (*i*=1, 2....44) in time *t* (*t*=1, 2...10)

BA_{it} =Board age of firm i in time t

BG_{it} =Board gender of firm i in time t

BI_{it} = Board independent of firm i in time t

FE_{it} = Financial Expertise of firm i in time t

C1, C2& C3=Control Variables

CP_{it} = CEO power of firm i in time t

S=Firm size

ε_{it} are the random error terms.

RESULTS

Descriptive Statistics

The descriptive statistics for the companies studied are presented in Table 1 respectively.

Table 1: Descriptive Statistics

<i>Variables</i>	<i>Min</i>	<i>Max</i>	<i>Mean</i>	<i>Std. Dev</i>
ROA	-16.63	54.33	10.51	8.45
BA (Board Age)	46	69	61.01	3.42
BG (Board Gender)	0.00	4	1.65	1.06
FE (Financial Expertise)	1.00	2.00	1.28	0.14
BI (Board Independence)	3.00	11.00	9	2.00
CP (CEO Power)	-0.59	3.22	1.17	2.62
C1 (Firm Size)	5.00	18.00	10.59	2.00
C2 (Leverage)	0.17	5.72	1.25	0.92
C3 (Industry)	0.08	1.08	0.54	0.19

Source: Research data 2017

Table 1 shows the firm performance measured by ROA ranged from -16.63 to 54.33% with an average of 10.51% and a standard deviation of 8.45. The average age of Board members stands at 61 years with a standard deviation of 3 years. Most of directors are part of the Board for long periods of 10 to 15 years. As a result, having the same directors in the Board implies a constant average age during the 5-year period. The youngest member is 46 years old and the oldest one is 69. On board gender, there was an average of 1.65 with the maximum at 4 women in a board. With less than 2% women on each board, this suggests that male totally dominated corporate decision making in Kenya.

The financial expertise tested whether the organizations listed under the NSE comprised financial expertise with the necessary qualifications. The test was based on their level of education with above diploma considered as the cutting line. The mean of 1.28 indicates that many financial experts had the needed expertise to carry out their functions. There are about 9 independent directors on average with a standard deviation of 2 directors. The minimum number of independent directors in the Board is 3 and the maximum is 9. A small percentage of members in the Board are insiders. This implies that the Boards are predominated by outside directors.

Tests for Regression Assumptions

Regression analysis requires certain assumptions be met before it can be used to analyse any data. These include normality of errors, linearity and independence of errors (William *et al.*, 2013). In addition, Gujrati, (2004) agrees that panel data requires testing for multi-collinearity and stationarity before it can be subjected to regression analysis. Severe assumption violations can result in biased estimates of relationships, over or under-confident estimates of the precision of regression

coefficients, untrustworthy confidence intervals and significance tests (Chatterjee and Hadi, 2012; Cohen *et al.*, 2003). The sections that follows present the results of the various assumption tests done in this study.

Test for Normality of Errors

The tests for normality of error terms was done using Jarque-Bera (JB) test. Brys *et al.*, (2004) argues that JB tests the hypothesis that the distribution of error terms is not significantly different from normal ($H_0: E(\epsilon) \sim N(\mu=0, \text{Var.} = \sigma^2)$). The results of the tests are presented in Table 4.2. The results show that the significance levels for the Jarque-Bera statistics were greater than the critical p-value of 0.05 implying that the errors were not different from normal distribution (Tanweer, 2011). This can also be confirmed from the normal P-P plots in Appendix 3.

Table 2: Test Statistics for Model Residual Normality

Model	JB (Prob).	Conclusion
	Z-Score _{it}	
Model 1	3.437 (0.168)	Normal
Model 2	2.583 (0.335)	Normal
Model 3	3.016 (0.223)	Normal

Source: Research Data (2017)

Tests for Linearity

According to Chatterjee and Hadi, (2012) a model relating the criterion variable to the predictors is normally assumed to be linear in the regression parameters. The parameter linearity assumption is often tested by plotting residuals against predicted values of the response variable (Osborne and Elaine, 2002). Thus, the relationship should take a linear form for this condition to be met. As indicated in Appendices 2 and 3, the linearity in parameter assumption was met for all models.

Tests for Independence of Errors

According to Chatterjee and Hadi (2012) Errors in a regression model are assumed to be independent or not serially correlated across different observations. The Durbin-Watson test of serial correlations was used to test for independence of error terms. The Durbin-Watson statistic (D) is typically used to test first order autocorrelations (ρ) with the null hypothesis that there is no residual correlation ($H_0: \rho = 0$) against the alternate hypothesis that positive residual correlations ($H_a: \rho > 0$) exist (Lind *et al.*, 2015). The error terms are independent when D is close to 2.00 Lind *et al.*, (2015). Values of D closer to zero indicate positive autocorrelation whereas large values of D point to negative autocorrelations, which seldom occurs in practice (Lind *et al.*, 2015). The results in Table 4.3 show that the error terms were independent for all the regression models of Z-score.

Table 3: Test Statistics for Independence of Errors

Model	Durbin Watson Statistic (D)	
	Z- Score	Conclusion
Model 1	1.653	Error terms are independent
Model 2	1.562	Error terms are independent
Model 3	1.719	Error terms are independent

Source: Research Data (2017)

Testing for Multi-Collinearity

Collinearity means that two or more of the independent variables in a regression have a linear relationship. Variance inflation factor (VIF) and tolerance were used in this study to determine for multi-collinearity in predictor variables. According to Field (2009). A tolerance of below 0.10 or a VIF greater than 10 or a correlation coefficient above 0.8 is

regarded as indicative of serious multi-collinearity problems. Tolerance is equal to the inverse of VIF. According to Gujrati (2004) the closer Tolerance is to zero, the greater the degree of collinearity of that variable with other regressors. On the other hand, the closer Tolerance is to 1, the greater the evidence that the variable is not collinear with other regressors. This study followed the procedure given out by (Gujrati, 2004) that included the use of TOL and VIF. As indicated in the Table 4.4 below, the tolerance statistics were all above 0.10 and VIF values were all below 10 meaning that there was no problem of multicollinearity among the independent variables.

Table 4: Collinearity Statistics for independent Variables

Predictor Variable	Collinearity Statistics	
	Tolerance	VIF
Industry	.727	1.376
Firm Size	.693	1.442
Leverage	.803	1.246
Board Age	.385	2.598
Board Gender	.657	1.523
Board Independence	.720	1.390
Financial Expertise of Directors	.306	3.269
CEO Entrenchment	.833	1.201

Source: Research data (2017)

Testing for Unit Roots

As per Gujrati (2003) data series must be primarily tested for stationarity in all econometric studies. Where a series is found to be non-stationary at levels, it is differenced until it becomes stationary (Gujrati, 2004; 2003 and Baltagi, 2001). Since panel data models were used in this study and the data set had a time dimension unit root existence was investigated by panel unit root tests.

This study conducted unit root test for the variables using the Levin-Lin unit root test. As shown in Table 4.5 the p-values for the Levin-Lin -Fisher Chi-square statistic was less than theoretical values of 0.05 for return on assets, board independence, board age, firm size, and industry. The null hypothesis was rejected implying that the variables do not contain a unit root therefore suitable for modelling and forecasting (Levin *et al.*, 2002). To correct for non-stationarity in financial leverage, gender and financial expertise the first difference of the variables [D (var)] were used in the regression models.

Table 5: Panel Unit Root Test Statistics

Series	((Lin- Fisher χ^2),	P-value	Conclusion
Firm Size	162.612	0.000	Reject H ₀
Profitability	130.000	0.000	Reject H ₀
Leverage	097.625	0.629	Do not Reject H ₀
Board Age	118.367	0.000	Reject H ₀
Board Independence	112.674	0.001	Reject H ₀
Board Gender	65.604	0.052	Do not Reject H ₀
Board Financial Expertise	20.427	0.431	Do not Reject H ₀
CEO Power	141.962	0.000	Reject H ₀
Return on Assets	112.165	0.001	Reject H ₀

(ADF), Null Hypothesis: Unit root process

Cross sections: 58

Source: Research data (2017)

Model Specification Tests Statistics

In this study the random effects model was used in constructing the panel regression models. The decision for using random effects models in this study was based on the Hausman specification test (Wooldridge, 2002; Greene, 2002). According to Gujrat (2004) Hausman specification test should be used to determine between random and fixed effects. Baum (2001) also concurs that Hausman specification test tests the null hypothesis that the slope coefficients of the models being compared do not differ significantly, with the fixed effects being used when there are differences in the slope coefficients. Consequently, the null hypothesis is rejected when Prob.> χ^2 is less than the critical p-value and in such a case the fixed effects regression is appropriate. Hausman test results of these three models are presented along with panel regression results are shown in Table 4.7. All the models were run on random effects since the significance levels were greater than the critical value of 0.05.

Table 4.6: Model Specification Test Statistics for Z score

Model	χ^2 Statistic	χ^2 d.f.	Prob.	Appropriate Model
Model 1	2.534	3	0.745	Random Effects
Model 2	6.745	8	0.571	Random Effects
Model 3	4.459	14	0.983	Random Effects

Source: Research data (2017)

Correlation Analysis

Table 7 presents inter-correlation between various variables of this study and the results indicate that the strength of correlation between most variables are weak hence produced small effect (± 0.1) while association between other variables produced moderate effect (± 0.3) and high effect (± 0.5) respectively.

Table 7: Correlation Results

	1	2	3	4	5	6	7	8	9
1 ROA	1.000								
2 BA	-.065	1.000							
3 BG	.107*	.159	1.000						
4 FE	.046	.197**	-.035	1.000					
5 BI	.513*	.410*	-.016	.036	1.000				
6 CP	.655*	.556**	.076	.099	.593**	1.000			
7 C1	-.201*	.718**	.106*	.156**	.447*	.621**	1.000		
8 C2	-.235*	.021	.145**	.184**	.442*	.714**	.662**	1.000	
9 C3	.093	-.138**	-.081	-.045	-.156**	-.194**	-.217**	-.218**	1.000

Note: *Correlation is significance at 0.01.

**Correlation is significance at 0.05.

Key: C3= Industry; C2 – Leverage, C1= Firm Size; CP= CEO Power; Bi=Board Independence; FE= Financial Expertise; BG=Board Gender; BA=Board age; ROA= Return on Assets

The findings in table 7 show that CEO Power is positively correlated to ROA ($p < 0.05$). This implies that when the CEO has more power profitability of the firm is higher and vice versa. The probable reasoning could be that with more power CEOs are in a position to influence decisions in the board and hence more performance. Board gender was found to be positively and significantly correlated with return on Assets ($p < 0.05$). This shows that when the board has significant number of female directors the return on assets improves. This could be explained by the fact that studies have shown that women directors are transparent and are effective in discharging their duties. Board independence was found to be positively and significantly correlated with return on assets ($p < 0.05$). This means that independence of the board will lead to high return on assets. This could be probably explained because of the independent directors not being employees of the firm are in a position to discharge their oversight role effectively. This could also be explained by agency theory.

In the same note, board age was found to be significantly correlated with financial expertise ($p < 0.05$). This means that with the age of the board increasing financial expertise of the directors also increases. Board age was also found to be positively and significantly correlated with CEO power ($p < 0.05$). Implying that as the age of the board increases the CEO's influence on making decisions also increases. It was also established that board age is positively and significantly correlated with board independence and firm size.

Correspondingly, BG ($r = 0.145$) and BE (Expertise) ($r = 0.184$) are highly positively correlated to firm size at 1% significant. This implies that as firm size increases there is need for gender inclusion and expertise to address the challenges associated with firm complexity. Board independence (BI), $r = 0.593$; 1% significant) has highest positive association with CEO power and this means board independence increase CEO power. Board size (C1) $r = 0.662$ is highly positively related to firm size meaning that as the firm is increasing in size more directors are needed on the board to manage the complexity of the firm. Furthermore, leverage (C3, $r = -0.218$ at 1% significant) strongly negatively related to firm size than other variables and this implies as firm size increases leverage may likely reduce.

Regression Analysis

Multiple regression analysis of this study was carried out in 3 steps. In the first step all the control variables were regressed to show their effect on the dependent variable. The variables in this step together formed regression model 1, which is presented in equation 1 below.

$$ROA = \beta_0 + \beta_1 C1_{it} + \beta_2 C2_{it} + \beta_3 C3_{it} + \epsilon_{it} \dots \dots \dots \text{Model 1}$$

Where β_0 is the intercept, $\beta_1 - \beta_3$ are coefficients and e is the error.

In the second step, all independent and control variables were regressed to obtain the main effect of the study and the result from this analysis was used to estimate the predictive power of these variables to meet the first four objectives of this study. Furthermore, this result was used to test hypotheses H_{01} , H_{02} , H_{03} and H_{04} . All the variables regressed in this step combined to give regression model 2.

$$ROA = \beta_0 + \beta_1 C1_{it} + \beta_2 C2_{it} + \beta_3 C3_{it} + \beta_4 BA_{it} + \beta_5 BG_{it} + \beta_6 AC_{it} + \beta_7 BI_{it} + \epsilon_{it} \dots \dots \dots \text{Model 2}$$

Where β_0 is the intercept, $\beta_1 - \beta_7$ are coefficients and e is the error.

To achieve the fifth, sixth, seventh and eighth objective of this study, the moderating effect of CEO power was introduced into regression together with independent and control variables and the moderating effect of CEO power was established. This was achieved by determining the interaction effect of the product term of the criterion variable and the moderator variable. This step was necessary to test hypotheses H_{04a} , H_{04b} , H_{04c} and H_{04d} . The variables in this step together formed regression model 3, 4, 5 and 6 as shown.

$$ROA = \beta_0 + \beta_1 C1_{it} + \beta_2 C2_{it} + \beta_3 C3_{it} + \beta_4 BA_{it} + \beta_5 BG_{it} + \beta_6 FE_{it} + \beta_7 BI_{it} + \beta_8 BA * CP_{it} + \beta_9 BG * CP_{it} + \beta_{10} FE * CP_{it} + \beta_{11} BI * CP_{it} + \epsilon_{it} \dots \dots \dots \text{Model 3}$$

Where β_0 is the intercept, $\beta_1 - \beta_{11}$ are coefficients and e is the error.

Regression results

Table 8: Regression Results

	Dependent variable (ROA)		
	Model 1	Model 2	Model 3
Constant	26.352 (5.475)***	20.399 (4.151)***	27.410 (4.916)***
C1 (Industry)	-0.344 (-3.452)***	-0.103 (-1.150)	-0.348 (-3.377)***
C2 (firm size)	0.571 (-6.836)***	-0.456 (-5.786)***	-0.576 (-4.523)***
C3 (leverage)	0.056 (1.361)	0.066 (1.310)	0.065 (1.373)
Age BA_i		0.102 (0.812)	0.195 (1.665) **
Gender BG_{it}		0.045 (0.893)	0.032 (0.608)
Expertise BE_{it}		0.297 (1.731)**	0.312 (2.765) **
Independence BI_{it}		0.187 (1.102)**	0.193 (1.213) **
CEO Power CP_{it}		0.456 (4.239)**	0.459 (5.173)**
$BA*CP_{it}$			0.146 (2.582)**
$BG*CP_{it}$			-0.033 (-0.721)
$BE*CP_{it}$			0.253 (2.874) **
$BI*CP_{it}$			0.176 (2.681) **
R ²	0.187	0.344	0.461
Adjusted R ²	0.178	0.338	0.455
Change in R ²	-	.0157	0.117
F	7.563	5.956	6.256
P	0.000	0.006	0.000

Significant levels are: *** P<.01, ** P<.05 and * P<.10

Source: Research data (2017)

Hypothesis H₀₁ hypothesized that C.E.O power does not moderate the relationship between age and financial performance of listed firms in NSE. The results indicated that the interaction term between board age and CEO power has a positive and significant effect on the relationship between board structure and financial performance ($\beta=2.582, p<0.05$). Hence, the hypothesis was rejected. This result implies that CEO power indeed moderates the relationship between board age and financial performance of listed firms. The reason could be that CEO has influence in decision making thus making. Thus, able to influence other directors to support his decisions. This can be supported by stewardship theory that managers are stewards and thus put organizational goals over and above personal goals.

Hypothesis H₀₂ postulated that C.E.O power does not moderate the relationship between gender and financial performance of listed firms in NSE. The findings showed that there was a negative but insignificant interaction term between gender and CEO power ($\beta=-0.721, p>0.05$). This hypothesis was therefore accepted as the study found no significant effect of moderating role of CEO power on the relationship between board gender and financial performance (ROA). Thus, concludes that C.E.O power does not moderate the relationship between gender and financial performance of listed firms in NSE. This result could imply that with CEO power does not moderates board gender.

Hypothesis H₀₃ stated that that C.E.O power does not moderate the relationship between financial expertise and financial performance of listed firms in NSE. The results indicated a positive and significant interaction between financial expertise of boards and CEO power ($\beta=2.874 p<0.05$). This implies that CEO power does moderate the relationship between

financial expertise of the board and financial performance of listed firms in Kenya in the period of study. This study therefore failed to reject hypothesis H₀₃ showing C.E.O power does moderate the relationship between financial expertise and financial performance of listed firms in NSE. Reasonably because with financial expertise of directors and CEO power the board is able to make decisions which will positively affect the firm's performance.

Lastly, Hypothesis H₀₅ suggested that C.E.O power does not moderate the relationship between board independence and financial performance of listed firms in NSE. The results showed a positive and significant interaction between board independence and CEO power ($\beta=2.681$ $p<0.05$). Thus, the hypothesis was rejected. Implying, that CEO power does moderate the relationship between board independence and financial performance of listed firms in Kenya. The probable reason could be independent directors are not part of management hence make independent decisions with regard to their monitoring role. This findings in turn support agency theory that independent directors are effective monitors.

DISCUSSION OF THE FINDINGS

This study provides empirical evidence on the relationship between board structure, CEO power and financial performance. This relationship is as conceptualized by the agency theory and supported by the stewardship theory and agency theory.

The results showed that financial expertise of directors is positively and significantly related with firm financial performance. The results support, previous studies (Kor and Sundaramuthy 2009; Guner *et al.*, 2008; Van der Walt and Ingley 2008 and Lee *et al.*, 1999) which indicated that the appointment of directors with expertise in finance significantly increases the financial performance of companies. However, the study contradicts the study by Noor and Iskandar (2012) who found a non-significant relationship between financial expertise of directors and financial performance of Malaysian firms.

The findings showed that board independence is positively and significantly related with financial performance. These findings are in support of with prior studies (Lakshana and Wijekoon, 2012; Platt and Platt, 2012; Darrat *et al.*, 2010; Lajili and Zéghal, 2010; Daily *et al.*, 2003 and Daily and Dalton, 1994) who found that board independence enhances financial performance of companies. The results also support a recent study by (Ombaba and Kosgei, 2017) which showed that board independence enhances financial performance of listed firms in Nairobi securities exchange. The argument behind this could be attributed to the fact that independent directors who are appointed aren't associated in any way with the appointing firm and hence they are independent from management. Thus, when discharging their roles, they are not influenced by the management of the firm.

However, this finding did not support the results by Chaganti *et al.*, (1985) and Simpson and Gleason (1999) who found a non- significant relationship between independent directors and firm's financial performance. The probable reasoning is that there could be lack of supportive environment that enhances independency of the board in discharging their monitoring and supervisory roles.

The results of the study suggest significant and positive moderation on the relationship between board structure and financial performance. It was established that CEO power moderates the relationship between board age and financial performance of listed firms in Kenya in the period of study. The findings also indicated that CEO power moderates the relationship between board independence and financial performance and also the relationship financial expertise and financial performance of listed firms in Kenya. These findings can be supported from the results shown in table 4.3 above. The results of change in R² indicates the moderation effects. These findings support agency theory notion that independent directors are effective managers unlike dependent directors. The results also support stewardship theory that managers are stewards who value organizational goals to personal goals. Thus, as steward's CEOs always strive to achieve organizational goals first.

CONCLUSIONS

The study successfully extended knowledge by studying and testing whether CEO power could moderate board composition and financial distress relationship. This study confirmed the argument by Hillman and Dalziel (2003) that CEO power is more apt to moderate the relationship between board structure and firm performance than to have a direct effect. It was found that CEO power moderates the relationship between board independence, board age and financial expertise of directors with financial performance. The study concludes that when the CEO is entrenched, the board tends to become passive and submissive to the discretion of the CEO.

Based on the findings of this study, the following conclusions can be drawn; Overall, the study is suggesting that the board plays an important role in the decision making of the firm. Board independence was found to be having a positive

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and significant effect on financial performance. This study concludes that board structure should comprise of more of independent directors as they enhance probability of financial soundness.

The impact of CEO power on financial performance cannot be overemphasized given the positive and significant effects of CEO power on financial performance. This finding qualified CEO power to be treated as a moderator for testing the interactions. This result showed that with CEO power and board independence there is more chances of financial success among firms. This finding is in support of the notion that with independent directors in the board there is effectiveness on the part of management. The study therefore concludes that when the board is independent chances of firm being financially is increased. Hence, independence of the board should be enhanced.

In conclusion, the findings of this study have important implications for both academic, finance and corporate governance. As scholarly inquiries into the notion of CEO power and financial performance have remained conceptual to date, this study is one of the first to attempt to test the concept in empirical setting. The policy makers will find useful implications that are relevant and can be used to endorse the findings of this research in corporate governance policies.

RECOMMENDATIONS OF THE STUDY

Based on the findings, this study provides valuable recommendations to both theory and practice. The researcher believes that these recommendations will create vital insights to both scholars and practitioners in finance and corporate governance.

Theoretical Recommendations

Notably, the findings of this study have enhanced the body of knowledge on board composition and financial performance by providing empirical evidence on how CEO power moderates the relationship between board composition and financial distress. By incorporating CEO power as a moderator in board structure and financial performance relationship this study has widened the theoretical prism of board composition effects. Consequently, the study upheld the prescriptions of stewardship theory that managers are stewards who put organisational interest over and above personal interest hence minimizing financial distress. Thus, if managers are appointed objectively moderate CEO power will lead the firm into financially sound position. The study also supported the prescriptions of agency theory that independent directors provide better control over management and that average tenured boards are beneficial to the firms than seasoned directors. The study therefore has boosted the existing literature on financial distress, CEO entrenchment and board composition which provide a reference point for academic discourse and future reference.

Policy Recommendations

As the corporate governance reformations are vigorously advocated in Kenya, this study provides insights into the roles of corporate governance in financial healthiness. As such the findings of this study provide valuable insights to authorities, managers and stakeholders on corporate governance. Specifically, these findings can be beneficial to authorities that formulate the policies, mainly the Capital Market Authority and Nairobi Securities Exchange.

Firstly, the study found the relationship between board independence and financial performance was positive and significant this point to the fact that independent boards effectively monitor management compared to dependent directors. Therefore, the composition of boards should take cognizance of members who are independent of management. Hence, the study recommends that the authorities should put structures that enhance the appointment of independent directors who have requisite skills and knowledge in the board. This will positively influence financial performance since independent directors are more effective and efficient in controlling and supervising the management.

Second, the study also takes cognizance of the value of financial expertise of the board. The researcher believes that financial expert boards serve the interests of shareholders. This is specifically important in Kenya, given the family ownership structure that is common to most firms. The study recommends that governance policies need to set a cap that the board should have financial experts as board members.

Lastly, the results suggest that relative CEO entrenchment moderates the relationship between board structure and financial performance, and that CEO power will make sound financial decisions. Thus, the study recommends that CEOs should be allowed moderately sufficient power. This recommendation is in line with stewardship theory which postulates that CEOs/managers are stewards and selfless persons whose goals come after the organizational goals.

Recommendations for Further Research

The following suggestions were made for further research based on the findings of this study;

Firstly, the study does recommend more board composition variables to be included in future research like ownership, audit committee composition, ethnicity, gender, age and level of education with financial performance.

Thirdly, this study only incorporated listed firms with complete data. The study therefore recommends future studies to incorporate those firms with incomplete data.

Fourth, to take research to the next level the study recommends that future research to undertake a study on mediated-moderated relationships.

Lastly, future research should strive to penetrate inside the black box of the internal control system for listed firms to better understand the complex dynamics of corporate decisions by looking at board processes of these firms.

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