IMPACT OF CORPORATE GOVERNANCE ON THE PERFORMANCE OF COMERCIAL BANKS IN KENYA

A CASE STUDY OF KENYA COMERCIAL BANK, MACHAKOS BRANCH

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DECLARATION

I Alexia Mwikali J. declare that this is my original work and it has never been produced by anyone in any other university.

Signature of student: ____________________

Date: 17th, June, 2010.

APPROVAL

This proposal has been supervised by me and submitted to the school of business and management with my approval.

Name of the supervisor: DR. STANLEY KINYATA

Supervisors Signature :

Date : 17/6/2010

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LIST OF TABLES

Table 1: Sex of the Respondents.....29

Table 2: Age of Respondents.....30

Table 3: Employment period of respondents.....30

Table 4: Education level of the respondents.....31

Table 5: Measurement of Board effectiveness.....31

Table 6: Expectations by the respondents.....33

Table 7: Actual results on banks.....37

TABLE OF CONTENTS

DECLARATION..1

APPROVAL..2

DEDICATION..3

ACKNOWLEDGEMENT...4

LIST OF TABLES...5

ABTRACT...8

CHAPTER ONE

INTRODUCTION

1.1 Introduction..9

1.2 Background of the study...9

1.3 scope of the study...10

1.4 statement of the problem...11

1.5Research questions...12

1.5 Objectives of the study..12

1.6 significance of the study..13

1.7 Conceptual framework...14

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction...15

2.2 Corporate Failure..15

2.3 Overview of Development in Corporate Governance.................................17

2.4 Theories of Corporate Governance...19

2.5 Models of Corporate Governance..21

2.6 Principles of Corporate Governance. 22

2.7 Need for Corporate Governance...25

CHAPTER THREE

METHODOLOGY

3.1 Introduction……………………………………………………………………………26

3.2 Research Design…………………………………………………………………………26

3.3 research population………………………………………………………………………26

3.4 sampling design…………………………………………………………………………26

3.5 sampling size……………………………………………………………………………27

3.6 Instruments………………………………………………………………………………27

3.7 research procedure………………………………………………………………………27

3.7Data analysis method……………………………………………………………………27

CHAPTER FOUR

DATA FINDINGS AND ANALYSIS

4.1 Introduction…………………………………………………………………………29

4.2 General Profile of Respondents…………………………………………………………29

4.3 Screening………………………………………………………………………………31

4.4 Expectations……………………………………………………………………………31

4.5 Actual performance……………………………………………………………………35

4.6 Comparison of the expected and the actual performance of the board……………………39

CHAPTER 5

CONCLUSION, LIMITATIONS OF THE STUDY AND RECOMMENDATIONS

5.1 Conclusion………………………………………………………………………………41

5.3 Recommendations……………………………………………………………………… 42

5.2 Limitations………………………………………………………………………………43

REFERENCES……………………………………………………………………………44

Appendix 1 .RESEARCH INTRUMENTS; Questionnaire………………………………46

Appendix 11. TIME PLAN………………………………………………………………50

Appendix 111. BUDGET……………………………………………………………………51

ABSTRACT

This survey was conducted between the months of February and June 2010. It is set to examine the extent of the application of Corporate Governance practices in the banking sector in Kenya. The survey was founded on the premises that Corporate Governance is a vital ingredient in maintenance of a dynamic balance between the need for order and equality in society. Corporate Governance is an integral part of the banking sector, considering the role played by the banking and financial institutions. The survey also sought to establish if there is a relationship between the actual Corporate Governance practiced in the banking sector and what the stakeholders expect.

The design used in this research was a survey of the descriptive kind. This design was used to acquire a lot of information through description and was useful for identifying variables. Primary data in this survey was collected using semi-structured questionnaires and was administered by face to face interviews. The quota size of the study was respondents drawn from commercial bank in Kenya (Machakos Branch). Analysis and results are shown through the use of percentages, mean scores, standard deviations, and tables are then used to present the data.

Most of Corporate Governance practices are undertaken and implemented by the Board of Directors and the top management. The level of involvement of the lower management and subordinates is very low thus raising various issues such as; How qualified is the Board of Directors?, How informed are the shareholders on matters of Corporate Governance?, and lastly how do you determine the extent of the application of Corporate Governance practices in the banking sector.

This survey shows that it is important for the Board of Directors and the top management to be highly qualified as this improves their performance and effectiveness thus improving the firm's performance. The survey also shows that banks should improve their application of Corporate Governance practices so as to bridge the gap between what is actually practiced in terms of Corporate Governance and what the stakeholders of the bank expect to happen.

CHAPTER 1: INTRODUCTION

1.1 Introduction

In this chapter, the background of the problem has been discussed as well as the statement of the problem. Both general and specific objectives of the study are covered, followed by the justification of the study and the scope of coverage.

1.2 Background of the study

Corporate Governance is regarded as the manner in which power is exercised in the management of economic and social resources for sustainable human development. It is a vital ingredient in the maintenance of a dynamic balance between the need for order and equality in society.

In ***A Board Culture of Corporate Governance*** business author Gabrielle O'Donovan defined Corporate Governance as *'an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity and integrity. Sound Corporate Governance is reliant on external marketplace commitment and legislation, plus a healthy board culture which safeguards policies and processes'.*

O'Donovan goes on to say that 'the perceived quality of a company's Corporate Governance can influence its share price as well as the cost of raising capital. Quality is determined by the financial markets, legislation and other external market forces plus the international organizational environment; how policies and processes are implemented and how people are led. External forces are, to a large extent, outside the circle of control of any board. The internal environment is quite a different matter, and offers companies the opportunity to differentiate from competitors through their board culture. To date, too much of Corporate Governance debate has centered on legislative policy, to deter fraudulent activities and transparency policy which misleads executives to treat the symptoms and not the cause (Holland 2005).

The efficient production and delivery of goods and services, accountability in the use of power, the protection of human rights and freedom and the maintenance of an organized corporate

framework with which each citizen can contribute fully towards finding innovative solutions to common problems. According to guidelines on Corporate Governance practices by public listed companies in Kenya, Corporate Governance is defined as the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account the interest of other stakeholders. (CMA Definition)

Corporate Governance is an integral part of the banking sector, considering the role played by the banking and financial institutions. The Corporate Governance of banks in developing economies is important for several reasons. First, banks have an overwhelmingly dominant position in developing-economy financial systems, and are extremely important engines of economic growth (Levine 1997). (Holland 2005).

Second, as financial markets are usually underdeveloped, banks in developing economies are typically the most important source of finance for the majority of firms. Third, as well as providing a generally accepted means of payment, banks in developing countries are usually the main depository for the economy's savings. Fourth, many developing economies have recently liberalized their banking systems through privatization/disinvestments and reducing the role of economic regulation. Consequently, managers of banks in these economies have obtained greater freedom in how they run their banks. (Theodor, 2002).

1.3 scope of the study

The study has been carried out in Kenya Commercial Bank, Machakos Branch, the researcher chose (K.C.B).because she had more information about the institution and she is familiar with more employees who will help her access more information as far as the topic of the research is concerned.

1.4 Statement of the Problem

Although Corporate Governance highly practiced in several institutions, no major studies have been conducted in developed economies to determine its efficiency and how it affects the growth of these institutions (Levine 1997). This study aims at finding how effective Corporate

Governance is in management of the banking sector. How it affects the production of such institutions and possible ways of improving the current Corporate Governance practices in order to improve the production and efficiency of such organizations. (Theodor, 2002).

In Kenya there is a need for good governance especially in banking sector because in the last two decades Kenya has had problems in the banking sector and a number of banking institutions have collapsed. It is therefore important to determine the main cause of failure. The role that CBK plays to ensure adequate supervision, enforcement of banking laws and prudential regulations by for instance both formal and informal, commercial banks and MFI'S needs to be understood(CBK 2001). One needs to examine the internal and external relationships among banks management, B&D or trustees, government agencies, donor serviced communities and other shareholders (Kim 2003).

Although Corporate Governance may be a conscious practice in the private and public sector, it's not evident as to whether and what to what extent it's practiced in the banking institutions in Kenya (Mugambi 2006). Prior research in Kenya has focused mainly on compliance without or the state of principles of Corporate Governance and best practices. Jebet (2001) on Corporate Governance structures prevalent in public companies, Kitenga (2002) or need for audit in Kenya, Mwangi (2002) on Corporate Governance practices in insurance industry (Mucuri, 2002) on Corporate Governance practices in motor vehicle sector in Kenya. Wamalwa (2002) on Corporate Governance practices in micro finance institutions Gakuo (2003) on Corporate Governance practices in NGO's, Wangombe (2003) on Corporate Governance practices of banks in Kenya.

1.5 study objectives

The objective of this study was to determine the extent of the application of Corporate Governance practices in the banking sector.

1.6 Research questions.

- What has been the contribution of Kenya Commercial Bank to the society?
- What has been the general performance of the commercial banks compared to other financial institutions?
- What was the impact of corporate governance in the private and public sector?
- How does governance affect the production of the banking sector?

1.7 significance of the study

Good Corporate Governance protects the market from unnecessary government control. Where shareholders are relatively powerless, there is real and perceived abuse of power threatening the market system. This plays for growth of securities and antitrust laws as primary means to keep management in line. Although protective laws could indeed stop enterprises from collusive oppressive and misleading behavior, enforcement activities could be evidence or wrongheaded resulting in misallocation of capital resources.

This research has the potential of providing objective input data in the debate for and against compulsory compliance. It has identified the extent of compliance and effectiveness of the enforcement criteria applied by CMA. The results of this study have been crucial to a widespread of stakeholders.

This survey has been useful to CMA in determining whether voluntary mechanism is adequate, determining the main barriers to compliance and determining whether statutory regulations are necessary to enforce compliance. The studies have also been useful to NSE as it will faster more information and depending on the resultant research findings, enhance confidence on quoted companies.

For publicly quoted companies the results have been an indicator of the direction without the regulatory authority will move. It will offer those companies delaying compliance with an incentive to comply toward off statutory enforcement. For the public, it has offered quantitative data in the debate for or against compulsory enforcement of the ode.

The study has been useful to policy makers in enhancing suitable policies to reinforce Corporate Governance practices. The study has added to the academic gap of knowledge in this area.

This study has been vital in determining how efficient Corporate Governance is in management of banks. It aimed at finding the weaknesses, strengths and ways of improving Corporate Governance practices in the management of banks. It was a stepping stone into finding new and better ways of managing banks and increasing the output, productions and profit margins of banks.

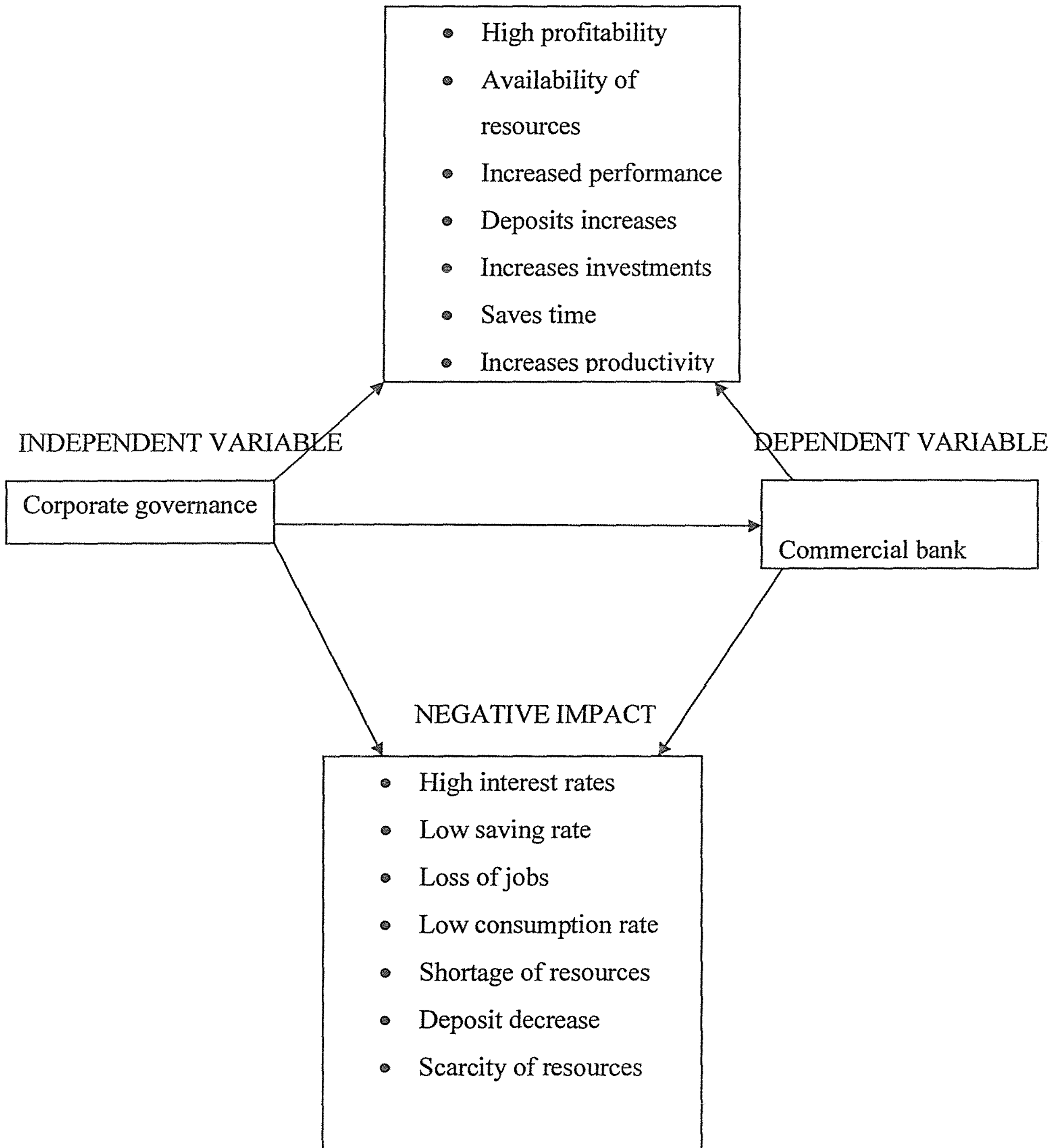
THE CONCEPTUAL FRAMEWORK

The independent variable, corporate governance has some positive impacts on dependent variable, the commercial bank in that there is high profitability, availability of resources, increased performance, deposits increases, increase in investments, saves time and increases productivity.

It also has some negative impacts in that there is loss of jobs, low consumption rate, shortage of resources, deposits increase, there is scarcity of resources, low saving rate and lastly causes the interest rates to rise.

CONCEPTUAL FRAMEWORK

POSITIVE IMPACT



CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

Governance is concerned with the processes, systems, practices and procedures both the formal and informal rules that govern institutions, the manner in which these rules and regulations are applied and followed, the relationships that these rules and regulations determine or create, and the financial nature of these relationships. (Theodor, 2002).

Corporate Governance is concerned with the establishment of an appropriate legal, economic and institutional environment that would facilitate and allow business enterprises to grow, thrive and survive as institutions for maximizing shareholder value while being conscious of and providing for the well being of all other stakeholders and society. It also requires that the stake puts in place and maintains an enabling environment in which efficient and well managed or companies can thrive (PSICG).

Research and markets a renowned industry and market research organization, observed that governance in banks is a considerably more complex issue than in other sectors since bank will attempt to comply with the same codes of good governance as other companies but, in addition, factors like risk management, capital adequacy and funding, internal control and compliance especially the CBK regulations all have an impact on their matrix of governance. (McCahery 2004).

2.2 Corporate Failure

The collapse of big organizations has cast doubts in the way corporations are managed and made accountable. Enron, an energy trading company, which collapsed in 2002, was found to have reported huge capital gains through fraudulent accounting. Huge amounts of money were hidden in off balance sheet special purpose entities and partnerships (Kelly 2002).
Another almost similar case was WorldCom, the biggest carrier of internet traffic of that time. It hid billions of dollars in expenses after failing to wring earnings from its merger with MCI.

Corporate expenses were treated as capital investments, this showed as huge profits in 2001 and first quarter of 2002 rather than losses. The Securities Exchange Commission sued WorldCom for fraud. Its shares plummeted from $64.5 to a low of 83P after the fraud was publicized. It collapsed towards mid 2002. (Newsweek, July 8, 2002.)
The judgment, signed by U.S. District Judge Jed S. Rakoff of the Southern District of New York: (1) Imposes the full injunctive relief sought by the Commission (2) Orders an extensive review of the company's Corporate Governance systems, policies, plans, and practices,(3) Orders an extensive review of the company's internal accounting control structure and policies (4) Orders that WorldCom provide reasonable training and education to certain officers and employees to minimize the possibility of future violations of the federal securities laws, (5) Provides that civil money penalties, if any, will be decided by the Court at a later date. The court reaffirmed the role of its appointed Corporate Monitor and retained jurisdiction for all purposes, including the imposition of further equitable relief and sanctions as may be determined following a hearing. WorldCom consented, without admitting or denying the allegations in the Commission's compliant, to the entry of the judgment.

The Commission's investigation into matters related to WorldCom's misled investors from at least as early as 1999 through the first quarter of 2002, and further states that the company has acknowledged that during that period, as a result of undisclosed income it reported on its financial statements by approximately $9 billion.

The judgment further orders that the report currently being prepared by WorldCom's Special Investigative Committee be transmitted to the Corporate Monitor, Richard Breeden, upon its completion, and that Mr. Breeden shall then review the adequacy and effectiveness of WorldCom's Corporate Governance systems, policies, plans and practices. This review will include but is not limited to inquiries into (1) whether WorldCom is complying with recognized standards of ''best practices'' with respect to Corporate Governance; (2) whether WorldCom has sufficient policies and safeguards in place (a) to ensure that WorldCom's Board of Directors and all committees of WorldCom's Board of Director (including without limitation the audit committee and the compensation committee) have appropriate powers, structures, composition,

and resources and (b) to prevent self –dealing by management; and (4) whether WorldCom has appropriate safeguards in place to prevent further violations of the federal securities laws, Following his receipt of the report of the Special Investigative Committee, the Corporate Monitor shall submit to WorldCom's Board of Directors, the Court and the Commission a report setting forth his recommendations with respect to the Corporate Governance issues he has reviewed. Within 60 days of the receipt of the report of the Corporate Monitor with respect to Corporate Governance, WorldCom's Board of Directors shall report to the Court and the Commission with respect to the decisions and actions taken as a result of each of the recommendations made by the Corporate Monitor.

2.3 Overview of Development in Corporate Governance

2.3.1 Global Initiatives on Corporate Governance.

In 1999 Global Corporate Governance Forum was established by the World Bank Group and the Organization for Economic Co-operation and Development to firstly build a consensus in favor of appropriate policy regulatory and corporate reforms; secondly, coordinate and disseminate Corporate Governance practices; thirdly to provide corporate development and human capacity building in associated fields of Corporate Governance and finally to train professionals and other agents essential to bring a culture of compliance.

The International Corporate Governance Network was also established to promote and coordinate research and development in Corporate Governance. On October 24 1999, the Global Corporate Governance Forum Secretariat published the 2nd Edition of "The Inventory –A survey of worldwide Corporate Governance Activity" in which it notes:" At a global level, the survey responses indicate that companies in these emerging markets, traditionally unwilling to pay Corporate Governance-related services, now understand the importance of changing their board and disclosure practices in order to better attract international sources of capital (Randall 2005).

2.3.2 Corporate Governance in the Common Wealth.

The above was developed during the Oct 1997 commonwealth Heads of Government in Edinburgh and it was resolved that, capacity should be established in all commonwealth counties to create and reinforce corporate to promote good Corporate Governance in particular codes of good practices establishing standards of behavior in public and private sector should be agreed to secure greater transparency and to reduce corruption.

The Commonwealth Association for Corporate Governance was subsequently established and developed the "CACG Guidelines-Principles for Corporate Governance in the Commonwealth." These were adopted at the November 1999 Commonwealth Heads of Government meeting in Durban, South Africa, "as guidelines for all commonwealth countries to develop or enhance their own national Corporate Governance principles (Randall 2005).

2.3.3 Corporate Governance in Africa

The Africa Capital Markets Forum is undertaking a study on the state of Corporate Governance in Africa. The Kings Committee Report and Code of Practice for Corporate Governance in South Africa published in 1994 continue to stimulate Corporate Governance in Africa, Zimbabwe, Ghana, Uganda and South Africa have put in place national institutional mechanisms to promote good Corporate Governance. Training, technical and awareness raising support has been extended by the World Bank and the Commonwealth Secretariat to various African countries to help them put in place appropriate mechanisms to promote good Corporate Governance developed to fit into the African business environment (Coffee 2006).

2.3.4 Corporate Governance in East Africa.

Regional conferences were held in Kampala, Uganda, in June 1998 and September 1999 because there was a need to create awareness and promote Regional Corporation in matters of Corporate Governance. It was resolved that each member state develops both a framework and a code of best practice and efforts be made to harmonize Corporate Governance in the East African region. Uganda has established the Institute of Corporate Governance of Uganda, and is formulating a national code of best practice for Corporate Governance. Tanzania organized an East African Regional Workshop on Corporate Governance early in the year 2000. (Dondo, 2000)

2.3.5. Corporate Governance in Kenya

The need to promote Corporate Governance among private entities in Kenya started with consultative corporate sector seminars held in November 1998 and March 1999 resolved that a Private's Sector Initiative for Corporate Governance be established for reasons including but not limited to:

Formulation and development of a sample code of best practices for Corporate Governance in Kenya, exploration of ways and means of facilitating the establishment of a national apex body, (the national corporate sector formulation) to promote Corporate Governance in Kenya, coordination of developments in Corporate Governance in Kenya with other initiatives in East Africa, Africa, the Commonwealth and globally.

The reasons for this development included, but were not limited to:

The quality of governance at all levels was increasingly being seen as the most important factor the success of both the politico-economy that its institutions; Corporate Governance expectation from society taking center stage, with the privatization and corporization of the economies globally; There was greater expectation from society that corporate organizations, especially private ones, should take a more leading role in the debate and implementation of economic revival strategies; In the face of major scandals leading to the collapse of big corporations especially state owned ones, with disastrous social and economic consequences. It was inevitable that the wider society, led by the mass media, would start questioning how these organizations were run; Shareholders, especially in publicly listed companies were becoming increasingly vocal demanding transparency and disclosure of information from their directors; Regulatory bodies, notably the CMA and the NSE, were already hinting that they would require good Corporate Governance practices amongst the publicly listed companies (Coffee 2006).

2.4 Theories of Corporate Governance

2.4.1 The Simple Finance Model

'In the finance view, the central problem in Corporate Governance is to construct rules and incentives (that is, implicit or explicit 'contracts') to effectively align the behavior of managers

(agents) with the desires of principals (owners)', (Hawley & Williams 1996:21). However, the 'rules' and 'incentives' considered are generally only those within the existing US system of publicly traded firms with unitary boards.

The rules and incentives in the finance model refer to those established by the firm rather than to the legal/political/regulatory system and culture of the host economy or the nature of the owners. The finance view represents a sub-section of the political model of Corporate Governance. The political model interacts with the 'cultural', 'power' and 'cybernetic' models rose in the following section.

It is the nature of the owners which exacerbates corporate control problems found in Anglo countries like the US, Canada, UK and Australia. In each of these countries, institutional investors own the majority of the shares in most of the largest publicly traded firms unlike in continental Europe and Japan (Analytica 1992). Institutional investors, such as pension and mutual funds, collectively owned more than 57% of the top US 1,000 firms in 1994 (Hawley & Williams 1996:8). The problem with institutional ownership is that their investment managers are fiduciary agents of the beneficial owners and so the situation is created of agents representing agents. Hence the term 'Fiduciary Capitalism' or what Peter Drucker (1976) more provocatively described as 'Pension Fund Socialism'.

2.4.2. The Stakeholder Model

In defining 'Stakeholder Theory' Clarkson (1994) states: '"The firm" is a system of stake holders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm's activities. The purpose of the firm is to create wealth or value for its stake holders by converting their stakes into goods and services'. This view is supported by Blair (1995:322) who proposes: the goal of directors and management should be maximizing total wealth creation by the firm. The key to achieving this is to enhance the voice of and provide ownership-like incentives to those participants in the firm who contribute or control critical, specialized inputs (firm specific human capital) and to align the interests of these critical stakeholders with the interests of outside, passive shareholders.

2.4.3 The Political Model

The political model recognizes that the allocation of corporate power, privileges and profits between owners, managers and other stakeholders is determined by how governments favor their various constituencies. The ability of corporate stakeholders to influence allocations between themselves at the micro level is subject to the macro framework, which is interactively subjected to the influence of the corporate sector.

According to Hawley & Williams (1996:29); 'the political model of Corporate Governance has had immense influence on Corporate Governance developments in the last five to seven years'. However, Hawley & Williams focus their discussion only on the micro aspects of how shareholders can influence firms. Firms have also been influential in molding the US political/legal/regulatory system over the last few centuries. According to Justice Felix Frankfurter of the US Supreme Court, the history of US constitutional law is 'the history of the impact of the modern corporation upon the American scene', quoted in Miller (1968:1).

2.5 Models of Corporate Governance

Although the US model of Corporate Governance is the most notorious, there is a considerable variation in Corporate Governance models around the world. The intricate shareholding structures of keiretsus in Japan, the heavy presence of banks in the equity of German firms, the chaebols in South Korea and many others are examples of arrangements which try to respond to the same Corporate Governance challenges as in the US. (McCahery 2004).

2.5.1 Anglo-American Model

There are many different models of Corporate Governance around the world. These differ according to the variety of capitalism in which they are embedded. The liberal model that is common in Anglo-American countries tends to give priority to the interests of shareholders. The coordinated model that one finds in Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community. Both models have distinct competitive advantages, but in different ways. The liberal model of Corporate Governance encourages radical innovation and cost competition, whereas the coordinated model of Corporate Governance facilitates incremental innovation and quality competition. However, there are important differences between the U.S. recent approach to governance issues and what has happened in the U.K. (McCahery 2004).

In the United States, a corporation is governed by a Board of Directors, which has the power to choose an executive officer, usually known as the chief executive officer. The CEO has broad power to manage the corporation on a daily basis, but needs to get board approval for certain major actions, such as hiring his/her immediate subordinates, raising money, acquiring another company, major capital expansions, or other expensive projects.

The U.K. has pioneered a flexible model of regulation of Corporate Governance, known as the "comply or explain" code of governance. This is a principle based code that lists a dozen of recommended practices, such as the separation of CEO and Chairman of the Board, the introduction of a time limit for CEOs' contracts, the introduction of a minimum number of non-executives Directors, of independent directors, the designation of a senior non executive director, the formation and composition of remuneration, audit and nomination committees. Publicly listed companies in the U.K. have to either apply those principles or, if they choose not to, to explain in a designated part of their annual reports why they decided not to do so. The monitoring of those explanations is left to shareholders themselves.

2.5.2 Non Anglo-American Model

In East Asian countries, family-owned companies dominate. A study by Claessens, Djankov and Lang (2000) investigated the top 15 families in East Asian countries and found that they dominated listed corporate assets. In countries such as Pakistan, Indonesia and the Philippines, the top 15 families controlled over 50% of publicly owned corporations through a system of family cross-holdings, thus dominating the capital markets. Family-owned companies also dominate the Latin model of Corporate Governance that is companies in Mexico, Italy, Spain, France (to a certain extent), Brazil, Argentina, and other countries in South America.

2.6 Principles of Corporate Governance.

According to the Private Sector Initiative on Corporate Governance, the principles of good Corporate Governance include;

2.6.1 Authority and Duties of Members/ Shareholders

Members or shareholders of the corporation shall jointly and severally protect, preserve and actively exercise the supreme authority of the corporation in general meetings. They have a duty,

jointly and severally, to exercise that supreme authority of the corporation to:
Firstly, to ensure that only competent and reliable persons are elected or appointed to the Board of Directors. But how are they able to determine competent and reliable persons to be appointed to the Board. Secondly, ensure that the board is constantly held accountable and responsible for the efficient and effective governance to achieve corporate objectives, prosperity and sustainability. How do them measures efficient and effective governance by the board. And lastly, change the composition of a board that does not perform to expectation or in accordance with the mandate of the corporation.

2.6.2 Leadership

Every corporation should be headed by an effective board that exercises leadership, enterprise, integrity and judgment in directing the corporation to achieve continuing prosperity and to act in the best interest of the enterprise based on transparency, accountability and responsibility. The question that arises here is, "how do we measure an effective board?" Different organizations may use different mechanisms to measure and effective board and so which method or mechanism should be used.

2.6.3 Appointments to the Board

Appointment to the Board of Directors through a managed and effective process, ensure that a balanced mix of proficient individuals is made and that each of those appointed is able to add value to bring independent judgment to bear on the decision making process. What comes into mind is (1). How are member of the board appointed both executive and non executive or independent (2). What criterion is used to reach to the best candidate for this job (Coffee 2006).

2.6.4 Strategy and Values

The Board of Directors should determine the purpose and values of the corporation, strategy to achieve purpose and implement its values to ensure that it survives and thrives and that procedures and values that protect its assets and reputations are put in place. "Is this really the functions of the Board of Directors" one may ask.

2.6.5 Corporate Performance, Viability and Financial Sustainability

The Board should monitor and evaluate the implementation of strategies; policies and

management performance criteria. The Board should review the viability and financial sustainability of the enterprise and must do so at least once every year. But is this time enough? given that the Board must do this at least once a year for reviewing the viability and financial sustainability of the enterprise.

2.6.6 Corporate Compliance

The Board should ensure that the corporation complies with all relevant laws, regulations, governance practices, accounting and auditing standards. Given that the appointment to the board may be questionable, how will they ensure that this is done?

2.6.7 Corporate Communication and Accountability to Members

The Board should ensure that the corporation communicates with all stakeholders effectively. The Board serves the legitimate interests of all members and account to them fully. . How do the board members communicate to all stakeholders effectively?

2.6.8 Responsibility to Stakeholders

The Board should identify the corporations internal and external stakeholder; agree on a policy or policies determining how the corporations should relate to, and with them, in creating wealth and the sustainability of a financially sound corporation while ensuring that the rights of stakeholders are respected, recognized and protected.

2.6.9 Balance of Power.

The Board should ensure that no one person or group of persons has unfettered power and that there is an appropriate balance of power on the board so that it can exercise objective and independent judgment. What happens to major shareholders of any particular company? How can they regulate the ability of major shareholders to purchase more shares of the firm and thereby increasing their power to vote and control the firm?

2.6.10 Internal Control Procedures

The Board should regularly review systems, processes and procedures to ensure effectiveness of its internal systems of control so that its decision making capability and the accuracy of its reporting and financial results are maintained at the highest level at all times.

of host communities and lastly, the corporation protects and preserves the environment.

2.7 Need for Corporate Governance

The Commonwealth assess for Corporate Governance in 1997 states: Good Corporate Governance is necessary in order to attract investors both locally and foreign and assure them that their investments will be secure and efficiently managed in a transparent and accountable process. In addition it enhances the accountability and performance of those entrusted to manage corporations. Fourthly it promotes efficiency and effectiveness in the use and distribution of limited resources.

Sound Corporate Governance principles are the foundation upon which the trust of investors is built. These principles are critical in growing the reputation that we have established over decades as a company dedicates to excellence in both performed and integrity. The trust and respect are fostered by both the Assurant Board of Directors and management team who work together under the guidance of our Corporate Governance guidelines. These guidelines as adopted by the Board of Directors, present the framework of responsibility for directors in accordance with the guidelines as set forth by New York Stock Exchange.

Our commitment to the highest business standards and effective governance is essential to achieving respect from key Assurant stakeholders, as well as Assurant communities' governments' officials and the general public.
Together, the board members ensure that assurance remains a company of uncompromised integrity and performance (president and CEO and chairmen of the board of New York stock exchange John M. Palms.)

CHAPTER 3: METHODOLOGY

3.1 Introduction

This section describes how the survey was conducted. It explains the research design, population sample used and the sampling methods applied. The section also explains the data collection methods applied and how the data was analyzed to produce the required information necessary for this survey.

3.2 Research Design

The study used a survey approach to elicit data from the respondents. A basic feature of a survey research is that the information was collected at one point in time with the intention of describing the nature of existing conditions or determining relationships that exist between variables. The design which was used in this research was a survey of the descriptive kind. This was because of the descriptive data collected. The survey research method had more advantages than other methods of data collection. (Mugenda, 1999) observed that survey research method was probably be the best method available to social scientist and other educators who were interested in collecting original data for purposes of describing a population which was too large to observe directly. Survey research was also excellent vehicles for the measurement and comparing the characteristics of a large population as was the intentions of the study.

3.3 Research population

The study focused on top and middle management of Kenyan commercial bank, Machakos Branch. The total population being 60 employees I sampled 20 employees hence the sampling fraction was 1/3.

3.4.1 Sampling Frame

The population of the survey included top and middle management of commercial banks in Kenya. However, due to certain limitations, the study focused on a representative sample of the total population. This l involved top and middle management of the selected banks. It was

assumed that this reflected on the opinion of the total population as the population was considered homogeneous in the sense that all the interviewers were university students.

3.5 Sample Size

. The number of respondents interviewed reflected the true percentage of the respondent type on the ground. The respondents were picked randomly to avoid errors due to biasness. The sample size was 20 respodents.this is 1/3 of the research population which was interviewed.

3.4 Data Collection Methods

The survey collected both categorical and numerical data. This was done through the use of a semi-structured questionnaire. This was conducted through drop and pick method. The data collected included the respondents' opinions on various aspects of Corporate Governance and ways of improving it. Open ended questions were used to capture the respondents' opinions. This was advantageous in the sense that responses were not limited by the questionnaire. However, closed questions were used to test the rating of various Corporate Governance attributes and this helped to reduce the number of related responses in order to obtain more varied responses.

3.5 Research Procedures

A pilot survey was conducted to determine the possible outcome and to test the questionnaire. A sample of 20 respondents were drawn from one bank each and used for the pilot survey. The results of the pilot were used to make any possible amendments to improve the questionnaire after which the final survey was carried out and the field work began. The information obtained was then interpreted and reported.

3.6 Data Analysis Methods

The data was collected and analyzed and results were shown in terms of frequency distribution, percentage mean scores, and standard deviation. The data was tabulated and classified into sub samples according to their common characteristics like sex, age, education level, and employment.

Quantitative data required establishment of percentages to facilitate comparison of responses for

those questions which had five answers, totally expect, partially expect, neutral, partially disagree and totally disagree in the expected findings and totally agree, partially agree, neutral, partially disagree and totally disagree in the actual findings. Quantitative information was analyzed by establishing the frequency of a given response to the question. These frequencies were tabulated and conclusions made about the extent of Corporate Governance practice in the banking sector in Kenya. The summarized information represented the overall situation of commercial banks with respect to what extent they practice Corporate Governance.

CHAPTER 4

DATA FINDINGS AND ANALYSIS

4.1 Introduction

This chapter contains summaries of data findings together with their possible interpretations. The chapter contains general information on the respondents, expectations of the respondents regarding their banks, and, the analysis of the extent to which these banks meets the expectations. A total of 30 questionnaires were received. This represents 30% response rate.

4.2 General Profile of Respondents

The general profile of respondents in the survey included the sex of the respondent, bank on which the respondent work for, age of the respondent and the respondents level of education.

4.2.1 Sex

Table 1: Sex of the Respondents

Sex	Frequency	Percentage %
Male	13	43.3
Female	15	50
No response	2	6.7
Total	**30**	**100.0**

The respondents were asked to indicate their gender while a number of those interviewed declined to reveal their sex, majority of the interviews were female at 50% while of all those who indicated their gender,43.3% were male.

4.2.2 Age

Table 2: Age of Respondents

Age group	Frequency	Percentage %
18 – 24	11	36.7
25 – 29	8	26.7
30 – 39	5	16.7
40 – 49	4	13.3
Above 50	0	0.0
Missing	2	6.6
Total	**30**	**100.0**

Analyses revealed that most (26.7%) of respondents interviewed were in the 25 – 29 age bracket, 36.7% fell under the 18 – 24 age group, 16.7% under the 30 – 39 age bracket, 13.3% fell under 40-49 age bracket, while none of the respondents were above 50 years of age. Two of the respondent did not indicate their age representing 6.6%.

4.2.3 Employment

Table 3: Employment period of respondents

Age group	Frequency	Percentage %
Less than 1 year	6	20
1 - 5 years	11	36.6
5 - 10 years	8	26.7
Over 10 years	3	10
Missing	2	6.7
Total	**30**	**100.0**

Analysis further revealed that 36.6% of the respondents had been in employment with their various banks for periods ranging from 1 to 5 years. 20% had been in employment for less than a year while 10% and 6.7% had been in employment between 5 to 10 years and for over 10 years respectively.

4.2.4 Education

Table 4: Education level of the respondents

Age group	Frequency	Percentage %
Primary	o	0
Secondary	2	6.7
College	6	20
University	20	66.6
Missing	2	6.7
Total	**30**	**100.0**

According to the above table, respondents were generally well educated. Majority of them 66.6% were university graduate, 20% are college graduates and 6.7% reached secondary school level of education. None of the respondents had below secondary school level of education while two respondents did not indicate their level of education representing 6.7%

4.3 Screening

Table 5: Measurement of Board effectiveness

Response	Frequency	Percentage %
No	7	23.3
Yes, by shareholders	12	40
Yes, by delegates	1	3.3
Yes, by Stakeholders	4	13.3
Missing	6	20
Total	**30**	**100.0**

Majority of the respondents (40+3.3+13.3= 56.6% to be precise) agree that the effectiveness of the Board of Directors is measured. Out of those who agree to the subject question (12/17x100%) 70.6% believe that the shareholders measure effectiveness of the BOD, (1/17X100/%) 5.882% believe that it is delegates who measure effectiveness of the BOD, while (4/17x100%) 23.529% believe that all stakeholders who include shareholders, employees, customers, supplies, creditors and the like are the ones who measure the effectiveness of the board. Out of the total respondents 23.3% do not agree that the effectiveness of the Board of Directors is measured. The remaining 20% of the respondents did not disclose this vital information.

4.4 Expectations: In order to determine the extent of application of Corporate Governance practices, it was important to know the expectation of the respondents on these practices. Each factor was analyzed to get the mean and the standard deviation.

Table 6: Expectations by the respondents

Variables	No of respondents who responded under each				
	Totally agree	Slightly agree	Neutral	Slightly disagree	Disagree completely
The bank stakeholders are responsible for electing competent members to the BOD	22	5	1	2	0
The BOD is accountable and responsible for efficient and effective governance	18	9	0	3	0
Stakeholders are allowed to change the composition of BOD in order to improve its efficiency	27	2	1	0	0
The BOD is responsible for laying out strategic planning of the company	20	7	0	0	3
The BOD is responsible implementing the laid out strategic planning activities	10	16	3	1	0
The BOD is responsible for the legal and financial compliance of the corporation	9	12	4	2	3
The BOD communicates with the lower management before implementing policies	28	0	2	0	0
The performance of the BOD is open to scrutiny by lower management	27	3	0	0	0
The performance of the BOD is open to scrutiny by stakeholders	21	6	1	1	1
The top management is open to suggestions and ideas by lower management	24	1	2	1	2

The responses from the above table generally summarizes that a lot of respondents totally expect the stakeholders to be responsible for electing competent members of the Board Directors. Stakeholders include employees, shareholders, customers, supplies, debtors and the like.
No employee of any particular firm or supplier for that case or even a customer would like to be associated with a bank/firm which has incompetent members as Board of Directors; such a firm may be deemed as incompetent Board of Directors make incompetent decisions.

The respondents expect that the Shareholders are the ones who do elect members of the board during AGM. The number of respondents corresponding to the subject question is 22 who totally agree, five who slightly agree. This means that most of the respondents do totally agree that the bank stakeholders are the ones responsible for electing competent members to the Board of Directors.

The respondents are actually in agreement when it comes to the Board of Director being accountable and responsible for efficient and effective governance. They are also in agreement that the Board of Director is responsible for laying out strategic planning of the company. This goes a long way compared to the principle of leadership which states that "every corporation should be headed by an effective board to achieve continuing prosperity and to act in the best interest of the enterprise based transparency, accountability and responsibility". The principle on strategy and values also states that "The Board of Directors should determine the purpose and implement its values to ensure that it survives and thrives and that procedures and values that protect its assets and reputations are put in place.

The respondents were varied on the question that stakeholders are allowed to change the composition of the Board of Directors in order to improve its efficiency. Stakeholders include shareholders, customers, creditors', suppliers, employees and the like and it is only the shareholders who are allowed to vote or elect a new Board of Directors. That explains why some respondents totally expected this to be the case; some did not expect this at all while some were neutral as to the question under study.

When it comes to the question of the board, being responsible for implementing laid out strategic planning activities and for the BOD being responsible for the legal and financial compliance of the corporation. The respondents partly expected this to be true as their responses were varied. Implementation of laid out strategic planning activities is a responsibility of the top management and not the Board of Directors. The top management is also the one responsible for legal and financial compliance of many corporations.

The respondents expect the performance of the BOD is open to scrutiny by lower management; that the top management is open to suggestions and ideas by lower management and that the performance of the BOD is open to scrutiny by stakeholders. This is supported by the massive response from the respondents.

4.5 Actual performance

The above analysis was based on the response of the expectations of the respondents on the corporate governance they expect to be practiced by the board of directors of the respective banks. This was later followed by the analysis if the actual performance of the board of directors on the corporate governance as follows.

Table 7: Actual results on banks

Variable	Totally agree	Slightly agree	Neutral	Slightly disagree	Disagree completely
The bank stakeholders are responsible for electing competent members to the BOD	1	16	1	9	3
The BOD is accountable and responsible for efficient and effective governance	5	15	2	3	5
Stakeholders are allowed to change the composition of BOD in order to improve its efficiency	5	20	3	2	0
The BOD is responsible for laying out strategic planning of the company	2	3	22	3	0
The BOD is responsible implementing the laid out strategic planning activities	1	4	23	2	0
The BOD is responsible for the legal and financial compliance of the corporation	3	14	10	2	1
The BOD communicates with the lower management before implementing policies	1	9	11	7	2
The performance of the BOD is open to scrutiny by lower management	1	7	15	5	2
The performance of the BOD is open to scrutiny by stakeholders	4	14	10	1	1
The top management is open to suggestions and ideas by lower management	1	25	2	0	2

From the above table, we can establish that some respondents totally agreed, some totally disagreed, others partially agreed while others partially disagreed and some were neutral to the subject question. From the table we can establish that there is a shift in response from the strongly agree towards the slightly agree and neutral rates.

The respondents partially disagreed that the banks stakeholders are responsible for electing competent members to the Board of Directors. This is due to the fact that stakeholders include shareholders, consumers, customers, employees, suppliers and creditors. It is only shareholders who are allowed to elect members of the board during annual general meetings (AGM's).

The respondents partially agree that the Board of Directors is accountable and responsible for efficient and effective governance. One of the principles of Corporate Governance states that "every corporation should be headed by an effective board that exercises leadership, enterprise, integrity and judgment in directing the corporation to achieve continuing prosperity and to act in the best interest of the enterprise based on transparency, accountability and responsibility.

On the part of stakeholders being allowed to change the composition of the board in order to improve its efficiency, the respondents partially agreed. However, they were neutral on the fact that the board is responsible for laying out strategic planning of the company and implementing the laid out strategic planning activities of the company. This is seen as a preserve of the top management and not the Board of Directors. Also seen as a preserve of the top management is the responsibility for legal and financial compliance of the corporation and that is why the respondents partly agreed on this matter.

The respondents were neutral on the fact that the Board of Directors communicates with the lower management before implementing policies. The Board of Directors would rather communicate with the top management than the lower management before implementing policies. That is why the respondents were neutral and varied according to the response to this question meaning the respondents had not any general agreement on this question.

"The performance of the Board of Directors is open to scrutiny by lower management." As to this question, the respondents were neutral and varied meaning they did not have any agreement but on the performance of the Board of Directors being open to scrutiny by stakeholders, the respondents partially agreed that the top management is open to suggestions and ideas by lower management.

4.6 Comparison of the expected and the actual performance of the board

From the above response tables; table 6 and table 7, the difference show that the respondents had higher expectations of Corporate Governance practices by the Board of Directors, as compared to what actually happens. This is so because of the differences and the apparent shift in the responses from the different ratings of the response. Hence this made the researcher to conclude that the boards of governors of most of the banks do not actually perform as they are expected by the stakeholders of the bank and that the shareholders are mainly the stakeholders that are involved directly with the board since the board is answerable to the shareholders' mainly.

From the analysis of the response there were no major differences in the following statements such as the bank stakeholders are responsible for electing competent members of the Board of

Directors, the Board of Directors is responsible for efficient and effective governance, shareholders being allowed to change composition of the Board of Directors so as to improve its efficiency, the Board of Directors being responsible for laying out strategic planning of the company, the Board of Directors being responsible for implementing the laid out strategic planning activities, and the performance of the Board of Directors being open to scrutiny by stakeholders.

CHAPTER 5

CONCLUSION, LIMITATIONS OF THE STUDY AND RECOMMENDATIONS

5.1 Conclusion

The survey revealed that Corporate Governance practices in the banking sector are guided by guidelines given by the private sector initiative on Corporate Governance and not the central bank of Kenya. This is a major setback as we do not see any differences between guidelines in Corporate Governance in the banking sector and other sectors of the economy. The Central Bank only regulates commercial banks but not in terms of Corporate Governance.

The survey also revealed that all banks practice Corporate Governance and that the Board of Directors is responsible for efficient and effective governance and that the performance of the Board of Directors is open to scrutiny by the stakeholders. What differs is the extent to which Corporate Governance is practiced in the various banks.

The survey revealed that the stakeholders had high expectations for better Corporate Governance practices, but what was actually happening in terms of Corporate Governance was way below what they expected to happen as can be seen from the comparison tables in chapter three.

The Board of Directors is accountable and responsible for efficient and effective Corporate Governance practices and so the Board of Directors is an important asset to the Bank. Appointments or election therefore becomes a sensitive matter as those appointed and or elected make some of the most important decisions of the Banking institution.

5.2 Recommendations

From the study, we see that a lot of what is expected is actually what is practiced.

The Board of Directors should be accountable and responsible for efficient and effective governance, they should be responsible for lying out of strategic planning of the company, and the top management should be open to suggestion and ideas by lower management.

The performance of the board should be open to scrutiny by lower management and also open to scrutiny by stakeholders. This promotes higher accountability on the part of the board of directors.

The Board of Directors does not communicate with lower management before implementing policies. This should be abolished and the board should communicate with the whole before implementation of the policies.

Further research should use more in-depth interviewing techniques to provide a more complete picture of Corporate Governance practices in the banking sector in Kenya. It will also be useful to see what measures are taken for those institutions that do not use these practices to govern their banks.

5.3 Limitations of the Study

A limitation of the study stems from its design which involved the use of a questionnaire to capture relevant information. Financial statements might have obtained more information. Another limitation also comes from the fact that, there is no standard way of measuring how effective a Board of Directors is as some view it in terms of profitability, dividend payout, expansion etc.

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APPENDICES

Appendix I: Instruments

Questionnaire

SOCIAL CLASS:	**SEX:**	**AGE**	**Employment Period**	**Education level**
AB...............1	Male................1	18-24............1	Less than 1 year...1	Primary......................1
C1................2	Female............2	25-29............2	1-5 years 2	Secondary..................2
C2................3	**Bank**	30-39............3	5-10 years 3	College. 3
D.................4	KCB 1	40-49............4	Over 10 years 4	University.....................4
E.................5	NIC 2	Above 50 5		Primary......................1

PART 1

SCREENING

1. Is the effectiveness of the board measured?

Yes ☐

No ☐

And by whom?

....

....

2. How much do you expect your bank to practice the following Corporate Governance guidelines?

	Statement	Totally expect	Partially expect	Neutral	Don't expect	Don't expect at all
A	The bank stakeholders are responsible for electing competent members to the BOD	1	2	3	4	5
B	The BOD is accountable and responsible for efficient and effective governance	1	2	3	4	5
C	Stakeholders are allowed to change the composition of BOD in order to improve its efficiency	1	2	3	4	5
D	The BOD is responsible for laying out strategic planning of the company	1	2	3	4	5
E	The BOD is responsible implementing the laid out strategic planning activities	1	2	3	4	5
F	The BOD is responsible for the legal and financial compliance of the corporation	1	2	3	4	5
G	The BOD communicates with the lower management before implementing policies	1	2	3	4	5
H	The performance of the BOD is open to scrutiny by lower management	1	2	3	4	5
I	The performance of the BOD is open to scrutiny by stakeholders	1	2	3	4	5
J	The top management is open to suggestions and ideas by lower management	1	2	3	4	5

APPENDIX 111: BUDGET

The funds were provided for by the researcher with the help of the parents.

Item	Amount (Kshs)
Internet	200
Transport	1000
photocopying	1000
Binding	1000
Stationery	1500
Secretarial services	1000
Miscellaneous expenses	800
Total	6500