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Abstract

Purpose: The purpose of the study was to assess the influence of corporate governance practices on the financial performance of investment firms trading at the Nairobi Securities Exchange (NSE).

Methodology: The present study employed a correlational research methodology and positivist philosophy to investigate the impact of firm-specific characteristics on the financial performance of sixty-three investment businesses that were listed on the Nairobi Securities Exchange (NSE) between 2014 and 2023. NSE, CBK, and KNBS were among the secondary sources from which data was gathered using a census technique. The links between corporate governance, risk management, portfolio diversification, and asset allocation were examined using panel regression models, with diagnostic tests guaranteeing the accuracy of the data. Additionally, the moderating influence of ownership structures was assessed, and the results were displayed through the use of statistical analysis software such as SPSS. The information was also shown using tables and figures.

Findings: The analysis of corporate governance practices among NSE-listed investment firms highlighted the rarity of CEO duality and diverse board compositions, with boards averaging 5.29 members. Leverage showed significant variability, increasing until 2022 before declining, while board sizes gradually grew over the study period, reflecting enhanced governance focus. Regression analysis confirmed a positive and statistically significant relationship between governance practices and financial performance indicators like ROA, ROE, and composite performance.

Unique Contribution to Theory, Practice and Policy: Firms should focus on establishing clear governance structures, ensuring effective oversight by the board of directors, and implementing robust internal controls. Promoting transparency and accountability in operations, along with regular reviews of governance practices to align with best practices and regulatory requirements, will enhance decision-making, increase investor confidence, and improve overall financial outcomes.

Keywords: *Financial Performance, Corporate Governance, CEO Duality, Board Diversity*

JEL Codes of Classification: *L25, G34, G34, M14*

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INTRODUCTION

Corporate governance plays a crucial role in enhancing financial performance, mitigating risks, and fostering investor confidence. In Kenya, regulatory bodies such as the Capital Markets Authority (CMA) and the Nairobi Securities Exchange (NSE) have introduced stringent corporate governance requirements for listed companies. These include the appointment of independent directors, the establishment of audit committees, and the implementation of corporate codes of conduct (Kamau & Mwangi, 2020). While these measures have improved governance structures, the significance of corporate governance in investment firms warrants further emphasis.

Investment firms operate as key players in Kenya's capital markets, influencing capital flows, market stability, and economic growth. Effective governance within these firms is essential for ensuring transparency, accountability, and sustainable financial performance. Studies have shown that strong corporate governance practices, such as regular compensation reviews, auditor independence, and the protection of shareholder rights, establish clear decision-making processes that reduce financial misconduct and unethical behavior (Abebe et al., 2022). These governance mechanisms are particularly important in investment firms, where the management of assets and investor funds requires strict oversight.

Internationally, corporate governance frameworks have evolved to meet global best practices. In the UK, the Corporate Governance Code emphasizes the independence of directors and the protection of shareholder rights, which has helped strengthen investor trust (Kyere & Ausloos, 2021). Similarly, research from India highlights that adapting corporate governance to international standards enhances financial performance and attracts foreign investment (Al-Alhdal et al., 2020). These findings underscore the need for investment firms in Kenya to align with global governance standards to remain competitive. Regionally, corporate governance practices vary across African markets. South Africa has implemented a robust governance framework through the King IV Report, which promotes transparency, accountability, and ethical leadership (IoDSA, 2016). Conversely, Tanzania faces significant governance challenges due to limited regulatory oversight and enforcement mechanisms (Mlowe & Kyeyune, 2018). Kenya stands between these two extremes, with regulatory efforts that have improved governance but still require further strengthening, particularly in investment firms.

The evolution of corporate governance in Kenya has also been influenced by the growing adoption of Environmental, Social, and Governance (ESG) principles. Many firms are incorporating ESG factors into their decision-making processes as part of a broader strategy to align with global investment trends and attract responsible investors (Oduor, 2019). ESG integration not only enhances corporate reputation but also promotes long-term financial sustainability. Despite these advancements, gaps remain in the governance of investment firms specifically. While corporate governance is a widely discussed topic for listed companies, investment firms require tailored governance frameworks that address their unique operational risks and market functions.

Statement of the Problem

Consistent profitability, expansion, and financial stability are anticipated for NSE investment businesses, stockbrokers, and fund managers (Ngeno, 2018; Roche, 2021). Their financial success has been erratic, too, with events such as Discount Securities Limited's demise illustrating the industry's unpredictability (NSE, 2022). Overall performance is still uneven, even if certain businesses, like Sanlam Investments East Africa, had better success, increasing

their income from Ksh. 742,000 in 2021 to Ksh. 2,414,000 in 2022 (Sanlam Investments East Africa Limited, 2022).

Research has shown that governance including board diversity and are important performance-influencing elements (Chen & Mahmood, 2020; Kiragu & Namusonge, 2017; Nderitu & Kariuki, 2019). Gaps still exist: local research like that of Kiragu and Namusonge (2017) and Nderitu and Kariuki (2019) did not sufficiently examine corporate governance practices in investment firms, while international study by Chen and Mahmood (2020) have geographical and contextual gaps. Therefore, this study sought to fill this gap by evaluating the influence of corporate governance practices on the performance of investment firms trading at NSE.

LITERATURE REVIEW

Theoretical Framework

A concept that examines the connection between principals (generally owners or shareholders) and agents (usually managers or executives) inside an organization, agency theory was first put out by Stephen Ross and Barry Mitnick in the 1970s (Ross & Mitnick, 1973). The main focus of the theory is on the possible conflicts of interest that can occur when principals and agents have different objectives and driving forces. According to the theory, an agency problem occurs when agents put their own interests or goals first, resulting in actions that are contrary to the principals' interests (Ross & Mitnick, 1973). It recognizes that principals may not always be able to keep an eye on or directly manage agents, which can lead to information asymmetry and moral hazard.

Agency theory proponents contend that it offers a useful framework for comprehending and resolving the agency problem. Meckling and Jensen (1976). They suggested that the agency problem causes agency costs, like bonding and monitoring expenses, which can be reduced by a number of strategies, such as corporate governance procedures and executive compensation contract design. Critics counter that it makes irrational assumptions about human behavior and oversimplifies the intricate interactions inside organizations. Agency theory is criticized for its oversimplification of organizational dynamics and shareholder bias. It assumes that all agents act opportunistically, ignoring intrinsic motivation and ethical considerations. Additionally, it prioritizes shareholder interests over other stakeholders, neglecting social and environmental concerns. Critics argue it fails to capture complex governance structures and real-world managerial behaviors (Fama & Jensen, 1983). According to some, agency theory has a tendency to put shareholders' (principals') interests ahead of those of other stakeholders, possibly ignoring more general ethical and societal issues (Grossman & Hart, 1988). Notwithstanding the criticism, the use of agency theory was utilized to investigate how corporate governance procedures function as a means of alleviating the performance in investment firms trading at NSE.

Empirical Review

In the United Kingdom, Kyere and Ausloos (2021) demonstrated that corporate governance mechanisms impact financial performance in non-financial listed companies, albeit with varied effects. This underscores the importance of context-specific governance strategies rather than a one-size-fits-all approach. However, the study leaves a geographical gap, as governance in developing economies like Kenya may function differently due to regulatory, economic, and cultural factors.

In India and the GCC countries, Al-Ahdal et al. (2020) found that transparency and disclosure negatively affected Tobin’s Q, while Indian firms outperformed their GCC counterparts in

governance and financial performance. These findings suggest that economic environments and cultural factors play a vital role in shaping governance outcomes. The differences between Indian and GCC firms emphasize why Kenyan investment firms require tailored governance approaches suited to local economic realities.

The role of board diversity and CEO duality emerged as a focal point in multiple studies. Musah and Adutwumwaa (2021) found that board independence positively influenced financial performance in Ghana's rural banks, while gender diversity had a negative impact. Similarly, Gebrayes and Edeit (2022) found mixed results in Ethiopian commercial banks, with CEO duality showing a positive but statistically insignificant correlation with ROE. In contrast, Ahmed et al. (2021) concluded that CEO gender and share ownership influenced performance in Nigerian insurance companies, suggesting that governance structures must reflect the industry and country-specific dynamics.

Kenya-specific studies highlight governance's crucial role in financial performance. Omware, Atheru, and Jagongo (2020) analyzed Kenyan commercial banks, showing that board size, board independence, and diversity positively influenced financial performance. However, research focusing on investment firms remains limited, leaving a significant gap in understanding governance's role in this sector. Similarly, Korir and Tenai (2020) concluded that CEO duality did not significantly impact firm performance in NSE-listed firms, reinforcing the need for governance practices tailored to investor expectations.

Several studies highlight sectoral differences in governance impact. Uya et al. (2022) found that board independence and gender diversity improved financial stability in banking and insurance but had limited effects in investment banking. This suggests that governance strategies should be sector-specific rather than generalized. Muange and Ngetich (2020) extended governance discussions beyond financial performance by demonstrating how CEO duality and board tenure influenced CSR investments in Kenya, indicating a broader impact of governance structures.

While extensive research has examined corporate governance in banks and insurance firms, investment firms remain understudied, especially in Kenya. The sectoral variations in governance effects, as highlighted by Uya et al. (2022) and Musah and Adutwumwaa (2021), emphasize the need for context-specific governance studies. Furthermore, the role of CEO duality remains inconclusive, with studies such as Korir and Tenai (2020) and Gebrayes and Edeit (2022) showing mixed or insignificant results. Thus, this study seeks to bridge these gaps by evaluating how corporate governance practices influence the financial performance of investment firms trading at the NSE, ensuring that governance strategies align with industry needs, investor confidence, and financial stability.

Research Gaps

The existing studies on corporate governance practices and financial performance of investment firms reveal several conceptual, contextual, geographical, and methodological gaps. Contextually, studies like that of Njuguna and Nyanjiru (2020) are predominantly focused on sectors like banking and insurance, which may not accurately represent the dynamics of investment firms. This leaves a gap in the literature, particularly regarding the specific regulatory environment and operational dynamics of firms listed on the Nairobi Securities Exchange (NSE), where financial practices may differ significantly from those in other industries. Geographically, much of the existing literature is concentrated in developed markets such as the UK (Madhani, 2018) or emerging economies like India (Osei-Assibey &

Ntiamoah, 2020), creating a gap in understanding the unique regulatory and economic context in Kenya. Research by Chirchir and Rutto (2021) also focuses on Kenya but does not account for time-series data, failing to provide an in-depth longitudinal perspective on corporate governance practices. Methodologically, many studies such as those by Oketch (2022) and Madhani (2018) employ cross-sectional designs, which provide only a snapshot of firm performance at a single point in time. This overlooks the longer-term effects of governance practices. The present study bridges this gap by employing panel regression, which captures changes over time, and a census sampling technique, ensuring a more comprehensive and representative dataset than the convenience sampling typically used in previous research. Panel regression analyzes data over multiple time periods, capturing both firm-specific and time-related effects. Unlike cross-sectional regression, it tracks governance impacts over time, reducing bias and improving accuracy. This makes it ideal for assessing long-term financial performance trends in NSE investment firms, offering deeper insights than single-year analyses.

METHODOLOGY

In order to investigate the impact of firm-specific characteristics on the financial performance of investment businesses listed at the Nairobi Securities Exchange (NSE), the research employed a positivist mindset, placing an emphasis on empirical observation. Panel data for the years 2014–2023 was gathered from secondary sources including NSE, CBK, and KNBS using a correlational study approach. With 63 investment businesses as the target population, a census technique guaranteed thorough coverage free from sampling error. Panel regression models were used in data analysis to look at the connections between corporate governance, risk management procedures, portfolio diversity, and asset allocation. Data dependability was confirmed by diagnostic procedures such as Hausman, normality, heteroscedasticity, and autocorrelation. It was also evaluated how ownership arrangements affected these interactions. The direction and intensity of variable correlations were assessed using Pearson correlation analysis. Regression models were used to display the results, and data analysis was supported by SPSS Version 27. The strategy was in line with the study's objective of methodically assessing the financial performance and procedures of individual firms.

RESULTS

Descriptive Results for Corporate Governance Strategies

The descriptive analysis of corporate governance practices revealed the following insights: CEO duality, measured as a binary variable (1 for no duality and 2 for duality), had a mean of 1.0189 with a low standard deviation of 0.1362, indicating that most firms did not have CEO duality. Leverage, with a mean of 3.5516 and a standard deviation of 1.2205, showed a wide range of leverage ratios among firms, from 1.0206 to 7, reflecting varying degrees of financial risk. Board composition, averaging 5.2878 members with a standard deviation of 1.9839, ranged from 1.296 to 11 members, suggesting diverse board sizes. These descriptive statistics provided a snapshot of corporate governance practices, highlighting variability in leverage and board composition, while indicating a prevalent lack of CEO duality among the investment firms trading at NSE.

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Table 1: Descriptive Results for Corporate Governance Strategies

Variable (billions)	Obs	Mean	Std. Dev	Min	Max
CEO Duality	530	1.018868	.1361871	1	2
Leverage	530	3.551617	1.220537	1.0206	7
Board composition	530	5.287796	1.983869	1.296	11

Trend Analysis for Corporate Governance Strategies

The trend analysis of corporate leverage from 2014 to 2023 showed how governance strategies influenced a firm's financial structure. The rise in leverage from 3.24 in 2014 to 3.86 in 2022 suggested a governance approach that favored increased debt to boost growth and invest in expansion. However, the subsequent decline to 3.27 in 2023 indicated a shift in governance practices towards reducing debt levels to enhance financial stability, align with regulatory changes, or respond to market conditions.

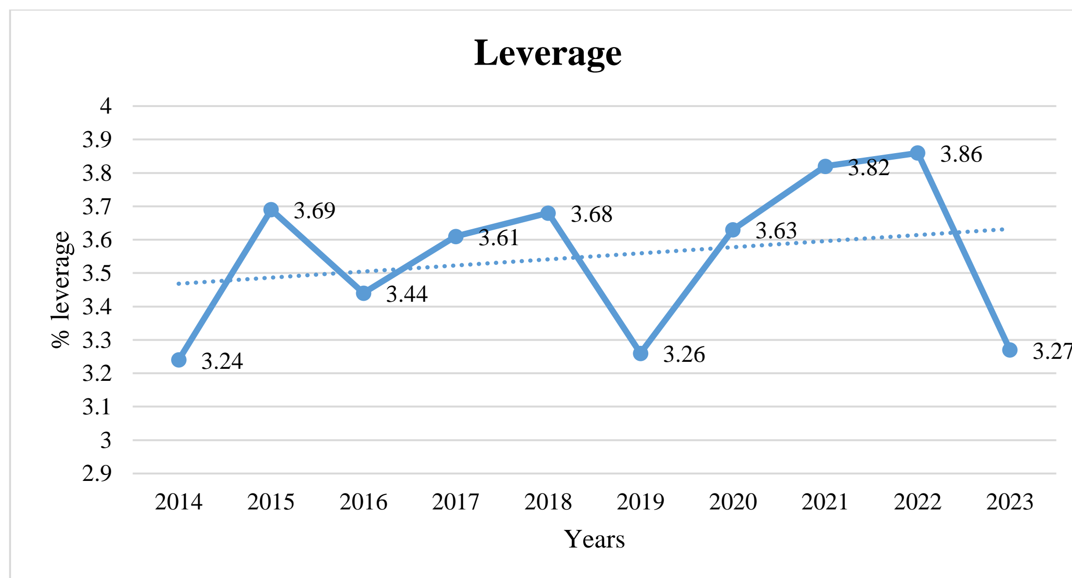

Figure 1: Trend Analysis of Corporate Leverage

The average trends in board composition from 2014 to 2023 reveal a generally increasing trend in the number of board members. Starting at 3.96 in 2014, the average board size grew to 5.81 by 2018, indicating a gradual expansion of boards. Although there were minor fluctuations, including a slight decline to 5.20 in 2021, the overall trend remained upward, reaching 5.75 in 2022 and 5.59 in 2023. This increase suggests a growing emphasis on diverse and potentially more effective board governance structures, reflecting a strategic move to enhance decision-making, oversight, and overall corporate governance.

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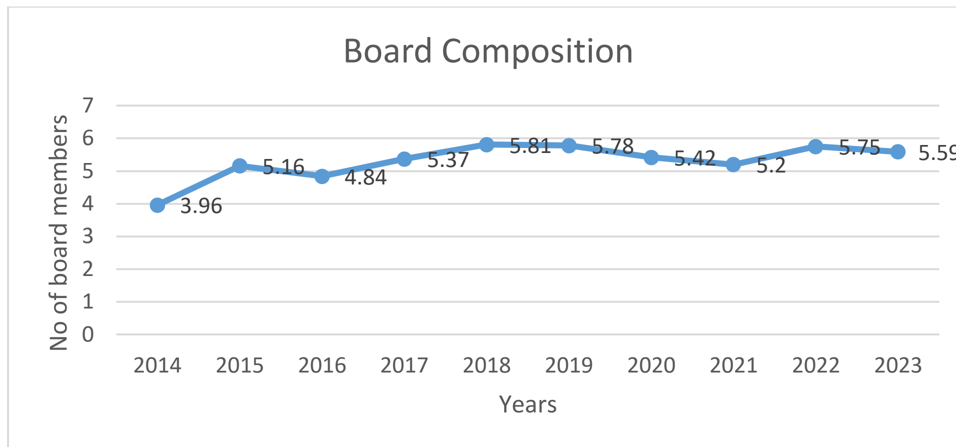

Figure 2: Trend Analysis of Board Composition

Out of the 53 companies assessed, only one practiced CEO duality, where the CEO also served as the board chair. This rarity reflected a strong preference among firms for separating these roles to enhance checks and balances, avoid conflicts of interest, and ensure better governance. The overwhelming majority likely believed that independent leadership and oversight were crucial for effective decision-making and accountability within the corporate governance framework.

Figure 3: CEO Duality

Relationship between Corporate Governance and Financial Performance Indicators

In the first model, the analysis revealed that corporate governance practices had a positive impact on ROA, with the coefficient being 0.3003558. The R-squared value was 0.2890, indicating that approximately 28.90% of the variance in ROA could be attributed to CEO duality, leverage, and board composition. The model was statistically significant, as indicated by the p-value of 0.0000. This positive relationship suggests that firms with robust corporate governance structures, including a clear separation of the CEO and board chair roles, prudent leverage management, and an optimal board composition, were better at utilizing their assets efficiently. This finding is consistent with agency theory, which posits that effective governance mechanisms reduce conflicts of interest and enhance managerial oversight, leading

to improved asset utilization and profitability (Omware et al., 2020). The study's results align with those of Kyere and Ausloos (2021) who found that firms with strong governance practices tend to perform better in terms of ROA.

The second model examined the relationship between corporate governance practices and ROE, showing a positive coefficient of 1.9586148. The R-squared value was 0.2674, indicating that 26.74% of the variance in ROE was explained by the governance practices. The model's statistical significance (p-value of 0.000) reinforced the critical role of governance in influencing shareholder returns. The higher coefficient in the ROE model compared to the ROA model suggests that corporate governance practices, particularly the separation of CEO and board chair roles, had a more substantial impact on shareholder returns. Agency theory supports this finding by suggesting that effective governance reduces agency costs and aligns managerial actions with shareholder interests, thereby maximizing returns on equity (Jensen & Meckling, 1976). This is further illustrated by Gathara et al. (2019) study, which emphasized that good governance practices lead to better financial outcomes for shareholders.

The third model combined ROA and ROE to assess the overall impact of corporate governance on financial performance. The analysis found a positive relationship between governance practices and composite financial performance, with a coefficient of 1.129502 and an R-squared value of 0.2887, suggesting that nearly 28.87% of the variance in overall financial performance was attributable to the governance practices. The consistent positive impact of corporate governance practices across all models reinforces the idea that well-structured governance mechanisms, including non-CEO duality, prudent leverage management, and appropriate board composition, are crucial for financial success. Agency theory emphasizes the importance of reducing agency conflicts and ensuring effective oversight through a well-composed board (Korir & Tenai, 2020). This is further supported by the findings of Omware et al. (2020) and Al-Ahdal et al. (2020), who argued that a capable and diverse board enhances the effectiveness of governance and leads to better financial outcomes. The positive relationship between these corporate governance practices and financial performance across all models underscores their importance in optimizing firm performance, reducing agency costs, and enhancing shareholder value. Therefore, effective corporate governance is shown to be a key driver of financial success for firms trading at the Nairobi Securities Exchange.

Table 2: Relationship between Corporate Governance and Financial Performance Indicators

Model	Model 1(ROA)	Model 2(ROE)	Model 3(Composite Financial Performance)
Corporate governance practices	.3003558	1.9586148	1.129502
_Cons	.1527822	1.246337	.6995594
Number of obs	530	530	530
F	214.57	194.08	215.75
Prob > F	0.0000	0.000	0.000
R-squared	0.2890	0.2674	0.2887
T	149.2981	6825.36051	2103.14298
DoF	529	529	529

Hypothesis Testing for the Relationship between Corporate Governance Strategies and Financial Performance

H_{03}: Corporate Governance Practices have no significant influence on Financial Performance of Investment Firms Trading at the NSE.

Based on the findings, the null hypothesis was rejected. The results from the three models indicated a significant positive impact of corporate governance practices on financial performance indicators, including ROA, ROE, and a composite financial performance measure. In Model 1 (ROA), the coefficient for corporate governance practices was 0.3003558, with an R-squared value of 0.2890 and a p-value of 0.0000, indicating statistical significance. Similarly, Model 2 (ROE) showed a positive coefficient of 1.9586148, with an R-squared value of 0.2674 and a p-value of 0.000, also demonstrating statistical significance. Finally, in Model 3 (Composite Financial Performance), the coefficient was 1.129502, with an R-squared value of 0.2887 and a p-value of 0.000, further reinforcing the significance of the relationship. The consistently low p-values across all models suggested that the influence of corporate governance practices on financial performance was statistically significant, leading to the rejection of the null hypothesis. These findings underscored the importance of effective governance in driving financial success among investment firms trading at the NSE.

SUMMARY, CONCLUSION AND RECOMMENDATIONS

Summary

The descriptive analysis of corporate governance practices among NSE investment firms provided key insights. CEO duality was rare (mean = 1.02), indicating that most firms separate CEO and board chair roles. Leverage varied significantly (mean = 3.55), reflecting diverse financial risks. Board composition averaged 5.29 members, highlighting variations in governance structures. Trend analysis (2014-2023) showed an increase in leverage until 2022, followed by a decline, while board size gradually increased, signaling a stronger focus on governance. The regression analysis found that corporate governance practices positively influenced financial performance, with statistically significant relationships across ROA, ROE, and composite financial performance ($p < 0.001$). Specifically, a 1-unit improvement in governance practices was associated with a 0.30 increase in ROA, a 1.96 increase in ROE, and a 1.13 increase in overall financial performance. The R-squared values (ROA: 0.2890, ROE: 0.2674, Composite: 0.2887) suggest governance explains a moderate proportion of financial performance variance. However, governance effectiveness is not universally positive. In some firms, excessive board control or overly rigid governance structures may hinder strategic decision-making, leading to diminished financial agility. Additionally, firms with high leverage ratios may experience governance inefficiencies, as board oversight alone may not offset financial risk exposure. These nuances highlight that while governance plays a crucial role in financial success, its effectiveness depends on the firm's specific structure and financial strategy.

Conclusion

The third objective aimed to evaluate how corporate governance practices affect the financial performance of investment firms listed on the NSE. The analysis revealed that most firms did not have CEO duality, indicating a separation between the CEO and board chair roles. There was significant variability in leverage ratios and board sizes among the firms. Regression analysis showed that corporate governance practices positively influenced ROA, suggesting that firms with strong governance structures, including clear role separation, prudent leverage

management, and optimal board composition, utilized their assets more efficiently. This aligns with agency theory, which posits that effective governance reduces conflicts of interest and enhances oversight. The study also found a positive relationship between governance practices and ROE, indicating that good governance significantly impacts shareholder returns. Overall, robust corporate governance practices were crucial for the financial success of these firms.

Recommendations

The study's findings highlight the critical role of corporate governance in enhancing financial performance among investment firms at the Nairobi Securities Exchange (NSE). To strengthen governance frameworks, the Capital Markets Authority (CMA) of Kenya should enforce policies that mandate clear governance structures, independent board oversight, and robust internal controls. Regulators should also require firms to adopt transparency measures, such as regular financial disclosures and governance audits. Additionally, periodic reviews of governance practices should align firms with global best practices and evolving regulations. These measures will promote accountability, boost investor confidence, and ultimately improve financial stability in Kenya’s capital markets.

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