CORPORATE GOVERNANCE PRACTICE AND ITS EFFECT ON FINANCIAL PERFORMANCE IN SACCOs (A case study of Urban SACCOs in Kirinyaga County - Kenya)

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A research project submitted to the school of business in partial fulfillment of the requirements for the award of the degree of Master of Business Administration (Finance) of Kenyatta University.

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DECLARATION

This research project is my original work and has not been presented for a degree in any other university or any other award.

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The study sought to examine the effects of corporate governance practices on financial performance of SACCOs, and it was conducted in Kirinyaga County in Kenya. The independent variables that were used are: board size, internal audit function and frequency of board meetings. Return on Capital Employed was used as a measure of financial performance. Financial information for the period between year 2006 and 2009 was used. Data was collected using a questionnaire. The study employed descriptive survey design. The population for the study was drawn from thirteen active urban SACCOs in Kirinyaga County. Complete census of the population was used since the number of urban SACCOs is not very big; hence it was possible to reach all of them within a reasonable time. Data was analyzed using regression analysis technique. The findings of this study indicate that there is a negative relationship between the size of the board and the financial performance; the average board size being seven. The study also revealed a positive relationship between the frequency of board meetings per year and ROCE; the average number of meetings per year being ten. Regarding the presence of internal audit function, the study revealed a negative relationship between ROCE and the presence of the internal audit function, with only 23.7% of the respondents indicating that they have audit departments in their SACCOs. The study recommends regular board meetings, which should focus on initiating strategic actions for the SACCOs. The study also recommends enhancement of independence and effectiveness of internal audit function in SACCOs. It further recommends a board size that suits the needs of each SACCO, and which provides desired mix of skills, effective communication and cohesiveness of the board.
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DEDICATION

To my wife Teresia Kagendo, children, mother, brothers and sisters, thank you all for your honest understanding, support and encouragement in this endeavor.
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ABBREVIATIONS

A.G.M. - Annual General Meeting
C.C.G. - Centre for Corporate Governance
C.E.O. - Chief Executive Officer
C.M.A - Capital Market Authority
M.O.C.D.M. - Ministry of Cooperative Development and Marketing.
N.S.E. - Nairobi Stock Exchange.
R.O.C.E. - Return on Capital Employed
SACCO - Savings and Credit Cooperative Society
U.S.A. - United States of America
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Operational definition of key terms

Cooperative society - an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise.

Member - a member is the part owner of the cooperative society. They contribute share capital, which is used by the cooperative society to finance its operations such as buying of equipment, expansion of structures, investment and so on.

SACCO Society - a cooperative society owned and operated by and for its members, according democratic principles, whose objective is to encourage its members to save, and in turn provides credit facilities and other related financial services at reasonable rates of interest.

Urban SACCOs - these refer to the employee-based SACCOs.

Corporate governance: the structures, processes, cultures and systems that engender the successful operation of an organization. This concept emphasizes the role that the members of management committee should play in guiding the cooperative societies towards success. It is the process through which organizations are led toward the attainment of the objectives for which they were founded.

Good governance: It addresses the allocation of resources to respond to collective problems. It calls for among other things; a strong and independent audit function, a balanced board composition and effective board processes.

Financial performance – it is a measure of how well a firm can use its resources to generate profits.
CHAPTER ONE
1.0 INTRODUCTION

1.0.1 Background information

Corporate governance issues in firms arise from the agency problems engendered by the separation of ownership and control (Keasey et al, 2005). Due to poor governance practices most firms, are wallowing in managerial scandals, corporate indebtedness and a financial system that is burdened with bad loans. Solomon, (2007) pointed out that good governance addresses the allocation and management of resources to respond to collective problems; it is characterised by participation, transparency, accountability, rule of law, effectiveness and equity. Since the turn of the millennium, the public eye has focused on the prominent topic of corporate governance and its importance in the world economies. Increased corporate failures and uncovering of major incidents of fraud have brought about increased pressure for accountability by directors, and to lawmakers to introduce legislation to protect the rights of investors, creditors, employees and customers. Improvement of corporate governance practices is widely recognised as one of the essential elements in strengthening the foundation for the long term economic performance of countries and corporations (Wiley et al, 2005),

1.1 Historical perspective of corporate governance.

1.1.1 Global perspective

The concept of corporate governance is as old as 15th Century, but it was not until the 19th Century that it gained importance. This as it was observed by Solomon (2007) was due to increased demand for transparency and accountability. The modern process of corporate governance reforms can be said to have started in the United Kingdom (UK) with the establishment of the first corporate governance committee; the Cadbury committee on the Financial Aspects of Corporate Governance in 1991 by the conservative government (Mutisya, 2006). This followed concerns over standards of corporate governance in UK. The committee was set up in response to three inter-related areas of concern in the existing arrangement. Firstly, there were anxieties over the use of "creative accounting" devices which were believed to be obfuscating the calculation of shareholder value.
Secondly, there were concerns over a string of corporate failures in late 1980s and early 1990s, particularly those associated with high profile domineering Chief Executive Officers (CEOs) who were apparently able to conceal financial weaknesses through opacity of the control mechanisms. Finally, there was a growing public unease over the rapid growth of executive remuneration, especially in apparent failure to relate increases more strongly to performance.

The recommendations of the committee, according to Wiley et al (2005), centred on ways to increase the transparency and accountability of the executives. Cadbury recognized that a system of good corporate governance allows board of directors to be free to drive their companies forward with freedom to use managerial power, but exercise that freedom within a framework of effective accountability. From Cadbury onwards, successive reformers have tried to increase the transparency of the executive pay setting process, distance it from the influence of the affected executives, while generally looking for a pay determination process which strengthens the link between rewards and corporate performance.

In 1996, the global corporate governance forum was established by the World Bank and the Organization for Economic Cooperation Development (OECD) to coordinate and disseminate corporate governance practices and activities. The forum was also mandated to spearhead the training and capacity building of the human resources in the field. The Common Wealth Association for Corporate Governance (CACG) was established in 1999 due to recognition that, firstly, capacity needed to be established in all Common Wealth countries to promote good corporate governance, and secondly, codes of good practices establishing standards of behaviour in public and private sector should be agreed, to secure greater transparency and reduce corruption. The CACG came up with the guidelines for all Common Wealth countries on good corporate governance. Recently, as pointed out by Kabura (2006), there has been considerable worldwide interest in the corporate governance practices, particularly since the high profile collapse of large US firms such Enron Corporation and World Com. Globalisation of market has also ushered in an era where the traditional dimensions of corporate governance defined within the local laws, regulations and national priorities are becoming increasingly challenged by circumstances and events having an international impact (CACG, 1999).
1.1.2 African perspective

Good governance is an important concept for African development and is related to necessity to create the basic extra economic conditions that are important for the growth of African economies as for example, an effective public administration, an efficient regulatory structures and transparent systems for financial and legal accountability. In this context, it is the issue of quality of the public goods supplied at the country level that makes good governance such an important concept (ADB, 1994).

Godfrey (2002) posits that in addition to the South African king report; there has been a rapid growth in the development of African thinking on corporate governance. The recent initiative of the African union (AU) to develop an AU convention on combating corruption addresses the importance of declaring public officers’ assets, and also breaks ground by targeting unfair and unethical practices in the private sector. Corporate governance is now established in Africa as an important component of the international financial architecture. As pointed out by Billioch (2008), in 1999, there were an estimated two hundreds and seventy four conferences in thirty nine countries on corporate governance, but most were in developed countries. Different countries in Africa have established national codes of best practice to address their own special requirements with regards to corporate governance. In East African, during a forum for East African member countries held in Kampala, Uganda in September, 1999, it was agreed that each member state develop a code of best practice for corporate governance which should be harmonized with the rest of the world.

1.1.3 Corporate Governance in Kenya

On the Kenyan scene, as pointed out by Mutisya (2006), corporate governance is still at its infancy stage, with the subject now becoming a household name in many companies, as they strive to compete and satisfy all their stakeholders. Corporate frauds have continued to feature as a result of inadequate systems of corporate governance, leading to the collapse of several financial institutions such as the Euro bank, Trust bank, Akiba microfinance among others.
Concerted efforts and arrangements have been put in place with an aim of creating awareness and enforcing good governance in the private and the public sectors. The institutions that have been at the forefront in sensitizing the corporate sector on good corporate governance are the Capital Market Authority (CMA), the Nairobi Stock Exchange (NSE), the Centre for Corporate governance (CCG) and the Central Bank of Kenya (CBK). The Capital Market Authority created a major impact in the development of the corporate governance guidelines when it issued in 2002, the CMA guidelines on corporate governance practice by the public listed companies. The stated objectives of the CMA guidelines are to strengthen and to promote the standards of self regulations and bring the level of governance practices in line with the international trends. The NSE on its part amended its listing manual and incorporated the CMA guidelines on corporate governance into the continuous obligations of listed companies and it continuously monitors compliance by the listed companies with these obligations. The CCG on the other hand has developed a code of best practice for state owned corporations and for cooperative societies, which has been harmonised with codes from other parts of the world. The institute of Certified Public Accountants (Kenya) encourages its members to report on the corporate practices of companies they audit. The institute of Certified Public Secretaries (Kenya) on its part encourages its members to ensure compliance with the corporate governance. Both institutions undertake training of their members on corporate governance issues.

In the cooperative scene, the sector, after independence, thrived; and with it came development and prosperity to a good number of the populace. However, in 1990s and afterwards, a litany of problems, mostly mismanagement (Nation correspondent, 2010) and poor governance practices, saw the collapse of some previously thriving ventures (CCG, 2005). In its efforts to alleviate governance problems in Cooperatives, the Centre for Corporate Governance developed a code of best practice on cooperative governance. Despite this code most cooperative societies continue to experience numerous governance problems among them: poor board processes, poor risk management, due to absence of, or ineffective internal audit function; and inappropriate size of the board. Consequently, many cooperative societies have been on the spotlight following fraud and
poor governance. In order to sustain a cooperative sector that is globally competitive, these problems require not only an urgent but also an appropriate action.

1.2 Research problem statement

Savings and Credit Cooperative Societies (SACCOs) in Kenya have continued to play a major role in improving the financial well being of the shareholders, and generally contribute greatly in accelerating the growth of the national economy. Despite the growing awareness of corporate governance issues, most SACCOs are wallowing in managerial scandals, resulting from poor governance practices (CCG, 2005). This situation leads to unfavourable financial performance and in some cases, collapse of some SACCOs. The collapse of a SACCO deprives the members of both their lifetime savings, and an affordable source of convenient credit. This consequently leads to unemployment and poverty in the country.

Good corporate governance comes in to alleviate this problem. It puts in place measures that stem the mismanagement and collapse of these organizations. Thus, an examination of its relationship with the financial performance of SACCOs is desirable. Therefore, this study investigated the effect of good corporate governance on the financial performance of urban SACCOs.
1.3 Objectives of the study

1.3.1 General objective
To investigate corporate governance practice, and its effect on the financial performance of Urban SACCOs, in Kirinyaga County.

1.3.2 Specific objectives
a) To determine the relationship between financial performance and board size.
b) To establish the relationship between financial performance and internal audit function.
c) To investigate the relationship between financial performance and frequency of board meetings.

1.4 Hypotheses
The researcher focused on testing the following hypothesis:

$H_0$: There is no relationship between: the size of the board; frequency of board meetings; internal audit function; and the financial performance of SACCOs.

$H_a$: There is a relationship between: the size of the board; frequency of board meetings; internal audit function; and the financial performance of SACCOs.

1.5 Significance and justification of the study
With the large number of cooperatives in Kenya, their poor performance and the immense hope casted on them by the members and the public in general, the study has initiated a research to enable these cooperative societies become efficient and effective in their day to day activities aimed at the community. The study will benefit different groups of people as follows:

a) Members – the study will create an understanding of the role of the management, thus demand good and timely corporate governance practice.
b) Management – The study will enable the management committee in implementing good corporate governance practice, which facilitates making informed decision
using realistic success drivers based on transparency, accountability, effectiveness and equity.

c) **Policy makers** – The researcher can not forget the paramount importance of the study to the policy and key decision makers. The study will help them in making policies that are consistent with the good corporate governance practice. In their regulatory roles, the study will help them in assessing the extent to which the cooperative movement has implemented good corporate governance practice.

d) **Other scholars** – The study will contribute towards bridging the existing gaps in the field of corporate governance. It will stimulate other scholars to carry out more studies in the field of corporate governance.

e) **The researcher** – the researcher will benefit from the study for it will shed light on an area he is a player, thus being an eye opener for better performance.

### 1.6 Scope and limitations of the study

#### 1.6.1 Scope of the study

This study investigated the effect of corporate governance on financial performance of SACCOs. It was conducted in Kirinyaga County, which comprises five districts namely: Kirinyaga East, Kirinyaga West, Kirinyaga South, Kirinyaga North and Kirinyaga Central district. The area was selected due to convenience reasons.

The study used data relating to financial performance covering the period from year 2006 to 2010. Relevant financial data was obtained from the audited financial statements.

#### 1.6.2 Limitations of the study.

In the course of the study the researcher faced the following limitations:

**Time:** The time provided for the completion of this study was indeed limited. Considering that the researcher is in full time employment, time was certainly a great limitation, forcing the researcher to work sometimes at odd hours of the night.

**Suspicious respondents:** The respondents are people managing competitive businesses. As a result, some of the respondents were initially hesitant to cooperate due to suspicion. However, through the intervention of the District Cooperative Officers in the county, they eventually cooperated.
CHAPTER TWO
2.0 LITERATURE REVIEW

2.1 Introduction
This chapter deals with the literature that has been reviewed for purpose of this study. The literature is mainly on corporate governance. The literature has been derived from various sources in a bid to tackle the topic appropriately. The description of the conceptual framework and how the variables relate to each other is also displayed.

2.2 Corporate governance
2.2.1 Background information
At the end of the Second World War in 1945, many countries embarked on the reconstruction of their industries and infrastructure. The shared common spirit of goodwill and patriotism in the reconstruction endeavours was high among senior corporate executives, who acted in the best interest of their countries and shareholders (Murimi, 2004).

The spirit of goodwill continued through 1960s and 1970s where personal interests of the managers were subordinate to those of the institutions they served. Managers did their work diligently with minimum external supervision and exploited opportunities for growth and prosperity of the companies. This, however, changed with time when senior corporate managers started using their positions to ensure job security and maximize their benefits rather than increase shareholders’ wealth or pay requisite attention to other stakeholders. It is after this change that the shareholders and other stakeholders started struggling to control and monitor the activities of the management in order to align managerial interests and objectives with their own.

According to Daft, (2005), this led to increased control in many organisations, particularly in terms of corporate governance, which helps to protect the interests of the corporate owners. Solomon, (2007), recognised the importance of ethical behaviour in business, explaining that corporate governance checks and balances serve only to detect, and not to cure unethical activities, and that however good an organisation’s apparent
financial performance is, if there is unethical behaviour at the highest level of management, little, if anything, can avoid its eventual disaster of collapse.

Corporate governance issues according to Muriithi (2009) came to the forefront as a result of rising scandals, where the directors have acted illegally or in bad faith towards their shareholders. This led to the establishment of corporate governance codes, meant to give the investors high level of assurance that the directors will act in the shareholders' best interest.

Codes of corporate governance are intended to specifically guide behaviour where the law is ambiguous, where a higher level of behavioural prescription is needed than can be provided in the available legislation. The level of inherent trust within the business sector and within the society has been questioned in the recent times. Specifically, there has been a decline in the public's confidence in institutions, such as corporations and investment organisations. This decline in trust presents one major driving force behind the corporate governance reforms, which may be interpreted as attempts to build the public's trust in companies, investment institutions and other organisations. The purpose of corporate governance code is therefore to improve the general quality of governance, defining the best practices and specifying specific steps that organisations can take to improve corporate governance. Demonstrating effective system of corporate governance creates productivity and efficiency, and can have a positive impact on the society as a whole.

2.2.2 Parties to corporate governance

According to Cadbury (2006), parties to corporate governance include the governing or regulatory body, CEO, board of directors, management and the shareholders. Other stakeholders who take part include suppliers, employees, creditors, customers and the community at large. In corporations, the principal (Shareholder) delegates decision rights to the gent to act in the principal's best interest. This separation of ownership from control implies loss of effective control by the shareholder over managerial decisions. Partly as a result of this separation between the two main parties, a system of corporate governance controls is implemented to assist in aligning the incentives of the managers with those of the shareholders, in order to limit the self satisfying opportunities of the
managers. With the significant increase in equity holdings of institutional investors, there has been an opportunity for reversal of the separation of ownership and control problems because ownership is not so diffuse.

Board of directors often plays a key role in the corporate governance. It is their responsibility to endorse the organization’s strategy, develop directional policy, appoint supervise and remunerate senior executives and to ensure accountability of the organization to its owners and authorities. All parties to corporate governance have an interest, whether direct or indirect, in the effective performance of the organization. Directors, workers and the management receive salaries, benefits and reputation, whilst the shareholders receive capital returns. Customers receive goods and services, suppliers receive compensation for their goods and services. In return, these individuals provide value in the form of natural, human, social and other forms of capital (Cadbury, 1992).

A key factor in an individual’s decision to participate in an organization is trust that they will receive fair share of the organizational returns. If some parties are receiving more than their fair returns, such as exorbitant executive remuneration, then other participants may choose not to continue participating, potentially leading to organizational collapse, for example the shareholders withdrawing their capital. Corporate governance is the key mechanism through which this trust is maintained across all stakeholders.

2.2.3 Assumptions and pillars on which good corporate governance is framed.

In all fields of human endeavour, good governance is founded upon the attitudes, ethics, practices and values of the society concerned. Good corporate governance is premised on five assumptions (CCG, 2005):

Firstly, the major role of the government is to provide a conducive and enabling environment in which business activities can thrive. The enabling environment encompasses the legal framework that controls business activities, and the effectiveness of public governance in enhancing investor confidence. Secondly, societies within which corporate entities operate uphold the highest moral values and business ethics; requires accountability, legitimate representation, democracy and fairness; and demands efficient and effective use of resources. In addition, the license to operate granted to corporate
entities by the society carries with it the important caveat that the corporate entity will be responsible, responsive and accountable to the society within which it operate. Moreover, those entrusted with the governance of these corporate entities will act in a socially responsible manner and exercise their focused intelligence with discipline, loyalty and integrity. Lastly, those corporate entities which do not operate effectively and efficiently for the benefit of society will be sanctioned through market forces or by the government. For corporate entities to be efficient and productive, they must apply good corporate governance practices that are framed on five pillars according to Nyaga (2008), namely: accountability, efficiency and effectiveness, probity and integrity, responsibility and, transparency and open leadership. There must be an all inclusive approach to governance that recognizes and protects the rights of members and stakeholders. The organization must be governed and managed in accordance with the mandate granted to it by its owners and the society, and take seriously its wider responsibilities to enhance sustainable prosperity. The Corporate governance framework provides an enabling environment within which its human resources can contribute and bring to bear their full creative powers towards finding innovative solutions to shared problems.

2.2.4 Theories of corporate governance

There are three theories according to Solomon (2007) that try to explain the nature and the role of corporate governance; namely, the agency theory, transaction cost theory and stakeholder theory. Agency theory views corporate governance as ways of reducing agency costs; while transaction cost theory states that it is the way in which a firm is organised that determines its control over transactions i.e. cost of production and price of products. Stakeholder theory demands that corporate firms be held accountable for their impact on a wider group of stakeholders.

2.2.4.1 Agency theory

The introduction of limited liability and opening up of corporate ownership to the general public through share ownership had a dramatic impact on the way corporate bodies were controlled. The owners who are principally the shareholders delegate the running of the organisation to the members of management. According to Solomon, (2007) this results
in the separation of ownership and control, a situation that has led to the notorious agency problem. Agency problem was first explored by Ross (1973), with the first detailed theoretical exposition of agency theory presented by Jense & Meckling (1976), who defined the managers as agents and the shareholders as the principals. The principal delegates day to day decision making to the members of management who are the shareholders’ agents. The problem that arises, according to Solomon J., as a result of this system of corporate ownership is that the agents do not necessarily make decisions in the best interest of the principal.

One of the principal assumptions of agency theory is that the goal of the principal and the agent conflict. In finance theory, the basic assumption is that the primary objective for companies is the shareholders’ wealth maximisation. However in practise, this is not necessarily the case. It is likely that corporate managers prefer to pursue their own personal objectives such as aiming at gaining the highest bonuses possible. Managers are likely to display a tendency towards egoism, which can engender another tendency called “Short-termism”; where the management focuses on projects and investments that provide high short term profits, so that they can earn high bonuses rather than the maximisation of the long term shareholders’ wealth through investment in projects that are long term in nature.

Short-termism has been defined by Demirag and Tylecote (1992), as the tendency to foreshorten the time horizon applied to investment decisions, or raise the discount rate above that appropriate to the firm’s opportunity cost of capital.

In corporate governance environment, managers are tempted to supplement their salaries with many perquisites such as holidays through the firm, office equipments and the like. This, according to Solomon (2007), leads to a reduction in shareholder value. Overall, it is apparent that ownership structure leads to a significant problem of divergent objectives. This problem presents the shareholders with need to control the management by demanding good corporate governance practice. However, it is expensive and difficult to verify what the agent is doing since agency costs arise from attempts by the
shareholders to monitor activities of the management. Incentive schemes and contracts are examples of monitoring techniques as observed by Solomon (2007).

Solutions to agency problems involve establishing a ‘nexus’ of optimal contracts between the management and the share holders. These contracts include remuneration contracts and debt contracts. Although agency costs arise from establishing these contracts, costs are also incurred from the agent’s side. The management are keen to demonstrate to the share holders that they are accountable, and that they are following the shareholder wealth maximisation objective. They may for example, provide extra information about risk management in their annual reports, which will add costs to the accounting process. They may expend additional resources in arranging meetings with the share holders. The costs associated with such initiatives are referred to as ex-ante bonding costs. The total agency cost arising from agency problem has been summarised as comprising of: the sum of principal’s monitoring expenditure, the agents bonding expenditures and any residual loss (Hill & Jones, 1992). These costs can be reduced through the four basic corporate governance mechanisms namely; legal and regulatory mechanisms, internal control mechanisms, external control mechanisms, and product market competition.

A firm’s system of internal control represents from agency theory perspective, corporate governance mechanism that can be used to align the interests of the managers and the share holders. Within a firm’s system of internal controls, the external audit represents one of the most indispensable corporate governance checks and balances that help to monitor the management’s activities, thereby increasing transparency. The Cadbury report, (1992), emphasized that the annual audit is one of the cornerstones of corporate governance. The audit provides an external and objective check on the way in which the financial statements have been prepared and presented.

2.2.4.2 Transaction cost theory.

An exposition of transaction cost theory, and its historical development was described by Williamson (1996). He stated that transaction cost theory is an interdisciplinary alliance of law, economic, and organisation. This discipline was initiated by Cyert and March (1973), in their work that has become one of the cornerstones of industrial economics and
finance theory. Theirs was an attempt to view a firm not as an impersonal economic unit in a world of perfect markets and equilibria, but rather as an organisation comprising of people with differing views and objectives.

This theory is based on the fact that firms have become so large that they in effect substitute for the market in determining the allocation of resources. Indeed, corporate bodies are so large and complex that price movements outside, direct production and the markets coordinate transactions. Within the companies, such transactions are removed and management coordinate and control production (Coase, 1937). According to Solomon (2007), organisation of a firm, for example the extent of vertical integration seems to determine the boundaries beyond which the company can determine price and production. In other words it is the way in which a firm is organised that determines its control over transactions.

Clearly, it is in the interest of the management to internalise transactions as much as possible. This internalisation removes risks and uncertainties about future products and quality. Internalisation allows organisations to remove the risk of dealing with outsiders to some extent. There are trivial and prohibitive costs in carrying out transactions in the market place, and it is indeed cheaper for organisations to do it for themselves through vertical integration. Traditional economics considers all economic agents to be rational, and profit maximisation to be the primary objective of the business. Conversely, transaction cost economics attempts to incorporate human behaviour in a more realistic way. In this paradigm, managers and other economic agents practice a “bounded rationality”. This is a behaviour that was intentionally rational but limitedly so. (Simon, 1957)

Transaction cost economics also makes the assumption of “opportunism”. The theory assumes that some individuals are opportunistic, some of the time. The result of assuming bounded rationality and opportunism is that corporate firms must organise transactions so as to economise on bounded rationality while simultaneously safeguarding the transactions in question against the hazards of opportunism (Williamson, 1996). Opportunism, according to Crozier (1964), is the active tendency of the human agent to
take advantage in any circumstances, of all available means to further own privileges. Given the problem of bounded rationality and opportunism, managers organise transactions in their best interest, and this activity need to be controlled. Such opportunistic behaviour could have dire consequences on corporate finance as it could lead to conflict of interest. As such, this theory just like agency theory presents a rationale for management to be controlled by the shareholders. This control comes in the form of good corporate governance practice, so that the management can pursue the shareholders' interests and strive towards profit maximisation, rather than their self interests.

2.2.4.3 Stakeholder theory
This theory developed gradually since 1970s. The role of corporate entities in the society has received increasing attention over time, with their impacts on employees, the environment, local communities as well as the shareholders on focus. Solomon, (2007) observed that social and environmental lobby groups have gathered information on business activities and have targeted companies that have treated the stakeholders in unethical manner. A basis of stakeholder theory is that companies are so large, and their impact on the society so pervasive that they should discharge accountability to many more sectors of the society than solely their shareholders.

Though there are many ways of defining “stakeholder theory” and “stakeholder”, one commonality characterising all definitions, according to Pearce (1982), is the acknowledgement of their involvement in an “exchange” relationship. Not only are the stakeholders affected by the corporate entities, but they also in turn affect these entities in some way. They hold a “stake” rather than simply a share in the corporate entity. Indeed, the stakeholder relationship has been described by March & Simon (1958) as one of the exchange, where the stakeholder group supply the company with “contributions” and expect their own interests to be satisfied via inducements.

Using this analytical framework, the general public may be viewed as corporate stakeholders because they are the taxpayers, thereby providing firms with national
infrastructure in which to operate. In exchange, they expect firms as “corporate citizens” to enhance, not degrade their quality of life (Hill & Jones, 1992). As such corporate entities should be accountable for their impact on a wide group of stakeholders.

Linked to stakeholder theory is the idea of corporate social responsibility, which according to Solomon (2007) is becoming a major issue for companies in the current political and social climate. Companies are being actively encouraged by social and environmental lobby groups to improve their attitudes towards stakeholders and to act in a socially responsible manner.

Quinn and Jones (1995) described social responsibility as “non instrumental ethics” arguing that the management have no special rules that allow them to ignore their moral obligation as human beings and that, whether ethical behaviour is profitable or not, it must be adhered to.

2.2.5 Rules or principles
In some countries such as USA, corporate governance is a legal requirement and companies must comply (Muriithi, 2009). This is a rules based jurisdiction. It takes a “one size fits all” approach. Companies must “comply and complain”, for compliance is mandatory. In other countries, it is a case of principles based jurisdiction, where companies are required to recognise the importance of corporate governance provisions. They are supposed to comply with general principals of the code of corporate governance but could also choose not to, so long as they give a convincing explanation in their annual report on the extent of non compliance and the reasons behind it. The principle is “comply or explain”

2.2.6 Contribution of corporate governance to sustainable development
A country’s capacity to achieve sustainable prosperity, which is progressive economic growth and social development over a prolonged period of time, depends on decisions about the allocation, utilization and investment of resources. In the liberalized global market, a country’s capacity to create and produce wealth is closely related to the process by which corporate resources are allocated, utilized or invested. Strategic decisions about
the allocation and utilization of corporate resources are foundations of investments in productive capacities that can make innovation and economic development possible. Corporate decisions on whether to invest, how soon to invest, what to produce, and whether to employ, ultimately affect the incomes, employment and indeed livelihoods of the entire society. These decisions are made by or await the judgment of the boards of corporations. The national capacity to compete in borderless and liberalized global market increasingly depends on the competitiveness of individual corporate entities and their ability to produce goods and services that meet the test of international competition. Corporate competitiveness depends on the ability of boards to apply focused intelligence to generate innovative ideas, acquire and apply the knowledge to push and integrate their corporation into the competitive global market. Efficient corporations can only be established and developed by responsible, creative and innovative boards.

Indeed, without efficient business enterprises, a country will not create and produce wealth or generate employment opportunities. Without credible, stable and sustainable corporations, investors will not invest their resources into productive capacity. Without investment, business will stagnate and collapse. If there are no corporations that prosper, there will be no economic growth, no employment, no taxes paid and invariably there will be no development in a country.

2.2.7 Challenges to corporate governance

a) National policies
The national economy and development policies re rarely followed as framework for economic growth. They are largely ignored and replaced by political declarations.

b) Economic injustices
Research by the global anticorruption watchdog; Transparency International, has placed the law enforcement agencies at the top of corruption list. Kenya has severally appeared in the list of ten most corrupt nations prepared by the Transparency International.

c) Attitude
As it is the case with many other public officers, most members of management and management staff work with little enthusiasm. Most of them indulge in theft of time and
sluggish conduct. Work that should have taken hours, take weeks and months (National council of churches of Kenya)

d) Legal obstacles
The Cooperative Societies Act (2004) has mandated the members of cooperatives who are the owners to elect their office bearers, without prescribing competitive academic and professional qualifications. As a result, most of those elected lack managerial skills to manage and supervise the senior staff, who in turn take advantage of that gap and divert the resources and efforts to enrich themselves.

2.3 Corporate performance.
Performance can take many forms depending on who and what the measurement is intended for. Different stakeholders require different performance indicators to enable them make informed decisions. The content, format and frequency of reports depend on who needs the information and for what purpose. Environmental and social groups are keen in following the actions that the company undertakes with regards to corporate social responsibility; shareholders will be interested in viability, growth in profitability, market share and turnover (Brown et al, 2003). The government and multilateral agencies are interested in expected social and economic benefits to micro entrepreneurs, such as increases in employment and income levels. There are various measures of performance including financial and non financial measures. Most of these measures make use of financial statements. Financial analysis seeks to evaluate management performance in several areas including profitability, efficiency and risk (Reily & Brown, 2007). For purposes of this study, the researcher used Return on Capital Employed (ROCE) as a measure of financial performance.

ROCE is a fundamental measure of business performance. It expresses the relationship between the operating profit generated during a period and the average long term capital invested in the business during that period. The ratio according to Atrill and Mchaney (2008) illustrates that what is important is not simply how much profit has been generated, but how well the capital has been employed. A company with a higher ROCE is said to have made better use of its capital.
2.4 Past studies and the gap to be filled by the study

Though in the Kenyan scene corporate governance is still at its infancy stage as observed by Wanjau (2007) and Mutisya (2007), a lot of materials have been written on the fundamental concepts of corporate governance, most of them written from a broad perspective. Little has been done on corporate governance in relation to cooperative societies and specifically in relation to SACCOs.

Past scholars who have made enormous contributions in the field of corporate governance include Miring’u (2009), who studied the effect of corporate governance on the performance of commercial state corporations. In her study, she applied regression analysis and found that all the independent variables taken (Board size, board composition and CEO duality) were positively correlated to performance of commercial state corporations. This study recommended enforced compliance with prescribed governance structures; intensified regulation by the concerned ministries and that the post of the CEO and that of the chairman to the board be held by different people.

Billioch (2008) conducted a study of corporate governance practices in Forex Bureaus in Nairobi using descriptive statistics. She showed that the composition and the structure of the board, the audit function and the board committees all led to improved return on investment and reduces business risks. In her study, she recommended widening of the reward system to make it all inclusive as well as include both financial and non financial rewards. She also pointed out the need for new and relevant laws that would ensure adequate application of corporate governance practice by Forex Bureaus, calling for the government to provide good work environment.

In a related survey, Maina (2007) studied corporate governance practices in insurance industry in Kenya, using descriptive statistics. He measured prevailing corporate governance practices in this sector against the universal principles of corporate governance. His study concentrated on supervision, regulation, ownership and control; and information distribution between insiders and outsiders. In his study he established that there was lack of internal audit functions, minimum academic and professional qualifications for board members, lack of induction and training programmes for the management and lack of succession plans in the management. His study revealed that those companies with high gross turnover and profits were also found to have highly
qualified directors, existence of code of conduct and separation of ownership and management. He recommended that all the above governance issues be addressed.

Another study was conducted by Kiamiha (2008) who studied the effect of corporate governance on financial performance of local authorities. He used multiple regression model to show the relationship between the selected variables (frequency of meetings, political composition, role of internal audit, role of audit committee and the size of the full board) and the financial performance. He showed that the financial performance in local authorities is mainly influenced by political composition, the internal audit and managerial approaches applied by the chief officers. He recommended regular assessment of performance, and proper coordination between the internal and external auditors.

Mulinge (2007) in his study of corporate governance in the National Hospital Insurance Fund established that fundamental corporate governance practices were in place, but recommended regular assessment of performance and effectiveness of board members individually and as a group, induction of new board members and a well defined code of ethics.

Another significant contributor in the field of corporate governance is Mutisya (2006) who looked into the relationship between corporate governance and financial performance of listed companies on the NSE. In her study, Mutisya identified size of the board, number of meetings held in a year and the proportion of shares held by top directors and management as having significant influence on the performance of the listed companies. Her recommendation was an increase of women representation in the board meetings.

Wanjau (2007) surveyed the relationship between corporate governance and performance in microfinance institutions (MFIs) in Kenya. The corporate governance attributes used in this study are the board size, board structure and CEO duality. In his study, he established that MFIs have strong corporate governance principles. Using correlation analysis, he found out that the board size and board structure were positively correlated to financial performance of MFIs while CEO duality was negatively correlated to performance of MFIs. He recommended regular strengthening of corporate governance structures.
In the field of cooperatives, Nyaga (2008) did a general survey of corporate governance in SACCOs in Nyeri district, and has shown that most SACCOs have specific aspects of corporate governance. He recommended that the governance practice in this sector be improved in order to make these organizations more competitive in an already competitive financial sector. Osambo (2006) conducted a study on corporate governance systems in SACCOs, focusing on Front Office Savings (FOSA) entities. He has shown that the objective of FOSA as an activity in SACCOs reflects the objective of the members, and that SACCOs have specific aspects of corporate governance. However, he recommended that code of ethics be put in place and greater management involvement in the day to day running of these entities in order to strengthen good governance practices.

The preceding review of work done confirms that despite the growing awareness of corporate governance issues, not much has been done to investigate the influence of corporate governance on financial performance in SACCOs, making the information relating to this sector scanty. Osambo (2006) concurs that not much has been done on corporate governance of SACCOs. As pointed out by Mulinge (2007), in the past, governance reforms in Kenya mainly concentrated on the companies listed in the Nairobi Stock Exchange. This study is therefore a genuine attempt to fill the void and add more literature in the context SACCOs, in Kenya, with the larger Kirinyaga district as the case of analysis.

2.5 Conceptual framework

The conceptual framework comprises of the dependent variable corporate governance and the independent variables:
Conceptual framework

Independent variables

- Size of the board
- Internal audit function
- Frequency of board meetings

Intervening variables
- Economic factors
- Political factors
- Regulatory framework
- Government policies

Dependent variable

Financial Performance (Return on capital employed)

Figure 1: A pictorial presentation of conceptual framework
Source: Researcher (2011)
2.6 Interpretation of the key variables.

Measures of good governance in cooperative societies as provided by the Centre for Corporate Governance include: disclosure of interest by the directors, composition, mix of skills and competencies of the board, risk management, appointment and development of the chief executive officer, succession planning, independence and performance of the board, among others. For purposes of this study, the researcher has taken: board size, internal audit function and board meetings as the key independent variables. This section gives a detailed interpretation of these variables.

2.6.1 Board Size

Organizational theory suggests that larger groups take more time to make their decisions. Steiner (1972) documents that process losses increase rapidly with group size. Thus for a given level of output, a large group will therefore require more input time. Lipton and Lorsh (1992) suggest an optimal board size of between seven and nine directors. Vafeas (1999) finds that the size of the corporate board is positively related to board activity, consistent with larger groups requiring more time to attain a given level of output.

The available literature on board performance as observed by Mulinge (2007) places great emphases on selecting appropriate directors and particularly the CEO. It also advocates on choosing members who are multi skilled, experienced in a variety of business areas, prepared to update their knowledge, flexible, analytical and prepared to monitor and assess their individual or collective capabilities.

In the private sector, it is common to have a mix of internal and external directors to complement the skills of the company executive members, and to provide greater independence from the management. It is important to have more independent non executive directors on board. This is because they can provide independent judgment, outside experience and objectivity.

In cooperatives, the directors are the agents, with powers and duties of carrying out the business of the cooperative, subject to the restrictions imposed by the cooperative societies Act and SACCO Societies Act. It is the responsibility of the board of directors to endorse the organizational strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organization to its...
owners and authorities (Conger et al, 1998). The directors are elected democratically by members, using the policy of one man one vote. As observed by Moywaywa (2006), most shareholders in SACCOs are poorly informed, on the desired qualities of a good leader. They elect board members on the grounds of acquaintance, or in other cases, yield to the influence of interested candidates, who campaign aggressively in their effort to quell their desire for power. Consequently, some of the board members elected lack the desired competencies to run the organisation efficiently. Moywaywa recommends education to the general membership on good governance; and leadership qualities to look for at the time of electing their leaders. He further recommends a provision in the by-laws for each cooperative society, on desired qualities and qualification that one must attain, to become eligible for election.

The Cooperative Societies Act sets the board size to between five and nine. This number is believed to be appropriate to allow for interactive discussion during the meetings and inclusion of wider expertise and skills to improve the effectiveness of the board. The boards of cooperative societies should ensure that they have in place appropriate committees to enable to enable them conduct their activities effectively and efficiently (CCG, 2005).

2.6.2 Frequency of Board meetings

In order to bring about effectiveness in the governance of cooperative societies as business enterprises, the directors should devote their time and resourcefulness to their cooperative societies, by meeting as regularly as dictated by the needs of each society, but at least once every month (CCG, 2005). Demb and Neubauer (1992) recommend that board meetings should be frequent, adding that directors in boards that meet more frequently are more likely to perform their duties in accordance with the shareholders expectations. The Cooperative societies Act places restriction on the number of directorship that one person can hold at any given time to two. The rationale is perhaps to create time for board meetings when called. Conger et al (1998) suggest that board meeting time is an effective resource in improving the effectiveness of the board. Dedicating ample time for the board meetings makes the board proactive in improving the governance, and not a fire fighting device that responds only when things go wrong.
Vafeas (1999) conducted an empirical study of 307 firms in the United States to examine the importance of frequent board meetings, by testing whether boards of firms that meet more frequently outperform firms that meet less frequently. He concludes that board activity measured by board meeting frequency is an important dimension of board operation and that on balance, frequent board meetings are one way the board increases its efficiency and effectiveness.

2.6.3 Internal audit function

Auditing involves independent examination of books of accounts and vouchers of a business, with a view of forming an opinion as to whether these have been kept properly according to the Companies Act and as to whether the statements drawn there from portray a true and fair view of the state of affairs as at a given date (Manas’seh, 1990). An effective audit as a crucial component of corporate governance provides a complementary vehicle for implementing relevant control systems in incorporating sound risk management plans. An effective control system alerts the managers on timely basis when something is wrong and gives them time to respond to opportunities and threats. It provides accurate information and gives managers a true picture of organisational performance.

The internal audit function plays an important role by examining and reporting on the control structures, risk exposures and risk management efforts. In a bid to strengthen risk management efforts, the SACCO societies Act (2008) requires that every SACCO appoints an internal auditor, mandated to report to the board of directors on the internal control systems and financial matters of the society.

Hespenheide (2003) observed that the audit practices have a significant role to play in an organisation’s demonstration of good corporate governance and that effective internal audit function embraces a broader concept of risk management. The institute of internal auditors (2003) points out that internal audit function is one of the cornerstones of good governance alongside the board, executive management and external audit. With right positioning in an organization and with professional staff and leadership, an internal audit function will provide independent and objective opinions on an operation, and will report these regularly to the board, audit committee and management. Bateman et al (1999)
asserts that over the years, management audit have developed as a means for evaluating the effectiveness and efficiency of various systems within an organization.

Hamaker (2003) states that the purpose of good corporate governance is to ensure integrity of accounts and financial reporting systems including independent audit and have appropriate financial controls, risk monitoring and compliance with rules and regulations. As observed by Nombiro (2004), the evidence of association between audit related governance factors, and firm performance is mixed. Brown & Caylor (2004) showed that independent audit committees are positively related to divided yield, but not to the operating performance or the firm valuation. Klein (2002) documents a negative relation between earnings management and audit committee independence. Moeller (2004) notes that internal audit function has a corporate governance role in many organisations. The Institute of the Internal Auditors (IIA) named internal audit function as one of the four cornerstones of good corporate governance, alongside the board of directors, executive management, and external audit (IIA, 2004).

Woda (2002) states that the auditor has been a strong supporter and catalyst for helping organizations establish governance in information technology and operational management.
CHAPTER THREE
3.0 RESEARCH METHODOLOGY

3.1 Introduction
This chapter presents the research methodology techniques that will be used to carry out the research. It contains the research design, target population, sampling procedures and sample size, data collection instruments, data collection procedures, data analysis and data presentation.

3.2 Research design
The study used descriptive survey, which involves collecting data by interviewing or administering a questionnaire to a sample of individuals (Orodho, 2003). According to Gay (1999), descriptive research is a process of collecting data in order to answer questions concerning the current status of the subjects in the study.

3.3 Target population
The target population in the study was drawn from the thirteen (13) urban SACCOs in Kirinyaga County which are registered by the Ministry of Cooperative Development and Marketing (M.O.C.D.M.) as depicted in appendix 1. The chief executive officer and the four executive board members in each SACCO were targeted, giving a population of sixty five.

3.4 Sample design.
The study adopted a complete census of all thirteen (13) urban SACCOs operating in the Kirinyaga County. This is because the number of urban SACCOs is small, making it possible for the researcher to reach the whole population within a reasonable time. As provided in the Cooperative Societies Act, each cooperative society should have a minimum of five and a maximum of nine board members elected by the general members. Those elected then elect from among themselves an executive board of four members. The respondents in this study were the four members of the executive board and the chief executive officer in each SACCO, as they are in a position to give valuable
information necessary for successful completion of this study. This gives sixty five (65) respondents as shown in the below table, a number considered appropriate going by the one widely used rule of the thumb that require a sample size of thirty (30) or more (Daniel & Terrel, 1975)

Table 3.1: Table of targeted respondents

<table>
<thead>
<tr>
<th></th>
<th>Number in each SACCO</th>
<th>Total number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive board members</td>
<td>4</td>
<td>52</td>
</tr>
<tr>
<td>Chief executive officer</td>
<td>1</td>
<td>13</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>5</strong></td>
<td><strong>65</strong></td>
</tr>
</tbody>
</table>

Source: Researcher (2011)

3.5 Data collection instruments and procedures

Data was collected by use of a questionnaire, containing both open ended and closed ended questions, filled by the four executive board members and the chief executive officer of each SACCO. Permission to collect data from SACCOs was obtained from the District Cooperative Officers in the respective districts. The questionnaires were delivered to the respondent by the researcher in person and collected at an agreed later date.

3.6 Data analysis

Data was analyzed using multiple regression analysis method. E-views statistical package was used as an aid during the analysis. To test the stated relationship between the dependent variable and the independent variables a multiple regression model was used. The regression equation is of the form:

\[ Y = \beta_0 + \beta_1 \text{Board size} + \beta_2 \text{Frequency of board meetings} + \beta_3 \text{Internal audit} \]

Where; \( Y \) is the performance represented by the return on capital employed (ROCE). \( \beta_0 \) is a constant representing performance which is explained by other factors other than board size, board meetings and audit function.
\( \beta_1, \beta_2 \) and \( \beta_3 \) are the coefficients of board size, board meetings and audit function. 

\( B_1 \) was determined using the Hypothesis:

\[ H_0: \beta_1 = \beta_2 = \beta_3 = 0 \]

\[ H_a: B_1 \neq 0 \]

The analysis was done at 95% level of confidence.

The variables used have been defined as follows:

Table 3.2: Table of variables used

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return On Capital Employed</td>
<td>Profit before interest and tax ( \times 100 ) Capital Employed</td>
</tr>
<tr>
<td>Board size</td>
<td>Number of members in the board</td>
</tr>
<tr>
<td>Board meetings</td>
<td>Number of meetings in a year</td>
</tr>
<tr>
<td>Audit function</td>
<td>Presence of an effective internal audit function</td>
</tr>
</tbody>
</table>

Source: Researcher (2011)

3.7 Presentation

Analyzed data collected was presented using tables, pie charts and bar graphs.
CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND FINDINGS

4.1 INTRODUCTION

This chapter contains summaries of data findings and their interpretations. It commences with an analysis of the general characteristics of the respondents. The chapter then focuses in detail on the main subject of the study in accordance with the research objectives.

4.2 CHARACTERISTICS OF THE RESPONDENTS

This section presents the results obtained on demographic and economic characteristics of the respondents.

4.2.1 Response summary

The questionnaire return rate was 90.76%, with all those targeted having positively responded to the questionnaire except six, who could not be traced at the time of collecting the questionnaire; despite numerous efforts put to have the questionnaires back. A total of 59 respondents participated in the study as exhibited in appendix 7.

4.2.2 Respondent distribution by gender

Out of the respondents who participated in the study, 71% were male while only 29% were female. This shows that leadership in SACCOS is male dominated. The gender composition is exhibited in figure 4.1
4.2.3 Respondents Distribution of respondents by position

The study targeted in each SACCO; the chief executive officer, the chairman, treasurer, and the vice chairman. A summary of their response pattern is displayed in figure 4.2.
4.2.4 Highest level of education of the respondents

The highest education levels of the respondents varied between secondary school to post graduate studies. Twenty three respondents had attained secondary education only, twenty two had diploma, three with CPA qualifications, eight had first degrees and only two had attained post graduate training. The highest level of education of the respondents is summarised in figure 4.3

Figure 4.3: Highest level of education of the respondents

<table>
<thead>
<tr>
<th>Level of education</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Secondary</td>
<td>23</td>
</tr>
<tr>
<td>Diploma</td>
<td>22</td>
</tr>
<tr>
<td>Degree</td>
<td>8</td>
</tr>
<tr>
<td>Post Graduate</td>
<td>2</td>
</tr>
<tr>
<td>CPA</td>
<td>3</td>
</tr>
</tbody>
</table>

4.3 BOARD SIZE

This section presents the findings concerning the board size.

4.3.1 Board descriptive statistics

The mean board size was 6.97 members comprising of 5.9 male members and 1.07 female members. The largest board comprised 9 members while the smallest had 5 members giving a range of 4 members.
Table 4.1: Board descriptive statistics

<table>
<thead>
<tr>
<th>Parameter</th>
<th>N</th>
<th>Range</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size of The board</td>
<td>59</td>
<td>4</td>
<td>5</td>
<td>9</td>
<td>6.97</td>
<td>1.640</td>
<td>2.688</td>
</tr>
<tr>
<td>Number of male board members</td>
<td>59</td>
<td>6</td>
<td>3</td>
<td>9</td>
<td>5.90</td>
<td>1.729</td>
<td>2.989</td>
</tr>
<tr>
<td>Number of Female board members</td>
<td>59</td>
<td>3</td>
<td>0</td>
<td>3</td>
<td>1.07</td>
<td>.962</td>
<td>.926</td>
</tr>
</tbody>
</table>

4.3.2 Response on suitability of board size

Majority (92%) of the respondents were satisfied with their board sizes while only 8% were unsatisfied with the size of their boards. Some of the dissatisfied respondents felt that, their board should be trimmed from 9 to 5 members.

Figure 4.4: Response on suitability of board size

4.3.4 Disclosure of board’s academic and professional qualifications

Overall majority (76%) of the board members never disclosed their academic and professional qualifications. This is as displayed in figure 4.5
4.3.5 Existence of codes of ethics for boards of directors

Most of the SACCOs (53%) had codes of ethics for their board of directors. The remainder (43%) did not have the codes.

Figure 4.6: Existence of codes of ethics for boards of directors
4.4 FREQUENCY OF BOARD MEETINGS

This section presents the results on the frequency of board meetings.

4.4.1 Existence of board schedule of meetings

Majority (88%) of the respondents said that their SACCOs had schedules of board meetings. Another 10% SACCOs did not have the schedules of board meetings. 2% of the respondents did not respond on this.

Figure 4.7: Existence of board’s schedule of meetings

![Pie chart showing the existence of board's schedule of meetings]

4.4.2 Number of board meetings per year

The average number of meetings per year was 9.51 with the maximum being 15 and minimum 3.

Table 4.2: Number of board meetings per year

<table>
<thead>
<tr>
<th>Number of board meetings per year</th>
<th>N</th>
<th>Range</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>59</td>
<td>12</td>
<td>3</td>
<td>15</td>
<td>9.51</td>
<td>3.678</td>
<td>13.530</td>
</tr>
</tbody>
</table>
4.4.3 Suitability of board meetings to the SACCO needs.

All the respondents considered their board meetings adequate. They were also comfortable with the length of the board meetings.

4.4.4 Unanimous board decisions

Majority (98.3%) said that their SACCO board members reached unanimous decisions during meetings, which is an indication of good governance (figure 4.8).

Figure 4.8: Board decisions

4.4.5 Impromptu meetings of the board

All the respondents said that their boards held impromptu meetings to address unexpected issues which came up from time to time.

4.4.6 Existence of filed minutes for all board meetings

Majority (83.1%) of the respondents said that their boards kept filed minutes for all their meetings, while 16.9% indicated that their boards did not file their minutes (figure 4.9).
4.5 INTERNAL AUDIT FUNCTION.

This section presents the findings regarding the audit function of the SACCOs.

4.5.1 Existence of an internal audit department

Only 23.7% of the respondents indicated that their SACCOs had an internal audit function or department while the majority of the respondents (76.3%) indicated that their SACCOs did not have an internal audit function (figure 4.10).

Figure 4.10: Existence of an internal audit department
4.5.2 **Reporting line of the internal auditor**

Among the SACCOs which had an internal audit department, ten respondents said that the internal auditors report directly to the board while only four said that the internal auditors report to the CEO (figure 4.11). For the internal audit function to be independent, it should report directly to the board on policy issues and to the CEO on day to day managerial issues.

![Figure 4.11: Reporting line of the internal auditor](image)

4.5.3 **Existence of written internal audit recommendations**

Majority of the respondents (11) from the SACCOs that had an internal audit function said that there existed written internal audit recommendations within their SACCOs (figure 12). A minority of 3 respondents said there were no written internal audit recommendations. For the internal audit function to be effective there is need to ensure that it documents all its reports and maintains an appropriate filing system for its reports.
4.5.4 Action on internal audit recommendations

All the respondents said that there was action on the internal audit recommendations. This shows that the internal audit departments are functional and useful to the SACCOs.

4.5.5 Implementation of the recommendations of internal audit department.

Seven respondents said that the board was the one responsible in implementing the internal audit recommendations. Another five respondents said the recommendations were implemented by the affected departments while two respondents did not respond to this question (figure 4.13)
4.5.6 Effectiveness of the internal audit department in preventing fraud

All the respondents in SACCOs with internal audit function were of the opinion that internal audit department were effective in preventing fraud in their SACCOs.

4.5.7 Measures to ensure that the internal audit department is strong and independent

Several measures were suggested by the respondents from the SACCOs with audit department to ensure that the internal audit department is strong and independent. Seven respondents suggested that their internal audit department be given more independence in its work. An equal number felt that their internal audit departments could become more effective if allowed to report directly to the board of directors. Five other respondents suggested that the department could report directly to the District Cooperative Officer. In addition, two respondents suggested that internal guiding rules and policies be developed for the department. Lastly, two other respondents recommended formation of an audit committee in the SACCOs. This is as summarised in figure 4.14
From the above recommendations, it is evidently clear that there is need to re-consider the operations of the internal audit department, to ensure that it works independently and effectively.

4.6 Hypotheses testing

The study sought to establish whether there is any relationship between: the size of the board; frequency of board meetings; internal audit function; and the financial performance of SACCOs. The hypothesis was stated as follows:

**H₀**: There is no relationship between: the size of the board; frequency of board meetings; internal audit function; and the financial performance of SACCOs.

**Hₐ**: There is a relationship between: the size of the board; frequency of board meetings; internal audit function; and the financial performance of SACCOs.

The results were as follows:

4.6.1 Regression results

Tables 4.3 and 4.4 display the regression results of the study.

**Table 4.3: Regression results**

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>d.f.</th>
<th>Mean Square</th>
<th>F</th>
<th>P value</th>
<th>Decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>303.410</td>
<td>3</td>
<td>101.137</td>
<td>8.148</td>
<td>.000</td>
<td>Reject the null hypothesis</td>
</tr>
</tbody>
</table>
Table 4.4: Regression results

<table>
<thead>
<tr>
<th>R</th>
<th>R²</th>
<th>Adjusted R²</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>.555</td>
<td>.308</td>
<td>.270</td>
<td>3.52312</td>
</tr>
</tbody>
</table>

Notes:

a) Predictors: Size of The board, Existence of an internal audit department and the number of board meetings per year.
b) Dependent Variable: Return on capital employed
c) H₀: There is no relationship between: the size of the board; frequency of board meetings; internal audit function; and the financial performance of SACCOs.

From the above results, we have a strong evidence (p<0.05) to reject the null hypothesis, that is to say; either the size of the board, frequency of board meetings or internal audit function is significant in predicting the Return on Capital Employed (ROCE). The adjusted R-square value (0.270) shows that the model accounted for 27% of variance in the ROCE.

4.6.2 Testing the independent variables.

If an independent variable does not contribute significantly in predicting ROCE, the coefficient of the variable will be equal to zero.

Variables results are as displayed below:

Table 4.5: Variables results

| Model: Y = β₀ + β₁Board size + β₂Frequency of board meetings + β₃Internal audit |
|----------------------------------|----------------|----------------|
| Constant                         | Beta     | t       | P value |
| Size of the board                | -0.389   | -2.831  | .006   |
| Number of board meetings per year| 0.246    | 1.727   | .090   |
| Existence of an internal audit department | -0.499  | -3.705  | .000   |

From the above results, the prediction equation becomes:

ROCE = 17.745 - 0.389 Board size + 0.246 Board meetings - 0.499 Audit function.

The standardized beta coefficients give a measure of the contribution of each variable to the model. A large value indicates that a unit change in this predictor has a large effect on the criterion variable. The t and p values give an indication of the impact of each predicator variable; a big absolute t value and a small p value suggests that a predictor
variable is having a large impact on the criterion variable. As indicated in the results displayed in table 4.5, both the Size of the Board and the Internal Audit function, have a negative relationship with the financial performance. However, both variables are significant in predicting ROCE. On the other hand, there is a positive relationship between the Board meetings and the financial performance. Board Meetings is; however, not significant in predicting ROCE.
5.0 Introduction

This chapter covers the summary of major findings drawn from the study, conclusions and recommendations arrived at by the researcher. The chapter also presents suggestions for further studies.

5.1 Summary of findings

The study examined the effect of corporate governance on the financial performance of urban SACCOS in Kirinyaga County.

The findings of this study indicate that there is negative relationship between the size of the board and the financial performance as represented by the ROCE. This implies that larger the board size leads to lower financial performance, represented specifically by ROCE. The findings of this study are consistent with the findings of Goodstein et al (1994) who argued that largeness of the board inhibits the board’s ability to initiate strategic actions.

Concerning the frequency of the board meetings, the study revealed a positive relationship between the frequency of board meetings per year and ROCE. This implies the greater the number of meetings per year, the higher the financial performance. This is possibly because; regular meetings give the directors an opportunity to confer, set strategies and monitor the activities of the management. This is in line with the findings of Mululu (2005) who established that boards increase the frequency of their meetings following poor performance and as a consequence, increase the performance of their firms.

Regarding the presence of internal audit function, the study revealed a negative relationship between ROCE and the presence of the internal audit function. This means that presence of internal audit function leads to reduction in the ROCE in SACCOs. This is in line with the argument of Brown & Caylor (2004), that costs related to audit are negatively related to performance of the firm.
5.2 Conclusion

Improvement of corporate governance practices is widely recognised as one of the essential elements in strengthening the foundation for the long term economic performance of organisations.

5.3 Recommendations.

1. The board of directors should meet at least once per month as provided by the Cooperative Societies Act. It should not only meet to approve loans, but should have in its schedule of meetings, special meetings for initiating strategic actions.

2. The size of the board in each SACCO should be matched with the ability of the SACCOs to meet its costs, at the same time, considering the desired mix of skills, effective communication and cohesiveness of the board.

3. The Ministry of Cooperatives Development and Marketing being the key advisors and supervisors of cooperative societies should help the management of SACCOs in boosting the independence and effectiveness of the audit department.

5.4 Suggestion for future research study

The researcher suggests the following areas, which the researchers can consider for further research:

1) A similar study in other types of cooperative societies such as housing cooperative societies and Farmers marketing Cooperative societies.

2) Effect of the regulation of SASRA (Sacco Societies Regulatory Authority) on the financial performance of the SACCOs.

3) Since the study covered the Urban SACCOs in Kirinyaga County, comparative studies would be appropriate in other areas.
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## APPENDIX 1: ACTIVE URBAN SACCOS IN KIRINYAGA COUNTY

<table>
<thead>
<tr>
<th>Serial number</th>
<th>Cooperative Society(CS) Number</th>
<th>Name of the society</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>10044</td>
<td>Kaboss SACCO</td>
</tr>
<tr>
<td>2</td>
<td>2485</td>
<td>Kangaita SACCO</td>
</tr>
<tr>
<td>3</td>
<td>9766</td>
<td>Kipris SACCO</td>
</tr>
<tr>
<td>4</td>
<td>2271</td>
<td>Kicowo SACCO</td>
</tr>
<tr>
<td>5</td>
<td>11826</td>
<td>Kiriwasco SACCO</td>
</tr>
<tr>
<td>6</td>
<td>4102</td>
<td>Margsta SACCO</td>
</tr>
<tr>
<td>7</td>
<td>6618</td>
<td>Muhigia SACCO</td>
</tr>
<tr>
<td>8</td>
<td>1984</td>
<td>Mwendiwega SACCO</td>
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<tr>
<td>9</td>
<td>3683</td>
<td>Mwonania SACCO</td>
</tr>
<tr>
<td>10</td>
<td>3774</td>
<td>Ndigimwe SACCO</td>
</tr>
<tr>
<td>11</td>
<td>6150</td>
<td>Maranatha SACCO</td>
</tr>
<tr>
<td>12</td>
<td>8744</td>
<td>Neema SACCO</td>
</tr>
<tr>
<td>13</td>
<td>11194</td>
<td>Tescom SACCO</td>
</tr>
</tbody>
</table>

Source: Kirinyaga Central District Cooperative office.
# APPENDIX 2: WORK PLAN

<table>
<thead>
<tr>
<th>ACTIVITY</th>
<th>TIME</th>
</tr>
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<tbody>
<tr>
<td>Proposal writing</td>
<td>One month</td>
</tr>
<tr>
<td>Proposal correction</td>
<td>One month</td>
</tr>
<tr>
<td>Pilot study</td>
<td>One week</td>
</tr>
<tr>
<td>Data collection</td>
<td>One month</td>
</tr>
<tr>
<td>Data analysis</td>
<td>One month</td>
</tr>
<tr>
<td>Compiling the project</td>
<td>One month</td>
</tr>
<tr>
<td>Submission of the project</td>
<td>One day</td>
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</table>
## APPENDIX 3: TIME SCHEDULE

<table>
<thead>
<tr>
<th>Month</th>
<th>Proposal writing and correction</th>
<th>Pilot study and Data collection</th>
<th>Data analysis</th>
<th>Compiling the project and submission</th>
</tr>
</thead>
<tbody>
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<td>July 2011</td>
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<tr>
<td>August 2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>September 2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>September 2011</td>
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<tr>
<td>October 2011</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>November 2011</td>
<td></td>
<td></td>
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</table>
### APPENDIX 4: BUDGET

<table>
<thead>
<tr>
<th>ACTIVITY</th>
<th>INPUTS</th>
<th>COST (Kshs)</th>
</tr>
</thead>
<tbody>
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<td>Typesetting</td>
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<td>Printing</td>
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<td></td>
<td>Flash disk (4 GB)</td>
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<tr>
<td></td>
<td>Binding</td>
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<tr>
<td></td>
<td>Travelling</td>
<td>3,000.00</td>
</tr>
<tr>
<td></td>
<td><strong>Sub total</strong></td>
<td><strong>12,500.00</strong></td>
</tr>
<tr>
<td>Piloting</td>
<td>Questionnaire printing</td>
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<tr>
<td></td>
<td>Photocopies</td>
<td>1,200.00</td>
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<tr>
<td></td>
<td>Travelling</td>
<td>1,500.00</td>
</tr>
<tr>
<td></td>
<td><strong>Sub total</strong></td>
<td><strong>2,800.00</strong></td>
</tr>
<tr>
<td>Actual research</td>
<td>Printing services</td>
<td>2,500.00</td>
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<td></td>
<td>Travelling</td>
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<tr>
<td></td>
<td>Photo copies</td>
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<tr>
<td></td>
<td><strong>Sub total</strong></td>
<td><strong>20,500.00</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>35,800.00</strong></td>
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<tr>
<td></td>
<td>Contingencies</td>
<td>15,000.00</td>
</tr>
<tr>
<td></td>
<td><strong>Grand total</strong></td>
<td><strong>50,800.00</strong></td>
</tr>
</tbody>
</table>
APPENDIX 5: INTRODUCTORY LETTER TO THE RESPONDENT

P.O BOX 2354 - 60100,
EMBU.
7th October, 2011.

Dear respondent,

RE: COLLECTION OF DATA ON CORPORATE GOVERNANCE.

I am a student at Kenyatta University pursuing Master of Business administration (M.B.A.) degree. In partial fulfilment of the stated degree, I am undertaking a study of corporate governance practice and its influence on financial performance of SACCOs. In that connection, I have developed a questionnaire to help in obtaining relevant data for this research. I would appreciate if you kindly take some of your time to answer the questionnaire appropriately. The information gathered will be accorded a high degree of confidentiality.

Thank you.

Yours faithfully,

LAWRENCE K. KAMONJO
D53/OL/16277/2006
The District Cooperative Officer,

.................................................... District,

RE: PERMISSION TO COLLECT DATA.

I am a student at Kenyatta University pursuing Master of Business administration (M.B.A.) degree. In partial fulfilment of the stated degree, I am undertaking a study on corporate governance practice and its influence on financial performance of SACCOs. In that connection, I would like to request your office to grant me permission to visit SACCOs in your district for purposes of data collection. The information gathered from each SACCO will be accorded a high degree of confidentiality.

Thank you.

Yours faithfully,

LAWRENCE K. KAMONJO
D53/OL/16277/2006
APPENDIX 7: RESPONSE SUMMARY

<table>
<thead>
<tr>
<th>Name of the SACCO</th>
<th>Number of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kaboss SACCO</td>
<td>5</td>
</tr>
<tr>
<td>Kangaita SACCO</td>
<td>5</td>
</tr>
<tr>
<td>Kipris SACCO</td>
<td>5</td>
</tr>
<tr>
<td>Kicowo SACCO</td>
<td>5</td>
</tr>
<tr>
<td>Kiriwasco SACCO</td>
<td>4</td>
</tr>
<tr>
<td>Margsta SACCO</td>
<td>5</td>
</tr>
<tr>
<td>Muhigia SACCO</td>
<td>5</td>
</tr>
<tr>
<td>Mwendiwega SACCO</td>
<td>5</td>
</tr>
<tr>
<td>Mwonania SACCO</td>
<td>5</td>
</tr>
<tr>
<td>Ndigimwe SACCO</td>
<td>5</td>
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<tr>
<td>Maranatha SACCO</td>
<td>5</td>
</tr>
<tr>
<td>Neema SACCO</td>
<td>0</td>
</tr>
<tr>
<td>Tescom SACCO</td>
<td>5</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>59</strong></td>
</tr>
</tbody>
</table>
APPENDIX 8: QUESTIONNAIRE

SECTION I: GENERAL INFORMATION

a) Name of your SACCO .................................................................

b) Registration number of your SACCO ...........................................

c) Postal address ...........................................................................

d) Gender Male ( ) Female ( )

e) Position in the SACCO ..............................................................

f) Highest education level:

( ) Primary
( ) Secondary
( ) Diploma
( ) Degree
( ) Post graduate
( ) Others

SECTION II: SIZE OF THE BOARD

1. What is the size of the board of directors in your SACCO? (Specify) ..............................................

2. How many of them are: a) Females ........................................ b) Males .............................................................

3. a) Is the size of the board suited to the needs and ability of your SACCO?

   Yes ( ) No ( )

   b) If your answer above is 'No', what is your recommended size? (Specify)

4. Is there a disclosure of academic qualifications and professional qualifications of each member in the board?

   Disclosed ( ) Not Disclosed ( )

5. Has the board of directors developed procedures for removal of members who fail to meet high standards of ethical conduct and personal accountability in their work?
SECTION III: FREQUENCY OF BOARD MEETINGS

1. Does the board have a schedule of meetings? Yes ( ) No ( )

2. How many meetings does the board of directors of your SACCO hold in a year? (Specify) .................................................................

3. a) Is the frequency of the meetings suited to the needs of your SACCO? 
   Yes ( ) No ( )
   b) If your answer above is ‘No’, what is your recommended number of meetings per year.................................................................

4. Is the length of meetings adequate to enable useful exchange of ideas? 
   Yes ( ) No ( )

5. Does the management reach a unanimous decision during its meetings? 
   Yes ( ) No ( )

6. Does the board hold impromptu meetings to address urgent issues? 
   Yes ( ) No ( )

7. Are there filed minutes of all the meetings held by the board? Yes ( ) No ( )

SECTION IV: INTERNAL AUDIT FUNCTION

1. Does your SACCO have an internal audit department? Yes ( ) No ( )

2. To whom does the internal auditor report to? Board of directors ( ) C.E.O. ( )
   Any other (Specify) ........................................................................................................................

3. Are there written recommendations compiled by the internal audit department? 
   Yes ( ) No ( )

4. (a) Are the recommendations by the internal auditor acted upon appropriately? 
   Yes ( ) No ( )
   (b) If your answer above is ‘yes’, who implements those recommendations? ...........................................................................................

5. Do you think that the internal audit department is effective in preventing and discovering fraud? 
   Yes ( ) No ( )

6. What measures are in place to ensure that the internal audit department is strong and independent?
The questions in this survey may not be all embracing and comprehensive and may not have afforded you an opportunity to report some things you may wish to say about your job, organisation or yourself. Please make any additional comment in the space provided.

I sincerely appreciate your time and cooperation. Please check to make sure that you have not skipped any question inadvertently, before handing over the questionnaire.

Thank you for the information.