

**CORPORATE GOVERNANCE, COST OF CAPITAL AND
PROFITABILITY ON NON-FINANCIAL FIRMS LISTED IN
NAIROBI SECURITIES EXCHANGE, KENYA**

NGUE ELIZABETH MINOO

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DECLARATION

This independent study paper is my first-hand work and has not been conferred for a degree in another university.

Signature

Date

NGUE ELIZABETH MINOO

D86/CTY/PT/25373/2024

Department of Accounting and Finance

School of Business, Economics and Tourism

Kenyatta University

I confirm that this independent paper was done by the candidate under my guidance as the university appointed supervisor.

Signature

Date

Prof. Ambrose Jagongo (PhD)

Senior Lecturer

Department of Accounting and Finance

School of Business, Economics and Tourism

Kenyatta University

DEDICATION

I dedicate this independent study paper to my family for their relentless backing over the research undertaking. My Mother Juliana Ngali Ngue and My Father Dishon Ngue Muthama for their indispensable help in my life. I thank God for you. I love you.

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TABLE OF CONTENTS

Table of Contents

DECLARATION	ii
DEDICATION	iii
ACKNOWLEDGEMENT	iv
TABLE OF CONTENTS	v
LIST OF TABLES	vii
LIST OF FIGURES	viii
OPERATIONAL DEFINITION OF TERMS	ix
ABBREVIATIONS AND ACRONYMS	x
ABSTRACT	xi
CHAPTER ONE	1
INTRODUCTION	1
1.1 Background of the Study.....	1
1.1.1 Profitability.....	4
1.1.2 Corporate Governance.....	6
1.1.3 Cost of Capital.....	7
1.1.4 Non-financial firms listed in NSE, Kenya.....	8
1.2 Statement of the Problem.....	10
1.3 Objectives of the Study.....	12
1.3.1 General Objective.....	12
1.3.2 Specific Objectives.....	12
1.4 Research Hypotheses.....	13
1.5 Significance of the Study.....	13
1.6 Scope of the Study.....	14
1.7 Limitations of the Study.....	14

CHAPTER TWO	16
LITERATURE REVIEW	16
2.1 Introduction.....	16
2.2 Theoretical Framework.....	16
2.2.1 Agency Theory	17
2.2.2 The Trade-Off Theory	17
2.2.3 Stakeholder Theory.....	18
2.2.4 Modern Portfolio Theory	19
2.2.5 Pecking Order Theory	19
2.3 EMPIRICAL LITERATURE REVIEW	20
2.3.1 Board Composition and Independence and profitability of non-financial firms listed in NSE Kenya	20
2.3.2 Ownership Structure and Profitability of Non-financial firms listed in NSE, Kenya .	22
2.3.3 Audit Committees and Governance Codes and Profitability of Non-financial firms listed in NSE, Kenya	23
2.3.4 Cost of Capital, Corporate governance and profitability of non-financial firms listed in NSE, Kenya	24
2.4 Summary of the Literature and Research Gaps	27
2.4 CONCEPTUAL FRAMEWORK.....	44
REFERENCES	45
APPENDICES	52
APENDIX1: List of Non-financial firms listed in NSE, Kenya.....	52

LIST OF TABLES

Table 1.0: Summary of Literature reviews and research gaps.....28

LIST OF FIGURES

Fig. 1.1 Conceptual framework.....44

OPERATIONAL DEFINITION OF TERMS

Profitability	This is the measure of a firm's profit relative to its expenses.
Corporate governance	These are the rules, practices and agreed upon processes employed to control and govern a firm.
Board Independence	The presence of independent directors who have no direct relationship with a firm's stakeholders and can make decisions without any influence.
Government codes	Government backed frameworks and principles to be adhered to in ensuring transparency, accountability, and ethical management within a firm.
Cost of Capital	This represents the cost of using debt and equity to a firm.
Regulatory framework	A structured set of rules, guidelines and standards put in place by government agencies or industry bodies to govern the operations in firms
Non-Financial Firms	These are profit entities either public or private that produce tangible goods or non-financial services rather than financial intermediation.

ABBREVIATIONS AND ACRONYMS

CMA-Capital Markets Authority

NSE- Nairobi Securities Exchange

ROA- Return on Assets

GDP-Gross Domestic Product

MPT- Modern Portfolio theory

EA -East Africa

ROI-Return on Investment

EAU- East African Union

SMEs- Small and Micro Business

EU - European Union

ABSTRACT

Corporate governance has become a fundamental topic in corporates management due to its pivotal obligation in enhancing accountability, transparency and profitability. Non-financial firms listed in Nairobi securities exchange Kenya have been greatly affected by corporate governance mechanisms and consequent cost of capital which significantly and jointly affect their profitability. Corporate governance has been known to have a great influence on the eventual profitability of listed firm. The declining profitability of non-financial firms poses a challenge to the realization of the Sustainable Development Goals and Vision 2030 as a whole. The period before, during and after COVID 19 is critical since its impact needs to be closely monitored.

The study therefore looks to examine the effect of corporate governance, cost of capital on performance of non-financial firms listed in Nairobi Securities exchange Kenya. Specifically, to determine the effect of board independence on profitability of non-financial firms listed in NSE, Kenya, to determine the effect of ownership structure on profitability of non-financial firms listed, to determine the effect of audit committees and government codes on profitability of non-financial firms listed and to determine the moderating effect of cost of capital on the relationship between corporate governance and profitability of non-financial firms listed in NSE, Kenya. The study will be anchored on Stakeholder theory, Modern Portfolio Theory, Agency Theory, Pecking order theory and Trade-off theory. Secondary data from published audited annual financial statements will be gathered from the NSE, Kenya website to be utilized in this inquisition for the period 2016-2025. Descriptive analysis and correlation analysis will be utilized. Multiple linear regression and panel regression will be used.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Corporate governance has become a fundamental topic in corporates management due to its pivotal obligation in enhancing accountability, transparency and profitability. Globally, corporate failures and financial scandals such as Enron, WorldCom, and Parmalat uncovered the fragility in governance frameworks and accentuated the aftermath of inefficient neglect on a firm's value and shareholder confidence. These unfolding heightened regulatory reforms and academic inquisition into governance frameworks that align managerial actions with shareholders' interests (Jensen & Meckling, 1976).

In emerging frontier markets, corporate governance is vital because of weak institutional frameworks, concentrated ownership structures, underdeveloped capital markets and high information asymmetry. These realities have increased institutional risks prompting investors to ask for higher returns which in turn increases cost of capital, constraints investments and growth (Myers& Majluf, 1984). Consequently, effective corporate governance has been oftenly viewed as a strategic tool to decrease agency conflicts, lower cost of capital and increasing profitability.

Globally corporate governance has gained vitality as a crucial instrument towards enhancing profitability, safeguarding investor's confidence and ensuring efficient allocation of capital. Separation of ownership and control in modern corporates mostly creates agency problems between managers and shareholders which if not paid attention can lead to increased risk and

erosion of firm value (Jensen & Meckling, 1976). High profile failures such as Enron, Worldcom and Lehman Brothers unearthed weakness in governance systems and showcased poor oversight can increase the cost of capital in return reducing profitability.

In developed capital markets such as the United States, United Kingdom and European union, strong corporate governance tactics have been employed to protect investors and enhance transparency. Empirical evidence on these markets has shown that firms with efficient governance frameworks enjoy lower cost of capital due to reduced information asymmetry and agency risk (La Porta et al., 2002). Investors looked at well managed firms as less risky thereby charging reduced rates of returns and improved profitability. Cost of capital is an important determinant of investment decisions and firm value. According to Modern Portfolio theory, investors require compensation for systematic risk and governance quality (Markowitz, 1952). Studies from developed markets show that firms with independent boards, strong shareholder rights and transparent disclosures practices experience lower equity risk premium (Bebchuk & Weisbach, 2010). Lower cost of capital in return enables firms to undertake more profitable projects, enhance competitiveness and sustain long-term growth.

In Africa, corporate governance has become vital as countries seek to attract foreign investment, promote private sector led growth and deepen capital markets. African capital markets are known for weak institutional frameworks, limited disclosures, concentrated ownership structures and liquidity distress. These said factors lead to an increase in investment risk and elevating cost of equity for listed firms (Ntim, 2015).

African economies have therefore adopted governance reforms inspired by excellent global practices including adopting regulatory insights by their capital market authorities and corporate governance codes. Ghana, South Africa, Nigeria and Egypt have implemented governance

frameworks which are aimed at enhancing accountability and transparency. Empirical evidence for these countries indicates that corporate governance significantly impacts firm's financial performance and cost of capital. (Ntim et al,2017) found out that complying with King codes experience lowered cost of equity and improved profitability due to improved investor confidence in South African markets. Despite the above evidence. Governance effectiveness in African countries remains uneven as many firm experience political interference, weak enforcement of governance codes and limited investor protection. These shortcomings horn agency problems and increase cost of capital, thereby limiting firm's ability to access cheaper long-term financing. Also, many African firms prefer internal financing and short-term debt which limits growth and profitability. Despite the said challenges, enhancing corporate governance is looked at as a pathway of lowering cost of capital and enhancing firm's financial performance.

In East Africa, corporate governance reforms have mainly focused on improving disclosures. Strengthening regulatory frameworks and enhancing board effectiveness. Despite these improvements, many listed firms continue to face governance struggles which include weak board independence, limited transparency and dominant shareholders. The Eat African Community has put in place efforts geared towards regional market integration in a bid to enhance cross-border investments and enhance market efficiency. For these reforms to bring a positive change, listed firms are required to demonstrate strong governance practices which reduce perceived risks and consequently lower cost of capital.

In Kenya, Nairobi Securities exchange, which is the most developed capital market in the East Africa region, plays a critical role in mobilizing long term capital for economic development. Non-financial listed firms operate in key sectors such as construction, energy,

telecommunications and manufacturing which are the backbone to the economy especially in realizing the Vision 2030 blueprint. Despite NSE's superiority in the EA region, it has experienced reduced investor participation and delisting over the recent past. Several listed corporations have noted decreasing profitability and consequent earnings volatility, raising concerns about financing costs and governance.

Capital Markets authority brought about code of Corporate Governance Practices for issuers of securities to the public in 2015 in a bid to strengthen governance among listed firms. The codes emphasized risk management, shareholder protection and disclosures and board composition. While compliance is a must, enforcement struggles exist and governance quality varies among listed firms. According to CMA reports, Uchumi, Athi River mining and Mumias sugar company share value declined leading to reduced profitability which are attributed to governance issues and liquidity issues. Empirical studies in Kenya clearly show that governance impacts firms' performance and cost of capital with independent boards and effective audit committees enhancing profitability and decreasing risks (Wambugu 2018) as well as (M'Ithira & Musyoki 2020).

Despite of the growing body of knowledge, only a few studies have jointly determined corporate governance, cost of capital and profitability of non-financial firms listed in NSE, Kenya. This study looks to bridge this contextual gap by examining how corporate governance affects profitability of non-financial firms listed in NSE, Kenya moderated by the cost of capital.

1.1.1 Profitability

Profitability is an essential measure of corporation's financial performance and sustainability. Parameters such as return on assets (ROA) and return on equity (ROE) indicate management

competency and the firm's capability to bring about returns from invested resources. Profitability remains a crucial index of corporate success, demonstrating how adeptly firms make use of their resources to beget returns. Global empirical studies display a strong linkage between governance quality and profitability estimators like return on assets and return on equity (Gompers et al., 2003). Firms with healthy governance mechanisms incline towards displaying higher-up financial performance owing to elite monitoring, declined managerial opportunism, and enhanced strategic decision-making.

In spite of these advances, governance difficulties linger even in developed markets, especially in relation to executive compensation, board effectiveness, and shareholder activism. These shortcomings underscore the requirement for incessant assessment of governance tactics and their influence on cost of capital and profitability.

Prior empirical studies in Kenya indicate that governance attributes such as board independence, ownership structure, audit committee effectiveness, and executive compensation influence profitability; however, findings remain mixed and fragmented (Wambugu, 2018; Karanja, 2015).

Musyimi, A. M. et.al., (2025) sought to study business risk, profitability, asset structure and firm value of non-financial firms listed in the Nairobi Securities Exchange. Findings showed that Profitability and asset structure had positive significant effects while business risk had negative significant effects. The study established that business risk can positively impact firm value through the potential for higher returns. However, care should be taken on amount of risk taken to avoid financial distress. The profitability allows the company to have a strong financial position.

Zachary, James M. & James N. (2019), found out that Leverage has significant positive effect on financial performance of selected companies listed at NSE, Kenya. They recommended that managers of the selected companies listed at NSE, Kenya could make use of the various sources of financing since financial structure has a positive effect on the performance of the listed firms. The proportion of leverage could be increased in financing the companies due to its high contribution to performance.

1.1.2 Corporate Governance

This is the set of rules and regulations for a particular company used by its stakeholders to control and monitor management decision making, harmonize manager's interests to stakeholders and tackle issues when they arise.

Mukaria & Aluoch (2025) found that corporate governance had significant effect on profitability moderated by inflation. The study concluded that corporate governance and inflation have significant effect on profitability. It was recommended that Capital Market Authority should set up an optimal board size that should be availed as a benchmark by these listed firms. Therefore, to increase profitability of the listed manufacturing firms in Kenya, there is need for more independent and executive directors to be included on boards.

Shareholders of the listed manufacturing firms in Kenya should occupy a central role and demand for inclusion of more female and foreign directors to bring in new skills that can enhance profitability. The number of meetings held in a financial year by the board should be increased. The meetings convened by boards should have clear agenda in

place. There is need for the Central Bank of Kenya to have in place relevant policies that can stabilize overall prices of goods in the economy.

1.1.3 Cost of Capital

The cost of capital constitutes the return required by equity investors to counteracts for the risk of investing in a firm. In markets characterized by information asymmetry and weak governance, investors demand higher equity risk premiums, which increase financing costs and reduce firm valuation (Markowitz, 1952). Efficient corporate governance can alleviate these challenges by enhancing disclosure quality, cutting down on agency costs, and intensifying investor confidence, thereby the cost of capital in Kenya remains commensurately high due to market inefficiencies, macroeconomic volatility, and information asymmetry. Elevated cost of capital limits investment and restraints corporations' capability to take up profitable projects, thereby weakening long-term sustainability. Understanding how corporate governance can lessen the cost of capital and enhance profitability is therefore crucial for policymakers, investors, and corporate managers.

Kenya is one of the chief frontier markets in Sub-Saharan Africa, with the Nairobi Securities Exchange (NSE) acting as a crucial platform for rallying long-term capital. The NSE accelerates price discovery, advances transparency, and aids economic growth through well-structured capital allocation. Non-financial firms listed at the NSE substantially fosters Kenya's economy through, innovation, industrial development, employment creation and tax revenue generation. Notwithstanding their significance, a good number of these firms have encountered reducing profitability, earnings volatility, and increasing cost of equity over the past ten years.

To resolve the governance challenges, Kenya has set up a number of regulatory reforms targeted at boosting corporate governance practices. The Capital Markets Authority launched the Code of Corporate Governance Practices for Issuers of Securities to the Public in 2015, accentuating board effectiveness, shareholder protection, risk management, and disclosure. While compliance with the code is compulsory, the scope to which these governance rectifications have transformed into reduced cost of capital and higher profitability among non-financial firms remains empirically uncertain (M’Ithiria & Musyoki, 2020).

1.1.4 Non-financial firms listed in NSE, Kenya.

Musyimi, Gatauwa,& Kimutai (2025) explored the relationship between business risk, profitability, asset structure, and firm value of non-financial firms listed in NSE, Kenya making use of panel data from 2016 to 2022. The study employed panel regression techniques to control firm-specific heterogeneity and unearthed that profitability significantly magnifies firm value. The robustness of this study resides in its robust utilization of panel data and its rooted in enterprise risk management and financial-constraint theories, presenting a strong theoretical and empirical foundation. However, the study primarily concentrated on firm value (Tobin’s Q) rather than accounting profitability measures like ROA or ROE. Additionally, the operationalization of business risk was restricted, and the study did not investigate the role of corporate governance tactics in affecting profitability, leaving critical gaps that justify further investigation.

Obong'o, Nasieku & Gekara (2024)) probed to the effect of current asset structure on financial performance of non-financial firms listed in NSE-Kenya. Employing longitudinal data from 2011 to 2020 and making use of multiple regression analysis, the study accentuated the significance of liquidity management and asset composition for firm performance. The study's robustness includes its extended time frame and theoretical linkage to Pecking order theory, Agency theory and Trade-off, theory which defend the scrutiny of financing and operational decisions. Even so, financial performance was broadly explained, potentially combining profitability with other indicators like cash flow, and the study left out critical influences namely, risk exposure, poor governance and macroeconomic factors, limiting the soundness of its conclusions.

Chirchir, Kalui, & Tari (2024) looked into the linkage between firm characteristics and financial performance, covering the non-financial firms listed from 2009–2018. Their methodology, merging cross-sectional and panel data analysis, granted the examination of attributes like asset tangibility, growth, and firm age proportional to profitability. The study's robustness incorporated the use of audited financial statements and a multi-dimensional technique to firm characteristics. However, the study is affected by the potential of omitted variable bias by leaving out governance and capital structure predictors and the time period does not pick up recent market dynamics post 2018. In addition, profitability was not integrated, restraining distinct appreciation of its operational efficiency.

Mwangi, Kiptui & Olweny (2023) concentrated on the link between capital structure determinants and stock returns for non-financial firms listed in NSE. Despite their discoveries showing that profitability and liquidity significantly influence determined stock returns, the study's attention to market returns other than accounting for profitability restraints its significance to appreciating the concept of internal financial performance. Further, governance

factors were kept out, and the assumption of homogeneity across firms has the potential of bringing about bias to the results given sectoral differences in NSE.

Kilonzo (2023) investigated financial indicators, and share returns among agricultural firms listed at the NSE. The study provides sector-specific insights, highlighting the effect of profitability and leverage on stock performance while considering tax as a moderating variable. Despite its strengths in sectoral focus, the study's small sample size and emphasis on stock returns rather than accounting measures of profitability restrict generalizability and limit direct application to overall non-financial firms' operational performance.

Kimondo(2014) sought to find out the relationship between liquidity and profitability of non-financial firms listed in NSE Kenya. A significant link was found, consequently listed nonfinancial firms should always make certain that good levels of liquidity to guarantee steady profitability

Mwangi et al. (2014) unearthed that capital management components such as cash conversion cycles and receivables management positively affected performance and profitability of manufacturing, construction and non-financial firms listed in NSE. Kenya. Wairegi (2019) brought to light that liquidity had a significant effect on profitability of non-financial firms listed in NSE, Kenya. This champions stringent measures to ensure absence of liquidity distress for the firms to remain afloat.

1.2 Statement of the Problem

Non-financial firms listed in the Nairobi Securities Exchange have shown inconsistent financial performance over the past decade, characterized by declining profitability, reduced dividend

payouts, delisting's, and erosion of market capitalization. Several firms have reported persistent losses, while others struggle to attract long-term equity financing despite improvements in the regulatory environment.

Previous empirical evidence suggests that weak corporate governance increases agency conflicts due to availability of high information asymmetry. Thus, leading to investors demanding higher cost of capital premiums which constraints investments and undermines profitability (Kariuki,2018). Although Kenyan firms have adopted well thought out governance code of conduct, its effect in reducing cost of capital and increasing profitability remains unpredictable.

Prior studies have looked into corporate governance and financial performance, and cost of capital in isolation without interlinking them. Few studies have, however, consolidated the three in their empirical framework. Majority of the studies have, however, made use of cross sectional data and short tenures in that way, inhibiting the ability to represent trends or dynamic relationships over a considerable period.

This lack of empirical evidence has posed a challenge to policymakers, regulators and corporate managers to come up with a comprehensive governance framework which can conveniently aid in lowering the cost of capital and amplifying profitability of non-financial firms listed in NSE, Kenya. This inquisition seeks to solve this problem by making available empirical evidence on the effect of corporate governance on cost of capital and profitability of non-financial firms listed in NSE, Kenya.

Non-financial listed firms have encountered consistently declining profitability from their financial statements. This decline in profitability has led to an increase in volatility of earnings and a decline in investor confidence over the past ten years. Regardless of the introduction of

governance codes and regulatory oversight, several firms are still struggling with limited ability to access capital which is also charged high rates for acquisition. This situation brings attention to the inadequacy of present governance in lessening the cost of capital and inflating profitability.

Previous inquiries have looked into corporate governance and profitability or cost of capital in seclusion. This brings about limited empirical evidence on the possibility of combined relationship between the three. Besides, the studies available relied on cross sectional designs in that way curbing observation of the relationship over the years. This study will make use of time series data to study trends and help inform decisions. This current inquiry will look at a time scope of ten years ,2016-2025, incorporating the COVID 19 period to aid check its aftermath on profitability of non-financial firms listed in NSE, Kenya.

1.3 Objectives of the Study

1.3.1 General Objective

The general objective of this inquiry is to examine the effect of corporate governance on the cost of equity and profitability of non-financial firms listed at the NSE, Kenya.

1.3.2 Specific Objectives

- i. To determine the effect of board composition and independence on the profitability of non-financial firms listed at the NSE, Kenya.
- i. To determine the effect of ownership structure on the profitability of non-financial firms listed at the NSE, Kenya.

- ii. To determine the impact of audit committees and government codes on profitability of non-financial firms listed at the NSE, Kenya.
- iii. To establish the mediating role of cost of equity in the relationship between corporate governance and profitability of non-financial firms listed at the NSE, Kenya.

1.4 Research Hypotheses

- i. H₀₁: Board composition and independence has no significant effect on the profitability of non-financial firms listed at the NSE, Kenya.
- ii. H₀₂: Ownership structure has no significant effect on the profitability of non-financial firms listed at the NSE, Kenya.
- iii. H₀₃: Audit committees and Government codes has no significant effect on the profitability of non-financial firms listed at the NSE, Kenya
- iv. H₀₄: Cost of capital has no significant moderating effect on the relationship between corporate governance and profitability of non-financial firms listed at the NSE, Kenya.

1.5 Significance of the Study

The findings from this inquiry will inform policymakers and regulators, especially the Capital Markets Authority, about the effectiveness of corporate governance reforms. Corporate managers will gain insight into management practices that help reduce financing costs and enhance profitability of non-financial firms. Investors will gain improved understanding of bad

governance indicators. This study will contribute to the existing body of knowledge in frontier market context.

1.6 Scope of the Study

The inquiry aims to look into the effect of corporate governance on the cost of capital and profitability of non-financial firms listed at the NSE, Kenya over a 10-years period (2016-2025). Secondary data will be drawn from the financial statements submitted to the NSE, Kenya. The period of consideration is vital since it encompasses the Covid-19 season which critically impacted profitability of such firms. The trend is critical to policy makers since it will show how different economic periods impact profitability. Financial firms are excluded due to their unique regulatory environment and capital structure characteristics.

1.7 Limitations of the Study

The study counts on secondary data, which may be vulnerable to reporting inaccuracies and missed observations since the data gathered was for a different purpose. The analysis is limited to non-financial firms listed in NSE Kenya 2016-2025 thereby the findings cannot be generalized to non-financial firms listed in NSE, Kenya. Some qualitative aspects of governance may not be fully captured using quantitative proxies. The study consequently uses weak form efficiency which entails historical price not considering the other form of efficiency.

1.8 Organization of the study

This independent paper contains two chapters. The introduction is by background, statement of the problem, research objectives, research hypothesis, significance of the study, its scope and limitations of the study all contained in chapter one. Chapter two delves into theoretical review empirical literature review and ends with the conceptual framework.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The functioning of non-financial firms listed on the Nairobi Securities Exchange (NSE) has attracted significant scholarly attention in view of its implications for economic growth and investor confidence. Corporate governance, cost of capital, and profitability have attracted a lot of attention in the recent past. This chapter looks into the theoretical framework and the empirical literature, showing research gaps therein, backing up the interaction between these two vital mixes of factors influencing profit making of these firms. This chapter also captures the conceptual framework which exhibits the relationship between corporate governance and profitability moderated by cost of capital.

2.2 Theoretical Framework

This section looks into the linkage between corporate governance, cost of capital, and profitability. It reviews five critical theories and interlinks them to empirical findings in Kenya. As explained by (Kivunja,2018), a theory is a generalized statement of abstractions that elucidates and further envisions relationship or connections between or among phenomena, within the bounds of critical bounding assumption that the theory distinctly makes. This study is guided by five theories namely, Agency theory, the Trade-off theory, Pecking order theory, The Modern portfolio theory and Stakeholders theory. Each theory informs the variables discussed in this inquisition.

2.2.1 Agency Theory

Agency theory advanced by Jensen and Mecklings (1976) asserts that the main role of managers in a firm is to maximize wealth of shareholders. Agency theory argues that managers are prone to pursue self-serving goals at the expense of shareholders, leading to misappropriation and higher costs of capital. Effective corporate governance processes such as independent boards and performance-linked compensation mitigate these agency conflicts (Jensen & Meckling, 1976). This theory argues that due to possession of more information by managers compared to owners. A conflict might arise since managers mostly serve their interests in a bid to maximize their personal benefits rather than owners value (Eisenhardt, 1989). This misalignment of interests may lead to agency problems, namely inefficient investment decisions, misappropriation of firm's resources and manipulation of earnings. These agency problems can be mitigated by formation of independent boards, inclusion of incentive-based compensation and ownership concentration (Fama&Jensen 1983). Agency theory informs the corporate governance bit of this study, explaining how managers decisions and behaviors impact the profitability on non-financial listed firms.

2.2.2 The Trade-Off Theory

Trade-off theory argues that firms balance the tax benefits of debt against the costs of potential financial distress (Kraus & Litzenberger, 1973). This theory explains why corporations strive for an optimal capital structure that reduces the weighted average cost of capital (WACC). Trade off incorporates agency costs since weak management could bring about financial distress. Firms with poor governance face high default risk which might consequently increase cost of capital

(Graham& Harvey 2001). This theory informs the corporate governance bit of this inquisition and the interaction between corporate governance and cost of capital in the listed non-financial firms. Good governance strategies reduce expected distress costs thereby enhancing monitoring, improving risk oversight and enhancing cash flow stability. Well managed firms can exploit debt tax shields which in return enhances profitability. This clearly shows that corporate governance is crucial in increasing profitability of non-financial firms listed in NSE, Kenya. Studies by Mugenda & Mugenda (2019) show that non-financial firms listed at the NSE with moderate leverage achieved lower WACC and higher profitability.

2.2.3 Stakeholder Theory

Stakeholder theory expands beyond shareholders to include customers, employees, and the community as stakeholders whose interests' firms must consider (Freeman, 1984). Governance practices that accommodate diverse stakeholder interests may enhance corporate reputation, reduce risk premiums, and lower cost of equity. Long term corporate value is enhanced by balancing the interests of all the stakeholders, this arises from reduced conflict and improved performance (Donaldson& Preston. 1995). When firms manage stakeholder relationships efficiently, they reduce reputational and operational risk which consequently reduces cost of capital since financiers have faith in them (El Ghou et al.,2011). Firms with strong shareholder orientation exhibit good social responsibility, profitability and long-term value creation (Harrison&Wicks,2013). This theory backs up the corporate governance bit interlinking its efficiency to cost of capital and eventually profitability of listed non-financial firms in NSE, Kenya.

2.2.4 Modern Portfolio Theory

Modern Portfolio Theory (Markowitz, 1952) emphasizes risk-return trade-offs, providing a framework for understanding how the cost of capital impacts investment and diversification decisions. It argues that rational investors seek to maximize expected returns for a given level of risk by coming up with well diversified portfolios. Modern Portfolio theory in this inquisition builds on the corporate governance bit of this study. This is because good corporate governance acts as a risk reducing mechanism from an investor's perspective. MPT theory also touches on the cost of capital bit, which is the moderator between effects of corporate governance on profitability since strong governance strategies lead to lower perceived risk which leads to lower required returns and consequently lower cost of capital. Cost of capital on the other hand spells out how efficiently profits translate into firm value and improved sustainability in returns. Therefore, in accordance with MPT theory, cost of capital suitably moderates the linkage between corporate governance and profitability. In Kenya, Kariuki (2018) found that firms aligning investment decisions with risk-adjusted returns achieved stronger financial performance.

2.2.5 Pecking Order Theory

Pecking Order Theory (Myers & Majluf, 1984) advises that firms prefer internal financing over debt, and debt over equity, due to information asymmetry and issuance costs. This theory is especially relevant to NSE-listed firms, where market imperfections can raise capital costs. In this inquisition, The Pecking order theory offers a background for grasping the concept of financing tendencies in markets prone to information asymmetry and market imperfections. Consequently, firms facing such rely mostly on internal financing and short-term debts as a result

of high cost of long-term debts (Ngugi,2020). Njuguna (2017) found evidence of a pecking order preference among Kenyan non-financial firms, which partially explained variations in profitability and WACC. In this study Pecking order theory backs up the importance of good corporate governance since it reduces information asymmetry, which in return lowers adverse cost of attaining capital. Lower cost of capital maximizes profitability which avails more retained earnings to be used in refinancing. Therefore, non-financial listed firms should uphold efficient governance strategies in order to avail cheaper sources of capital for profitability maximization.

2.3 EMPIRICAL LITERATURE REVIEW

2.3.1 Board Composition and Independence and profitability of non-financial firms listed in NSE Kenya.

Prior inquiries consistently exhibit that diverse and independent boards lead to an improvement in monitoring and reduction of agency costs. Mukaria & Aluoch (2025) sought to check the impact of board size and independence on profitability of manufacturing and allied firms listed in NSE, Kenya over 2016-2023. Using descriptive and correlation analysis the study discovered that board size, and independence and diversity had varying relationships with profitability as moderated by inflation. The study made a conclusion that corporate governance and inflation have an influence on profitability. However much the study touches on corporate governance and profitability it was done on manufacturing and allied firms leaving a contextual gap which this study will fill by looking into the listed non-financial firms.

Muriuki & Minja (2025) sought to look into corporate governance practices effect on the financial performance of constitutional offices in Kenya: A case of National Land Commission.

Using Pearson correlation and simple linear regressions the study unearthed that Kenyan constitutional offices should make their financial reporting more transparent, reinforce accountability through audits and reports, and incorporate value of ethics into their corporate culture. This study looked into the National land commission leaving a contextual gap which the current study seeks to fill by carrying out an investigation on non-financial firms listed.

Omware, Atheru&Jagongo (2020) found out that key governance variables such as board size, board independence and educational level of board members, gender diversity, and ethnic composition were positively associated with financial performance of commercial banks listed in NSE,Kenya. A Spearman Correlation Coefficient and Multiple Regression Analysis was employed. This gave rise to the phenomenon that board characteristics play a crucial role in enhancing firm performance. The study was carried out in commercial banks leaving a contextual gap which the current inquisition seeks to fill by looking at non-financial listed firms.

Weta, Muchiri & Jagongo (2024) examined cross listed EA community listed firms from 2010-2020 using random effects panel regression. They unearthed that internal governance, mechanisms and regulatory compliance influenced firms' profitability, highlighting the moderating role of regulation. The study was done on cross-listed firms leaving a contextual and knowledge gap which this current inquiry will fill by looking at non-financial listed firms.

Gatauwa, Kurgat & Simiyu (2025) analyzed board composition and financial performance of agricultural cooperatives in Kericho county from 2017-2022 using panel regression. They found out that board composition negatively impacts returns on investment. The study however does not directly address cost of capital or profitability, thereby posing a gap in empirical evidence on the impact of corporate governance on cost of capital and profitability on non-financial listed

firms which this current study seeks to fill. The study was carried out in Kericho county leaving a contextual gap which the current inquiry fills by looking at non-financial listed firms.

2.3.2 Ownership Structure and Profitability of Non-financial firms listed in NSE, Kenya

Nzuki & Njoka (2021) investigated the combined effects of ownership structure and corporate governance practices on financial performance of listed firms over 2014-2018. Using panel regression analysis institutional local ownership structure was found to have a positive significant effect on return on assets. He also found out that board independence improved performance outcomes. The study was carried out on all listed firms leaving a knowledge gap which this current study seeks to fill by looking into non-financial firms specially how corporate governance affects profitability moderated by cost of capital.

Mokaya & Jagongo (2015) examined the relationship between ownership structure and financial performance on NSE, Kenya listed firms. They discovered that ownership structure significantly influences financial performance, thereby insinuating that concentrated structure improves monitoring and reduces agency conflicts. The study left out a knowledge gap the moderating effect of cost of capital which this current inquisition fills.

Abdullahi & Simiyu (2024) looked at effect of internal corporate governance mechanisms on firm value among listed companies in NSE, Kenya. Ownership structure, board independence and board structure formed the components of governance. Panel regression unearthed that ownership structure had no significant effect while the other two were significant. This highlighted the complexity of ownership dynamics in corporate governance. These findings

leave a methodological and knowledge gap which the current study seeks to fill by narrowing down to non-financial firms listed in NSE, Kenya.

Macaria, Aluoch & Kosgei (2024) examined effect of ownership structure on financial performance of manufacturing firms listed in NSE, Kenya. Multiple regression results displayed that individual and government ownership had a significant positive influence while institutional and foreign ownership had a negative significant effect on financial performance. The study took place in listed manufacturing firms while the current inquiry is in listed non-financial firms filling the contextual gap therein.

2.3.3 Audit Committees and Governance Codes and Profitability of Non-financial firms listed in NSE, Kenya

Wagana & Karanja (2015) examined the effect of corporate governance policies, such as board oversight, financial reporting quality, and minority shareholder protection, on the market value of NSE-listed firms. The inquisition strength is its empirical approach using a decade of NSE data and its focus on governance tactics relevant to emerging markets. The findings imply that good governance positively impacts firm value, providing indirect backing for the idea that good governance can reduce investor risk. Nevertheless, the inquisition does not explicitly look into the cost of capital or accounting profitability, and it aggregates governance variables rather than analyzing specific tactics such as board independence or audit quality. Consequently, further research is required that directly links governance practices to cost of capital and profitability which this current study will focus on to cover this knowledge gap.

Chepngetich & Musau (2025) found out that independence, diversity, size and expertise of audit committees significantly enhanced corporate governance outcomes in state corporations under National treasury, underscoring compliance with governance codes.

Ojuwa & Wamugo (2023) found out that audit committee expertise and independence significantly improved financial reporting quality in Kenya state owned corporations, thus reinforcing the role of audit in supporting governance frameworks. The study took place in state owned corporations leaving a contextual and knowledge gap since their operations are different from those of non-financial listed firms. This current study will fill those gaps.

Kariuki & Nasieku(2019) aimed at establishing the effect audit committee on financial performance of deposit taking Sacco's in Nyandarua County, Kenya. The study established that audit committee had a positive significant relationship with the financial performance. The study took place in Nyandarua county creatin a contextual ga that this current study seeks to fill by looking at non-financial listed firms. A knowledge gap also exists since SACCOS have different set-ups compared to non-financial listed firms.

2.3.4 Cost of Capital, Corporate governance and profitability of non-financial firms listed in NSE, Kenya

Krajcsák Z (2024), aimed to investigate the relationship between corporate governance and financial performance in the case of publicly listed companies in Vietnam for the period from 2019 to 2021. Financial performance was determined by Tobin's Q, return on equity (ROE) and return on assets (ROA). He unearthed a positive relationship between transparency disclosure

and financial performance and a positive correlation between CG and company size. This inquiry took place in Vietnam leaving a contextual gap and knowledge gap to be filled by the current inquiry in nonfinancial listed firms in NSE, Kenya.

Mwangangi, Kinyua, & Wanyoike (2023) analyzed how long-term debt, total debt to assets, and liquidity influenced financial performance. The inquiry exhibited that while long-term debt had a negative but statistically insignificant effect, total debt to assets negatively and significantly affected performance. correlation analysis was employed. The study's strength lies in its use of recent NSE data and multiple debt measures, underpinned by agency, pecking order, and trade-off theories. However, the research did not explicitly examine cost of capital, corporate governance mechanisms are also absent, leaving an important gap in knowledge how cost of capital interacts with managerial oversight to affect profitability.

Muthoni, Jagongo & Muniu (2019) investigated the effect of equity financing on shareholder value creation of non-financial firms quoted at the Nairobi Securities Exchange for the period 2008-2014. Ordinary Least Square regression analysis was employed. They unearthed that equity financing had a statistically significant positive effect on shareholder value creation. This study focused on equity financing as an independent variable while current study focuses on cost of capital as moderating variable thereby filling a conceptual gap.

Kennedy & Njagi (2023) examined how the cost of preference shares, alongside cost of equity and debt, influences investment decisions of non-financial firms listed at the Nairobi Securities Exchange. The study found that higher costs of preference share negatively and significantly affect investment decisions. A key strength of this study is its direct measurement of preference share cost within the NSE context, making it highly relevant for understanding financing behavior in Kenyan firms. However, the study does not investigate the role of corporate

governance mechanisms, nor does it link preference share cost to overall firm profitability, leaving important empirical gaps for further exploration.

Nyongesa & Jagongo (2024) investigated the effect of capital structure on profitability of commercial state corporations in Kenya. Panel Regression was utilized. They unearthed that equity capital and long-term debt positively influenced profitability while short term debt had a negative effect highlighting how financing decisions impact performance. This study was in commercial state operations creating a contextual gap. Capital structure was the independent variable while in the current study corporate governance comes as an independent variable covering the knowledge gap.

Kimaru, Jagongo & Wamugo (2023) assessed the relationship between profitability and voluntary disclosure in Kenyan banks finding that profitability significantly impacts the extent to which voluntary information disclosure is availed which is a vital governance-performance link. Pearson correlation analysis was employed. This study focused on Kenyan banks leaving a contextual gap which this study fills by looking at listed non-financial firms.

Aluoch (2023) examined corporate governance practices, financial characteristics and macroeconomic variables on financial performance of commercial banks listed in NSE, Kenya over 2006-2020. Using panel regression, it was unearthed that financial leverage, interest rates and inflation significantly influenced ROA, while corporate governance variables showed a mixed effect on performance. The study concluded that corporate governance, financial characteristics and macroeconomic variables affect financial performance by commercial banks. The study however was concentrated on Commercial banks creating a contextual gap which this study fills by looking at no-financial firms listed.

While these recent studies provide valuable insights into the impact of cost of capital on firm performance, none explicitly measures cost of capital, and governance variables are largely ignored. Moreover, most studies focus either on operational efficiency or profitability without integrating both outcomes, and sectoral differences are often overlooked. The current study addresses these gaps by investigating how corporate governance tactics affect the cost of capital and profitability of non-financial NSE-listed firms, using a comprehensive dataset and robust empirical methodology. This approach adds to the existing literature by linking profitability, governance, and cost of capital in a coherent model relevant to both theory and practice.

2.4 Summary of the Literature and Research Gaps

The literature review above unearths that corporate governance has an effect on profitability of firms however much the studies were conducted in different industries and locations. The following table summarizes the studies showing research gaps to be filled by this current inquiry as well as critiquing methodologies used by previous inquiries.

Table 1.0: Summary of Literature Review and Research Gaps

Author(s) & Year	Variable Studied	Methodology	Main Findings	Research Gaps and focus of current study
Abdullahi & Simiyu (2024)	effect of internal corporate governance mechanisms on firm value among listed companies in NSE, Kenya.	Panel regression	Ownership structure had no significant effect while the other two were significant.	methodological and knowledge gap which the current study seeks to fill by narrowing down to non-financial firms listed in NSE, Kenya.
Mukaria & Aluoch (2025)	board size and independence on profitability of manufacturing and allied firms listed in NSE,	descriptive and correlation analysis	corporate governance and inflation have an influence on profitability	However much the study touches on corporate governance and profitability it

	Kenya over 2016-2023			was done on manufacturing and allied firms leaving a contextual gap which this study will fill by looking into the listed non-financial firms.
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Author(s) & Year	Variable Studied	Methodology	Main Findings (Kenya)	GAP
Musyimi, Gatauwa & Kimutai (2025)	Business risk, profitability, asset structure, firm value	Panel data regression (2016–2022)	Profitability positively and significantly affects firm value	This study focuses on corporate governance, cost of capital and profitability

<p>Omware, Atheru&Jagongo (2020)</p>	<p>board size, board independence and educational level of board members, gender diversity, and ethnic composition effect on financial performance of commercial banks listed in NSE,Kenya</p>	<p>A Spearman Correlation Coefficient and Multiple Regression Analysis</p>	<p>key governance variables such as board size, board independence and educational level of board members, gender diversity, and ethnic composition were positively associated with financial performance of commercial banks listed in NSE,Kenya.</p>	<p>The study was carried out in commercial banks leaving a contextual gap which the current inquiry seeks to fill by looking at non-financial listed firms.</p>
<p>Karanja (2015)</p>	<p>Board oversight, financial reporting quality, minority shareholder</p>	<p>Descriptive research, census of 66 NSE firms, secondary data, OLS regression</p>	<p>Board oversight and financial reporting quality positively affect firm value</p>	<p>Focused on firm value (Tobin's Q); did not examine cost of capital or direct</p>

	protection, firm value			profitability measures
Gatauwa, Kurgat & Simiyu (2025).	analyzed board composition and financial performance of agricultural cooperatives in Kericho county from 2017-2022	panel regression	board composition negatively impacts returns on investment	The study however does not directly address cost of capital or profitability, thereby posing a gap in empirical evidence on the impact of corporate governance on cost of capital and profitability on non-financial listed firms which this current study seeks to fill.

				The study was carried out in Kericho county leaving a contextual gap which the current inquiry fills by looking at non-financial listed firms.
Weta, Muchiri & Jagongo (2024)	Effect of internal governance, mechanisms and regulatory compliance influence on cross listed EA community listed firms from 2010-2020	random effects panel regression	internal governance, mechanisms and regulatory compliance influenced firms' profitability, highlighting the moderating role of regulation	The study was done on cross-listed firms leaving a contextual and knowledge gap which this current inquiry will fill by looking at non-financial listed firms.

Kariuki (2017)	Board size, board independence, gender diversity, CEO duality, ROA	Descriptive design, secondary data (2008–2014), regression analysis	Governance variables significantly affect firm performance (ROA)	Limited sample (4 insurance firms); time excludes recent market dynamics; cost of capital not included
Nzuki &Njoka (2021)	combined effects of ownership structure and corporate governance practices on financial performance of listed firms over 2014-2018.	Using panel regression analysis	institutional local ownership structure was found to have a positive significant effect on return on assets. He also found out that board independence improved performance outcomes.	The study was carried out on all listed firms leaving a knowledge gap which this current study seeks to fill by looking into non-financial firms specially how corporate governance affects profitability

				moderated by cost of capital.
Mokaya & Jagongo (2015)	examined the relationship between ownership structure and financial performance on NSE, Kenya listed firms.	Correlation and regression	Ownership structure significantly influences financial performance, insinuating that concentrated structure improves monitoring and reduces agency conflicts	The study left out a knowledge gap the moderating effect of cost of capital which this current inquisition fills.
Muriuki & Minja (2025)	corporate governance practices effect on the financial performance of constitutional offices in Kenya:	Pearson correlation and simple linear regressions	Kenyan constitutional offices should make their financial reporting more transparent,	This study looked into the National land commission leaving a contextual gap which the

	A case of National Land Commission.		reinforce accountability through audits and reports, and incorporate value of ethics into their corporate culture	current study seeks to fill by carrying out an investigation on non-financial firms listed.
Musyimi, Gatauwa & Kimutai (2025),	Business risk, profitability, asset structure, firm value	Panel data regression (2016–2022)	Profitability positively affects firm value	Focused on Tobin’s Q rather than accounting profitability; governance variables not included
Macaria, Aluoch & Kosgei (2024)	effect of ownership structure on financial performance of manufacturing	Multiple regression	individual and government ownership had a significant positive influence while	The study took place in listed manufacturing firms while the current inquiry is in listed non-

	firms listed in NSE,		institutional and foreign ownership had a negative significant effect on financial performance	financial firms filling the contextual gap therein.
Wagana & Karanja (2015)	effect of corporate governance policies, such as board oversight, financial reporting quality, and minority shareholder protection, on the market value of NSE-listed firms.	Multiple linear regression	Good governance positively impacts firm value, providing indirect backing for the idea that good governance can reduce investor risk.	Further research is required that directly links governance practices to cost of capital and profitability which this current study will focus on to cover this knowledge gap.

<p>Chepngetich & Musau (2025)</p>	<p>Effect of audit committee characteristics such as independence, diversity, size and expertise of audit committees on corporate outcomes in state corporations under National treasury, governance outcomes</p>	<p>Multiple regression analysis</p>	<p>independence, diversity, size and expertise of audit committees significantly enhanced corporate governance outcomes in state corporations under National treasury, underscoring compliance with governance codes.</p>	
<p>Ojuwa & Wamugo (2023)</p>	<p>Influence of audit committee expertise and independence on financial reporting quality in Kenya state</p>	<p>Multiple regression analysis</p>	<p>audit committee expertise and independence significantly improved financial reporting quality</p>	<p>The study took place in state owned corporations leaving a contextual and knowledge gap</p>

	owned corporations,		in Kenya state owned corporations, thus reinforcing the role of audit in supporting governance frameworks	since their operations are different from those of non-financial listed firms. This current study will fill those gaps.
Obong'o, Nasieku & Gekara (2024)	Current asset structure, financial performance	Longitudinal study (2011–2020), multiple regression, secondary data	Current asset structure significantly influences financial performance	Governance, capital structure, and macroeconomic factors omitted; financial performance broadly defined
Kariuki & Nasieku(2019).	effect audit committee on financial performance of deposit taking	Multiple regression Descriptive analysis	audit committee had a positive significant relationship with	The study took place in Nyandarua county creatin a contextual ga

	Sacco's in Nyandarua County, Kenya		the financial performance.	that this current study seeks to fill by looking at non-financial listed firms. A knowledge gap also exists since SACCOS have different set-ups compared to non-financial listed firms.
Krajcsák Z (2024)	the relationship between corporate governance and financial performance in the case of publicly listed companies in Vietnam for the		a positive relationship between transparency disclosure and financial performance and a positive correlation	This inquiry took place in Vietnam leaving a contextual gap and knowledge gap to be filled by the current inquiry in nonfinancial

	period from 2019 to 2021		between CG and company size.	listed firms in NSE, Kenya.
Mwangangi, Kinyua, & Wanyoike (2023)	Capital structure and financial performance.	Panel Regression analysis	While long-term debt had a negative but statistically insignificant effect, total debt to assets negatively and significantly affected performance.	the research did not explicitly examine cost of capital, corporate governance mechanisms are also absent, leaving an important gap in knowledge how cost of capital interacts with managerial oversight to affect profitability

Muthoni, Jagongo & Muniu (2019).	the effect of equity financing on shareholder value creation of non-financial firms quoted at the Nairobi Securities Exchange for the period 2008-2014.	Ordinary Least Square regression analysis	equity financing had a statistically significant positive effect on shareholder value creation	This study focused on equity financing as an independent variable while current study focuses on cost of capital as moderating variable thereby filling a conceptual gap
Chirchir, Kalui & Tari (2024)	Firm characteristics (asset tangibility, growth, firm age) and financial performance of non-financial firms listed in NSE, Kenya.	Cross-sectional & panel data, secondary data (2009–2018)	Certain firm characteristics influence financial performance	A knowledge gap exists which the current study seeks to fill

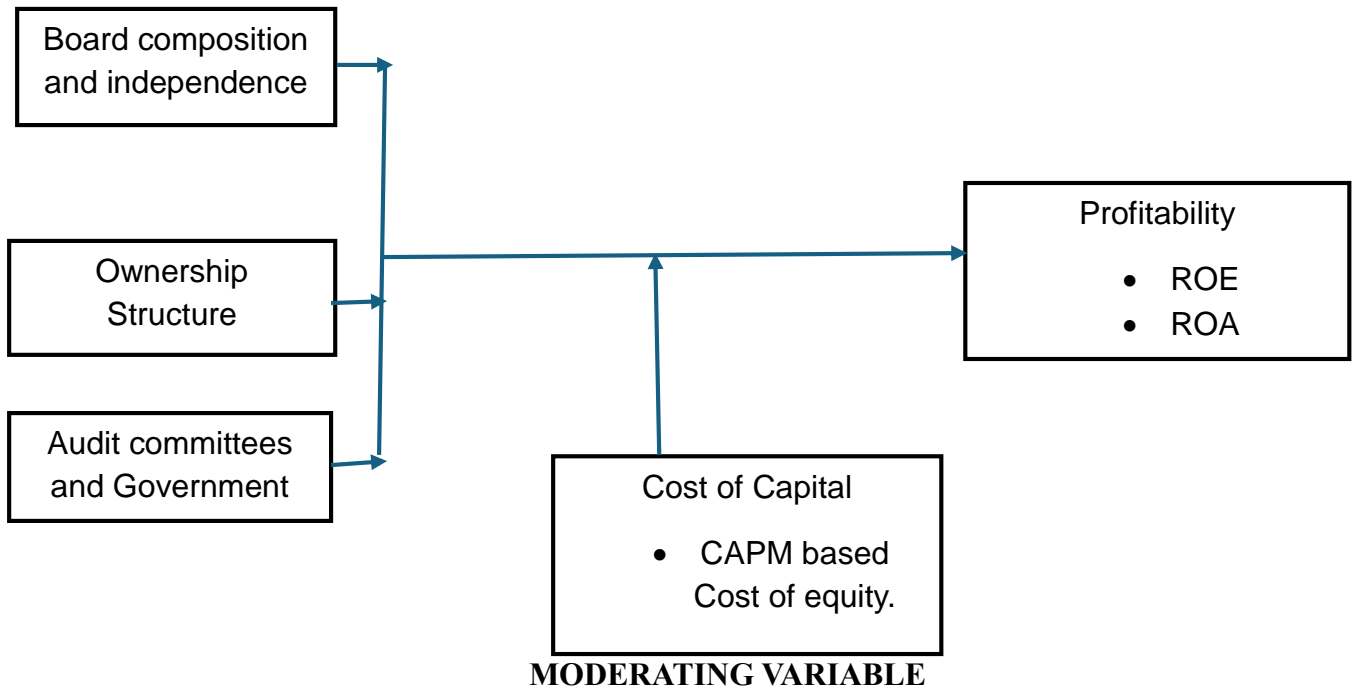
<p>Nyongesa & Jagongo (2024)</p>	<p>effect of capital structure on profitability of commercial state corporations in Kenya.</p>	<p>Panel Regression</p>	<p>Equity capital and long-term debt positively influenced profitability while short-term debt had a negative effect highlighting how financing decisions impact performance</p>	<p>This study was in commercial state operations creating a contextual gap. Capital structure was the independent variable while in the current study corporate governance comes as an independent variable covering the knowledge gap</p>
<p>Kimaru, Jagongo & Wamugo (2023).</p>	<p>the relationship between profitability and voluntary</p>	<p>Pearson correlation analysis</p>	<p>profitability significantly impacts the extent to which voluntary information</p>	<p>This study focused on Kenyan banks leaving a contextual gap which this</p>

	disclosure in Kenyan banks		disclosure is availed which is a vital governance-performance link	study fills by looking at listed non-financial firms
Aluoch (2023)	corporate governance characteristics and financial performance of commercial banks listed in NSE, Kenya over 2006-2020.	panel regression	that financial leverage, interest rates and inflation significantly influenced ROA while corporate governance variables showed a mixed effect on performance	The study however was concentrated on Commercial banks creating a contextual gap which this study fills by looking at non-financial firms listed.

2.4 CONCEPTUAL FRAMEWORK

INDEPENDENT VARIABLE

DEPEDENT VARIABLE



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APPENDICES

APENDIX1: List of Non-financial firms listed in NSE, Kenya

1. Deacons (East Africa) PLC (DCON)
2. Eveready East Africa PLC (EVRD)
3. Express Kenya PLC (XPRS):
4. Homeboyz Entertainment PLC (HBE)
5. Kenya Airways PLC (KQ)
6. Longhorn Publishers PLC (LKL)
7. Nairobi Business Ventures PLC (NBV)
8. Nation Media Group PLC (NMG)
9. Standard Group PLC (SGL)
10. TPS Eastern Africa (Serena) Limited (TPSE)
11. Uchumi Supermarket PLC (UCHM)
12. WPP Scangroup PLC (SCAN)
13. KenGen PLC (KEGN)
14. Kenya Pipeline Company PLC (KPC)
15. The Kenya Power and Lighting Company PLC (KPLC)
16. TotalEnergies Marketing Kenya PLC (TOTL)
17. Umeme Limited (UMME)
18. A. Baumann and Company Limited (BAUM)
19. BOC Kenya PLC (BOC)
20. British American Tobacco Kenya PLC (BAT)
21. Carbacid Investments PLC (CARB)
22. East African Breweries PLC (EABL)
23. Flame Tree Group Holdings PLC (FTGH)
24. Kenya Orchards Limited (ORCH)

- 25.Mumias Sugar Company Limited (MSC)
- 26.Unga Group PLC (UNGA)
- 27.Safaricom PLC (SCOM)
- 28.LAPTRUST Imara I-REIT (LAPR)
29. ILAM Fahari I-REIT (FAHR)
30. Acorn D-REIT
- 31.. Acorn I-REIT
32. New Gold ETF (GLD)
- 33.ARM Cement PLC (ARM)
- 34.Bamburi Cement PLC (BAMB)
- 35.Crown Paints Kenya PLC (CRWN)
- 36.East African Cables PLC (CABL)
- 37.East African Portland Cement PLC (PORT)
- 38.Car & General (Kenya) PLC (CGEN)
- 39.Sameer Africa PLC (SMER)
- 40.Eaagads Limited (EGAD)
- 41.Kakuzi PLC (KUKZ)
- 42.Kapchorua Tea Kenya PLC (KAPC)
- 43.Limuru Tea PLC (LIMT)
- 44.Sasini PLC (SASN)
- 45.Williamson Tea Kenya PLC (WTK)