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Abstract

Firm decisions are majorly affected by the operating environment in which they exist. Environmental context represents an exterior ecosystem. Effect of external environment context on strategic management is a discussion that is ever ongoing within which the organizational decisions and strategy are integrated. Operating environment either pose a threat or offer opportunities necessary to steer organization performance. The purpose of this study was to establish whether the operating environment had any moderating effect on the relationship between corporate governance and performance of firms listed at the Nairobi Securities Exchange (NSE). The study targeted all of the 66 the firms listed at the NSE within the period of the study. Both primary and secondary data sources were used. Reliability and validity of the study instruments was ascertained. Stepwise regression analysis was used to test for the moderating effect of operating environment. From estimation, it was revealed that corporate governance had a positive and significant effect on performance of listed firms at NSE whereas operating environment significantly moderated the relationship between corporate governance and firm successes amongst companies listed at NSE. Based on the findings, the study recommends for strict adherence to guidelines by listed firms as proposed by capital markets authority. There is a necessity for firms to clearly identify and define the components and dimensions of the environment under which they operate. The study therefore recommends for organizational blending with their environment in order to remain relevant.

Keywords: Corporate Governance, Board Size, Board Structure, Operating Environment, Firm Performance, Nairobi Securities Exchange

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Introduction

Corporate Governance (CG) can be explained as power which is exercised over companies (Tricker, 2015). It is made up of the activities of the corporation's panel of directors and its associations with investors, administrators and valid shareholders. The association between company control and goal attainment is one appealing and non-agreeable issues that has received much attention around the world. The global crisis that happened in 2007 raised major concerns around the policy and practices of many economies in the world (Tricker, 2015; Nguyen and Nguyen, 2016). Good CG has a positive impact on business performance (Aduda, Chogii & Magutu, 2013), while weak corporate governance undermines investor assurance and external investments (Vo & Nguyen, 2014).

According to Kalsie and Shrivastav (2016) affirm that corporate governance and its implication on firm performance has raised major empirical arguments in strategic management despite being acknowledged in the principles of corporate governance that its effectiveness encourages firms in using resources more efficiently through the capital costs and therefore improve the firm performance. The Operating Environment (OE) embodies the major eventualities encountered by a company (Tosi & Slocum, 1984). A vast body of study has been gathered that explores the influences of the operating environment on the approaches, processes, structures and results of the organization. Given the substantial variances in environmental possessions from business to business and from corporate to corporate success will also vary from one environment to another.

This study is grounded on agency theory, and supported by environmental dependency theory, it specifically explores the relationship between corporate governance in particular looking at multiple directorship, the size of the board of directors, audit committees and duality of CEOs, and secondly, the composition of the operational, political, economic, social, technological, ecological and legal environment on the corporate attainment of their set objectives and goals.

Literature

The consequence of the operational setting on business performance has been deliberated by various researchers over the years in developed and developing countries (Carpenter & Westphal, 2011; Ingley& van der Walt, 2011; Klein, 2014; Naushad & Malik, 2015). There has been no agreement on the results of these studies, with variant results: some show a positive relationship between corporate governance and firm performance some show a negative relationship while others show no relationship. Wakaisuka (2017) investigated whether regulation can be effectively used to replace internal control mechanisms and control conflicts among agencies in a company. The study found that, overall, the effect non-management directors is reversely related to ownership of insider shares while it is not influenced by the duality of CEOs. The duality among CEO and President is however less expected when the ownership of initiated shares increases. The study also revealed that inside control devices are less significantly related with controlled companies.

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According to Liang, You and Liu (2010), business performance is explained by the value of IT capabilities within the business, and therefore organizations can leverage on It and other related innovations to increase competitiveness of the company. Their study found that technological possessions increase external capabilities, which substantially impact on business performance. The results were consistent with opposing philosophies of organizational choice-making and evidence sharing regarding information technology governance processes and environmental dynamism. It was concluded that, the level of environmental dynamism, complexity and munificence if studied carefully can give companies a superior advantage and thus offer improved performances in their sector of activity (Peterson et al., 2002).

Wanjiru, Muathe and Kinyua (2019) contented that exogenous affects the correlation among company tactics and business accomplishment. Furthermore, Kacperczyk (2009) reported that firms pursuing international diversification tended to have CEOs with backgrounds in marketing and production. He argued further that, firms that pursue diversification were more expected to have CEOs with backgrounds in finance and accounting. Different chief executives may display variations in terms of their demographic characteristics. These variations are explained in terms of age, gender, education, culture, experience, and other personal attributes which affects firm performance. This has bearing on governance such that while recruiting managers of an organization, it is the sole responsibility of board of directors to make sure that they recruit the right managers to govern their institutions on their behalf. Akgul, Gozlu and Tatoglu (2015) in their research involving 211 companies that listed at Turkey's most industrial companies revealed that environmental dynamism is undoubtedly besides meaningfully related to environmental dynamism and, operational strategy is also found to have a strong effect on financial success.

Altunoglu (2012), in a study focusing on emerging markets corporate culture, firm size and governance practices, established that there are relationships among organizational designs and corporate governance applications. Further the success of corporate governance depends on the conditions under which it is employed. Machuki (2011) observed that the location of firms is critical and thus cannot be ignored. When the environment becomes hostile, as it sometimes does, the resources get scarce, a situation that forces businesses to manage in a state of ambiguity which often ends in inadequate achievement.

Methodology

The survey was grounded on a positivist philosophy approach. The main reason the study adopted the positivist philosophy was based on the fact that the survey was to empirically and objectively analyze the relationships among the variables and the hypothesis was taken from theories and descriptive survey plan

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was adopted. According to Sekaran and Bouge (2009), a description describes the features of the variables of interest in a situation. The study collected primary and secondary data from all 66 companies listed at the NSE. Descriptive statistics and step wise or hierarchical regression model was used to analyze the data.

The stepwise regression model is based on the suggestions of Baron and Kenny (1986) and was used to establish the moderating effect of operating environment on corporate governance and firm performance of entities listed at Nairobi Securities Exchange. First a regression model (step 1) predicted firm performance of entities listed at Nairobi Securities Exchange from the predictor in this case was corporate governance. Step 2, regression involving corporate governance, operating environment and firm performance of entities listed at NSE. Step 3, incorporating the interaction effect. If both moderator and interaction term are significant, then moderation is said to have occurred. The P value, the F ratio and the t statistic were used to examine the hypothesized relationship.The models tested in this hypothesis were as follows;

FP= f (Corporate Governance, Operating Environment, Interaction Term)

$$FP= \alpha+ \beta_1 CG + \varepsilon$$

$$FP= \alpha+ \beta_1 CG+ \beta_2 OE+\varepsilon$$

$$FP= \alpha+ \beta_1 CG+ \beta_2 OE+\beta_3 CG*OE + \varepsilon$$

Where α =constant (intercept), β1, β2, β3 are the regression coefficients. FP = Financial Performance; CG= Aggregated score for corporate governance, OE= Operating Environment, CG*OE= the interaction term of corporate governance and operating environment; ε -is an error term. In testing significance, model summary, Analysis of Variance (ANOVA) and coefficient of determination (R2) was used. Hypothesis was tested at 5 per cent level of significance.

Results And Discussion

The firm profile demographics that were considered in the study include year's organization has been in existence, sector of operation, scope of operation and the size of organization. These firm characteristics established in the study are all summarized in the table 1. Results indicate that most of the surveyed organizations (at 76%) that were listed in the NSE had been in operation for more than 20 years. This finding indicate that majority of the organizations have been in service for a long time.

In addition, the study sought to establish the sector of operation of the surveyed companies. Results generally indicate firms were evenly distributed across all the sectors. The finding indicated that most of the firms (that is 18%) were in banking industry. The study sought to establish scope of operation and size of the organizations listed in the NSE. Scope of operation is a long-term capacity decision which involves a long-term commitment on the geographical static factors that affect a firm, and therefore an important strategic level decision which influence firm performance. Results of the finding indicate that majority of the organizations operated

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regionally (only within East Africa) and continental (only in Africa) at 30% each. The study also sought to determine the size of the organizations in terms of personnel. The findings indicate that majority of the organizations (at 52%) had employees who were over 400 in number. The results are as shown in Table 1.

Table 1: Organization Demographic Profiles

Years Organization has been in the Industry	Frequency	Percentage (%)
Less than 5 years	1	2.0
11 to 15 years	3	6.0
16 – 20 years	8	16.0
Over 20 years	38	76.0
Sector in which Organization operates in		
Agriculture	5	10.0
Telecommunication & Technology	2	4.0
Banking	9	18.0
Investment Services	4	8.0
Construction & Allied	4	8.0
Commercial Services	5	10.0
Automobile & Accessories	4	8.0
Insurance, Investment	7	14.0
Energy & Petroleum	5	10.0
Manufacturing & Allied	5	10.0
Scope of Organization		
National (Only Within Kenya)	13	26.0
Regional (Only within East Africa)	15	30.0
Continental (only in Africa)	15	30.0
Globe (Africa and other Continents)	7	14.0
Size of Organization in terms of personnel		
Between 101-200	**7**	14.0
Between 201-300	**7**	14.0
Between 301-400	10	20.0
Over 400	26	52.0
Total	**50**	**100**

Source: Research Data (2020)

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The main objective of this study was to examine the effect of the operating environment on the link between CG and performance of organizations listed on the NSE. To establish the hypothesized relationship, the study employed stepwise regression as described by Baron and Kenny. The findings are as indicated in Table 2.

Table 2: Model Summary, Analysis of Variance and Coefficients

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.652[a]	.426	.414	.551
2	.680[b]	.462	.439	.553
3	.694[c]	.482	.448	.555

a. Predictors: (Constant), Corporate Governance

b. Predictors: (Constant), Corporate Governance, Operating Environment

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	10.810	1	10.810	35.574	.000[b]
	Residual	14.586	48	.304		
	Total	25.396	49			
2	Regression	11.741	2	5.871	20.206	.000[c]
	Residual	13.655	47	.291		
	Total	25.396	49			
3	Regression	12.234	3	4.078	14.252	.000[d]
	Residual	13.162	46	.286		
	Total	25.396	49			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Corporate Governance

a. Predictors: (Constant), Corporate Governance, Operating Environment

b. Predictors: (Constant), Corporate Governance, Operating Environment, Interaction Term

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Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	.983	.356		2.761	.008
	Corporate Governance	.663	.111	.652	5.964	.000
2	(Constant)	.629	.541		1.163	.251
	Corporate Governance	.632	.117	.622	5.504	.000
	Operating Environment	.226	.102	.100	2.204	.009
3	(Constant)	2.159	2.009		1.075	.288
	Corporate Governance	.152	.619	.149	.245	.807
	Operating Environment	-.304	.122	-.254	-2.486	.591
	Interaction Term (CG*OE)	.267	.117	.237	2.274	.003

a. Dependent Variable: Financial Performance

Table 2 shows the results of the moderating effect of operating environment on the relationship between corporate governance and financial performance via step wise regression. In model one the result shows that the association between corporate governance and final performance was moderate and significant (*R=.652, R^2=.426, F=35.574, p<.05*). The results in model two (*R= .680, R^2=.462, F=20.206, p<.05*) shows that both corporate governance and operating environment significantly explaining dependent variable whereas in model three (R= .694, R^2=.482, F=14.252, p<.05) implied that corporate governance (independent variable), moderator (operating environment) and interaction term significantly explain the dependent variable at 5% level. However, the direction of the moderating factor and significance (β= -.304, t=-.254, p>.05) changed to be insignificant whereas the interaction term (β= .267, t=2.274, p<.05) had a significant effect. This suggests presence of a complete moderating effect in model three after an interaction term is introduced.

As indicated, corporate governance had a significant and positive link on performance of listed firms. Studies at numerous occasions have been orchestrated with the aim of getting an insight of how governance at corporate level influences performance at firm level. From the literature, a lack of effective corporate governance at the executive and management level can

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lead to bad business decisions, which can lower the overall value of the company and make it more difficult for the business to meet its financial obligations (AbuGhazaleh et.al. 2012).

Based on the results, the study rejected the null hypothesis that there is no significant moderating effect of operating environment on the relationship between corporate governance and financial performance of firms listed on NSE, Kenya. This finding was supported by the study result obtained Peterson et al., (2002) who concluded that, the level of environmental dynamism, complexity and munificence if studied carefully can give companies a superior advantage and thus offer improved performances in their sector of activity. Also, Machuki (2011) concurred to the fact that when the environment becomes hostile, as it sometimes does, the resources get scarce, a situation that forces businesses to manage in a state of ambiguity which often ends in inadequate achievement. In addition, Akgul, Gozlu and Tatoglu (2015) revealed that environmental dynamism is undoubtedly linked to operational strategy with a strong and effect on financial success of an organization.

To survive in a business competitive environment coupled with competing firms and the desire to satisfy customers and create value for both the organization and the shareholders, Ho (2005) suggests that firms have to develop competitive strategy through application of the necessary corporate governance mechanisms to perform exemplary than the available competitors. This concurs with the findings of this study where corporate governance was found to have a significant and positive effect on performance of listed firms while operating environment was also revealed to have a moderating effect on the hypothesized relationship.

Conclusions

The study concludes that corporate governance had a significant and positive influence on performance of listed firms at NSE. Performance of the firm has been a key consideration for all organizations irrespective of formations. The study also conclude that operating environment moderates the relationship between corporate governance and performance (financial and non-financial) of listed firms at NSE. Based on these conclusions, the study suggests to management of various organizations or firms listed at NSE to adhere to the main objective of the implementation of good corporate governance in order to optimize value for shareholders and stakeholders in the long run. It is evident that corporate governance affects the development as well as functioning of capital markets and exerts a strong influence on resource allocation. If well adopted and implemented, it may impact upon the behaviour and performance of firms, innovative activity, entrepreneurship as well as the development of an active sub sectors in trade industry.

The operating environment is where such factors originate from within and without in any situation that a firm is operating. Operating environment in this study was found to moderate the relationship between cooperate governance and performance of listed

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firms. It is thus evident that environmental dimensions are critical for effective strategic management as well as performance. The volatility such as instability, munificence, and complexity of the industries are such attributes over which firms have little direct control, but which their management need to consider in their strategies and designs. Firms depend on the environment for performance to be realized. Firm performance is therefore highly influenced and related to the changes and the dynamism nature of the relationship that exist between the organization and the operating environment.

Business bodies needs to perform thorough scanning in order to achieve their performance targets. The study suggests to the entities that wish to remain competitive, that they cannot afford to ignore corporate governance and the corresponding dynamics of the environment in which they operate. From the foregoing results, this study has supported the agency theory and environment dependency theory. Shareholders and managers are therefore expected to have full understanding of their operating environment in line with the corporate governance with regard to growth of their organizations. In addition, this study reinforces the earlier findings in this area and supports the philosophy that professionally managed firms that scans their operating environment critically tends to posit superior performance compared to their competitors.

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