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Corporate Governance Practices and Financial Performance of Non-Governmental Organizations in Homa Bay County, Kenya

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Abstract

Purpose: *The purpose of the study was to establish the effect of corporate governance practices on the financial performance of non-governmental organizations in Homa Bay County.*

Methodology: *The study employed descriptive research design and secondary data to study a population of 38 international and local NGOS registered under the NGO board and operating in Homa Bay County. The data collected was analyzed through descriptive and inferential statistics.*

Findings*: The study findings pointed to a relationship between corporate governance practices and financial performance. Number of board meeting was found to significantly influence financial performance. Board training and board diversity was found to have no significant influence of financial performance of non-governmental organizations.*

Implications*: The overall conclusion was that corporate governance practice influences the financial performance of organizations NGOs in Homa Bay County. Individual variables analyzed showed that only board meetings significantly correlated with financial performance unlike other two dependent variables which did not have significant influence. However, when a regression analysis was done with all the three dependent variables, corporate governance practices came out as having a significant relationship with financial performance due to significance of board meetings.*

Value*: the study extends knowledge of theory building around the corporate governance around Non-Governmental Organizations. NGOs should widen their scope and adopt more corporate governance practices for better financial performance. Organization should focus more on consistent meetings and monitoring of their performance, having more proactive boards and more relevant practices.*

Key words: *financial Performance, corporate governance practices, NGOs*

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1.1 Introduction

The growth of the subject corporate governance is attributed to the crisis which has been faced globally and even nationally in management. Organization misconduct and financial scandals are among the crises which have pushed organization to put corporate governance at the forefront of their management (Price water house Coopers, 2010). Corporate governance practices are guidelines put in place to evaluate and improve corporate governance (Organization for Economic Co-operation and Development 2015) financial performance is a key indicator of the wellbeing of an organization. Financial performance is also defined by how much an organization is able to be efficient in carrying out its day to day activities, survive through its weaknesses and external threats while at the same time making use of their strength and external opportunities to ensure growth (Association of certified fraud examiners, 2010).

The theories that underpin the study include; Agency theory which describes the agent- principal relationship. According to Padilla (2002) the agent will not always make decisions on behalf of the stakeholders and will serve to advance their own interest. Stewardship theory looks at the agent as protecting the interest of the shareholders (Donaldson and Davis, 1991). This theory encourages autonomy of the managers to allow them maximize shareholders' wealth since they share in the same vision. Shareholders theory considers an organization as serving the interest of the various groups served and affected by the organization which include the employees, clients, investors and members of community. Stakeholders affect decision making process in an organization (Freeman, 1984). They are therefore a force which cannot be ignored in governance of an organization.

Non-governmental organization sector has grown tremendously in the recent past since 1980s (Malena, 1995). There has been an increase in donor funding due to the size and types of project undertaken. Competition for funding among the player in the sector has been on the rise due to their increasing number hence effective governance is seen as key in attracting donor funding for continuity of organizations (Ngeno, 2009). The government and international organizations have shifted their focus to NGOs with governance being top on the list in order to realize good result (Owiti, 2017). The rapid growth in NGOs has had its effects on ethics, values, organization competence and management which are reflected on problems of accountability, programme evaluation and structured growth (Moore and Stewart, 1998).

1.1.1 Corporate Governance Practices

Cadbury, 1992 defines corporate governance as a system through which organizations are directed and controlled. According to Organization for Economic Co-Operation and Development (2015) corporate governance is the relationship between company management, shareholders and stakeholders. It provides a structure through which the company's objectives are set, means of attaining them and monitoring their performance. Corporate governance is also the use of power to manage the resources of an organization for sustainable development (Private Sector Corporate Governance Trust, 1999). Corporate governance practices are set of guidelines put in place to help policy makers evaluate and improve the legal, regulatory and institutional frame work of corporate governance, they provide guidance on the role and responsibilities that stakeholders have in developing good corporate governance (OECD, 2015). Ngéno (2009) further defines corporate governance practices as the code of conduct which governs the operation of board.

Corporate governance practices are built upon a number of pillars which are transparency, accountability and fairness. The institute of chartered accountants, 2009 also adds openness, integrity, reducing the potential of conflict and reconciling the interest of shareholders and directors to the pillars which support good corporate governance. Securities and Exchange Board of India (2003) indicates that corporate governance practices can be divided in five categories which include board and management structure, auditing, financial transparency and disclosure, ownership and exercise in control rights in leadership. Corporate governance practices when broken gives guidelines on appointment of board members, its constitution and independence, remuneration, appointment of directors, audit committees, board meetings, communication to stakeholders, board training and development and board diversity and evaluation (Tricker, 2015; Ngéno, 2009).

The Public Benefit Organizations Act, 2013 gives the constitution power in the NGOs governance. It requires the constitution to explicitly state the intention of having a board, rules for conducting meetings, appointment of members to the governing body or the board and procedures of electing new governing body. Studies done measure corporate governance using board meeting, split CEO roles, independence of committees, board composition and role of board members (Wairimu 2011, Areba 2009, Memba and Ochoi 2015, Ngeno, 2009).

1.1.2 Financial Performance

Financial performance is the measurement of the result of accountability to an entity's policies, operations and activities over a qualified period of time (Mwangi, 2012). It's also a tool for evaluating if an organization is achieving its objective which is its ultimate goal of existence and it allows the organization look into making available financial resources (Wairimu 2011).

Financial performance has been measured using return gained from investment, equity, assets and profitability (Wairimu 2011, Areba 2011, Mwangi, 2013). The performance of organizations in financial terms has also been measured using ratios since it allows the financial data to be reduced to understandable forms. Measuring financial performance in not for profit sector have been more difficult since it's not profit oriented and scholars have not reached a consensus on its measurement (Ritchie and Kolodinsky, 2003). Despite this fact donor have been keen to assess the financial performance of these organization since this informs their funding choices. According to Lewis (2009), donors measure financial performance using elements in the financial statements together with ration analysis. The aim being to establish financial sustainability, efficiency and effectiveness of the non-governmental organizations.

Ritchie and Kolodinsky (2003) identify three categories of measuring financial performance in NGOs. Fundraising efficiency, which measures the relationship between total contribution and the amount raised per cost incurred by the organization, fiscal efficiency ratio, which measures how an organization is able to cater for its expenses compared to the resources at its disposal and public support ration which analyses the extent to which an organization is dependent on direct public support in terms of donations and gifts. In a study done (Zender, Gilman and Durgin, 2012), performance in nonprofit organization is measured using; revenue diversification which looks at the revenue sources of the organization, resource management aspect that relates an organization's ability to use minimum resources to produce maximum output and liquidity aspect of financial measurement which expects an organization to have enough resources to meet its liabilities when they come due. All this can be summed up into three measures which include: - public support which is the ration of total contribution / total expenses, fundraising efficiency which is total revenue / fundraising expenses and fiscal efficiency which is total revenue / total expenses.

1.1.3 Corporate Governance Practices and Financial Performance

A number of empirical studies conclude that corporate governance has an influence on the financial performance of an organizations (Ochoi and Memba 2015; Areba, 2009). However other scholars still conclude that no significant relationship exist between this two variables (Leng, 2014). A study done by Areba (2009) uses the size of the board, split of chairman /CEO role, composition of the board and committee independence to measure corporate governance and to establish an existence of relationship between the two variables.

Ochoi and Memba (2015) bring out the board as significant player in evaluating governance practices in an organization. A study done by Mweberi and Kemei (2017) brings out education of board members as an important element since it enhances open communication and helps board members to understand their roles. The study also concludes that independent internal audit positively influences the performance of an organization financially.

Leng (2014) uses the proportion of non-executive directors, CEO/chairman duality and audit committee to measure corporate governance. This study concludes the practices measured do not influence financial performance and it makes a conclusion that there is no significant relationship between corporate governance practices and financial performance.

Kimungunyi et al, (2015) looks at corporate governance practices and its effect on financial performance in NGOs in the health sector in Kenya. The study uses audit committees and performance evaluation of the board as main measures of corporate governance. It uses fiscal performance and fundraising ratios as measures of financial performance.

Odondi (2011) uses donor funding level, transparency and accountability to measure financial performance in Non-governmental organizations in Kibera. Governance practices on the other hand are measured using board size and composition, separation of ownership and control, independence of management committees, financial reporting and disclosure. The study brings in independence of management committee as an important in measuring corporate governance practices which has a significant effect on financial performance.

1.2 Research Problem

Corporate governance practice and financial performance is an area which has intrigued a number of researchers. Even though majority concludes to an existence of relationship between the two variables others conclude to no existence of relationship. Corporate governance practices have been measured using board size, existence of non-executive directors, management efficiency, composition of the board, CEO duality, independent audit committees, skilled directors and board diversity (Wairimu 2014; Durgavanshi 2014; Memba and Kimungunyi 2015, Leng, 2014). Researchers have not done a lot of work in the NGO sector in line with corporate governance practices and financial performance this presents a gap since very limited information is available in the public relating the two variables.

NGOs in Homa Bay County play an important role in terms of providing social services and employment. These organizations face tough financial times due to decreased funding from donors which has been experienced across the globe including Kenya and has been partly attributed to poor structures of management and mismanagement of funds (Lee, 2010; Orendo and Muturi, 2017). Audit reports also point out significant gaps in terms of financial management in these NGOs. The NGO board has deregistered a number of these organizations in Kenya including organizations in Homa Bay County due to mismanagement (NGO Board, 2014). Durgin et al (2012) found out that donors give funding based on their faith that the organization will effectively manage their donations and generate a positive social return which is demonstrated through organizations accountability which is seen in its financial performance. Based on this, organizations in Homa bay are facing financial constraints and the end result has been massive staff turnover since organization cannot sustain staff levels. Due to their important role focus need to be put on the financial health of these organizations and the practices they have adopted to strengthen governance.

Kimungunyi et al (2015) in looking at corporate governance practices and financial performance uses two variables that is audit committee and performance evaluation of the board to measure corporate governance. Financial performance on the other hand is measured using fundraising ratio and fiscal ratio as measures of financial performance. A study done by Odondi (2011) in the NGO sector brings in donor funding level, transparency and accountability as measures of financial performance. From the two studies done in the NGO sector there is no consistency in measuring financial performance since every scholar uses different measures in evaluating financial performance in NGOs. Researchers across the board both corporate sector and NGOs, have not covered extensively issues around board meeting, independence of board members, and continuous education which are also measure of corporate governance practices.

A number of studies have been done on corporate governance practice and financial performance. A consensus has not been reached on the effect of corporate governance practices on financial performance. A number of researcher conclude to a positive relationship (Areba, 2011; Durgavashi 2014; Wairimu, 2014) while other conclude that no relationship exists between the two variables (Leng 2014). Financial performance has been measured using Rate of return on asset, profitability, yield on portfolio, and return on equity and operation sufficiency. This is based on the context of this studies which include commercial banks, commercial state cooperation and micro finance institutions. The measures used across in measuring corporate governance practices include board size, composition, board diversity, existence of non-executive directors, existence of audit committees and split chairman /CEO role (Areba, 2011; Durgavashi 2014; Wairimu,2014; Leng 2014). Researchers are of the same opinion that Board size and audit committee influences financial performance. However, there is no consensus on the effect of split chairman/CEO role, board diversity and existence of non-executive directors, as measure of corporate governance practices on financial performance.

Most of the studies have opted to use descriptive research methodology with a difference in the mode of data collection; secondary data has been used more compared to primary data. Studies done presents a gap in terms of corporate governance practices used to make generalization since there is no consensus on the effect of some of these practices on financial performance. Less focus has also been given to board training and board meeting. Most of the studies have been done in commercial set up hence only limiting financial performance measurement to profit measures. Based on the gaps in NGOs in Homa Bay county and gaps in previous studies, the study sought to answer the question: - How do corporate governance practices affect the financial performance of non-governmental organizations in Homa bay county?

1.3 Research Objectives

To establish the effect of corporate governance practices on the financial performance of non-governmental organizations in Homa bay County.

2.1 Literature Review

The study is based on these three theories; agency theory, stakeholder’s theory and stewardship theory.

2.2 Empirical Review

Studies done by scholars on corporate governance practices and financial performance have had conflicting conclusions on this subject matter. One group points to a positive relationship between the two variables while other concludes that no significant relationship exists. Scholars also draw to different conclusion on effects of various corporate governance practices and the effect they have on financial performance.

Areba (2009) in his study concludes that corporate governance positively influences financial performance. Split of chairman /CEO roles, size, composition and independence of board members are the practices used in measuring corporate governance practices. The board members are key in decision making of an organization, from the study a bigger board influences financial performance negatively since it slows down the decision making process. Board composition, committee independence influenced financial performance of the organization positively.

A study done by Durgavashi (2014) looking at corporate governance practices in microfinance institution in India and the impact they have on financial performance of this institutions makes general conclusion that a positive correlation exists between the two variables. The study makes a differing conclusion and concludes that spilt of CEO /chairman roles and committee independence has no significant effect on financial performance in any way. The conclusion of the study gives weight to board competence in influencing organizations performance financially. Board members who are skilled are able to question management decisions and keep them on check.

Ochoi and Memba (2015), in studying this subject matter also make a conclusion that corporate governance influences financial performance and a positive correlation exist among the two variables. The study puts an emphasis, that good financial performance is achieved only when the board members and managers work closely in an organization. Wairimu, 2014 on the other hand in his study on corporate governance practices and financial performance concludes that maintaining an optimal size of board members is necessary. Smaller, below minimum and larger board size both has a negative effect on the performance of an organization financially. Gender diversity is also seen to have no influence on financial performance of an organization, from the study other aspects other aspects of diversity can be instrumental in improving financial performance but not gender diversity. A conflicting conclusion is given by Leng (2014), that corporate governance practices does not affect financial performance. In his study he uses proportion of Non-executive directors, audit committee and role of CEO as chair of the board to measure corporate governance practices and the conclusion is that these practices do not have an influence on financial performance.

Studies done Kimungunyi et al (2015) and Odondi (2011) on corporate governance practices and finance performance in non-governmental organizations have looked at NGOs in Nairobi in the health sector and Kibera slums. The studies are not in agreement in the measures of financial performance in NGOs. Kimungunyi et al (2015) uses fundraising and fiscal performance ratio while Odondi (2011) uses accountability, transparency and donor funding level. In measuring corporate governance practices the studies have only considered a few elements that is board size, separation of ownership and control, independence of management and committee, financial reporting and disclosure, evaluation of board members and audit committees. The studies have used elements of corporate governance practices previously looked at by other researches and they also left out other element which could be used in measuring corporate governance practices. Most researchers have centered their work on board size, board diversity, independence of the board and CEO duality. However, not much work has been done on board meeting and continuous education as elements of corporate governance in relation to organizational financial performance.

3.1 Methodology

The study used descriptive research design, since it made it possible to describe affairs exactly as they exist (Mugenda and Mugenda, 2003). Data collection was through secondary data collection tools both at organization level and from the organization websites. Descriptive and inferential statics was used to analyze the data and to draw conclusion as to the relationship between the two variables.

4.1 Findings, Conclusions and Recommendations

The findings pointed to an existence of a significant relationship between the two variables in NGOs in Homa Bay County. Corporate governance was measured using board characteristics which included board meeting, trainings and female members while financial performance was measured using fiscal performance. The relationship between the two variables was established using multiple regressions.

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.459[a]	.210	.179	.42365

Table 2: ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	3.634	3	1.211	6.749	.000[b]
	Residual	13.640	76	.179		
	Total	17.274	79			

The data was analyzed as shown in the table above and the findings pointed to existence of significant relationship between the two variables as measured by board meetings, board member training and board diversity and fiscal performance. This significance of relationship was further given by 6.749 which is the F statistic and 0.00 which was the P value at a significance level of 95%.

Table 3: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients			95.0% Confidence Interval for B	
		B	Std. Error	Beta	t	Sig.	Lower Bound	Upper Bound
1	(Constant)	.958	.143		6.694	.000	.673	1.243
	BT	-.034	.065	-.053	-.519	.605	-.164	.096
	BM	.064	.016	.409	3.936	.000	.031	.096
	FB	-.027	.021	-.136	-1.313	.193	-.069	.014

BT: Board Training BM: Board Meetings FB: Females in the Board

ANOVA pointed to a positive relationship between corporate governance practices and financial performance, however not all the measures of governance had a relationship with dependent variable in NGOs in Homa Bay County. Only board meeting presented a significant positive relationship while other independent variables had no significant effect on the dependent variable.

Number of board meetings and financial performance had a significant positive relationship. Frequent meetings allowed organization boards to discuss and address arising maters which may negatively affect the organization. It also gave the board an opportunity to set strategic goals and be able to constantly follow up on their achievement. Board training on the other hand had no effect on the dependent variable. From the previous literature, board competence is necessary, however it’s not achieved by training which is on the job. It is a factor which should be looked at when recruiting board members. An organization should ensure the people on board are competent and able to offer meaningful input to the organization. Board diversity which was measured by females present in a board had no significant relationship with financial performance. It should therefore not be a major focus area when an organization constitutes a board.

The overall conclusion was that corporate governance practice influences the financial performance of NGOs in Homa Bay County. Individual variables analyzed showed that only board meetings significantly correlated with financial performance unlike other two dependent variables which did not have significant influence. However, when a regression analysis was done with all the three dependent variables, corporate governance practices came out as having a significant relationship with financial performance due to significance of board meetings.

Non-governmental organization should widen their scope and adopt more corporate governance practices for better financial performance, since the study concludes that there is a positive effect on financial performance when corporate governance practices are embraced by an organization. Based on the research findings, the NGO board should help lay emphasis and encourage board members to meet frequently. This will give the board an opportunity to catch up with the activities of the organization and undertake restorative measures in instances when things are not going well in the organization.

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