INFLUENCE OF CORPORATE GOVERNANCE PRACTICES ON PERFORMANCE OF SMALL AND MEDIUM FAMILY OWNED FOOD AND BEVERAGE ENTERPRISES IN NAIROBI COUNTY, KENYA.

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ABSTRACT
The purpose of study was to explore the influence of corporate governance practices on the performance of small and medium family owned food and beverage enterprises in Nairobi County, Kenya. The study sought to investigate the existence of a Board or family council in the family business, frequency of their meetings role of the founder in the family business, establish ownership and control systems and their influence on the performance of the family business. A sample size of 84 family businesses were selected from a population of 146 Food and Beverage enterprises registered under Kenya Association of Manufacturers (KAM) Directory. Respondents were sampled using non-probability convenient sampling procedure. Data was collected using questionnaires which had both open and closed ended items. The collected data was analyzed using descriptive and inferential statistics. The findings of the study revealed that most family businesses had a system of governance as indicated by the presence and participation of a Board or a family council. This was more prevalent among the family businesses of Kenyan of Asian origin than those of Kenyan of African origin. Family businesses that had effective governance structures performed better in terms of longevity and sales turnover than those that had less effective governance structures. The role of the governance structures was to add value by directing, guarding, monitoring and protecting the assets of the family business. The role of the Board or family council provided clarity on roles, rights and responsibilities of the different systems of the
family business. It is recommended that for better performance of family businesses in Kenya, family business governance structures and practices should be strengthened with a clear separation of the family affairs and those of the business. It is also important to professionalize family business management.

**Key words:** Family business, corporate governance, firm performance, SMEs, accountability and professionalism.

### 1.1 Introduction

The global events concerning high profile business failures have put back the policy agenda and intensify debate on the efficiency of corporate governance mechanism as a means of increasing high performance (Sanda et al., 2005). International Finance Corporation (IFC) family business handbook suggests that some of the challenges faced by family business can be addressed by adapting a sound corporate governance structure which should clearly define the roles, responsibilities, rights and interaction among the company’s main governing body.

According to centre for Corporate Governance of Kenya (CGK) (2004), governance is the manner in which power is exercised in the management of economic and social resources for sustainable human development and is concerned with the processes, systems, practices and procedures, the formal and informal rules and regulations as applied and followed. It is how the power of the corporation is exercised in the stewardship of the corporation’s total portfolio of assets. The pillars of good governance according to CGK include accountability of power, democratic values in respect of the sharing of power and efficient and effective use of resources for the production of goods and services among others. Based on the arguments advanced by Tricker (1984), Keasey and Wright (1993), emphasize the need to view corporate governance as having two broad dimensions. The first is the monitoring of management performance and ensuring accountability of management to shareholders, which emphasizes the stewardship and accountability dimensions of corporate governance. The second is governance structures and processes needed to encompass mechanisms for motivating managerial behaviour towards increasing wealth of the business.
Corporate governance in Kenya has been top concern, particularly in the family business that lacked governance structures. According to Centre for Corporate Governance of Kenya (CCG K) (2004), focus on corporate governance intensified following the collapse of certain Kenya banks and other family owned businesses. According to private sector initiative for corporate governance, the quality of governance at all levels was increasingly being seen as the most important factor for the success of both the political – economy and its institutions. It was also noted that publicly listed companies were becoming increasingly vocal demanding better transparency and disclosure of information from their directors. It is in this view that the Capital Markets Authority (CMA) developed guidelines on corporate governance practices by public listed companies in Kenya in 2002 the objective being to strengthen corporate governance and promote the standards of self regulation in line with international trends (CMA, 2002).

Family businesses are the dominant and important segment of the global economy contributing more than 75 percent of the Gross Domestic Product (GDP) in most countries and employing 85 percent of the working population around the world (Poza, 2007). In Kenya, Small and Medium Enterprises (SMEs) of which majority are family owned are an important pillar of the Kenyan economy contributing over 18 percent GDP and over 75 percent of total employment (Kenya National Bureau of Statistics, 2010).

Given the dominance of family businesses and their contributions to the economy of most countries, the poor survival rate is, however, a continuing source of concern (Sharma, 1997; Morris et al., 1997). The collapse of some stock brokerage firms for instance in Kenya in the early 2000, which majority were family owned, led the Kenya Government to pass laws through the Kenya Finance Bill of 2008 which would bring in changes in firms’ ownership structures. Over the years, investment analysts have raised concern that the line between the ownership and management of family firms had contributed to lack of controls and accountability leading to poor performance. The problems facing these family firms were also attributed to failed succession planning (Aron, 2009). The common squabbles in the family businesses and high failure among the family businesses in Kenya as reported in media and elsewhere have raised more concern over the management and performance as indicated by longevity and growth of family businesses in Kenya.
1.2 Problem Statement
Given the dominance of family businesses and their contributions to the economy of most countries, the poor survival rate is a continuing source of concern (Sharma, 1997; Morris et al., 1997). Although the family firm is a dominant and popular model in the world and in Kenya, the issue of corporate governance has been a great concern. This concern has been raised concerning ownership and management practices of family businesses leading to lack of controls and accountability which contributes to poor performance and sometimes total collapse. While effective governance at all levels is increasingly being seen as the most important factor for the success of many institutions and the economy Small and Medium family owned enterprises in Kenya has continued to witness lack of controls, accountability and high failure rate. It is in view of this that this study sought to investigate the influence of corporate governance among the small and medium family owned enterprises in Nairobi County, Kenya.

1.3 Research Objectives
The study aimed to achieve the following objectives.

1. To investigate the role of the founder(s) of the family business and their influence on performance of small and medium family owned enterprises.
2. To establish how ownership and control systems influence the performance of small and medium family owned enterprises.
3. To determine the role of the Board or Family Council and their influence on the performance of small and medium family owned enterprises.

2.0 Literature Review
2.1 Nature of Corporate Governance
According to Blair (1995), corporate governance revolves around ownership and control and Zhuang (1999), argues that ownership structure is one of the most important factors in shaping the corporate governance system of any country. Trandelilin et al. (2007), concurs with this observation and asserts that the central concern of corporate governance has been the role of ownership structure. According to Short et al. (2001), good corporate governance can be seen as
referring to the mix of devices, mechanisms, structures which provide control and accountability. Matama (2006) observes that good corporate governance entails a strong performance ethic framework leading to a true meritocracy. It is essential for family businesses to acknowledge the distinction between ownership and management.

For the proper functioning of a family owned business, there is need to have clear roles, responsibilities and rules of engagement for the various stakeholders such as the owner managers and other outside professional managers working in the family business. However, in many small and medium family-owned businesses, there is no clear separation between business and the family as noted by Bula (2013). Families contribute labour and other resources to the business and in turn, they withdraw financial resources for the support of the family in times of need. The lack of separation if not controlled can contribute to the dismal performance of the family business as the business is left with little financial resources for expansion.

Matama (2006) further observes that family ownership concentrates control and facilitates decision making, which can both lower governance costs and permit unconventional but strategically advantageous decisions. A well functioning system helps build trust within the family, and a good family dynamic, in turn becomes an asset to the business because it enables each separate piece of governance to function better and add more value while remaining aligned with the other components of the governance system. During the early stages of the family business life cycle, the founder plays an important role of providing values, ethics, and systems of control and strategic direction of the firm. He or she gets involved in almost all functions of the business such as finance, production, and marketing and the human resource. There is usually no clear separation of roles, duties, responsibilities and no formal structures. However, as the business grows, it becomes increasingly complex, creating the need for a more formal organization structure with clear roles and responsibilities based on transparency and accountability which are the key dimensions of corporate governance.

2.2 Role of the Board of Directors
In a comparative analysis of family business, Rue and Ibrahim (1995), found that those who perform at a better than the industry average have higher participation by the Board of Directors in business and planning. Upton et al. (2002), observes that the boards involvement in the strategic
planning process may be somewhat related to performance of the business. The board of directors is a crucial part of a family business corporate governance structure. Its role, according to Ward (1991) and Bender (2002), is to add value by directing, guarding, monitoring and protecting assets. According to the principles for corporate governance in Kenya as prepared by private sector initiative for corporate governance, the role and functions of the board include the following among other roles.

a) Exercise leadership, integrity and sound judgments in directing the corporation as to achieve continuing prosperity and to act in the best interest of the enterprise while respecting the principles of transparency and accountability.

b) Ensure that through a managed and effective process board appointments are made that provide a mix of proficient directors, each of whom is able to add value and bring independent judgment to bear on the decision making process.

c) Determine the corporation’s purpose, and values, determine the strategy to achieve its purpose and to implement its values in order to ensure it survives and thrives, and to ensure that procedures and practices are in place that protect the corporation’s assets and reputation.

d) Monitor and evaluate the implementation of strategies, policies, management performance and business plans.

e) Ensure that no one person or a block of person has unfettered power and that there is an appropriate balance of power and authority on the board which is, usually reflected by separating the roles of the chief executive officer and chairman, and by having a balance between executive and non-executive directors.

According to Johanisson and Huse (2000), agency theory suggests that principals that are the owners should select board members to monitor management who are the agents. Separation of ownership and control, mistrust and information asymmetric are dominant ingredients of the agency theory framework. The argument is that this reasoning implies that two main attributes are associated with outside board members. The first as Johanisson and Huse, (2000), argues is that the prospective board members are financially and psychologically independent of the executive management and will use the integrity to monitor the managers. The second is that the board, as a collective, has sufficient competencies to monitor management. From these arguments, it is
therefore assumed that family owned businesses that have a board are likely to have better performance than those without a board.

According to Charantimath (2006), effective governance in a family business system generates a sense of direction, values to live by or work by, and well understood and accepted policies that tell organization members how they should behave or what they should do in certain circumstances. Effective governance brings the right people together at the right time to discuss the right things. Good governance contributes three fundamental ingredients for a healthy family business system functioning. The clarity of roles, rights and responsibilities, secondly discipline to help members of the family and employees act responsibly and thirdly regulating appropriate family and owner inclusion in business.

Rwigema and Venter (2004) assert that the successful continuation of a family business is largely dependent on an understanding of the importance of a sound governance structure. The businesses that survive the succession to second generation have good governance structures within the business and the family. Hough et al. (2008), notes that governance is a task of leadership and direction within an organization, suitable risk management and control over its performance and the way in which its performance is released to shareholders and other stakeholders. Some of the benefits of business governance according to Hough et al. (2008) include; increase the value of the business, foster the spirit of the enterprise, to give confidence to the market, improves efficiency and improve competitive advantage among others.

Good governance influences individual’s attitudes towards business, responsibilities, leadership, honesty and integrity. This is likely to add to the success of a business by making leaders conscious of sound decision making in the best interests of the business, its shareholders and stakeholders (Hough et al. 2008). According to Rwigema & Venter (2004), the simplest and most common family governance structure is the family meetings. Poza et al. (1997), assert that family meetings, councils, retreats and assemblies are systematic communication forums; vital to a positive family culture as well as facilitating reinvestment in interpersonal as the family and business.

2.3 Theoretical Perspective
2.3.1 Agency Theory

Agency theory attempts to account for the inability of owners of the business to control their agents effectively (Fox & Hamilton, 1994). Agency theory is most often employed to explain divergent motivations in organizations. Rooted in the economic model of man, according to assumptions of agency theory, the interests of shareholders/principals and agents diverge as each wishes to maximize their own personal wealth and utility. The assumptions of agency theory suggest that agents exploited their access to superior information for personal gain. As argued in (Demsetz, 1988; Eisenhardt, 1989; Fama & Jensen, 1983) the information asymmetry and contradictory incentives between owners and agents demands the need to introduce governance initiatives to ensure clarity, accountability and transparency for stakeholders. According to Dyer (2006) agency benefits could contribute to high family business performance when there are lower agency costs due to the alignment of principal-agents goals or due to high trust and shared values among family members. Likewise, higher agency costs due to conflicting goals in the family or from opportunism, and adverse selection because of altruism (family members fail to monitor each other) could contribute to lower performance in the family business. According to Dicke and Ott (2002) and Wasserman (2006) agency theory has driven the development of system of external control with two complementary purposes to control agents and reduce agency costs.

Schleifer and Vishny (1997) argues that theoretically there were reasons to expect that firms where ownership is concentrated in the hands of a family were more efficient than other firms, the reason being that concentrated ownership gives the owners a particular incentive to monitor the managers, thus reducing agency cost connected to hired management. However, there were other reasons to believe that family-owned businesses may be less efficient than non-family businesses. According to Barth et al. (2005) concentrated of ownership implies a limited diversification of financial risk and a higher cost of capital due to higher risk premium. This makes family owners to be cautious when making new investment and reluctant to raise loans or invite new investors.

Some Scholars of agency theory such as Schulze et al. (2001) have found settings where assumptions of agency theory do not hold. The behavior of family members in family-owned firms is one such setting. In agency theory, Davis et al. (1997) observes that there is an assumption that both owners and their agents are individualistic, opportunistic, self – maximizing wealth seekers,
with divergent goals and interests. When the interests of the principal and the agent are aligned, according to Tosi et al. (2003) controlling agents is however, not a problem. Business performance is likely to improve when there is congruence between the principal and the agents. In family business, the owners who are the principal appoint other people to help in running of the business as agents. The two may have similar or divergent goals which are a major determinant of family business performance.

3.0 Research Methodology

This study used descriptive research design. This was found appropriate as it is undertaken to ascertain and describe the characteristics of variables of interest in a situation which this study sought to do. It is undertaken to understand the characteristics of organization that follows certain common practices (Sekeran and Roger, 2009). Target population consisted small and medium sized Food and Beverage family owned enterprises in Nairobi County. Because of non availability of family owned business data, the option available was to use a comprehensive list of those listed under a reputable Trade Association such as the Kenya Association of Manufacturers (KAM) Directory then make a preliminary survey to ascertain the family businesses according to operational definition of family business. This is a common trend among family business researchers facing unreliable database in many countries (Ventor, 2003). A total of 84 small and medium family owned enterprises were selected from a population of 146 according to KAM directory. The sample was selected using non-probability convenience sampling procedure which is generally used when researchers want swift and cost effective manner and to obtain a large number of completed questionnaire (Zikmundi, 2003). It is a process of acquiring sampling units who are most conveniently available. The process of the sampling took place over two stages to identify family business sampling frame from KAM Trade Directory, the second stage was to identify SME family business among the sampling frame. Survey was used using telephone calls and mailing to ascertain family business.

The study used both primary and secondary data. Secondary data included journal articles, books, periodicals, media reports and other publications. Primary data was collected from the CEOs and/or founders of the SME family business. The questionnaire used had open and closed items. Both validity and instrument reliability were tested and confirmed. This was done using experts
opinion, colleagues and pilot testing. Data was collected using self administered questionnaire and analyzed using descriptive and inferential statistics with strict adherence to ethical standards in planning and conducting the research.

4.0 Findings and Discussions

Governance Practices in the Family Business

The study sought to evaluate the influence of the family business governance practices on the performance of the business. The items included under this study are meant to bring clarity on the role of family governance practices in the small and medium family business in Nairobi County, Kenya. International Finance Corporation (IFC) family business handbook suggests that by adapting a sound corporate governance structures which clearly defines the roles, responsibilities, rights and interaction among the company’s main governing body many of the family business problems would be minimized.

The findings of the study reveal that 78% of the respondents had formal board of directors that was mandated in running of the family business while 22% lacked formal board. Good corporate governance however, is not having a board but that board must have regular meetings to deliberate on the wellbeing of the business. It was observed that a majority of the businesses with boards (up to 54%) held meetings regularly while 34% board meetings were not regular and 12% had no board meetings at all. It was observed that in the absence of the board, family businesses have an alternative body in the form of a family council that performs similar role as that of the board. An effective council just like the board according to Charantimath (2006) ensures clarity of roles, rights and responsibilities for all members of the family system and discipline through periodic family meetings. This system of governance was found to be more prevalent among the Kenyan of the Asian origin than among the Kenyan of African origin.

Extent to which respondents agreed with statements relating to Governance practices in the family business

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<tr>
<th>Statement</th>
<th>Mean</th>
<th>Stdev</th>
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<tr>
<td>The board of directors has effective meeting procedures (i.e. meeting agendas are distributed in advance).</td>
<td>3.6</td>
<td>0.3</td>
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The board of Directors is responsible to the vision, mission and strategic plan. 3.6 0.2
The governance responsibilities in this business are clearly defined. 4.0 0.3
There is a clear separation between the business and the family 3.5 0.1
The business provides equal access to information for shareholders. 4.4 .89
Family members in the business follow the same work rules as non-family members. 3.4 .82
The family has a forum for family members to discuss relationship between the family and the business. 3.6 .85
The business has a family charter describing rules that guide family members in the business. 4.1 .85
Our business considers family business governance as a positive part of the family and business 4.2 .93

In this section, the researcher sought to find out the extent to which the respondents agreed with various statements about family business governance practices in the family business. According to the findings, respondents agreed that the business provides equal access to information for shareholders as shown by a mean of 4.4 and a standard deviation of 0.89; that the business considers family business governance as a positive part of the family and business as shown by a mean of 4.2 and a standard deviation of 0.93; that the business has a family charter describing rules that guide family members in the business as shown by a mean of 4.1 and a standard deviation of 0.85; that the governance responsibilities in this business are clearly defined as shown by a mean of 4.0 and a standard deviation of 0.3; that the family has a forum for family members to discuss relationship between the family and the business as shown by a mean of 3.6 and a standard deviation of 0.85; that the board of Directors is responsible to the vision, mission and strategic plan as shown by a mean of 3.6 and a standard deviation of 0.2; that the board of directors has effective meeting procedures (i.e. meeting agendas are distributed in advance) as shown by a mean of 3.6 and a standard deviation of 0.3; that there is a clear separation between the business and the family as shown by a mean of 3.5 and a standard deviation of 0.1; and that family members in the business follow the same work rules as non-family members as shown by a mean of 3.4 and a standard deviation of 0.82.

The findings from the statements clearly indicate not only the existence of a board of directors or family councils but also an indication of good family governance practices among the respondents. Hough et al. (2008) points out that effective family governance practices have a number of benefits.
which among other include, increasing the value of the business, fostering the spirit of the enterprise, to give confidence in the market, improve the efficiency and improve the competitive advantage.

**Conclusions and Implications**

One of the indicators of the family business governance practices is the existence of a well performing board of directors and in the absence of a board, there is a family council that meets regularly to resolve family business issues and conflicts. The purpose of the governing bodies is to ensure separation of roles, responsibilities and to provide direction to the family business.

Although 78% of the family business had formal board, it’s only about 54% which held meeting regularly with 34% indicating that board meetings were not regular and 12% indicated that they have never held any meeting at all. The role and functions of the board and family council is to provide leadership, vision, determine the business purpose, monitor and evaluate the implementation of strategies, policies and management performance. The governing body also ensures there is an appropriate balance of power and authority on the board which is reflected by separation of the roles and responsibilities. The family business that have a well functioning governance structures were found to perform better in terms of sales, profitability and longevity than those that did not have good governance structures. Good governance influences good leadership, responsibilities, honesty and integrity hence guarding, monitoring and protecting the assets of the family business.

The study concluded that although the involvement of the family in the business may beneficial during the early years stages of the business, continued family involvement may not be beneficial as the business grows both in size and complexity. It is further observed that for the proper functioning of the family business in Kenya there should be clear separation of the family and business operation. The findings of this study contributes to the growing body of research on family business characteristics an area of growing research interest (Sharma, 2008) which a number of Scholars such Dyer (200) recommended further investigation in the area particularly as suggested by Astrachan and Shanker (2005) that different social-cultural setting is bound to influence family business characteristics and performance. The study has also established that
family characteristics and more so family business governance previously ignored as factor in SMEs performance is a great contributor to the performance of this important sector of the Kenyan economy.

Based on the findings of this study, it’s recommended that Small and Medium family business in Kenya should strengthen the family business governance practices. The mere presence of the Board of Directors or a Family Council is not adequate; mechanism must be put in place to make the governance practices functional and effective. There should also be a clear separation of the family and family business with well defined roles and responsibilities. It is also important to professionalize family business management for better performance.
References