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Relationship between Corporate Governance Practices and Agency Costs of Manufacturing and Allied Firms Listed in Nairobi Securities Exchange

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Abstract: *Despite the listed firms adopting corporate governance practices as issued by Capital Markets Authority and Nairobi Securities Exchange, some of the firms have continued to financially underperform compared to their peers while others have sought bailouts. This may be partly attributed to uncontrolled agency costs. Kenya's entities have had a history of poor governance systems with about 70% of the malpractices attributed to weak corporate governance practices, lack of internal controls and weakness in regulatory and supervisory systems as well as conflict of interest, which in turn increase agency cost. Correlational research design was adopted for this study. The target population consisted of manufacturing and allied firms listed at the NSE and a census of all the firms in this sector was the sample. This study used secondary data. Both descriptive and quantitative analyses were applied in the study. Pearson's correlation, multivariate linear regression and ANOVA analyses were used. The results of the study showed that there was significant positive relationship between the two of the independent variables (director ownership and ownership concentration) and agency cost whereas board composition and size of the board were found to have no significant relationship with agency cost. The independent variable, CEO duality had significant negative relationship with the agency cost. The overall model was tested using F-test at 5% level of significance. The results of the analysis indicated that all the independent variables had a significant combined effect (R^2= 0.424) on the agency cost. The findings of this study will contribute to the agency theory debate, expand frontier of knowledge in this area, is crucial to investors and other stakeholders in a firm as it will lead to a better understanding of how the corporate governance practices mitigate agency costs in a firm, as well as make up for paucity of scholarly papers in Kenya on corporate governance and agency costs. It is recommended that firms adopt and implement good corporate governance practices in order to reduce agency costs and thus improve performance, Capital Markets Authority and NSE to continue enforcing and encouraging firms to adhere to the guidelines on corporate governance practices and corporate entities should continue practicing good corporate governance practices to send a positive signal to potential investors*.
Key Words: *Agency Costs, Agency Theory, Corporate Governance, Manufacturing Firms*

I. Introduction

Agency cost is one of the most critical issues facing large corporations in the 21st century. As the corporations expand, separation of ownership and control widen. The shareholders hire managers to run the firm on their behalf. The managers ought to serve the interest of the shareholders by maximizing the value of the firm. The principal-agency relationship suggests that hired managers will have different objectives from that of the owners as they will use the firm's resources to satisfy their own demand (Oyejide & Soyibo, 2001). The shareholders have a big challenge in getting the managers to act in their interest because of the likelihood of the managers acting in their own interest. This is caused in part by the principal's inability to observe the agents actions and the existence of information asymmetries. Information asymmetries occur when there is a difference in the information processed by the two parties. Many are times managers tend to use the excess cash flow to fulfill their personal interest instead of increasing returns to the shareholders (Jensen & Ruback, 1983). Agency theory is concerned with aligning the interests of owners and managers (Jensen & Meckling, 1976; Fama, 1980; Fama & Jensen, 1983) and is based on the premise that there is an inherent conflict between the interest of a firm's owners and its management (Fama & Jensen, 1983).

Due to conflict of interest between the agents and the principals, corporate governance practices have been suggested in Kenyan companies. Corporate governance practices are mechanisms that protect the shareholders interest. Corporate governance provide incentives for the board and management to pursue the objectives which are in the best interest of the shareholders and provide the structure which monitor the relationship among the shareholders, board of directors, management and other stakeholders and leads the firms to control capital cost and transaction cost and encourage the firm to use the resources more efficiently. Corporate governance provides structures through which the corporation objectives are set; and the means of attaining these objectives and monitoring performance". This increases the reliability of firms' activities and management policies in favor of stakeholders' interest.

The clear indication for corporate governance from agency theory perspective is that adequate monitoring or control mechanism need to be established to protect shareholders from management's conflict of interest-the so-called agency costs of modern capitalism (Fama & Jensen, 1983). Corporate governance deals precisely with problems of conflict of interest, designs ways to prevent corporate misconduct and aligns the interests of stakeholders using incentives and monitoring mechanisms. Agency theory leads to normative recommendations that boards should have a majority of outsider and, ideally independent directors and that the position of chairman and CEO should be different persons (OECD, 1999). The ingredients of good corporate governance practices include the board size and composition, CEO/Chair duality role, board compensation, and so on, all of which have association with agency problems and agency costs.

In order for the principal to control the agent, agency costs are incurred. Jensen and Meckling (1976) defined agency costs as the sum of the monitoring expenditures by the principal, the bonding expenditures by the agent and the residual loss. Monitoring costs are expenditures paid by the principal to measure, observe and control the agents' behavior. These costs may include: audits; writing executive compensation contracts and ultimately the cost of hiring and firing top managers. Bonding costs refers to the structures that management ultimately sets up to compel them to act in shareholders' best interests and includes compensating shareholders in the event of failure to act as such. Residual loss refers to residual agency losses that arise from conflicts of interest after both monitoring and bonding measures have been effected (Baker & Anderson, 2010). According to Baker and Powell (2005) there are two types of agency costs, direct and indirect agency cost. Shareholder incur direct costs in order to reduce potential conflicts with managers (bonus, stock option plan, audit fees, managerial incentives and infrastructure) put in place to control the behavior of managers. Indirect agency cost is as a result of manager's failure to make profitable investment (free cash flow mismanagement, etc). The significance of agency cost is that it helps mitigate the effects of the agency problem. Baker and Powell (2005) defined agency problem as referring to the difficulties faced by financiers in ensuring that their funds are not expropriated or wasted on unattractive projects. With this framework, shareholders are assumed to derive purely financial benefits from ownership of their equity investments (Baker & Anderson, 2010).

This study was based on five hypotheses;

H_{01}: There is no significant positive relationship between director ownership and agency costs of manufacturing and allied firms listed at Nairobi Securities Exchange.

H_{02}: There is no significant positive relationship between composition of board of directors and agency costs of manufacturing and allied firms listed at Nairobi Securities Exchange.

H_{03}: There is no significant positive relationship between size of the board and agency costs of manufacturing and allied firms listed at Nairobi Securities Exchange.

H_{04}: There is no significant positive relationship between CEO duality and agency costs of manufacturing and allied firm listed at Nairobi Securities Exchange.

H_{05}: There is no significant positive relationship between ownership concentration and agency costs of manufacturing and allied firms listed at Nairobi Securities Exchange

II. Literature Review

Corporate governance deals precisely with problems of conflict of interest, designs ways to prevent corporate misconduct and aligns the interests of stakeholders using incentives and monitoring mechanisms. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, the managers, shareholders and other stakeholders and spells out the rules and procedures for making decisions on corporate affairs. Good corporate governance can occur in the organizations by putting the balance between the ownership and control and also among the interests of stakeholders of the firm.

It is an acknowledged fact that the principal-agent theory is generally considered a starting point for any debate on the issue of corporate governance emanating from the classical thesis on "the Modern Corporation and Private Property" (Berle & Means, 1932). According to this theory, the fundamental question is primarily due to the separation between ownership and control. Modern firms are seen to suffer from separation of ownership and control, therefore are run by professional managers who cannot be held accountable by dispersed shareholders. In this regard, the fundamental question is how to ensure that managers follow the interest of shareholders in order to reduce costs associated with agency problem. The owners are confronted with two main problems. Apart from facing an adverse selection problem in selecting the most capable managers, they are also confronted with a moral hazard problem. They must not only give agents the right incentives but also monitor them to make decision aligned with shareholders' interest. In further discussion of agency relationship and cost, Jensen and Meckling (1976) describe agency relationship as a contract under which "one or more persons (principal) engage another person (agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent". In this scenario, there exists a conflict of interests between managers and controlling shareholders leading to the tendency that the former may extract some perquisites" (perks) out firms' resources, shirk responsibility, be less interested to pursue new profitable ventures or engage in outright theft of resources.

Stakeholder theorists suggest that managers in organizations have a network of relationships to serve – this include the suppliers, employees and business partners. It is argued that this group of network is important to the owner – manager- employee relationship as in the agency theory. Stakeholder theory suggests that organizations will respond to the concerns and expectations of powerful stakeholders. The theory takes account of a wider group of constituents rather than focusing on shareholders. The developed financial markets follow the outsider system of corporate governance as the shareholdings are dispersed and capital allocation takes place in an efficient manner in these markets (Rashid, 2008). The regulatory authorities are efficient in monitoring the firm, as a market for corporate control exists. Furthermore, managers in these markets have sufficient power to discipline the firm and can play an important role in affecting the decisions of board of directors. The goal of management in these markets is to create a short-term improvement in the value for the shareholders (Wei, 2003). According to Bhagat and Jefferis and Gompers, Ishii and Metric (as cited in Rashid, 2008), the shareholders' votes, board of directors and independent Chief Executive Officer (CEO) play an important role in improving the value of a firm in developed markets. They further argue that shareholders can discipline the management to improve the value of their shareholdings. Similarly, the board and CEO can also safeguard the interest of the shareholders by creating more value for them.

In contrast, Rashid (2008) contends that shareholding is concentrated in developing financial markets and follows a hybrid system of corporate governance suggesting that the block holders play an important role in monitoring the activities of a firm in these financial markets. Pyramidal and cross-shareholding, illiquid capital markets and ineffective regulatory authority are also features of these markets. According to Rashid (2008), the regulatory and judicial framework in a developing market is ineffective in playing any role in improving the value of a firm. The agency cost among different players in the market is not handled properly and the firms in a developing market are not involved in value creation for the shareholders.

According to the Asian Development Bank, Dallas and Nam and Nam (as cited in Rashid, 2008), various instruments are used in financial markets to improve corporate governance and the value of a firm. Economic and financial theory suggests that the corporate governance practices affect the value of a firm in developing and developed financial markets. Corporate governance practices have their own role. One of their role is the shareholders votes. The shareholders vote plays an important role in improving the value of a firm and there is a positive relationship between the value of a firm and shareholders rights. Each shareholder has been delegated with a vote to play a role in the operations of a firm and can use their vote in removing and appointing the board of directors. They can make decisions about the compensation of employees in a firm and can also participate in financial decisions of a firm as argued by the World Bank and Dallas (as cited in Rashid, 2008). The shareholders enjoy the right to represent themselves on the board. They are also allowed to gain financial information from the officials of a firm such as analysts, board of directors and employees. The easy access to public and private information by the shareholders can reduce the information asymmetry between the shareholders and managers and results in improvement in the value of a firm (Asian Development Bank, 1996).

Unfortunately, the role of majority shareholders is negative in affecting the value of a firm in the developing market, as they do not allow the minority shareholders to participate in the affairs of these firms. Due to weak corporate law and market imperfections, the minority shareholders are disadvantaged in the developing financial market compared to the developed financial market as posited by Ahunwan, Nam and Nam (as cited in Rashid, 2008).

The role of auditor is important in implementing corporate governance principles and improving the value of a firm. The principles of corporate governance suggest that auditors should work independently and perform their duties with professional care. In case of any financial manipulation, the auditors are held accountable for their actions as the availability of transparent financial information reduces the information asymmetry and improves the value of a firm as argued by Bhagat and Jefferis (as cited in Rashid, 2008). However, in developing markets auditors do not improve the value of a firm. They manipulate the financial reports of the firms and serve the interests of the majority shareholders further disadvantaging the minority shareholders (Rashid, 2008). The weak corporate law and different accounting standards also deteriorate the performance of the auditors and create financial instability in the developing market.

The transparent and timely disclosure of financial policy (dividend and investment policy) is important for the value creation of shareholders. The management of a firm is responsible for spreading the information between majority and minority shareholders on an equal basis (Peirson et al., 2000; Damodaran, 2006). Furthermore, the infrastructure in a market plays an important role in affecting the efficiency of a market. The shareholders in the developing economies are disadvantaged, as they do not enjoy the availability of financial information on a timely basis because of the underdeveloped infrastructure. The advancement in communication systems can play an important role in decreasing the informational asymmetry and improving the value of a firm in a developing market (Pereiro, 2002; Ahunwan, 2003).

Theoretically, shareholders could play an active role in monitoring managers. However, given that the monitoring benefits for shareholders are proportionate to their equity stakes (Grossman & Hart, 1988), the shareholder with low proportion of ownership has little or no incentives to exert monitoring function. In general, the higher the amount of shares that investors hold, the stronger their incentives to monitor and, hence, protect their investment. Shareholders with numerous stakes have more incentives to supervise management and can do so more effectively (Shleifer &Vishny, 1986; Shleifer & Vishny, 1997; Friend & Lang, 1988). Additionally, large shareholders may also prevent the possibility of a takeover bid, it make managers to feel safer about their positions, hence corporate governance may help in the reduction of agency problems associated with managers (Shleifer & Vishny, 1986; Bukart, 1995). However, large shareholders may also harm the firm by causing conflicts between large and minority shareholders. In cases, when large shareholders gain nearly full control of a corporation, they are engaged in self-dealing expropriation procedures at the expense of minority shareholders (Shleifer & Vishny, 1997). When law does not effectively protect small shareholders and the diversity between cash and control rights of large shareholders is huge, any expropriation incentives are stronger (Grossman & Hart, 1986). Furthermore, the existence of concentrated holdings may decrease diversification, market liquidation and stock’s ability to grow and, therefore, may increase the incentives of large shareholders to expropriate firm’s resources. Several empirical studies provide evidence consistent with that view (Beiner et al., 2003).

According to Hanrahan, Ramsay and Stapledon (as cited in Rashid, 2008) the board of directors can play an important role in improving corporate governance and the value of a firm. The value of a firm is also improved when the board performs its fiduciary duties such as monitoring the activities of management and selecting the staff for a firm. The board can also appoint and monitor the performance of an independent auditor to improve the value of a firm. The board of directors can resolve internal conflicts and decrease the agency cost in a firm. The members of a board should also be accountable to the shareholders for their decisions as argued by Vance, Anderson and Anthony, Asian Development Bank, Nikomborirak and Tomasic, Pentony and Bottomley (Rashid, 2008). The board consists of two types of directors; outsider (independent) and insider directors. The majority of directors in a board should be independent to make rational decisions and create value for the shareholders. The role of independent directors is important to improve the value of a firm as they can monitor the firm and can force the managers to take unbiased decisions. The independent directors can also play a role of a referee and implement the principles of corporate governance that protect the rights of shareholders (Rashid, 2008).

Similarly, internal directors are also important in safeguarding the interests of shareholders. They provide the shareholders with important financial information, which will decrease the information asymmetry between managers and shareholders as argued by Rashid (2008). The board size should be chosen with the optimal combination of inside and outside directors for the value creation of the investors. The board of directors in the developing market is unlikely to improve the value of a firm, as the weak judiciary and regulatory authority in this market enables the directors to be involved in biased decision-making that serves the interests of the majority shareholders and the politicians providing a disadvantage to the firm (Asian Development Bank, 1997).

Gul et al. (2012) used a sample of 50 firms from Karachi stock exchange during the period 2003 to 2006 to examine the relationship between agency cost, corporate governance and ownership structure. Multivariate fixed effect regression was used to analyze the data. The results showed that higher director and institutional ownership reduces agency cost. Smaller sized boards also results in lowering agency cost. Board independence has a positive correlation with assets utilization ratio. The separation of the position of CEO and chairman and higher remuneration lower agency cost. The empirical results of Wang Junwei, Lu and He (2010) and Locke and Fauzi (2012) were in agreement with those Gul et al. (2012) that agency cost is proportional to the board composition. However, Kiel and Nicholson (2003), Bhattacharya and Rao (2005), Miring’u and Muoria (2011) and Aduda et al. (2013) found board composition is inversely related to agency cost.

Locke and Fauzi (2012) examined the relationship between board structure, ownership structure and firm performance: A study of New Zealand listed firms. They used a balanced panel of 79 New Zealand listed firms and employed a generalized linear model for robustness. At The results showed that board of directors, board committees and managerial ownership have a positive and significant impact on firm performance. The results also showed that non-executive directors on the board and institutional ownership lower firm performance. Using a sample of 30 respondents Miring'u and Muoria (2011) analyzed the effect of corporate governance on performance of commercial state corporations in Kenya. Their study sought to examine how corporate governance affects performance in commercial state corporations in Kenya. The study employed descriptive survey design. Data was analyzed through descriptive statistics and multiple regression technique. The findings revealed that the board size mean for the sample was found to be 10 while minimum of 3 outside directors is required on the board. In addition the study revealed that there is a positive relationship between return on equity and board size and board composition of all state corporations.

Board size plays an important role in affecting the value of a firm. The role of a board of directors is to discipline the CEO and the management of a firm so that the value of a firm can be improved. A larger board has a range of expertise to make better decisions for a firm as the CEO cannot dominate a bigger board because the collective strength of its members is higher and can resist the irrational decisions of a CEO as suggested by Pfeffer (1972) and Zahra and Pearce (1989). On the other hand, large boards affect the value of a firm in a negative fashion as there is an agency cost among the members of a bigger board. Similarly, small boards are more efficient in decision-making because there is less agency cost among the board members (Yermack, 1996). Using a sample of top 500 companies trading on Australian securities exchange limited in 1996 Kiel and Nicholson (2003) studied the relationship between board composition and corporate performance: how the Australian experience informs contrasting theories of corporate governance. The study revealed that there are three simple correlations between board demographics and firm's performance, namely proportion of outside directors, CEO duality and number of interlocks.

Kamyabi, Majbouri and Ashae (2014), examined the impact of corporate governance and ownership structure on agency cost in listed companies of Tehran stock exchange. Data from 723 firms during the years of 2010- 2012 is used. A multivariate regression index with constant effect is used to analyze data. The results reveal that there is a negative and significant relationship between agency cost with managerial ownership and the size of the board. Furthermore, there is no significant relationship between agency cost and CEO duality. These findings are in conflict with those of Ibrahim and Samad (n. d.) and Gill, et al. (2012). Ibrahim and Samad (n. d.), examined the relationship between corporate governance and agency cost of family and non-family ownership of public listed companies in Malaysia. They did a longitudinal study of the 290 publicly listed companies in the Main Board of the Bursa Malaysia over the period 1999 to 2005. The results showed that larger board size has a significant effect as a device in mitigating agency cost. In addition, independent directors in family ownership do not influence agency cost, CEO duality in family ownership reduces agency cost but non-family ownership experience high agency cost when duality exists on the board. Gill, et al. (2012) examined the relationship between corporate governance and the investment decision of small business firms in India. This study utilized survey research (a non-experimental field study design). 800 respondents from Punjab area in India were surveyed. Descriptive statistics, correlation and regression analysis were used to analyze data. Overall results showed that the CEO duality, board size, total assets of the firm, and the small business perform positively impact on the investment decisions of the small business firms in India.

Bhattacharya and Rao (2005) studied the role of foreign institutional investors in reducing agency costs. A total of 76 companies were studied. They used 3 years data from 2001-2003. Multiple regression analysis was used to analyze the data. Results showed that operating cost, a proxy for agency cost, is negatively correlated to foreign institutional investors and the proportion of independent directors. They also found that the operating cost is positively correlated to the board size. Foreign institutional investors and proportion of independent directors are negatively correlated to the agency cost. These research findings are inconsistent with those of Nahandi, Hasanzadeh and Sharifizadeh (2012) who examined the effect of ownership structure of corporate governance on agency cost. They used a causal- post-eventual research design to study a sample of 124 companies listed in Tehran stock exchange during the years 1982-1989. Their findings revealed that the percentage of state ownership has no effect on agency cost, percentage of director ownership and institutional ownership has no effect on agency cost. Locke and Fauzi (2012) also found that institutional ownership reduces performance and thus does not reduce agency cost. However, the results of Miguny, Zanjirdar and Gasemy (2013) and Gul et al. (2012) are concordant with those of Bhattacharya, et al (2005).

Miguny, Zanjirdar and Gasemy (2013) examined the relationship between agency cost and institutional ownership of firms accepted in Tehran stock exchange. Four criteria of economic added value, return of owner' equity, net income and ratio of price to earnings per share were used as proxy for agency cost. The results of studying 111 firms in the same period during the years between 2006 and 2011showed that there is a direct relationship between owners' equity and the ratio of price to earnings per share in firms with institutional ownership and there exists a reverse relationship between net earnings and agency costs in firms with institutional ownership.

Wang Junwei, Lu and He (2010) studied the relationship between agency cost and governance mechanisms: Evidence from China's A-Share listed companies. Their study was based on the panel data from 2006 to 2009 and they employed four proxies for agency cost: asset turnover ratio, sales and management expense ratio, free cash flows and asset liquidity ratio to examine the level of agency cost inherent in China's A-share listed companies and evaluate governance and ownership attributes that are hypothesized as mitigating agency cost and occurrence applying fixed effects regression analysis method. The results indicate a significantly positive relationship between free cash flows and board characteristics. The relations between the other three variables of agency cost and board characteristics are not significant. Board size, the proportion of independent directors and duality of chairman and general manager are indistinctively correlated with asset turnover ratio, sales and management expense ratio and free cash flows. The results also indicate there is no significant relationship between the four dependent variables used as proxy for the extent of agency cost and managerial ownership. This contradicts the findings of Ang et al. (2000) who found that agency costs are inversely related to the managers' ownership share. The sum of stakes of the top ten shareholders is positively correlated with sales and management expense ratio. The relationship between the sum of the stakes of the top ten shareholders and the three variables of agency cost are not significant.

Managers can play an important role in improving the value of a firm. They can reduce the agency cost in a firm by decreasing the information asymmetry, which results in improving the value of a firm (Monks & Minow, 2001). Managers in the developed market create agency cost by under and over investment of the free cash flow. Shareholders are disadvantaged in this case as they pay more residual, bonding and monitoring costs in these firms.

Managers in developing financial markets generally play a negative role in the value creation of investors. The rights of the minority shareholders are suppressed and the firms in these markets cannot produce real value for shareholders as actions of the managers mostly favour the majority shareholders. The management and the shareholders in a developing market do not use the tools of hostile takeover and incentives to control the actions of managers. In the case of a hostile takeover, the managers are forced to perform well to be able to hold their jobs. Bhagat and Jefferis (as cited in Rashid, 2008) posit that appreciation and bonuses can motivate managers to produce value for shareholders. The ownership of the management in a firm has an important bearing on its value (Morck, Shleifer & Vishny, 1988). Also, firms can improve their value in developing markets by streamlining the interests of managers with those of the shareholders. This results in the convergence of the goals of shareholders and managers ultimately improving the value of the shareholders as suggested by Mehran (1995).

Using a sample of 1708 small corporations Ang, Rebel, Cole and Lin (2000) studied the relationship between agency cost and ownership structure. They found that agency costs are significantly higher when an outsider rather than an insider manager manages the firm, are inversely related to the managers' ownership share and increase with the number of non-managers shareholders and to a lesser extent, are lower with greater banks monitoring. These findings are in conformity with those of Kamyabi, Majbouri and Ashae (2014), Gul et al. (2012), Locke and Fauzi (2012), and Mcknight and Weir (2009) but contrary to those of Wang Junwei, Lu and He (2010) Nahandi, Hasanzadeh and Sharifizadeh (2012) who found that director ownership has no effect on agency cost.

Mcknight and Weir (2009) studied the relationship between agency costs, corporate governance mechanism and ownership structure: a panel data analysis. This study examined the impact of governance and ownership variables on agency cost for a panel of large UK quoted companies. A range of techniques were used to analyze data: fixed effects, instrumental variables and Tobit Cadbury period have not generally affected agency costs. They also found that having a nomination committee increases agency cost. Increasing board ownership structure also helps to reduce agency cost. They also found that debt reduces agency cost. Similar to the other corporate governance practices; CEO duality plays an important role in affecting the value of a firm. A single person holding both the Chairman and CEO role improves the value of a firm as the agency cost between the two is eliminated (Alexander, Fennell & Halpern, 1993). On the negative side, CEO duality lead to worse performance as the board cannot remove an underperforming CEO and can create an agency cost if the CEO pursues his own interest at the cost of the shareholders (White & Ingrassia, 1992).

Zhao, Yang, (2011) examined the relationship between CEO duality, competition and firm's performance. A sample of 1927 unique firms from 1979 to 1998 was used in this study. Using an exogenous shock that increased competition, they found that duality firms outperform non-duality firms by 3% when competition intensifies. The positive effect of having a dual leadership structure is larger when firms face higher informational costs. These findings are supported by Kiel and Nicholson (2003) and Gill et al. (2012). However, these empirical results are contradicted by those of Wang Junwei, Lu and He (2010), Gul et al. (2012) who found that separation of CEO and chairman of the board positions reduces agency cost. Vintilla (2013) studied duality and corporate governance of companies listed in Bucharest stock exchange. Results based on data collected from the annual reports in 2010, indicate that CEO duality is negatively associated with board's independence and board size. The results show a positive and significant relationship between leverage and CEO duality. The study fails to indicate how duality or corporate governance impact on agency cost. Wellalage and Locke (n. d.) examined agency cost, ownership structure and corporate governance mechanisms: a case study in New Zealand unlisted small companies. This study investigated the linkage between agency cost, ownership structure and corporate governance in small business. Eleven years of data for 100 unlisted small businesses were collected and 1099 observations were analyzed using dynamic panel GMM estimation. The results indicate that ownership structure has the most significant governance effect and also has the largest impact on corporate governance. Agency cost varies with leverage and the size of the business. The study does not reveal how agency costs vary with corporate governance.

Aduda et al. (2013) carried an empirical test of competing corporate governance theories on the performance of firms listed at the Nairobi Securities Exchange. This study investigated significance of the board composition variables of size of the board, proportion of outside directors, and the role of CEO on firm's performance. This study found that the overall regression model for firm performance for both return on assets and Tobin Q ratio are significant. The study also found that the significance of the individual variables in the overall specific models have differing significance variables on the basis of the measure of performance selected. Yinusa and Babalola (2012) examined the impact of corporate governance on capital structure decision of Nigerian firms and none of the corporate governance variables significantly affected the capital structure of the companies, the board size, profitability of the company and firm size were negatively related while the board composition, institutional holdings and management holdings were positively related to the leverage position (capital Structure) of Nigerian companies. Empirical finance literature indicates that managers are generally reluctant to lose control over firm's cash. Managerial compensation, power, and status are frequently related to firm size. Therefore, managers may find it advantageous to ''grow the firm'' beyond the size that maximizes shareholder value. Even more important, managers may seek to ensure that the firm survives as an entity, especially if it is in a declining industry. Cash dividends, therefore, are a way of removing free cash flow from managerial control in firms that face limited investment opportunities. According to Cheung et al. (2008), Ben-Amar and Ameur (2006), and Khanchel (2007) found that firm size has a positive influence on the corporate governance quality. Firm size is an attribute that indicates the amount of corporate companies. Firm size in this study is measured by the natural logarithm of the book value of total assets value as used by (Ben-Amar & Ameur, 2006).

Raffournier (1995) suggested that big companies give more information than small firms. First, the detailed information for large firms is relatively cheaper because they are already providing this information for internal purposes. Second, the annual report is the main source of information for competitors. Small companies are reluctant to provide more detailed information about the activities of the company because it considers only will lead to competitive disadvantage. Third, large firms are more sensitive to political costs that will provide more information to eliminate public criticism or government intervention. This study further finds that larger companies encourage companies to implement better corporate governance, and better corporate governance quality to enhance shareholder value. The results of each variable, from the five of firm characteristics only firm size affects the governance quality, and four other variables such as firm age, profitability, leverage and firm growth does not affect the corporate governance quality. These findings indicate that companies are motivated to implement good corporate governance is not caused by the amount of profit earned, the old establishment of the company, or a small amount of debt, but more due to the small size of the company. The larger company has obligation to implement better corporate governance. The larger company will be more motivated to implement corporate governance much better than smaller one

Corporate governance is ultimately concerned with the decision making process, procedures, and attitudes that assist a business in achieving its objectives. Consequently, as the firm seeks to improve the professionalism and sustainability of its activities, it needs to give greater thought to issues of governance. Agrawal and Gort (1996, 2002) explain mature firms have more knowledge, more abilities and more skills. Mature firms acquire more knowledge and skills through their day to day activities and hire and train human capital. However, maturity can have adverse effects on firm financial performance. The main disadvantages are the organizational rigidities and inertia that maturity can bring (Loderer & Waelchli, 2010). Tripasa and Gavetti (2000) posit mature firms will reduce flexibility of management adaptations and are reluctant to change. The behavioral aspects, such as seniority rules, rules of conduct and rigid hierarchy, also lessen performance in mature firms. According to Loderer and Waelchli (2010), one of the more prominent aging effects in high-tech firms is that they are more exposed to competitive threats. Old machinery and equipment and declining market share and market growth all lead to a decrease in productive efficiency and profitability compared with younger firms in a similar industry.

From the foregoing empirical review it can be concluded that many researchers have examined the relationship between variety of corporate governance practices and agency costs. However, their findings are mixed. Some examine only the impact of one governance mechanism on agency costs or performance. Furthermore most of the studies have been done in developed markets or emerging markets. Hence the robustness of their results has not been adequately tested in developing countries like Kenya. Therefore this study sought to fill this literature gap since none of them covers the relationship among director ownership, board composition, board size, CEO-duality and ownership concentration and agency cost specifically of the manufacturing and allied firms listed at NSE.

III. Methodology

This study adopted a correlational research design. Panel data was collected, which all manufacturing and allied companies' year observations of six years over the period 2009-2014 were obtained. All manufacturing and construction firms listed in Nairobi Securities Exchange were studied. The data collected was from audited published financial statements from Nairobi Security Exchange and Capital Market Authorities libraries.

Data collected was analyzed using SPSS software and two levels of analysis were used; descriptive and quantitative data analysis. Descriptive data analysis was the first step and showed the maximum, minimum, the mean and standard deviation of each variable. Quantitative data analysis level followed that involved; correlation, linear regression and ANOVA analysis. Pearson's correlation was used to measure the degree and direction of association between different variables under consideration. Linear regression was used to estimate the causal relationship between agency cost and other chosen independent variables and finally, the ANOVA analysis was used to test the hypothesis of the study.

IV. Results And Discussion

The study attempts to examine the relationship between corporate governance practices and agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange during the period 2009 to 2014. The proxy selling, general and administration expense ratio was used to measure agency cost. Multivariate linear regression was used to analyze the data. Explanatory variables consisted of board size, board composition, director ownership, ownership concentration and CEO duality. Results indicate that out of a minimum of four and the maximum thirteen, the mean size of the board of the manufacturing and allied firms is 8.64. The mean suggests that on average manufacturing and allied firms have board membership of about eight directors. However, a standard deviation of 2.65 suggests that while some firms have relatively large boards others have smaller boards. With composition of the board, an average of 72.6 percent is non-executive directors. Thus the boards were considered to be independent because they had a higher proportion of outsiders. CEO duality has a mean value of .143 which means that sample firms where the CEO is also the chairperson of the board is less than 14.3%, the number of shares held by directors and institutions is 8.09% and 65.72% respectively of the total equity capital. This implies that corporate governance practices are not adopted in a homogenous manner across these firms.

Further the results showed there was a positive and significant relationship between director ownership and agency cost. These results led to rejection of the null hypothesis that there is no significant relationship between director ownership and agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. The findings also indicated that there was a positive though not significant relationship between size of the board and agency cost. These findings led failure to reject the null hypothesis that there was no significant between size of the board and agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. The results also revealed that there was a negative but not significant relationship between board composition and agency cost. These results led to failure to reject the null hypothesis that there was no significant between board composition and agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. Further the findings showed that there was a negative but not significant relationship between CEO duality and agency cost. These findings led to failure to reject the null hypothesis that there was no positive significant relationship between CEO duality and agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange.

The results also indicated that there was a positive and significant relationship between ownership concentration and agency cost. These results led to rejection of the null hypothesis and acceptance of the alternative hypothesis that there was a significant relationship between ownership concentration and agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange The study found that there was a strong combined effect of the study independent variables (Board size, board composition, director ownership, ownership concentration and CEO duality) on agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. The effect was further found to be statistically significant. The results showed that not all the explanatory variables (board size, board composition, director ownership, ownership concentration and CEO duality) made significant contribution in explaining the explained variable (agency cost). It was revealed that only CEO duality, director ownership and ownership concentration had a significant relationship with agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. Board size and board composition did not contribute significantly to agency cost.

The study also found that the firms agency cost overall model is significant which means that the independent variables of board composition, size of the board, CEO duality, director ownership and ownership concentration are important predictors of firm agency cost. However, when the relationship of the individual independent variable with agency cost is considered only director ownership and ownership concentration have significant relationship. It is also worthy to note that the explanatory power of the model was almost average (42.4%) meaning that there are other important factors that affect agency cost in manufacturing and allied firms listed at Nairobi Securities Exchange that were not captured by the model.

V. Conclusions and Recommendations

It can be concluded that there exists a positive and significant relationship between director ownership and agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. Director ownership was significant in explaining the agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. This implied that agency costs of manufacturing and allied firms listed at Nairobi Securities Exchange can be reduced by reducing director ownership of these firms. Further it can also be concluded that there exists a positive though not significant relationship between board size and agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. Board size was not significant in explaining the agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. This implied that agency costs of these firms cannot be mitigated by a change in size of the board. It can also be concluded that there exists a positive and significant relationship between institutional ownership and agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. Institutional ownership was significant in explaining the agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. From the findings of this study, it can be concluded that there exists a positive and significant relationship between CEO duality and agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. CEO duality was significant in explaining the agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. Further it can also be concluded that there exists a positive though not significant relationship between board composition and agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange. Board composition was not significant in explaining the agency cost of manufacturing and allied firms listed at Nairobi Securities Exchange

From the results of this empirical study, it can be concluded that the firm agency cost model was significant in capturing the variables that explain agency cost, institutional ownership was the most useful predictor of agency cost and CEO duality was the least. Although director ownership and institutional ownership had positive statistical significance with agency cost, this was in contrast with the predictions of this study. The relationship between CEO duality, size of the board and agency cost were found not to be statistically significant, yet, another contradiction to hypotheses of this study. It is recommended that firms should adopt and implement good corporate governance practices in order to have higher advantage of reducing agency cost and increasing performance. Furthermore, this will ensure that interests of the firms are served and there is easier access to funding from investors. Secondly, Capital Market Authorities and Nairobi Securities Exchange as the regulatory authorities to continue enforcing and encouraging firms to adhere to the guidelines on corporate governance practices. This can be ensured through enacting more rules and regulations thus ensuring that firms maintain confidence in shareholders and other stakeholders. This study recommends that corporate entities should continue practicing good corporate governance practices to send a positive signal to potential investors.

A related study could also be carried out to include more years of data in order to extend the study and add some control variables like leverage, growth, risk and size of the firm to investigate their role in mitigating agency cost. Furthermore, those who want to study the impact of governance practices and agency cost in the future need to cover the other sectors of the economy including financial sectors, which will not only extend this study but also the results will become more robust. In addition, further inquiry may be done into why the corporate governance practices exhibited the specified relationships and coefficient magnitude against agency cost. Finally, an investigation may be done to establish the key factors that constitute the residuals in this study.

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