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FIRM-LEVEL INSTITUTIONS AND PERFORMANCE OF COMPANIES LISTED ON THE NAIROBI SECURITIES EXCHANGE, KENYA

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Abstract

The objective of the study was to determine the effect of firm-level institutions on the performance of companies listed on the Nairobi Securities Exchange (NSE) and a corresponding hypothesis was formulated and tested. The study targeted Human Resource managers of each of the 64 companies listed on the NSE as at 31 December, 2014 and 34 of them responded. The study adopted the positivist research philosophy and a descriptive survey design. SPSS Version 21 was used to analyze data using simple regression analysis. Research findings from the test of hypothesis established that firm-level institutions have a positive and significant effect on company performance. The study findings support the Resource - Based

View (RBV) which underscores the crucial role of firm-level institutions in company performance. The study recommends further research in non-governmental organizations and small and medium size enterprises using more firm-level institutions.

Keywords: Firm-Level Institutions, Company Performance, Nairobi Securities Exchange, Regression analysis, Resource Based View

INTRODUCTION

Firm-level institutions constitute the internal organizational environment which defines the context in which strategic decisions are made and implement(Machuki, Leting' & Aosa, 2012) whereas organizational performance refers to a set of financial and non-financial measures which offer information on the extent to which organizational goals and objectives have been accomplished (Lebans & Euske, 2006). Firm-level institutions influence organizational performance (Higgins, 2005). Therefore, organizations should align all their firm-level institutions to enhance their performance (Higgins, 2005). The eight "S"s model (Higgins, 2005) for strategy execution and the RBV (Barney, 1991) explain the alignment of firm-level institutions and their effects on organizational performance. The RBV focuses on the internal capabilities of the firm in crafting strategies to achieve a sustainable competitive advantage. Therefore, an organization's resources and competencies are determinants of its performance. Most of the empirical studies have examined the effect of a single firm-level institution using performance indicators such as profitability, sales volume, market share, organizational citizenship behavior and employee attitudes (Gordon & DiTomaso, 1992; MacKenzie, Podsakoff & Rice, 2001; Csaszar, 2012). The current study has determined the collective effect of several firm-level institutions on the performance of companies in different sectors in Kenya.

Firm-Level Institutions

Firm-level institutions comprise of systems, leadership style, procedures, structure, internal controls, policies, culture and financial resources (Machuki *et al*., 2012). This study adopted organizational culture, leadership style, organizational policies, organizational procedures and organizational structure as firm-level institutions. The choice of firm - level institutions is informed by the eight "S"s model for strategy execution as developed by Higgins (2005). This model enables companies to align firm-level institutions with each new strategy that arises for that strategy to succeed, in order for strategic performance to occur. The selected firm-level institutions play a crucial role in organizational performance.

Organizational culture has been adopted as a firm-level institution because a company's culture influences everything that a company does and is the central driver of superior business performance (Gallagher & Brown, 2008). According to Tichy (1982:13), "culture is the glue that holds an organization together". The current study has adopted the operationalization of culture by the Human Factor International (2011) whose indicators of culture were individual performance, leadership, customer focus, organization structure, communication, conflict management, human resource management, participation, innovation, decision making, professionalism, organizational goal integration and fun.

Leadership is one of the critical elements in enhancing company performance and the main cause of competitive advantage for any kind of organization (Zhu, Chew & Spangler, 2005). Organizational policies and procedures provide the framework within which an organization operates, defining what they do and how they do it (Dale, 2007). According to Miller, Walker and Drummond (2002), leadership style is the archetype of relations between leaders and subordinates. McGuire (2005) explored basic leadership styles of different managers and came up with charismatic, persuasive, consultative, transactional, transformational and delegating managerial leadership styles. Contemporary literature on leadership mainly focuses on transactional and transformational leadership, hence the choice for this study. As defined by Burns (1978), transformational leadership is a process in which leaders and followers help each other to advance to a higher level of morale and motivation. Transformational leadership has also been defined as the process in which the leaders are able to move the organization toward the ideal standpoint by coordinating the employees and integrating all system components (Cacioppe, 2000).

Transformational leadership comprises four factors: idealized influence, inspirational motivation, intellectual stimulation and individualized consideration. Idealized influence is generally defined with respect to follower reactions to the leader as well as the leader's behavior. Inspirational motivation occurs when leaders provide symbols and simplified emotional appeals to increase awareness and understanding of commonly desired goals. Intellectual stimulation involves encouraging followers to question their old ways of doing things whereas individualized consideration is seen when followers are treated differently but equitably on a one-to-one basis (Bass, 1998). Transformational leaders build strong leaders on teams that are motivated, focused and highly effective in setting and implementing powerful goals, working within the framework of idealized influence, inspirational motivation, intellectual stimulation and individualized consideration (Ballou, 2012).

Transactional leadership focuses on the exchanges that occur between leaders and followers (Bass 1985; Burns, 1978). In this leadership, leaders lead primarily by using social exchanges for transactions (Robbins, Judge & Sanghi, 2007). These exchanges allow leaders to accomplish their performance objectives, complete required tasks, maintain the current organizational situation, motivate followers through contractual agreement, direct behavior of followers toward achievement of established goals, emphasize extrinsic rewards, avoid unnecessary risks, and focus on improved organizational efficiency. Transactional leadership has two fundamental dimensions: contingent reward and management-by-exception. Contingent reward implies that the leader and follower have a reciprocal understanding of the rewards or sanctions for performance or non-performance. The emphasis of contingent reward is on completing tasks that have been agreed upon based on previous expectations. In effect, the leader relies heavily on using contingent positive and negative reinforcement (Bass, 1985). In management-by-exception, the leader takes action only when major deviations from plans are evident (Bass, 1985). Transactional leadership allows followers to fulfill their own self-interest, minimize workplace anxiety and concentrate on clear organizational objectives such as increased quality, customer service, reduced costs and increased production (Sadeghi & Pihie, 2012).

Organizations have different policies which give guidelines on how things are done. Policies refers to principles established for leading a company, a general course of action in which some practices are developed collectively, in a constructive way, aiming to reach certain objectives (Singar & Ramsden, 1972). Organizational policies prescribe the acceptable methods or behaviors and identify the attitude, expectations and values of the organization concerning how individuals are treated as well as serve as point of reference for the development of organizational practices and for decisions made by people (Armstrong, 2009). When a policy is identified, procedures are written to describe how it will be applied. Procedures are a set of written instructions that describe the recommended steps for a particular policy (Edwards, 2008). They explain how to apply rules and regulations and define the course of action arising from the policy decision. Organizational structure is about the way people are grouped and how their work is coordinated and controlled (Wang, 2005). It also refers to formal design between individuals and groups regarding the allocation of tasks, responsibilities and authority within the organization (Greenberg, 2011).

Company Performance

Researchers have measured organizational performance using market share, sales, export proportions and growth rates in domestic and export sales growth, market share and return on

investment (ROI), return on assets (ROA), return on equity (ROE), profit before tax, sales growth, profit, sales volume, cash flow and the Balanced scorecard (Anwar et al., 2012; Kaplan & Norton, 1992; Li, 2000; Nguyen, 2008). The present study adopted the Balanced Scorecard methodology because it focuses on all functional areas in the organization, which include the customer, learning and growth, internal business processes, finance and the environment (Anwar, Djakfar & Abdulhafidha, 2012). It is a an appropriate measurement tool since it balances between financial and non-financial performance measures, lagging and leading indicators and internal and external perspectives of performance measurement (Abu-Jarad Yusof & Nikbin, 2010).

Companies Listed on the Nairobi Securities Exchange

The Nairobi Securities Exchange, formerly known as Nairobi Stock Exchange until July 2011, was formally recognized in 1954 by the London Stock Exchange as an overseas stock exchange (Nairobi Stock Exchange, 1996). It has grown to become a major financial institution. It is at present the fourth largest trading volume across the African continent and plays an important role in the growth of Kenya's economy (Olweny & Kimani, 2011). There were 64 firms listed on the NSE as at 31 December 2014 (*NSE Handbook*, 2014). Since these represent key sectors of the economy, which include Agriculture, Commercial, and Services Sector, Financial, and Investment sector and Development industry and Allied sector, NSE was the target for the study. The choice of listed firms for the study is further justified by the requirements for listing which include among others, that for a company to be listed, it must be a company limited by shares and registered under the Company Act (Cap. 486) as a public limited company and to publish audited financial statements regularly in compliance with international financial reporting standards at the end of each accounting period (The Company Act,2015). For the purpose of compliance, the listed firms issue their audited financial statements, which this study used to measure their financial performance (2012-2014).

The group of companies listed on the NSE was considered appropriate for the study because various stakeholders expect them to perform and for them to perform satisfactorily, they would need to align their firm-level institutions. The shareholders hold these firms accountable and expect them to facilitate generation of fair profits. The Government of Kenya aims to achieve and sustain an annual growth rate of 10% for it to realize the Kenya Vision 2030 (GOK, 2007) and therefore expects the NSE to play its role as a robust securities market. The Nairobi Securities Exchange, on its part, expects the listed companies to perform and meet the expectations of the stakeholders by enhancing their efficiency and competitiveness.To address

the expectations of stakeholders; managers of the listed companies should be competent enough to achieve organizational goals.

Firm-Level Institutions and Company Performance

Firm-level institutions play a significant role in sustaining corporate performance Barney (1991). Companies should therefore make proper use of their firm-level institutions to enhance their performance. Organizational culture provides sustainable aggressive advantage (Barney, 1991). Barney established that for culture to lead to superior organizational performance and create competitive advantage, it must be rare, have attributes and be imperfectly imitable. As established by a study conducted by Gordon and DiTomaso (1992), there is a positive link between culture and firm performance. Culture was found to be significantly related to profitability, sales volume and market share (Ezirim, Nwibere & Emecheta, 2010). Mackenzie, Podsakoff and Rich, (2001) found a relationship between transformational leadership and organizational performance. Obiwuru, Okwu, Akpa and Nwankwere (2011) conducted a study on effects of leadership style on organizational performance using selected small scale enterprises in Ikosi-Ketu Council Development Area of Lagos State, Nigeria and found that transformational leadership style had positive but insignificant effect on performance. Kim and Lee (2012) found evidence that HRM policies and practices improve strategic capabilities and firm performance in management consultant firms in South Korea.

Organizational structure affects organizational performance. North (1990) suggests that organizational structures become institutionalized over time and these have an effect on performance. A study carried out on the NSE established that structures had no statistically significant individual effect on profit before tax, new product introduction, market share and product/service quality (Machuki *et al*., 2012). As stated by Quangyen and Yezhuang (2013), organization structure decreases employee ambiguity and helps explain and predict behavior. Csaszar (2012) found a significant relationship between structure and organizational performance. Organizational procedures were found not to have a statistical significant effect on organizational performance (Machuki *et al*., 2012). In the same study, organizational procedures were positively related to market share but negatively related to operational efficiency, product/service quality and profit before tax. Organizational structures were found to be positively related to operational efficiency, new product introduction and sales volume and negatively related to product/service quality, ROI, market share and earnings per share. For the purpose of this study, the following hypothesis was formulated: Firm-level institutions have a positive and significant effect on the performance of companies listed on the Nairobi Securities Exchange.

METHODOLOGY

The study adopted a positivist philosophical tradition and a cross-sectional descriptive survey of all the 64 companies listed on the NSE as at 31 December, 2014. Primary data was collected from human resource managers or equivalent persons. Secondary data on financial performance (ROA) of companies listed on the NSE was extracted from the audited accounts for a three year period (2012-2014). The validation of the data collection instrument was achieved through validity and reliability tests.

Professionals in human resource management censured content validity because the focus of the study is in the area of HRM. Through researcher's own judgement, face validity was confirmed by checking the coverage of all the areas of investigation in the questionnaire and by adopting already tested instruments used by similar studies. This was used to complement the validity tests done by previous studies from which the research instruments were adapted. Construct validity was ensured through the operationalization of variables. The computed Cronbach Alpha coefficient values are shown in Table 1.

Table 1: Reliability Statistics

	Cronbach alpha for each Variable
Organizational Culture	0.765
Leadership Style	0.762
Organizational Policies	0.766
Organizational Procedures	0.776
Organizational Structure	0.760
Company Performance	0.932
Overall	0.822

The Cronbach Alpha coefficients were above 0.70, the minimum level for acceptable reliability (Nunnally & Bernstein, 1994). Thus, the data was reliable for analysis.

ANALYSIS AND FINDINGS

The study used both descriptive and inferential statistics to analyze data from the questionnaires and from the published audited accounts. Simple linear regression analysis was used to establish and test the predicted relationship between the independent variable and the dependent variable. The value of R-squared shows the amount of variation in the dependent variable caused by the independent variable. The beta values show the amount of change in the dependent variable attributable to the amount of change in the predictor variable. The F-

statistics measure the goodness of fit of the model. The statistical significance of the hypothesized relationship was interpreted based on R^2, F, t, β and p values. The regression model used was: $\mathbf{Y= \beta_0+ \beta_1 X_1+\epsilon}$, where Y= Company performance; $\beta_{0=}$ Intercept; β1=Coefficients; X_1 =Firm-level institutions and **ϵ=**Error term.

Study Response Rate

The target population of the study was 64 companies listed on the NSE as at 31 December, 2014. These companies form the unit of analysis for the study as each company has a unique set of firm-level institutions. Out of the 64 questionnaires issued to HR. Managers or equivalent officers, a total of 34 were filled and returned in a form usable for analysis, constituting a response rate of 53.1 %.

Table 2. Response Rate

Items	Frequency	Percentage
Filled and returned	34	53.1
Not returned	30	46.9
Total	64	100

As indicated in Table 2, the response rate was 53.1 %. The study response rate of 53.1 % was considered adequate for purposes of data analysis. In keeping with Bryman and Bell (2007), a response rate of 50 % or more is considered adequate.

Profile of Companies

The 34 companies that were surveyed represent the major sectors of Kenya's economy. Frequencies and percentages were used to examine the distribution of companies listed on the Nairobi Securities Exchange. Table 3 shows how the companies that responded to the study questionnaire are distributed per sector.

Table 3: Distribution per Sector

Sector	Frequency	Percentage
Agricultural	2	5.9
Commercial & Services	4	11.8
Automobiles & Accessories	2	5.9
Banking	11	32.3
Insurance	2	5.9

Table 3...

Manufacturing & Allied	6	17.7
Construction & Allied	3	8.8
Energy & Petroleum	2	5.9
Growth Enterprise Market Segment	1	2.9
Investment	1	2.9
Total	34	100

The findings in Table 3 indicate that out of the 34 companies that participated in the study, 32.3 % were in the banking sector; 17.7 % in the manufacturing and allied; 8.8% in the construction and allied; 11.8 % in commercial & services; 5.9 % in Agriculture, insurance and energy and petroleum; 2.9 % in growth enterprise market segment and investment. The majority of the companies that responded to the questionnaire were in the banking sector (32.3%) and manufacturing and allied (17.7%). Thus, most of the NSE listed companies (61.8%) which responded are in the banking sector, manufacturing and allied and commercial and services sectors. These companies play a major role in Kenya's economic growth (Olweny & Kimani, 2011). Table 4 shows the distribution of companies by level of employment and age.

Table 4: Distribution of Companies by Number of Employees and Age

Number of Employees	**Frequency**	**Percentage**	**Year of establishment**	**Frequency**	**Percentage**
Less than 100	6	17.65	1-30	3	9.82
100 – 300	3	8.82	31-60	18	51.94
301 – 500	5	14.71	61-90	6	17.65
501 – 700	4	11.76	Over 90	7	20.59
Over 700	16	47.06	TOTAL	34	100
TOTAL	34	100			

Table 4 shows that 47.06 percent of the companies listed on the NSE had in excess of 700 employees. The table further shows that cumulatively 73.53 % of the companies had more than 300 employees. The fact that there are 75.53 % of the companies with more than 300 employees implies that the majority of the companies listed on the NSE are large and mature. This finding may imply that the mature companies are experienced enough to align their firm-level institutions for optimal performance. From the analysis, it is evident that companies that have been in existence for 1-30 years accounted for 9.82 %, 31-60 (51.94%) , 61-90 (17.65 %) and over 90 years, (20.59 %). The analysis shows that most of the companies were between

31-60 years old. The fact that 90.18 % of NSE listed companies have been in existence for over 30 years implies that they are mature and established and must have aligned their firm-level institutions to enhance their performance.

Test of the Hypothesis

The study sought to determine the effect of firm-level institutions on the performance of companies listed on the Nairobi Securities Exchange. A corresponding hypothesis was formulated and tested using simple linear regression analysis. The results of the regression are shown in Table 5.

Table 5: Simple Linear Regression Results for the Effect of Firm-Level Institutions on the Performance of Companies listed on the Nairobi Securities Exchange

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.807[a]	.652	.641	7.52854

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3394.394	1	3394.394	59.888	.000[b]
	Residual	1813.724	32	56.679		
	Total	5208.118	33			

COEFFICIENTS

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	32.306	9.196		3.513	.001
	Firm-Level Institutions	.280	.036	.807	7.739	.000

Company Performance: Dependent Variable

Firm-Level institutions: Predictor Variable

DISCUSSION

The regression results presented in Table 6 indicate that firm-level institutions had a positive and significant effect on company performance (R Square= 0.652, F=59.888, $p<0.05$). The results of the analysis showed that 65.2 per cent of the variation in company performance is attributed to firm-level institutions.

The F-ratio indicates the regression of firm-level institutions on company performance was significant, which is evidence of the goodness of fit of the model. However, the model did not explain 34.8% of the variation in company performance. This implies that there are other factors associated with company performance that were not included in the regression model. The beta was significant (β=0.807; t=7.739; p <.001). The beta value implies that for one unit increase in the use of firm-level institutions, company performance increased by 0.807.

From the results of the analysis, it is observed that there was a positive and significant effect of firm-level institutions on company performance. The hypothesis that firm-level institutions have a positive and significant effect on company performance was supported.

Based on the regression results, firm-level institutions have a positive relationship with company performance. This is in agreement with Barney (1991) that firm-level institutions play a significant role in sustaining corporate performance. Consistent with the finding, MacKenzie, Podsakoff and Rich (2001) established positive and significant effect of transformational leadership style on organizational performance. In contrast, Obiwuru (2011) established that leadership style was positively but insignificantly related to organizational performance. Gordon and DiTomaso (1992) established that organizational policies and culture have a positive effect on organizational performance. However, the study findings differ with those of Machuki *et al.* (2012) whose findings established that the effect of firm-level institutions on organizational performance was not statistically significant.

CONCLUSION

The study aimed to establish the effect of firm-level institutions on the performance of companies listed on the Nairobi Securities Exchange. The study was conducted through a cross-sectional survey. The study adopted both descriptive and inferential statistics to analyze the data. Simple linear regression analysis was used to determine the effect of firm-level institutions on the performance of companies listed on the Nairobi Securities Exchange.

The study tested and confirmed the hypothesis that firm-level institutions have a positive and significant effect on the performance of companies listed on the Nairobi Securities Exchange. This implies that listed companies on the NSE that properly manage their firm-level institutions expect positive and significant effect on their performance.

LIMITATIONS OF THE STUDY AND SUGGESTIONS FOR FURTHER RESEARCH

The study only targeted companies listed on the NSE implying that the findings cannot be generalized and may not apply to firms of other categories. This study also used a descriptive survey design using averages for company financial performance data for a three-year period

(2012-2014). Collection of data was done at one point in time. The data collected was on financial performance and firm-level institutions at one point. The outcome of the study could have been more significant if there was an investigation of the effect of the period between which changes might have taken place in the companies listed on the NSE. The researchers suggest that a similar study be carried out among other categories of firms such as academic institutions, non-governmental organizations, small and medium sized enterprises and faith-based firms. The reason for such a necessity is that the findings for the companies listed on the NSE may not apply to other firms whose motives are different and that have unique characteristics that may require a different set of firm-level institutions.

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