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Joyline Nkatha Mukaria & Moses Odhiambo Aluoch

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Corporate Governance, Inflation and Profitability of Manufacturing and Allied Firms Listed at the Nairobi Securities Exchange in Kenya

^{*1}Joyline Nkatha Mukaria & ²Moses Odhiambo Aluoch

¹MBA(Finance) Student, Kenyatta University

²Lecturer, Department of Finance and Accounting, School of Business, Economics and Tourism, Kenyatta University

*E-mail of Corresponding Author: nkathajoyline@gmail.com

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Abstract

Despite being recognized as pillars of economic upsurge and development, the manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya have consistently faced challenges as far as their profitability is concerned. For instance, in the period 2016-2023, their average value of return on assets stood at -0.0134, meaning significant amount of loses were reported by these firms. Against this background, the study sought to establish the effect of corporate governance and inflation rate on profitability of manufacturing and allied firms listed at the Nairobi Security Exchange in Kenya. More specifically, this study sought to establish the effect of board size, board independence and board diversity on profitability of manufacturing and allied firms listed at Nairobi Securities Exchange. The agency, stewardship, resource dependence and Keynesian theories provided anchorage to the proposed study. The study adopted descriptive survey design targeting 13 manufacturing and allied firms that were listed on the Nairobi Securities Exchange and census was adopted. Information from auxiliary sources was gathered on a period 2016-2023 and SPSS guided processing. Correlation results were that while board size had a moderate but positive relationship with profitability, board independence also had a moderate but negative relationship with profitability. On the other hand, board diversity and inflation rate all had strong and positive relationship with profitability of the listed manufacturing firms in Kenya. The study concludes that corporate governance and inflation have significant effect on profitability. The study recommends that Capital Market Authority should establish an optimal board size should be used as a benchmark by these listed firms. To improve the profitability of the listed manufacturing firms in Kenya, there is need for more independent and executive directors to be included on boards.

Keywords: *Corporate Governance, Board Size, Board Independence, Board Diversity, Inflation, Profitability*

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1.0 Introduction

Around the world, the manufacturing sector has been recognized for its significant contribution to the growth of economies. Profitability of this manufacturing sector in the world has remained relatively stable represented by a margin increase in its value of ROA from 8.10% to 8.68% in 2019 and 2020 respectively (Awasthi, Saxena & Arun, 2020). In developed economies like USA, Canada and China among others, an estimated 35% economic growth is driven by the manufacturing industry in the country (Harb & Bassil, 2023). Right after services sector, manufacturing domain is the second biggest economic driver in Jordan (Allan, Kasim, Mustapha & Shah, 2018). As at 2016, manufacturing field accounted for 18.17% of GDP, while services industry accounted for 66.76%, industrial field accounted for 10.77%, and agricultural field accounted for 4.3% (Jordan's Economy, 2018). The rise of corporate scandals in the manufacturing sector around the world has increased more attention and recognition of corporate governance. These include the Valeant Pharmaceuticals scandal and the Kobe Steel scandal among other world renowned corporate scandals have created the need for strong corporate governance mechanisms.

Regionally in Africa, and especially in Nigeria, Oduola, Bello and Popoola (2022) argues that most of the manufacturing firms have been posting losses, especially after the rise of COVID-19 pandemic error with an estimated industry ROA average within the period 2020-2023 standing at -0.017. This according to Adu-Danso and Abbey (2022), has continued to affect the contribution of this manufacturing sector to the growth of African countries with regard to the gross domestic product (GDP). Nguimkeu and Zeufack (2024) indicate that there was a decline in the value of ROA from 1.6% to 0.7% in 2020 and 2021 respectively in the manufacturing sector in Sub-Saharan Africa. The manufacturing industry in Nigeria faces unfavorable conditions; data reveal that over 290 manufacturing businesses closed in 2022 output while others laid off employees. It is anticipated that the industry will contribute an average of 4.19% to GDP (Ehiedu & Toria, 2022). as a result of a lack of demand for their goods both domestically and overseas.

Locally in Kenya, its economy has experienced substantial growth and advancement primarily due to the manufacturing and associated sector (Fatoki, Wafula & Waweru, 2021). The manufacturing industry, which ranks fourth in Kenya, constitutes a significant proportion of the nation's GDP. Within Eastern Africa, this sector dominates the industrial landscape, contributing to almost three-quarters of its total output. Given its crucial role in economic progress and well-being, it has recently garnered the recognition it rightfully merits. The production industry in Kenya is largest in terms of expansion patterns compared to other nations in East Africa, and is developing at a much more rapid pace (Yator & Gitagia, 2023). Manufacturing companies in Kenya's economy have not yet reached their full revenue potential as a result of limited market access, limiting regulations, high finance costs, insufficient infrastructure, and a lack of ability to achieve product quality requirements. The industry's contribution to overall economic output (GDP) has remained at 10% and 8.4% in 2017 (Ajibade, Amuda & Olurin, 2019).

Corporate governance pertains the methods and structural systems employed by stakeholders to actively protect their concerns. It relates management and the board of the firm as they interact to maximize the wealth of shareholders and hence profitability. Owing to the proliferation and advancement of enterprises in both established and emerging economies, corporate governance has gained greater significance in the contemporary age (Kyere & Ausloos, 2020). Profitability serves as a gauge to assess the execution of companies' monetary assets. Corporate governance involves coordination of making, selling, and giving away of commodities and services and

encompasses multiple components that impact the institutional process and overall performance (Dufera, 2018).

The active role played by the corporate board to balance and align the interests of managers and shareholders of the firm to achieve financial goals is referred to as corporate governance (Larcker & Tayan, 2020). Board size, independence and diversity are important considerations in regard to corporate governance in an organization. Board size reflects the total number of directors in the firm. Most firms prefer to have a small board size. Effective decision making and flexibility do depend on the size of the board. From the agency theoretical view, large boards decrease information asymmetry between the directors and managers of the firm. On the other hand, the smaller the board, the easier it is to coordinate operations which positively influence profitability. In this study, board size was measured by the natural logarithm of the total directorship (Alshirah, Abdul Rahman & Mustapa, 2020).

Board independence is the second objective variable of this study. Soundness and efficacy of the board is strongly influenced by the existence of independent directors. Independent directors play a non-executive role in an organization (Al-Sawalqa, 2021). They are believed to be more objective and thus can drive objectivity to the board of an organization (Naseem, Xiaoming, Riaz & Rehman, 2017). In the proposed study, board independence was measured using the ratio of non-executive directors against the total number of directors in an organization. Board diversity is the third independent objective variable of the study. Having a diverse board is an important consideration that can contribute to effective decision making. In achieving diversity in boards, efforts are required to incorporate female directors (Makkonen, 2022). This is of particular importance to Kenya under the one third gender rule as required by the Constitution. There are several aspects of diversity that are documented in literature in gender, education level, professional competencies and specializations as well as race. In the present study, board diversity was measured using the ratio of female to total directorship in the board.

Profitability can be described as the ability of an entity to efficiently utilize its assets to generate revenue for shareholders (Aydoğmuş, Gülay & Ergun, 2022). A company's competitiveness, business potential, management's financial health, and how consistent current and upcoming contracts are, may all be used to assess its profitability (Dufera, 2018). Profitability is also frequently used to assess the performance of a company over a certain period, and is used to evaluate entire markets or contrast companies in same industry. There are several ways to evaluate a business's success, but each approach needs to be considered simultaneously. Additionally, to the overall sales figures, it is possible to use categories such as operational profit, flow of funds through business processes, including revenues from processes (Ledley, McCoy, Vaughan & Cleary, 2020). The indicators of profitability include money flow measurements such as cash flow from operations versus earnings and development signals such as previous growth in revenue. The financial viability of a business needs to be evaluated using criteria that are looking upwards, such as expansion, flow of cash, as well as predicted profitability (Almashhadani & Almashhadani, 2022).

Lim and Rokhim (2021) used margin of net interest as well as before-tax profit/total resources as business performance metrics. In previous studies, financial percentages of returns are thoroughly investigated. The effectiveness of the management of a business can be evaluated using measures like the percentage at which the executive team utilizes resources in order to produce financial earnings depending on the amount of investments, assets, or revenues (Almashhadani &

Almashhadani, 2022). For the present study, profitability was represented by ROA since company's performance is very dependent on the utilization of its assets.

Inflation is general rise in prices of products in the country within a given period of time (Halim, Astuty & Hubeis, 2022). State of economy is significantly impacted by inflation. Economy is affected by inflation either directly or indirectly, as it affects overall perception of people. Inflation is characterized by a rise in general price levels (Monadjemi & Lodewijks, 2021). Inflation is also viewed as a significant gauge of investment. Inflation itself impacts a nation's economy. Another perspective on inflation is perceiving it as a rise in the expenses of goods that diminishes purchasing power of money. Inflation is unfavorable for investors in financial markets. This is due to its potential to elevate the company's operational expenses and impact its dividends, thus lowering its future prospects (Violita & Sulasmiyati, 2017).

Empirical investigations on inflation frequently examine its origins, outcomes, and correlation with other economic factors. By empirically examining inflation, economists and policymakers acquire an understanding of its fluctuations, enabling them to develop suitable monetary and fiscal strategies to control inflation and sustain price steadiness in an economy or an organization to enhance efficiency (Stievany & Jalunggono, 2022), thus highlighting its significance in this research. Inflation is assessed using different techniques and indicators to monitor fluctuations in prices over a period. Popular indicators include Producer Price index, Consumer Price Index, GDP deflator, and Personal Consumption Expenditures (Purwoko, 2021). These indicators record variations in prices of goods and services used in households, goods and services manufactured by businesses, overall economic output, and individual spending. For this study, CPI was used as this data is available at the central bank of Kenya website. CPI assesses fluctuations in mean costs of collection of items and services utilized by households. It mirrors expenditure of living for typical buyers. National statistical organizations consistently gather price information for broad assortment of products and compute CPI based on weighted means of these costs (Rudianto, 2022). For instance, if CPI for a specific year is 110, signifying 10% rise compared to preceding year, it suggests that prices, on average, have increased by 10% during that duration. The justification for adoption of inflation rate as a moderator variable in the proposed study is because it is a widely documented macro-economic variable in various studies that has potential to contribute meaningfully towards the growth of an economy like Kenya.

Before Kenya's 1963 declaration of independence, stock exchange served as a place for traders to trade stocks and was far less controlled than those in industrialized nations. Since its founding, the Nairobi Security Exchange, Kenya has undergone several modifications, including the sequence of the swapping regulations, the Central Stores structure, the digitalization of the markets, and the demutualization from a shared company to company limited by shares (NSE, 2016). Nairobi Securities Exchange is greatly regarded in comparison to similar markets in the area since the largest corporations choose to list and trade their shares in Nairobi (Iraya & Musyoki, 2013). The Kenyan security market regulatory authority, the Capital Markets Authority (CMA), grants NSE a permit and oversees its operation. The Capital Market Authority is tasked with maintaining excellent corporate governance practices among registered firms and the enhancement of the capital market (NSE, 2016). The 64 firms presently listed on the Nairobi Securities Exchange are spread over several different sectors, including the growing market enterprise category, telecommunication and technology, manufacturing and allied agricultural, banking and insurance.

Major corporations are becoming more interested in investing and operating in Kenya because of the growth of the Kenyan industry (Ndiba, 2016). A favorable climate for manufacturing has been

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fostered by the Kenyan government, and it now significantly contributes to gross domestic product of country and has helped many Kenyans find employment. Manufacturing companies have raised equity money and made significant investments in the manufacture of maize, wheat flour, cement, sugar, food and beverages and glass, thanks to a safe and controlled securities market. Even with the significant expenditures made over the past ten years, the manufacturing sector is still not performing up to standard (Ng'ang'a, 2017). Due to the challenging economic climate created by high imports, heavy taxes, outdated technology, and a lack of essential materials, large corporations are still having trouble.

1.1 Statement of the Problem

The manufacturing industry of Kenya has been designated to contribute significantly towards attainment of the country's Vision 2030, hence its significance. This, however, can only be achieved when firms in this section perform optimally. In the past 8 years (2016-2023), the listed manufacturing firms in Kenya have continued to post losses which have in turn negatively affected profitability. For instance, the average value of ROA reported by these firms in the same period stood -0.0134 which implies losses that have continued to exert negative effect on operations of these firms (NSE, 2023).

Despite the studies done concerning corporate governance and financial performance, several research gaps are contained in these studies. Oyerogba, Memba, and Riro (2016) found substantial relationship between size of boards and traded company revenue. Current research, nevertheless, will concentrate on outlined manufacturing businesses in Kenya, whereas previous study concentrated on given banking institutions in Nigeria. Size of board has large and favorable impacts on profitability (Shunu, Bii & Ombaba, 2017). Board size has major impacts on profitability of Nigeria's commercial banking institutions (Okoye et al., 2020). Furthermore, Nazari, Basati, and Jamshidinavi (2017) shared that CG significantly enhance monetary performance. The study was however, based on Tehran Stock Exchange context, and not NSE. Similar observations about connections amongst governance practices and profitability were made by Abubakar, Umaru, and Daikwo (2019), although their research was limited to publicly traded businesses in Nigeria.

Thus, although various studies have been conducted on corporate governance and financial performance, some like Nazari, Basati, and Jamshidinavi (2017) largely focused on Iran while the study by Okoye et al., (2020) was on Nigeria and this creates contextual gap. Most of these studies failed to incorporate an appropriate variable like inflation that could have a moderating effect on the interaction between CG and monetary performance thus creating a conceptual gap.

1.2 Objectives of the Study

- i. To determine the effect of board size on profitability of manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya
- ii. To evaluate the effect of board independence on profitability of manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya
- iii. To analyze the effect of board diversity on profitability of manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya
- iv. To determine the moderating effect of inflation on the relationship between corporate governance and profitability of manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya

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1.3 Research Hypotheses

H₀₁: board size has no significant effect on profitability of manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya

H₀₂: board independence has no significant effect on profitability of manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya

H₀₃: board diversity has no significant effect on profitability of manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya

H₀₄: inflation has no significant moderating effect on the relationship between corporate governance and profitability of manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya

2.0 Literature Review

2.1 Theoretical Framework

2.1.1 Agency Theory

Jensen and Meckling (1976) came up with this theory and it advocates of the agency theory, proposed that there may be disputes between executives and stockholders regarding mutual concerns. Agency expenses, which owners incur to oversee and regulate the conduct of executives, can arise from these tensions. In numerous agency agreements, the principal seeks to manage, motivate, and monitor the agent's conduct to reduce agency costs, while the agent strives to maximize gains while minimizing the principal's secondary expenses. Agency theory is centered on the prevalent agency relationship, in which a principal assigns responsibility to another individual, known as the agent, who then fulfills those responsibilities. Agency theory aims to depict this connection using the analogy of a contract (Eisenhardt, 1989).

Grossman and Hart (1983) created a captivating story about the difference that can occur between the risk preferences of leaders and representatives. He explained that the principal's consumption can be influenced by the agent's performance, as the effort put in by the agent affects the firm's output. Therefore, the principal must find a balance between the agent's behavior and a suitable payment plan, for which an algorithmic model was used. The leader's knowledge of the level of accuracy of knowledge as well as the representative's propensity for taking up risks are two examples of the elements that affect the system of rewards. When an agent avoids taking risks, the issue of incentives may arise. The notion states that when business management is functional, the corporation performs better because the supervision in companies is used appropriately, and their abilities are supported in best interests of businesses along with shareholders. Key component of effective choice-making and problem-solving is the governing body of executives (Jwailes, 2021). According to agency theory, the types of stakeholders in a corporation as well as the degree of their involvement in it can have a substantial impact on conflict of interest within the organization, consequently influencing the overall performance of the firm (Habtoor, 2021). The agency theory will underpin profitability which is a dependent variable of this study, board independence, as they align with unique interests and goals of shareholders and agents to help improve decision making and profitability of a firm.

2.1.2 Stewardship Theory

Donaldson and Davis (1991) developed this theory. They contended that individuals, as caretakers, are assumed to have an inherent drive towards working for other individuals or groups in order to

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complete different duties that had been assigned to them (Donaldson & Davis, 1991). According to the idea, caregivers are pro-organizational because they choose a communal point of view as opposed to an autonomous method, which assumes that people are self-serving. A person in charge consequently puts forth an effort to advocate for the company along with the community's general well-being (Davis, Schoorman & Donaldson, 2018). Stewardship theory is a viewpoint in organizational theory and corporate governance that highlights the position of managers as stewards or guardians of the organization's assets and concerns. It proposes that managers are driven by a sense of duty and inherent principles, and they operate in the organization's utmost interests instead of pursuing their self-interests (Subramanian, 2018). Stewardship theory presents another viewpoint to agency theory, which presupposes that manager is mainly motivated by personal gain and need external supervision and rewards. Stewardship theory proposes that through establishing favorable circumstances and harmonizing interests, managers can function as proficient caretakers, resulting in enhanced organizational performance and shareholder value (Torfing & Bentzen, 2020).

Scholars have extensively regarded stewardship theory as a framework that specifies the motivations behind an individual's behavior. The philosophy of stewardship theory is applicable in explaining the responsibility of the board (Torfing & Bentzen, 2020). Stewardship theory and corporate governance are closely connected. The connection between the two lies in focus on managerial behavior, board of directors' role, the ownership structure, openness, responsibility, and a long-term perspective. Stewardship theory provides insights into the principles that can guide effective corporate governance, fostering confidence, alignment of interests, and sustainable value creation within organizations, hence underpinning profitability, board size, and board ownership. The theory has however been criticized for several reasons for example Keay (2017) claimed that stewardship theory is based on excessively optimistic assumptions about the motivations and actions of managers. Critics contend that the theory fails to adequately address potential conflicts of interest between managers and owners, as well as need for monitoring and control mechanisms to mitigate these conflicts (Podrug, Filipovic, & Milic, 2010). The theory's focus on trust and delegation may overlook the risks associated with opportunistic behavior and slacking off. This theory has also been criticized by Albanese, Dacin, and Harris (1997) for overlying so much on trust and that its basic assumption of managers as stewards limits its realism and relevance in a modern corporation. Despite the criticisms, this stewardship theory will be used to underpin the broad independent variable being corporate governance. The theory is the foundational block of modern-day ethical practices within the corporate governance mechanisms of an organization.

2.1.3 Resource Dependence Theory

Pfeffer and Salancik (1978) formulated this theory, depicting firms as open systems that depend on the eventualities of the external environment. According to Hillman *et al.* (2000), the board serves as an intermediary for executives, helping them to accomplish authoritative aims. According to Hillman *et al.* (2000), CEOs ought to include the organization's resources including knowledge, experience, and connections to providers, consumers, participants, clear contracts, social events, etc. For instance, board members with particular skills may apply their skillfulness to mentor and train executives in a means to enhance credible performance. Additionally, people can draw the organization's resources by utilizing their support networks. Additionally, RDT is supported by the appointment of other persons to the board in order to acquire skills, improve their possibilities for obtaining information, and engage in a variety of interactions (Oyedokun, 2019). In order to reduce unpredictability and subsequently lower the cost of a transaction as well as the

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possibility of linking the company with outside entities, the RDT assumes that managers create assets such as knowledge, experience, essential components (buyers, providers, groups of people, government decision makers), along with constitutionality. This presents the opportunity to obtain additional resources to proficiency across multiple fields. Productive companies have internal mechanisms that match external ecological requirements, according to Lawrence and Lorsch (1967), who linked the RDT as a spontaneous consequence on corporate governance.

One of the underlying presumptions of RDT is that unpredictability casts a shadow over a company's ability to govern its finances, necessitating strategy adjustments that reduce dependence. The need for relationships with other firms rises in tandem with the growth in unpredictability and dependency (Hillman *et al.*, 2000). Businesses frequently adapt their corporate strategy to account for deficiencies responsible for relationships with different businesses that impact their ability to obtain resources. This theory has been critiqued for its lack of discrimination between imbalance in power and independence from mutual point of view. The theory has also been viewed to characterized by a lot of ambiguities in regard to its boundary circumstances. Despite these criticisms, by adopting this theory, the study is going to demonstrate how the makeup and composition of the governing body of executives (board size & independence) in Kenya's listed manufacturing and allied companies helps to introduce corporate governance practices and how those practices affect their profitability.

2.1.4 Keynesian Theory

John Maynard Keynes created the Keynesian Economic Theory during the 1930s. The idea holds that overall consumption is impacted by a wide range of determinants and sometimes operate periodically, in addition to inflation, rather than fundamentally, equaling the nation's capacity for production. A significant factor influencing the economy's output in the short term is general demand. According to Keynesian theory, the financial market must take proactive measures to address private sector policies that occasionally result in unfavorable macroeconomic effects. The theory states that regulations focus on the critical requirements including the ways in which fiscal management can quickly improve the economy of a country. The study advances the idea that a strengthening of finances might happen as a result of an increase in expenditure by governments and promotes an alternate framework that incorporates immediate government influence over investments. An increase in public spending encourages investments and decreases investment from the private sector since greater inflation reduces savings in private hands. The theory is pertinent to the research because the government makes a variety of fiscal as well as monetary choices that impact the financial well-being of manufacturing and related businesses in an effort to promote economic growth, hence underpinning inflation rate.

The criticism levelled against this theory is the fact that it overly focuses on economic stability from a short-term point of view while ignoring the long-term perspective as far as growth of an economy is concerned. Despite this critique, this theory holds that the administration is the only entity capable of ending financial as well as recessions in the economy by means of monetary or fiscal regulations, as well as by generating overall demand to raise the economy's output levels through the support of a financially sound system that can promote ongoing stability in the economy. The theory was therefore used to underpin the moderating variable being inflation rate.

2.2 Empirical Review

2.2.1 Board Size and Profitability

Shahid et al. (2020) determined the effect of board size as a mediator variable, working capital management, and basis factors of CG and performance of the firm. The study was done using 32 sugar milling listed firms in Pakistan. The period of the study covered 2014 all through to 2017. Generalized least square method was adopted for processing of the gathered information. It was clear after analysis that independent directors and ROA had positive and significant nexus with each other.

Okoye *et al.* (2020) examined impacts of business governances on Nigerian commercial banking institutions profitability. While using secondary data, size of governing body had substantial effects on business performances of commercialized banking institutions founded on Generalized Moments of Methods (GMM).

Vaidya (2019) determined the effect of board size on performance of the firm, with a focus on BSE 100 companies. The period covered by the study was 2018-19 and ROA was a proxy of performance. It was noted that board size did not exert any significant effect on monetary performance. Thus, board size was not seen to have any impact on performance of an enterprise.

Chaudhary *et al.* (2018) studied board size and financial performance relationships for five (5) automobile firms situated in India. The focus in terms of the period was from 2009 to 2013 and annual data was sourced. Board size was the predictor variable while ROE, ROA, Price per Earnings ratio as well as EPS made up proxies for the outcome variable. Board size possesses an unsubstantial effect on business performances and these outcomes cut across various indicators used. Rather than focusing on automobile companies, this investigation is going to be centered on manufacturing quoted at the Kenya's NSE.

Shunu, Bii and Ombaba (2017) analyzed board size and financial performance nexus with regard to listed firms in the Nairobi Securities Exchange while focusing on 68 of them as of 2015. An explanatory research method was utilized to obtain additional panel information from business accounting documents as well as NSE bulletins. Board size had significant direct implication on monetary performance. The current study however explored other aspects of corporate governance including board ownership and independence.

2.2.2 Board Independence and Profitability

Crifo and Roudaut (2022) determined the effect of independence of the board coupled with expertise on the value of the enterprise. This was an empirical study that tested formulated hypotheses using 120 large firms in France. The period of the study was 2006-2011 and after analysis, the findings were that expertise played a mediating role in the nexus between independence and the value of an enterprise.

Musah and Adutwumwaa (2021) studied financial outcomes of remote banks in Ghana on various corporate governance frameworks, including board independence. Investigation obtained secondary information from thirty regional institutions' yearly filings during ten years, from 2010 to 2019. The study's goals were addressed employing regression modeling, correlation evaluation, as well as statistical methods such as descriptive. Study found that financial results of small banking institutions were significantly impacted by autonomy of boards. The research is centered on realities in Ghana which differs from those of Kenya, which is focus of this study.

Gambo, Terzungwe, Joshua, and Agbi (2019) investigated effects of board autonomy, experience, including the inclusion of foreign members of the board on the monetary results of quoted Nigerian insurance businesses. The investigation focused on 26 insurance businesses that traded in Nigeria. An accurate representation of 17 insurance companies was obtained by random selection. The investigation discovered that ROA is significantly impacted by autonomy of board. However, it does not have significant impacts on ROE. Experts recommend that the authorities should ensure that board of directors includes capable and independent members. Study focused on insurance companies which is a different institution from focus of this study; Manufacturing and allied firms.

Shan (2019) examined whether the two-way connections between managerial ownership, board autonomy, and company performance are established. The coming-together-of-interests' hypothesis concerning the entrenched hypothesis analyzes the connection investigates the relationship amongst board autonomy and company efficiency as well as the relationship connecting ownership by executives as well as the theory of stewardship. The study utilizes a data set comprising 9,302 instances of Australian publicly traded companies from 2005-2015 as well as analyzed the bilateral connections using a three-stage minimum-squares simultaneous equations methodology. The results imply that board autonomy has an adverse effect on business effectiveness as well as the reverse. The variables considered are just managerial ownership and board independence in the study as this study will investigate dimensions, and autonomy, board qualifications, diversity for governing body alongside governing body ownership.

2.2.3 Board Diversity and Profitability

Morrone, Bianchi, Marsocci and Faioli (2022) attempted to experimentally confirm whether diversity of board of directors such as gender, age, and nationality impacts performances of company, which was evaluated using metrics of ROE, ROA, and EBITDA margin. The investigation mentioned a considerably larger group - utilized machine learning algorithms using a data-centric strategy built on a three-year (2017–2019) collection of information comprising 59,229 Italian small to medium-sized businesses (SMEs). According to the data, neither positive nor negative influences on firm performances can be attributed to board diversity. Absence of a correlation implies that does not impede appointment of immigrants, women, and young people as directors.

Dong, Liang and Wanyin (2022) examined link between board diversity and company success. Examined within realm of ESG initiatives, investigation's main emphasis was on openly traded Chinese businesses. Data used for analysis covered six years, specifically from 2014-2019. In order to model relationships dynamic approach was employed. According to data, there are significant and positive associations between board diversity and firm's success, suggesting that diverse boards are advantageous to firms. The study focused on board diversity but this research will consider board size, independence, diversity, qualifications, diversity and ownership.

Đặng, Houanti, Reddy and Simioni (2020) examined connection amidst variety of gender on boards and financial performances of companies. Investigation utilized control function (CF) methodology suggested by Wooldridge (2015) recently. The CF technique considers the problem of endogenous independent variables that could result in biased results. The study used a subset of companies comprising the S&P 500 from 2004 to 2015. Blau index of diversity or the percentage of female's executives on corporations governing body, both of which measure women's participation in corporate decision-making, were found to have positive and significant impacts on

business profitability, as measured by ROA. The study used the control function (CF) methodology however; the investigation of the study for the present investigation is going to be descriptive.

2.2.4 Corporate Governance, Inflation and Profitability

The impact of inflation on the stability of South Sudan's commercial banking institutions was evaluated by Chol (2022). The design selected was of a descriptive character. The investigator gathered data from various South Sudanese banking institutions. Data were drawn on first-hand and secondary sources. Every banking institution in the area participated in the census-based research. Data analysis employed frameworks of analysis for quantitative data. The investigation supported the idea that inflation has detrimental impacts on performance and profitability of banks. Inflation was the moderator variable in the present inquiry.

Aluoch (2021) looked into how governance of the company, financial traits, macroeconomic conditions, and the financial results of agricultural enterprises registered at the Kenya's NSE, relate to one another. To ascertain the combined impact of corporate governing, financial features, macroeconomic indicators (inflation), as well as financial results of quoted agricultural enterprises in Kenya. The study determined how inflation affected traded agricultural enterprises' corporate governances and financial performances in a moderating way. Seven agricultural enterprises that had been traded at NSE from 2002 and 2016 were the research's target demographic, which was determined using a census method. In the research, panel data was utilized. A longitudinal descriptive study approach was used in this research. Regression modeling on panel data and descriptive data were both done. Associations amongst corporate governance and financial performances was positively moderated by inflation, and it was proven that there are strong interactions involving governance of a company, finance features, as well as inflation on financial results.

Khue and Lai (2020) focused on the specified impact caused by inflation as they investigated how the ASEAN-6 countries' banks were affected by inflation. The empirical analysis depends on thresholds models of regression developed with panel data of the ASEAN-6 nations from 1996 to 2016. The outcomes show significant proof of the inflation-threshold effects. The investigation demonstrated that when inflation is within every of these benchmark rates, which are typically about 4-7%, it has a negative impact across all of the major measures of the effectiveness of banks. However, as inflation increases over these thresholds, the negative impact disappears. The asset-quality index, nevertheless, only becomes negative when inflation rises above 3%. The findings will help regulators in the ASEAN-6 nations choose an inflation goal framework that is consistent with the growth of their banking institutions. The study used time period from 1996 to 2016, this study will be conducted in Kenya and use time period from 2016 to 2023.

2.3 Conceptual Framework

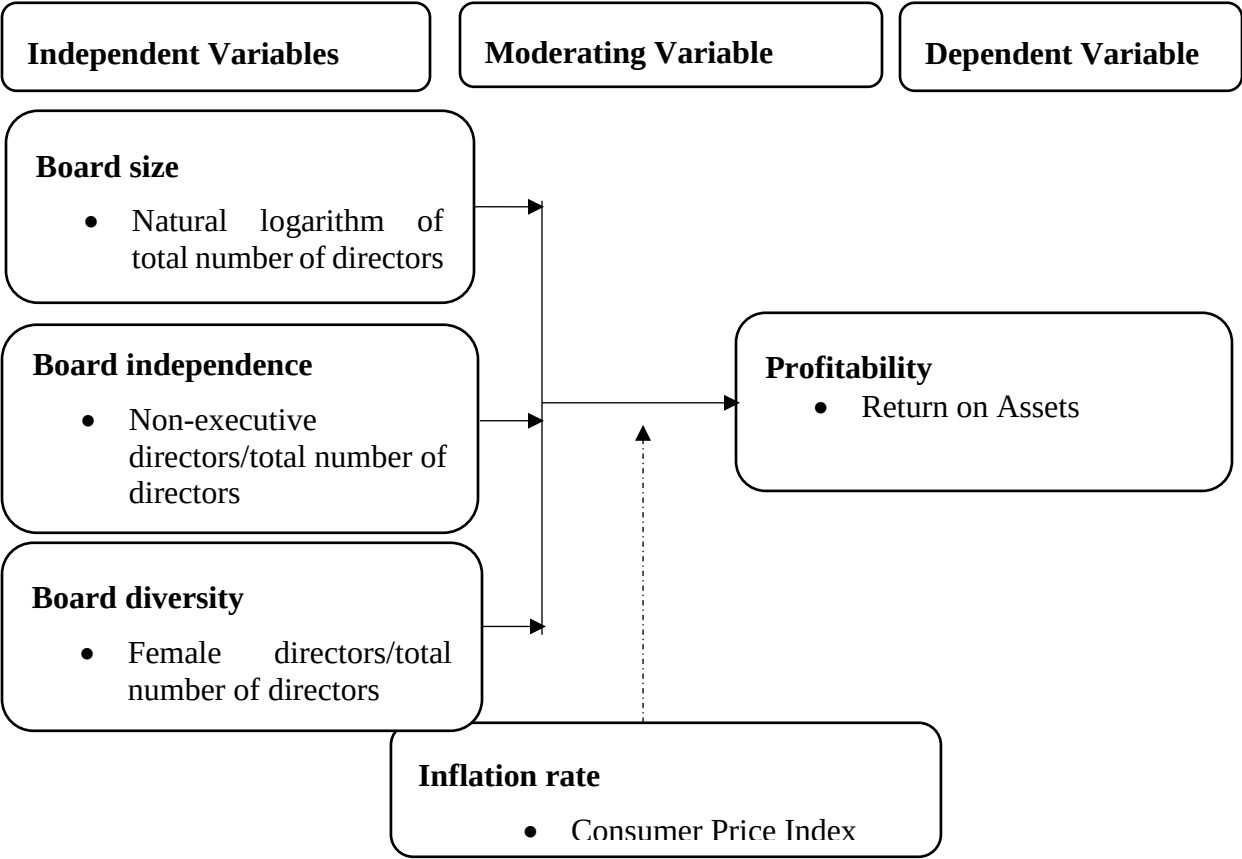


Figure 1: Conceptual Framework

3.0 Research Methodology

Research Design

The research design outlines the researcher’s plot to carry out research goals during data collecting and analysis. The rationale of adopting descriptive survey in this present study was because it enabled the researcher to unearth details that, when combined with quantitative data, identifies features of the population under investigation (Ledford & Gast, 2018).

Target Population

A collection of people or things having observable features a researcher seeks to use for research is known as a target population (Mugenda & Mugenda, 2013). This study targeted 13 listed manufacturing and allied firms on the NSE in Kenya (NSE, 2024).

Empirical Model

The study incorporated Whisman and McClelland (2005) models. The study’s direct empirical model is as indicated below:

Where:

<https://doi.org/10.53819/81018102t4315>

$$FP = \beta_0 + \beta_1BS + \beta_2BI + \beta_3BD + \epsilon \dots\dots i$$

Where: FP= Profitability; BS = Board Size; BI= Board Independence; BD = Board Diversity
 β_0 = Constant; β_0 - β_4 = Beta Coefficients; ϵ = Error term

Moderation Model

$$FP = \beta_0 + \beta_1CG + \beta_2IR + \epsilon \dots\dots\dots ii$$

$$FP = \beta_0 + \beta_1CG + \beta_2IR + \beta_3CG*IR + \epsilon \dots\dots\dots iii$$

Where: FP= Profitability; CG = Corporate Governance; CG*IR= Corporate Governance* Inflation Rate

Data Collection Procedure and Instruments

Information in its auxiliary nature was gathered in this study from CMA and NSE as well as CBK. This information was gathered on a period of 8 years (2016-2023). Secondary information on performance and company traits was gathered for the study from publicly accessible official statements of publicly listed firms, including annual financial reports and statistics. Through publicly accessible annual reports to shareholders and annual proxy statements to shareholders, secondary information on corporate governance was acquired.

4.0 Findings and Discussion

4.1 Descriptive Statistics

Table 4.1 is a breakdown of the findings of descriptive.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Board size	56	.70	1.08	1.0137	.05959
Board independence	56	.25	.46	.3345	.05986
Board diversity	56	.17	.60	.2659	.07735
Inflation rate	56	4.69	8.01	6.3862	1.19045
Profitability	56	.00	.45	.0668	.09063

Source: Researcher (2025)

Table 1 indicates that board size, independence, diversity, all averaged at 1.0137, 3345 and .2659. The average values for standard deviations and profitability were 6.3862 as well as 0.0668. On average therefore, 6.68% of the profits generated by the studied firms was attributed to effective utilization of the assets they had in place.

4.2 Correlation Matrix

Table 4.2 gives a review of the analyzed findings from correlation analysis:

Table 2: Correlation Matrix

		Profitability	Board size	Board independence	Board diversity	Inflation rate
Profitability	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	56				
Board size	Pearson Correlation	.485	1			
	Sig. (2-tailed)	.000				
	N	56	56			
Board independence	Pearson Correlation	-.387	.091	1		
	Sig. (2-tailed)	.525	.505			
	N	56	56	56		
Board diversity	Pearson Correlation	.863	.566	-.100	1	
	Sig. (2-tailed)	.000	.000	.461		
	N	56	56	56	56	
Inflation rate	Pearson Correlation	.052	.184	-.058	.072	1
	Sig. (2-tailed)	.706	.175	.673	.600	
	N	56	56	56	56	56

Source: Researcher (2025)

The study noted from Table 2 that board size ($r=0.485$) had a moderate but positive relationship with profitability. Board independence ($r= -0.387$) also had a moderate but negative relationship with profitability. On the other hand, board diversity (r of 0.863) had strong and positive link with profitability of the listed manufacturing firms in Kenya.

4.3 Regression Results and Hypotheses Testing

This helped to test the formulated hypothesis. The findings were established and presented as indicated in the subsequent sections:

Corporate Governance and Profitability

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.916 ^a	.838	.822	.03821

Source: Researcher (2025)

Adjusted R^2 is given as 0.822 ; this shows that 82.2% profitability of the studied listed manufacturing entities in Kenya can be explained by their corporate governance. It then follows that there exists other factors in addition to corporate governance which have an effect on profitability of the studied firms which future scholars should seek to establish. The findings on Analysis of Variance were established and presented as indicated in Table 4.

Table 4: Analysis of Variance

	Sum of Squares	df	Mean Square	F	Sig.
Regression	.379	3	0.126333	89.991	.000 ^b
Residual	.073	52	0.001404		
Total	.452	55			

Source: Researcher (2025)

The results in Table 4 generally indicate that on overall, the regression model that was adopted in this study was significant (F=89.991, p<0.05).

Table 5: Beta Coefficients and Significance

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-.070	.104		-.674	.503
Board size	.171	.113	.112	1.521	.135
Board independence	-.213	.088	-.009	-2.421	.019
Board diversity	.765	.096	.653	7.972	.000

Source: Researcher (2025)

The following equation is predicted and fitted between corporate governance and profitability:

FP = -0.070 + 0.171BS-0.213BI + 0.765BD + ε

Where: FP= Profitability; BS = Board Size; BI= Board Independence; BD = Board Diversity

β₀-β₄ = Beta Coefficients; ε = Error term

Taking the level of significance as 5%, the study noted that while board size was not significance (p lower than 0.05), board independence (p lower than 0.05), board diversity (p lower than 0.05), were significant. This means that on overall corporate governance significantly enhances profitability.

Test for Moderation

Stepwise regression analysis aided moderation testing and Table 6 gives the findings:

Table 6: Model Summary after Moderation

Model	R	R Square	Adjusted R Square	Std. ErrorChange Statistics						Sig.	F
				of Estimate	the Change	R Square	Change	df1	df2		
1	.706 ^a	.499	.490	.06475	.499	53.744	1	54		.000	
2	.733 ^b	.538	.520	.06279	.039	4.434	1	53		.040	
3	.748 ^c	.559	.533	.06191	.021	2.520	1	52		.119	

- a. Predictors: (Constant), Corporate Governance
- b. Predictors: (Constant), Corporate Governance, Inflation rate
- c. Predictors: (Constant), Corporate Governance, Inflation rate, Interaction Term

Source: Researcher (2025)

On overall, there were changes in R-square in model 2 and 3. In particular, there was an R-squared change of 0.039 and 0.021 in models 2 and after introduction of inflation and the interaction term respectively. These changes in R-squared signified the moderating influence of inflation in the model. Table 7 gives the findings of the regression ANOVA findings after testing for moderation of inflation.

Table 7: ANOVA Findings

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.225	1	.225	53.744	.000 ^b
	Residual	.226	54	.004		
	Total	.452	55			
2	Regression	.243	2	.121	30.798	.000 ^c
	Residual	.209	53	.004		
	Total	.452	55			
3	Regression	.252	3	.084	21.960	.000 ^d
	Residual	.199	52	.004		
	Total	.452	55			

a. Dependent Variable: Profitability
b. Predictors: (Constant), Corporate Governance
c. Predictors: (Constant), Corporate Governance, Inflation rate
d. Predictors: (Constant), Corporate Governance, Inflation rate , Interaction Term

Source: Researcher (2025)

Table 7 gives three F calculated values for models 1, 2 and 3 as 53.744, 30.798 and 21.960 with all resultant p-values being $p < 0.05$ implying model significance. Table 8 gives beta coefficients.

Table 8: Coefficients and Significance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.225	1	.225	53.744	.000 ^b
	Residual	.226	54	.004		
	Total	.452	55			
2	Regression	.243	2	.121	30.798	.000 ^c
	Residual	.209	53	.004		
	Total	.452	55			
3	Regression	.252	3	.084	21.960	.000 ^d
	Residual	.199	52	.004		
	Total	.452	55			

Source: Researcher (2025)

From the findings in Table 8 corporate governance is significant under model 1 ($p < 0.05$). In model 2, both corporate governance and inflation rate are significant ($p < 0.05$). With the introduction of interaction term in model 3, both inflation and corporate governance are still significant (p is lower than 0.05). Thus, inflation is a significant moderator.

4.4 Hypotheses Testing and Discussions

Table 9 gives a summary of hypotheses and the findings.

Table 9: Hypotheses Testing and Discussions

Hypotheses	P-value	Deduction
H₀₁: Board size has no effect on profitability of manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya.	.135	p>0.05 hence H ₀₁ was accepted
H₀₂: board independence has no effect on profitability of Manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya.	.019	P<0.05 hence H ₀₂ was rejected
H₀₃: Board diversity has no effect on the financial performance of Manufacturing and allied firms listed at the Nairobi Securities Exchange in Kenya.	.000	P<0.05 hence H ₀₃ was rejected
H₀₆: Inflation has no effect on the relationship between corporate governance and profitability of Manufacturing and allied firms listed at Nairobi Securities Exchange in Kenya.	.040 & .015	P<0.05 hence H ₀₆ was rejected

Source: Researcher (2025)

From results, board size had $p>0.05$ and hence the first hypothesis was accepted. The finding contradict with Shunu et al. (2017) who established that board size had significant positive influence on financial performance according to results of examination using multiple regression techniques. From the results, board independence had $p<0.05$ and hence the second hypothesis was rejected. It was therefore deduced that board independence had significant effect on profitability. The finding is consistent with Gambo, Terzungwe, Joshua, and Agbi (2019) who noted that ROA is significantly impacted by autonomy of board. Musah and Adutwumwaa, (2021) found that financial results of small banking institutions was significantly impacted by autonomy of boards.

From the findings, board diversity had p-value below 0.05 and hence this hypothesis was rejected. Thus, it was inferred that board diversity has significant effect on profitability. The finding is consistent with Morrone, Bianchi, Marsocci and Faioli (2022) who established that neither positive nor negative influences on firm performances can be attributed to board diversity. Dong, Liang and Wanyin (2022) established that there are significant and positive associations between board diversity and firm's success, suggesting that diverse boards are advantageous to firms.

From the results, p-values were $p<0.05$ and hence this hypothesis was rejected. It was therefore inferred that inflation rate was significant. The impact of inflation on financial stability in OPEC countries from 1970 to 2015 was examined by Mostafa and Mohammad (2019). According to findings of nonlinear assessment, impacts of financial stability in OPEC economies will diminish and possibly even become negative in over-threshold inflations. In the study by Odhiambo (2021), the associations amongst corporate governance and financial performances was positively moderated by inflation, and it was proven that there are strong interactions involving governance of a company, finance features, as well as inflation on financial results.

5.0 Conclusion

The nexus between board size and profitability was explored. Based on regression analysis, the study concludes that board size has no significant effect on profitability. The link between board independence and profitability was determined. From the results, the study concludes that board independence had significant effect on profitability. The nexus between board diversity and profitability was determined. From the findings, board diversity has significant effect on profitability. The moderating implication of inflation on the link between CG and profitability was explored. It was concluded from regression analysis that inflation rate was significant.

6.0 Recommendations of the Study

It is critical to review the constitution of directors working with listed manufacturing firms in Kenya. CMA should establish an optimal board size should be used as a benchmark by these listed firms. Board independence was noted to have significant effect on profits. Thus, to improve the profitability of the listed manufacturing firms in Kenya, there is need for more independent and executive directors to be included on boards. It was noted that diversity was significant. Thus, on the basis of this finding, shareholders of the listed manufacturing firms in Kenya should occupy a central role and demand for inclusion of more female and foreign directors to bring in new skills that can enhance profitability. It emerged that inflation had significant effect on profitability. Hence, there is need for the Central Bank of Kenya to have in place relevant policies that can stabilize overall prices of goods in the economy.

On overall, the value of adjusted R-square was given as 0.822; this shows that there exist other additional factors aside from ones that were covered in this study that can potentially influence the relationship between the two variables. Thus, future scholars should be conducted to establish these additional issues. Inquiries in future can be conducted focusing on other firms like those operating in the financial sector in Kenya aside from the manufacturing firms.

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