

# Influence of Corporate Governance on the Performance of Public Organizations in Kenya (a Case of Kenya Ports Authority)

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## Abstract

Corporate governance is a combination of corporate policies and best practices adopted by the corporate bodies to achieve their objectives in relation to their stakeholders (Mallin, 2007). It has been increasingly recognized in public organizations that appropriate corporate governance arrangements are a key element in corporate success (Meredith & Robyn, 2005). They form the basis of a robust, credible and responsive framework necessary to deliver the required accountability and bottom line performance consistent with an organization's objectives. Corporate governance in Kenya has been an important topic because of corporate scandals such as the recent complaints on the composition of the board members in the state corporations against the tribal lines basis. Mismanagement, bureaucracy, wastage, pilferage incompetence and irresponsibility by directors and employees are pointed out in the sessional paper 4 of Government of Kenya as the main problems that have made State Corporations (SC's) fail to achieve their objectives (Reuters, 2004). Kenya's entities have had a history of poor governance system with about 70% of the scandals attributed to weak corporate governance practices, lack of internal controls, and weaknesses in regulatory and supervisory systems as well as conflict of interest. Albeit a lot of literatures have drawn much emphasis on the relationship between corporate governance and ownership and on the relationships little is known about the influence of the corporate governance on performance of public organization. The factors considered include; Board composition, Management compensation, Governance structure and Board size. Kenya Ports Authority (KPA) is the case study in this study. The sample size was 251 respondents of KPA's employees. The study used primary data collected using questionnaires which were given to the respondents at their places of work. Out of the four variables studied it was found that the board composition had a greater influence on the performance of public organizations. The study recommends, among others, that the government should therefore enforce the measures it has laid down on corporate governance to ensure public organizations are following them so that the recommended governance structures are followed.

**Keywords:** Corporate governance, State Corporation, Board

## 1. Introduction

The study sought to establish the influence of corporate governance on the performance of public organizations. A case of Kenya Ports Authority (KPA) was used. Corporate governance is a matter of vital concern for all corporations, large or small, publicly traded or privately held. In Kenya, the policy discussion on corporate governance has focused almost exclusively on publicly traded companies because it is in these enterprises that failures of corporate governance have the most serious and far reaching consequences for the economies of the countries concerned.

Globally, corporate governance has received increased attention because of high-profile scandals stemming from excessive managerial compensation, various abuse of corporate power, recent events, such as the financial crisis that began in mid-2007 and other corporate governance failures (Transparency International, 2010). Corporate governance enhances performance of the corporation by motivating manager to maximize returns on investment, raising operational efficiencies and ensuring long- term productive growth (Coughlin & Schmidt, 1985). Good corporate governance practices can strongly contribute to market development and corporate stability. Without governance mechanisms in place – in particular, a board to direct and control - managers might 'run away with the profits'. Understood this way, good governance minimizes the possibility of poor organizational performance (Meredith & Robyn, 2005).

The challenging task facing policy makers is to design corporate governance frameworks that are secure and benefits all shareholders at large as effective monitors of management whilst preventing them from extracting excessive private benefits of control (Bebchuck et al 2004). Since the early 1990s, many prominent politicians were implicated in Scandals such as the Goldenberg, in which the Kenyan government paid over \$600 million for non-existent gold and diamond exports. There has been renewed interest concerning issues of corporate governance in Kenya, however, relevant data from empirical studies are still few and far between.

### 1.1 Purpose of the study

The study offers valuable contributions from both theoretical and practical points of view. Theoretically, it contributes to the general understanding of the influence of corporate governance on the performance of public organizations. From the practical standpoint, the study contributes greatly on the ongoing debate on corporate governance.

This study answers the following questions: (1) how do governance structures affect the performance of public organizations? (2) In what ways do the management compensation programs affect the performance of public organizations? (3) In which ways does the board composition affect the performance of public organizations? (4) How does the board size influence the performance of public organizations?

Governance in the SC's has become very sensitive issue lately, especially in Kenya due to the allegations of division along tribal lines. Therefore, the readiness of respondent to answer some questions was an issue. Most of the data especially to do with SCs scandals was not easily accessible and it's scanty. Kenya Port Authority is one of the entities found to be relevant to this study. The port of Mombasa can trace its history back many centuries to a time when dhows called at the Old Port on the north side of Mombasa Island. In 1977, the running of Kenya's ports was taken over by the national government, which established the Kenya Ports Authority (KPA) in 1978. The Kenya Port Authority's mandate is to maintain, operate, improve and regulate all scheduled sea ports situated along Kenya's coastline. One of the objectives of KPA is to Instill sound corporate governance practices over and above its aim of developing, maintaining and sustaining port facilities and infrastructure to meet the customer needs.

## 2. Theoretical Review

### 2.1 Agency theory of board composition

Jiatao (1994) developed hypotheses that link the board composition (percentage of outside directors on the board) with three major dimensions of ownership structures and how it affects performance based on agency theory. The effects of these ownership structure variables on board composition will shed light on the governance and control process of firms under different national types of institutional arrangement.

Larcker et al (2004) asserts that because of the agency problem between managers and owners (who are assumed to be represented by the outside directors), neither party will choose to communicate his or her information fully to the other. Outsiders are assumed to control agency problems by making some decisions themselves. When they do, the failure of insiders to communicate their information fully becomes costly. Since outsiders don't always delegate the decision to insiders optimally, shareholders can sometimes be better off by having boards controlled by insiders.

### 2.2 Resource dependency theory of board size.

Jensen & Meckling (1976) argue that board size is better explained by resource dependency theory. This theory suggests that firms examine both the costs and benefits of large boards in determining optimal board size. It suggests that companies are better off with large boards since each new board member brings both expertise and access to resources.

Having more board members would, therefore, provide the firm with greater expertise and access to resources. These resources could include access to markets, access to new and better technologies, and access to raw materials among other things. Large boards are more likely to contain directors with greater diversity in education and industry experience (Jensen & Meckling, 1976). This diversity allows the board members to provide management with high quality advice.

### 2.3 Normative deliberative theory of governance structure

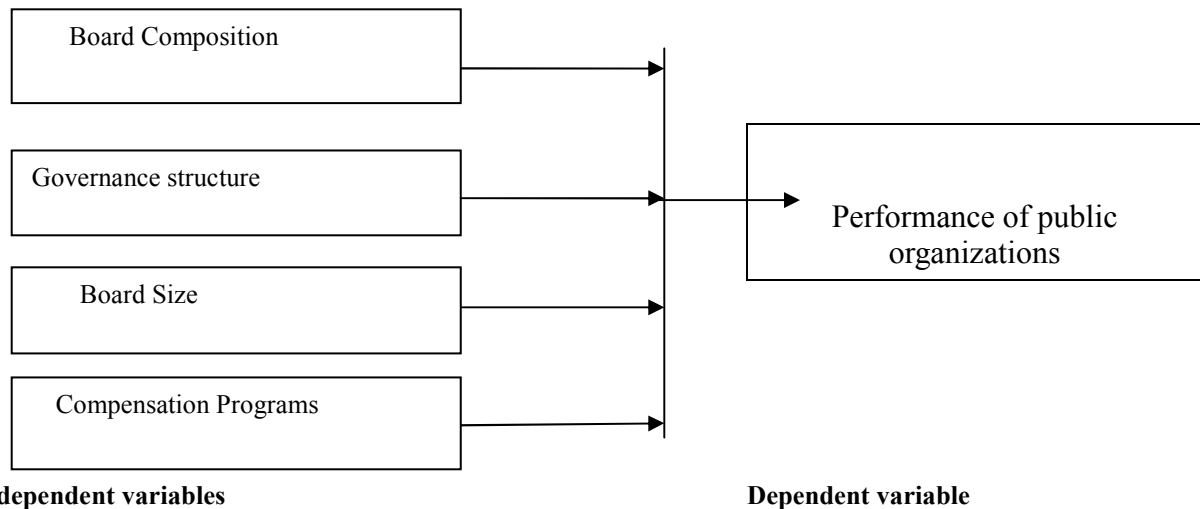
Normative deliberative theory of governance has been proposed by Hajer & Wagenaar (2003) and asserts that governance is explicitly about opening up the participatory processes of democracy, and the importance of language and interpretation in policy-making which determines the performance of a firm. It further argues that the core theme of governance is the same: deliberative governance refers to new places where politics are made under conditions of radical uncertainty and interdependence.

### 2.4 Agency theory of Compensation

Agency theory by Coughlin & Schmidt (1985) asserts that remuneration contracts are efficient if the level of compensation is linked to aspects of performance over which managers have some control. Otherwise, executives would not have any incentive to engage in significant effort to increase firm performance since they know they will be compensated regardless of the performance of the firm. However, Donaldson & Davis (1991) established that it is harder for an executive manager to claim that the company has performed poorly due to general market conditions if other benchmark companies are performing well. This says that contracts, in order to be efficient, we should relate compensation to rises in relative performance e.g. the performance of industry peers or direct competitors.

### 3. Conceptual Framework

A conceptual framework is a structure of the research idea or concept and how it is put together which elaborates the research problem in relation to relevant literature. It's summarized in a schematic diagram that presents the major variables and their hypothesized relationships (Cross et al, 1989). For this study the conceptual framework is summarized as follows.



**Figure 1 Conceptual framework**

### 4. Empirical Review

While the empirical evidence confirms the substitutive effects between direct monitoring by owners and compensation incentives, board monitoring or monitoring by institutional investors may also substitute for direct shareholder monitoring (Cosh & Hughes, 1997). In theory at least, the use of these other mechanisms should also reduce the level of pay-incentives needed to align managers' incentives with those of shareholders. In practice, however, board members become like management and agency costs are expected. Mehran (1995) finds empirical evidence to support this view. He finds that the presence of outside directors, rather than decreasing the level of executive remuneration, actually increases the percentage of equity-based compensation.

Kiel & Nicholson (2004) asserts that there is an "inverted U" relationship between board size and performance in which adding directors can bring the board to an optimal skills/experience mix level. A study by Larcker et al (2004) suggests that eight board members is described as "typical" while Leblanc & Gillies (2003) noted that eight to eleven board members is viewed as optimal. A study by Miring'u & Muoria (2011) found out that the board should neither be too large like 14 members and above nor too small like below 5 so as not to compromise the inter-active discussion during board meeting or to limit inclusion of a wider expertise and skills that are necessary for the board to be effective.

According to CCG (2004) the board should ensure that a proper management structure [organization, systems and people] is in place and make sure that the structure functions to maintain corporate integrity, reputation and responsibility. Systems and structures can provide an environment conducive to good corporate governance practices, but at the end of the day it is the acts or omissions of the people charged with relevant responsibilities that will determine whether governance objectives are in fact achieved.

Systems and structures can provide an environment conducive to good corporate governance practices, but at the end of the day it is the acts or omissions of the people charged with relevant responsibilities that will determine whether governance objectives are in fact achieved. Cairnes (2003) study which puts emphasis on the interaction of human behaviour with corporate governance practices and structures, provides a useful list of early warning signs of bad board behaviours.

Bhagat & Black (2002) undertook the first large sample survey to test whether the degree of board independence correlates with various measures of long-term company performance. They found that, "firms with more independent boards do not perform better than other firms. However, Hermlin & Weisbach (1991) reported that changes in board composition paralleled changes in the level of corporate expect that as diversification increases, the representation of out- siders improves performance. A sample literature reviews reveals a gap in that there is paucity of study about corporate governance influence on the performance. This study contributes to the literature by filling a gap of corporate governance influence on performance of public organizations.

## 5. Research Design Data Analysis and Processing.

The use of open and closed questionnaires contributed towards gathering of quantitative and qualitative data. Quantitative data collected was keyed in and cleaned in a statistical programme for processing. SPSS Version 17 has got descriptive statistics features that assist in variable response comparison and gives clear indication of responses frequencies (Dempsey, 2003). A descriptive research design was adopted in this study. Descriptive technique including mean of the outcome was calculated for each variable. The data was then be analyzed using multiple regression technique where the relationship between the independent and dependent variable was determined. A pilot study was carried out to test the reliability and validity of the questionnaires which helped establish whether the instruments are comprehensive to elicit the intended information exhaustively.

The population in target was KPA employees' of about 6000 at all three levels of management, including top level, middle level and lower level of management. This study used the purposive sampling technique to identify the sample of 251 from the employees. Data was collected using quantative method through the use of a questionnaire. The open and closed questionnaires were administered to a total of fifty respondents which was later analyzed.

**Table 1:**

Sampling frame

Sections	Population (Frequency)	Sample Ratio	Sample
Top management	25	0.2	5
Middle level management	35	0.2	7
Low level management	188	0.2	38
<b>Total</b>	251	0.2	50

Source: Author, (2012)

## 6. Research findings and discussion.

Out of the 50 questionnaires sent to the sampled population, consisting of the staff working in KPA, ICDE, 37 questionnaires were returned completely filled which makes a response rate of 74%. The commendable response rate was achieved after the researcher made telephone calls and personally administered the questionnaires. Each respondent was briefly introduced to the intent of the study and how his/her contribution would highly add value to the study.

This response was in line with Mugenda (2003) recommendation of an acceptable response rate of more than 60% of the sample which is adequate to small population whereas a response rate of more than 40% is required for big population. Mugenda indicates that high response rate reduces the risk of bias in the responses and if the response rate is very low the researcher should find out the reason behind non responses and whether those can jeopardize the outcome of the study.

### Board composition

The study sought to establish the extent to which board composition influence the performance of KPA. The board composition is the insiders and outsiders represented in the board. It also defines the political and professionals in the board of an organization.

The result on board composition indicated that respondents felt the board control by outsiders is sufficient to support the performance of KPA. A score of a mean of 4.4 shown that the respondents agreed with the sentiments of good board composition of outsiders and a score of a mean of 4.1 on insiders showed that the insider directors are well represented.

**Table 2**

Board composition	Mean
Board control by outsiders is sufficient to support performance	4.4
Insiders are well represented in the board to ensure performance	4.1
Number of Port professionals in the Board are adequate to ensure performance of KPA	4.4
Government officials in the board are controlled to ensure performance	3.6
Number of years of a member in the board supports KPA performance	3.84
Number of politicians in the board are well controlled to boost KPA performance	4.56

### Board size

The study was geared to establish whether the board size in KPA supports its performance. Board size was largely referring to the number of members in the board. The respondents were asked whether the board present is sufficient to support performance. From table 3, a score of 3.75 mean from the number of members in the Board indicates that the number of board members was deemed to be sufficient to support the performance of KPA. Table 3 further illustrates that the board independence had a score of 4.43 suggesting that the KPA board is deemed to be independent enough to support the performance of KPA. This concurs with Nicholson & Kiel (2004) study which points out that there are other reasons for appointing independent directors to the board: to ensure an appropriate mix of skills and expertise to govern effectively – in particular, to facilitate good decision-making - if they are not available in-house; to help ensure board diversity, in turn minimizing ‘group think’; and to gain access to external business and other contacts information and resources.

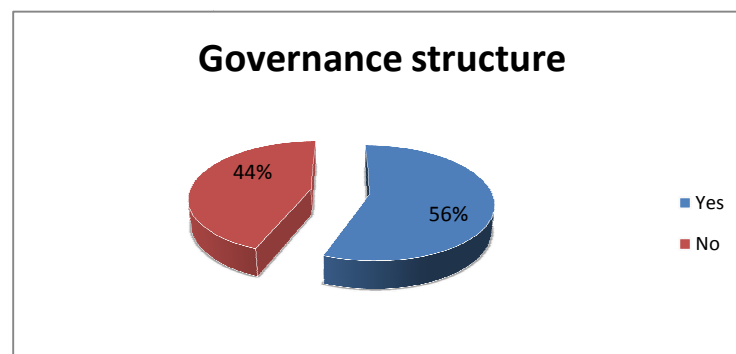
**Table 3 Board size**

Board size	Mean
Number of members in the board are sufficient to support performance	3.75
Number of independent in the board are sufficient to support performance	4.43
The replaced members in the board are few to reflect KPA good performance	3.72
Board members retire by rotation to support good performance of KPA	3.8
Professional members are adequate in the board to support KPA performance	4.2
Number of sacked members within the board the last three years is few to reflect KPA good performance.	3.1

### Governance structure

The study sought to establish the whether the governance structure in place supports the performance of KPA. This is presented in the figure shown below. Findings presented indicate that 56% of the respondent felt that the governance structure in place supports KPA performance. On the other hand 44% were of the opinion that the governance structure in place does not support the performance of KPA.

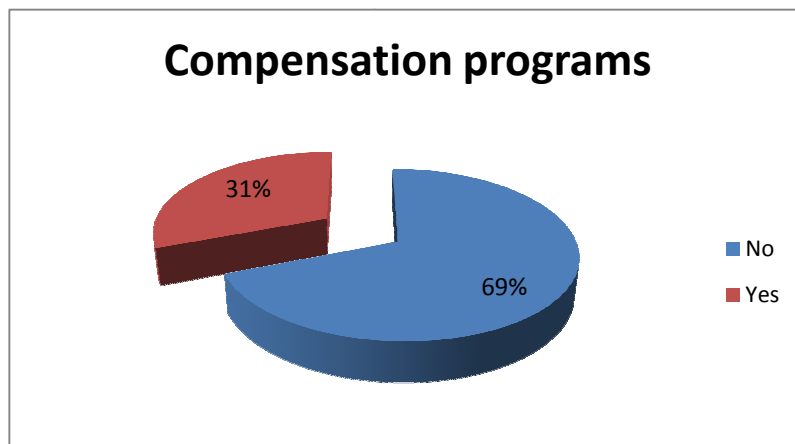
**Figure 2**



### Compensation Programs.

The study aimed at finding out the whether the compensation programs adequately supports the performance of KPA. The results were illustrated in the figure below.

**Figure 3**



Source: Field Survey (2012)

Findings presented indicates that 31% of the respondent were of the opinion that the compensation programs supports the performance of KPA while 69% do not agree that the compensations programs put in place supports the performance of KPA. Most of the disagreement was raised from the lower level of management who felt that the compensation programs were not supportive enough. This results were in line with those of Lawrence & Marcus (2004) in which their study on Corporate Governance and Firm Performance found out that independent board of directors, nominating committees, and compensation committees are associated with good firm performance, suggesting that these exchange requirements may facilitate good performance.

### 7. Regression Analysis

In this study, a multiple regression analysis was conducted to test the influence among predictor variables. The research used statistical package for social sciences (SPSS) to code, enter and compute the measurements of the multiple regressions. The regression equation below has established that taking all factors into account (board composition, board size, and governance structure and compensation programs) influenced the performance of KPA.

**Table 4: Model summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.875(a)	.76625	.766232	2.04485

a independent variable  $\alpha$ ,  $X_1$ ,  $X_2$ ,  $X_3$ ,  $X_4$

**Table 5: ANOVA (b)**

Model		Sum of squares	df	Mean square	F	Sig
1	Regression	37.537	5	7.50745	4.406	.003
	Residual	6.6903	63	0.1854		

a independent variable  $\alpha$ ,  $X_1$ ,  $X_2$ ,  $X_3$ ,  $X_4$

b dependent variable: Y

Equation:  $(Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon)$  becomes;  $Y=1.492 + 0.617X_1+ 0.702X_2+ 0.596X_3+ 0.883X_4$

**Table 6 Regression Coefficients**

		Unstandardized Coefficients				
		B	Std. Error	Beta	t	Sig.
Equation 1	(Constant)	15.75	0.842		4.009	0.000
	Board composition	0.617	0.145	-0.330	2.276	0.0115
	Board size	0.702	0.165	-0.089	0.849	0.0097
	Compensation programs	0.596	0.116	0.080	0.673	0.0074
	Governance structure	0.883	0.113	0.032	-0.408	0.0083

From table above, R-Squared is a commonly used statistic to evaluate model fit. R-square is 1 minus the ratio of residual variability. From the above table 4, the adjusted R<sup>2</sup>, also called the coefficient of multiple determinations, is the percent of the variance in the dependent explained uniquely or jointly by the independent variables (board composition, board size, and governance structure and compensation programs) 76.6% of the performance of KPA could be attributed to the combined effect of the predictor variables. Analysis of variance (ANOVA) above was used to investigate the degree of relationship between the variables of the study indicating the strength and the direction of association of each variable.

The probability of 0.03 indicates that the regression relationship was highly significant in predicting the influence of corporate governance on the performance of public sector. As per the SPSS generated table above, the equation; the F-critical at a 5% level of significance was 4.406 since F calculated is greater than the F-critical (value = 2.830), this shows that the overall model was significant (Table 6).

As per the SPSS generated in table 5, the equation;  $(Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon)$  becomes;  $Y=1.492 + 0.617X_1 + 0.702X_2 + 0.596X_3 + 0.883X_4$ . The equation above was established through taking into considerations all factors into account (board composition, board size, and governance structure and compensation programs). A standard deviation of 45 in the board composition shows that, board composition to a greater extent influence the performance of public organizations.

## 8. Results and Findings

The study targeted 251 respondents in KPA in collecting data with regard to the influence of corporate governance on the performance of public organizations. From the findings, 32.8% had served in KPA between 6-10 yrs, 23.9% between 1-5 years and 11-15 years respectively, 11.9% between 16-20 years while 7.5% had served for over 21 years in KPA respectively. Male respondents were 70.1% whilst the female respondents were represented by 29.9%. The study also required the respondents to indicate the highest level of education achieved. According to the research findings, 44.8% had degree certificates, 32.8% had masters while 22.4% had diploma certificates respectively. The respondents agree with the sentiments of good board composition of outsiders and the insider directors too are well presented. Also the respondents agreed the board members were sufficient to support the performance of KPA.

## 9. Recommendations

The study recommends among other things that the government ought to enforce the measures it has laid down on corporate governance to ensure public organizations are following them so that the recommended governance structures are followed. The concerned ministries should also be very keen in the supervisory role through the relevant committees to ensure that all regulations are enforced as required e.g. the board elected is independent. The government should ensure that the number of politicians sitting on the board in public organizations depends on the firm size, its juridical form, ownership structure and industry.

## 10. Recommendations for Further Studies

The study purports that good performance of public organizations is influenced in a way by corporate governance. However, the study does not openly rule out the fact that some other variables in the environment could be critical for public organizations performance. Hence, future research could usefully focus on corporate governance practices in other state corporations like the non – commercial state corporations comprising those that are of regulatory, educational, research institutes, and other institutions.

## 11. Conclusion

The study concludes that sufficient evidence emerged showing that it is necessary to embark on good board composition in public organizations which supports them in achieving better performance. According Hermalin and Weisbach (1998) those entities that are performing relatively well are those that have embraced corporate governance in their organization. Further, the study established most public organizations have opted to have relatively large board numbers whilst there are different group compensation systems as there are group practices, and each system has its own strengths and weaknesses.

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## APPENDICES

### **Appendix I: A letter.**

The Manager  
Inland Container Depot,  
Nairobi

### **RE: REQUEST FOR DATA COLLECTION**

My name is Sicily Makena a student at Jomo Kenyatta University undertaking Masters in Business Administration {finance option}. As part of my course, I am required to carry out a research on a topic of concern. I have chosen to study influence of corporate governance on the Kenya Ports Authority (KPA).

Having selected several KPA employees as participants in the research, I will require them to fill out questionnaires. Kindly allow me to collect data from the employees at this station. This is purely an academic study and note that all information given by you shall be treated with utmost confidentiality.

Attached is a copy of the questionnaire

Kind regards,

Sicily Makena.

### **Appendix II: Research Questionnaire**

#### **Introduction**

My name is Sicily Makena a student at Jomo Kenyatta University undertaking Masters in Business Administration {finance option}. As part of my course, I am required to carry out a research on a topic of concern. I have chosen to study on influence of corporate governance on the Kenya Ports Authority (KPA) and you have been selected as one of the participants in the study. Kindly fill in the questions that follow. This is purely an academic study and note that all information given by you shall be treated with utmost confidentiality.

Kindly fill in the following:

#### **SECTION 1: BACKGROUND INFORMATION**

1. Name (optional).....
2. Gender  
Male { } Female { }
3. What is your highest level of education?
  - a. Secondary { }
  - b. Tertiary college { }
  - c. University graduate { }
  - d. University postgraduate { }
  - e. Other (please specify ) \_\_\_\_\_
4. Which is your department?

Human resource	{ }	Finance	{ }
Procurement	{ }	Operations	{ }
Marketing	{ }	other specify.....	{ }..
5. Level of management  
{ } top level  
{ } middle level  
{ } bottom level
6. Number of years in KPA  
{ } Below one years  
{ } One to three years  
{ } Three to five years  
{ } Five years and above
7. How many employees fall under your supervision?

## SECTION 2: THE VARIABLES

### A. Governance structure

The table below illustrates views in regards to the governance structure in KPA Use a scale of 1 to 5 where 1 is Strongly Disagree, 2 is Disagree, 3 is Neutral, 4 is Agree and 5 is strongly agree.

Governance Structure	1	2	3	4	5
Do you believe the structure adopted by KPA management supports good performance					
All tribes are well represented for better performance in KPA					
Managing Directors Tenure is well and adequately determined to better performance of KPA					
The number of times there have been MD change since 2005 is once					
The board members retire after every 5 years					
There are sufficient number of co directors in KPA to support its performance					

8. Are there enough board members in KPA to make good decisions for the corporation?.....

9. Does the board established add value to the performance of KPA? Explain.....

10. In your view, are the current governance structures efficient in the case of KPA performance? Explain?.....

### B. Board composition

The table below illustrates views in regards board composition in KPA. Use a scale of 1 to 5 where 1 is Strongly Disagree, 2 is Disagree, 3 is Neutral, 4 is Agree and 5 is strongly agree.

Board composition	1	2	3	4	5
Board control by outsiders is sufficient to support performance					
Insiders are well represented in the board to ensure performance					
Number of Port professionals in the Board are adequate to ensure performance of KPA					
Government officials in the board are controlled to ensure performance					
Number of years of a member in the board supports KPA performance					
Number of politicians in the board are well controlled to boost KPA performance					

11. Do you think that the Board composition has well represented different communities in Kenya? .....

C. The CEO and chairman duties are separated or a lead director is specified?.....

### Board size

The table below illustrates views in regards board size in KPA. Use a scale of 1 to 5 where 1 is Strongly Disagree, 2 is Disagree, 3 is Neutral, 4 is Agree and 5 is strongly agree.

<b>Board size</b>	1	2	3	4	5
Number of members in the board are sufficient to support performance					
Number of independent in the board are sufficient to support performance					
The replaced members in the board are few to reflect KPA good performance					
Board members retire by rotation to support good performance of KPA					
Professional members are adequate in the board to support KPA performance					
Number of sacked members within the board the last three years is few to reflect KPA good performance.					

13. Does the board established add value to the performance of KPA? Explain .....

14. Do you think there are sufficient number of members in the KPA board to influence appropriate decision making.....

#### D. Compensation programs

The table below illustrates views in regards compensation programs in KPA. Use a scale of 1 to 5 where 1 is Strongly Disagree, 2 is Disagree, 3 is Neutral, 4 is Agree and 5 is strongly agree.

<b>Compensation programs</b>	1	2	3	4	5
Do you agree that the current compensation programs have many positive features?					
The key values' underlying the compensation programs supports the goals of the employees.					
Most employees in KPA are comfortable with the current compensation systems.					

15. Do you feel you that you are adequately compensated as one of the employees in KPA?.....

16. Do you feel you that you are adequately compensated as one of the employees in KPA?.....

#### E. KPA Throughput 2005-2009

The table below illustrates views in regards performance of KPA in five years span period.

Details	2005	2006	2007	2008	2009
Container traffic					
Transshipment					
Total Vessel Calls					

17. How many containers are cleared from this Inland Container Depot? Do you feel there is any container traffic? Explain.....

18. What are the events or things that would make you term KPA as inefficient or efficient? Explain.....