

The relationship between the Board of Director's Composition and Performance of Commercial State Corporations in Kenya

Mary Wanjira Kamaara

Jomo Kenyatta University of Agriculture And Technology Nairobi

Dr Hazel Gachunga

Jomo Kenyatta University of Agriculture And Technology Nairobi

Professor Martin Ogutu

University of Nairobi

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Abstract

The aim of the study was to assess the relationship between the board of directors' composition and performance of Commercial State Corporation in Kenya. The target population constituted 29 Commercial State Corporations in Kenya. The objective was to establish the relationship between the size, gender and representation of the board members and how these variables impact on performance.

A sample of 133 respondents was selected using stratified random sampling but only 100 respondents were interviewed using the questionnaire method.

The major findings from the study were that there is a relationship between the composition of the board of directors and the performance of Commercial State Corporations in Kenya.

The study further recommended that in the board composition factor framework, state corporation size, gender, and independence be considered in the appointment of directors of BODs of CSCs in Kenya. Specifically, the constitutional requirement of 30 percent presence of either gender be met, a board size of say 10-12 directors and independence of the parent ministry in appointment.

Keywords: Corporations, Boards, Relationships, State Corporations, Performance

1.0 Introduction

The board of governors (BOD) is the most recognized governance institution in any organization. Its major role is to regulate. The monitoring is between state incorporation laws and the stock exchange governance requirements. Most firms are required to have a board that meets a multitude of requirements: it must have at least so many members, it must meet with at least some specified regularity, it may need to have various committees, and some fraction of the directors may be obligated to have some nominal independence from management.

The Board of Directors like any other organization is a system in which the behavior is shaped by the design elements and the organization culture. The more effectively the elements in the BOD design are aligned with each other and the BOD's role and the more deliberate the BOD is in defining the behavior it wants to encourage, the more likely the system is to produce behavior that will make the BOD effective (Carter and Lorsch , 2004). Therefore each BOD needs to be redesigned from the ground up not in a piecemeal fashion but by understanding itself as a system in which the elements should all be aligned. Lorsch & Carter (2004) view the board design as: Board structure, its size and leadership and the committees it requires to accomplish roles. The BOD composition – the mix of experience, skills and other attributes of its members. The BOD processes – how it gathers information, builds knowledge and makes decisions

2.0 Statement of the Problem

In Kenya the board rooms have been dominated by males. Within the boards, the women generally hold the positions of non-executive independent directors. Currently with the recent transition of the devolved governments the role of the board cannot be overemphasized. The emphasis for organization performance demands for competent boards which will drive the organization to the next level. Boards need all rounded personalities with academic and high ethical standards. The requirements by the government for anyone taking up a public office to be vetted and cleared will go along way to give a facelift to the boards. Locally, although BOD has been a centre of focus, the relationship between the boards of directors' composition on performance of commercial state corporations has not received much study.

According to a report from the Business review (2013) "The inclusion of women on the board of a company is a matter of equal opportunity. Having women in the boards of companies simply makes good business sense." Kenyan women, it seems, are no longer waiting to be allocated a proportion of the jobs on offer. Instead, in every corner of the private sector, they are entering in greater numbers, and even capturing the top jobs because they are qualified and have so far proven to be outstanding. The gap is in the public sector in Kenya State corporations, where the women representation as board members and executives is less than 15%. The main question that the study will attempt to answer is: Does the board of directors' composition determine and affect performance of commercial state corporations in Kenya? This question will be addressed by examining how performance is affected by board composition which includes size, gender, and board representation.

3.0 Objectives

- i) To establish the relationship between board of directors size and performance of commercial state Corporations in Kenya.
- ii) To establish the effect of the board of directors gender and performance of commercial state corporations

- iii) To establish the relationship between the board of directors representation members and performance of CSC in Kenya

4.0 Justification of the Study

The performance of CSC in Kenya has been low. However, the government has put reforms in place which will address this issue. One of the requirements in the new constitution dispensation states that no gender should occupy more than two-thirds of boardroom seats in State-owned companies or in firms where the government's stake is more than half. The composition of the board should therefore be well balanced in terms of gender, size and representation of board members from all sectors. We cannot assume that the performance of the CSC relies a lot on the composition of the board members. It is therefore necessary to assess the performance of the commercial state corporations vis a vis the composition of the board of directors and determine whether there is a relationship.

5.0 Limitations

One of the limitations of the study was the fact that some of the relevant information related to board of directors is sensitive hence respondents may not be willing to divulge it. To counter this, respondents were assured of anonymity and confidentiality so that they do not feel at risk of victimization. The study scope required massive efforts in time for the respondents and this presented a problem given the limited amount of time allocated to the respondents for handling academic research issues or issues not related to the corporation's day-to-day operations. This was overcome through the preparation of a well calculated schedule and carrying the exercise through timely schedules and use of contingency planning.

6.0 Literature Review

According to the Corporate Governance report 2010, the board should have an optimum size of 7-11 directors. This is essentially good for firm performance according to researchers such as Jensen, (1993) and Lipton & Lorsch, (1992) who argue that large board sizes are less effective for firm performance. An appropriate mix of age, gender, geographical spread experiences and team roles. It also needs adequate size and appropriate levels of independence and commitment. Integrity is a fundamental requirement in choosing corporate officers and board members (Ritchie & Kolodinsky, 2009). In considering nominations for appointment to the Board, gender and diversity of experience is taken into consideration. The board size should have a balance of skills and experience appropriate for the requirement of the business. It is claimed that a greater proportion of outside directors on boards act to monitor independently in situations where conflict of interest between the shareholders and managers occurs, as potentially having a positive impact on performance (Fama & Jensen, 1983; Jensen & Meckling, 1976; Shleifer & Vishny, 1997).

On the issue of CEO duality most countries advocate for the separation of the two roles. CEO duality has been blamed for the governance failures in corporate giants such as Enron, WorldCom, and HIH, and hence, most of the governance reforms worldwide have pressured firms to split the chairman and CEO roles. The argument for splitting these two roles arises from the fact that one of the main tasks of the board is to evaluate top management, especially the CEO. In circumstances where the person who manages the firm also chairs the board meetings and controls the information given to the board, then it is questionable as to whether such a board is capable of seriously evaluating and challenging the CEO. A CEO who is the sole manager on the board is argued to be more powerful than boards consisting of other managers and thus may influence decision-making, which in turn can have a negative

impact on performance (Adams et al., 2005). This notion stems from the idea that other executives on the board could be rivals for the CEO's power and position and will influence decision making together with the CEO therefore making the CEO less powerful.

Though the issue of whether directors should be employees of or affiliated with the firm (inside directors) or outsiders has been well researched, yet no clear conclusion is reached. On the one hand, inside directors are more familiar with the firm's activities and they can act as monitors to top management if they perceive the opportunity to advance into positions held by incompetent executives. On the other hand, outside directors may act as "professional referees" to ensure that competition among insiders stimulates actions consistent with shareholder value maximization (Fama, 1980). John and Senbet (1998), argue that boards of directors are more independent as the proportion of their outside directors increases. Though it has been argued Fama & Jensen, (1983), Baysinger and Butler, (1985), Baysinger & Hoskinsson, (1990), Baums, (1994), that the effectiveness of a board depends on the optimal mix of inside and outside directors, there is very little theory on the determinants of an optimal board composition (Hermalin & Weisbach, 2002).

7.0 Research Methodology

The study used a descriptive research design to gather quantitative data that describes the relationship between the BODs composition on performance of commercial state corporations in Kenya.

The research study used quantitative and qualitative approaches. Quantitative approach was applicable since it involved dealing with statistical data which was verified on the ground and computed in numbers and percentages. Where some responses did not require statistical analysis, qualitative research method was used to give opinions and more details about the respondents. The qualitative approach was applicable during the informant interviews with the CSCs board of directors' members. According to Orodho et al (2003) describe it as a method of collecting information by interviewing or administering a questionnaire to a sample of individuals. It can be used to collect information about people's attitude, opinions, habits or any other social issues.

8.0 Target Population

Population can be defined as an entire group of individual or objects having common observable composition (Mugenda and Mugenda, 2003). According to the data available from the report on the Review of Performance Contracting in the Public Sector from the Prime Minister's Office (OPM) (2010), there are 29 state corporations. In this case, the unit of analysis was the commercial state corporations, of which 20 were selected purposively, to include only those corporations whose performance was ranked.

Similarly, Sekaran (2009) noted that units of observation represent the actual source of data collection from which the unit of analysis is assessed. In this study therefore, unit of observation was the BOD representatives who included 100 board members among them were the board chair, the secretary and representatives from government organizations as well as independent members from other organizations.

9.0 Sample Design

A sample is a collection of units from a population used to determine truths about the population (Field Andy 2005). Nachmias and Nachmias (2008) have observed that a sample must be derived from the population that is active in the phenomena being studied. Sampling is done to some elements of a population so that conclusions about the whole population can be drawn.

This study used stratified random sampling which according to Kothari (2007) consists of selecting the elements from each of the population strata. For the purpose of this study the sample frame was 20 commercial state corporations. Other scholars in this area used similar populations eg listed firms in the Nairobi Stock exchange to conduct studies on performance of publicly quoted companies in various countries (Irungu, 2007; Bathula, 2008; Kajola, 2008; Ongore, 2008). The sample for this study involved 20 state corporations which is 65% of the population with 204 board members who were the target respondents as according to Mugenda and Mugenda, (2006) over 30 units or 10 % of the population is adequate enough to conduct statistical inferences for a study. The study applied stratified random sampling to arrive at the 20 selected commercial state corporations within ease of accessibility. This would bring total sample size to be 133, which is 65% (133/204) of the total population

10.0 Research Instruments

The study used open and closed end questionnaires as the main data collection instruments. Questionnaires are effective data collection instruments that allow respondents to give much of their opinions pertaining to the research problem (Dempsey, 2003).

Many studies in the area of boards have used the likert scale these scholars in this study area include (Irungu, 2007; Ongore, 2008) who both studied boards in Kenya. The instrument was therefore adapted and contextualized. According to Cooper and Schindler (2006) structured and unstructured questionnaires address closed end questions and open end questions that assist respondents to give information sought by the study.

11.0 Secondary data

Secondary data was essential in getting details on the project. This data included the relevant acts, State Corporation guidelines, document, and performance reports among others.

12.0 Pilot Study

The researcher conducted a pilot study before the main collection of data. The piloting was carried out at 5 Commercial State Corporations through simple random sampling and administered the Questionnaire to them. A pilot study was conducted using questionnaires administered to 10 members of the boards from 5 commercial state corporations. Two respondents were selected from the five firms using random sampling. The rule of thumb of 1% for a pilot study as recommended by Nachmias & Nachmias, (2008) and Sekaran (2009) was applied in this study.

13.0 Data Collection Procedures

The researcher visited the 20 commercial state corporations prior to the actual research for familiarization with the environment. The questionnaires were distributed one day prior to the main study. The researcher went back after two days and administered the questionnaire. The collection of the questionnaire was done as scheduled with the respondents from the various organizations.

14.0 Findings from the study included:

14.1 Board Composition Size

According to the Centre for Corporate Governance report (2009) in Kenya the optimum size of the board should be 7 to 11 directors. An appropriate mix of age, gender, geographic spread experiences and team roles. According to David and Seem (2013) boards of directors are also critical players in the governance matrix. They observe that boards of large publicly-traded companies in the US range in size from 4 to 35 directors, with an average of 11 members. Boards in other countries average 12 but American boards tend to have far fewer insiders than boards in other countries. American boards typically have two or three insiders, while Japanese boards rarely have more than two outsiders. German and Dutch governance is built around a two-tier governance structure, with employees holding half of the upper-tier seats. British and Swiss governance is designed around a single-tier, management-dominated structure. Thus, practices differ even among those countries with the strongest and most tightly-linked economies.

According to this study the board size in the CSC was between 7 and 14 members. The board categories included the independent members who ranged between 4 and 3. The average number of independent board members in the CSC was between 4.56 with a relatively high variation of 2.086 confirmed by the fact that the minimum number was 0 and the maximum number of board members was 4. This study supports what other scholars concluded on independent directors. Shan and McIver (2011) in their study of corporate governance mechanisms and financial performance in China used sampled data from financial websites and the China Stock Exchange market covering 117 companies. They applied two board characteristics namely, independence of board of directors at management and supervisory boards, and level of concentration in the type of ownership of the company. The respondents from the government representative's members ranged between 4 to 5 members. This was expected as the CSC is State owned. From the research the state corporations are in line with the state corporation guidelines 2012 where government representation should form the majority of the members on the boards.

The boards of CSC also consist of member representatives from other organizations. This can be independent board members who are not employees of the government; they are either self employed or work for non governmental organizations or from the private sector, they are the minority on the board. This means that there were 3 representatives on average from other organizations.

14.2 Gender representation on the boards of commercial State Corporations

14.2.1 Gender independent representation - Male

In terms of gender representation on the boards' this study found that, the men sitting on boards from other organizations . The mean was 3 male members per board and the range was between 2 and 3 males per board. This is in support of what other scholars have said about men dominating the boards not only in Kenya but world wide. According to a study in the Business Daily (2013) on Corporate Kenya, of Nairobi Stock Exchange -listed companies it was observed that boards vary widely in their composition with regard to the ages of directors, professional background, gender and even nationality. While it may be said that there are companies whose boards exhibit admirable balance in the mix of personalities, most of the CSCs boards remain in the barely acceptable to the high concern territory. One clear area of lapse is in the fact that representation of women in the boards of CSCs and other companies in Kenya remains low. Overall, it is the finding of this study that a small fraction of CSCs meet the diversity threshold. But most are in bad shape and need to focus more on

professional, gender, age and nationality dimensions of inclusivity. The ball is squarely in courts of the respective nominations committees of the boards who must take time off to reflect on the diversity dividend that their companies may be missing in failing the test of inclusivity along the said lines. The one third rule and other considerations of regional balance as per the new constitution dispensation are areas that need to be put into consideration.

14.2.2 Gender independent representation - female

The representation of females on from other organizations ranged between 1 and 2 members. Within the CSCs boards, the women generally hold the positions of non-executive independent directors or represent the various ministries; none of these Commercial State Corporations has a woman as the chair person in the board. The women representation is low this has led to the 2/3 representation as per the new constitution dispensation in Kenya.

In comparison to the research from other scholars on the women members of the boards, an example of Nairobi Stock Exchange companies, only two women directors who are chief executives or managing directors of the companies in whose boards they sit. Another issue of interest with regard to the two sole female CEOs of the companies is that they are both non-citizens of Kenya. A survey by Brain Trust Strategies (2012) shows that women now occupy a total of 55 positions as directors in Kenya's publicly quoted firms. This means that the number of women in the boards of companies listed at the NSE globally has grown almost sevenfold in the last decade. "The inclusion of women on the board of a company is a matter of equal opportunity. Having women in the boards of companies simply makes good business sense," says the report. Kenyan women, it seems, are no longer waiting to be allocated a proportion of the jobs on offer. Instead, in every corner of the private sector, they are entering in greater numbers, and then capturing the top jobs because they are qualified and have so far proven to be outstanding.

It appears the few women who break into the directorship league are used by several firms, meaning that while more companies may have female representation, the trajectory is towards the emergence of a special club of boardroom girls.

The under-representation of women has also been caused by the requirement in many companies that one has either previous boardroom or executive experience, especially that of CEO and chief financial officer to serve in a board. Slow and marginal as the advance of women may be, women need to groom themselves to take up the top jobs.

14.2.3 Gender male the GOK representation

Gender GOK representatives ranged between 2 to 3 male members. According to Scott and Mazhindu (2005) Standard deviation is a measure of the variation of the data that evaluates how much this case deviates from the mean. The standard deviation is low, indicating that the dispersion of the number of men representing GOK on the board from the mean is higher than that of women.

But the survey also shows that old habits are dying only slowly and about a third or 22 firms listed at the Nairobi bourse do not have female directors in their boards yet. Male dominance on boards is blamed on old boy networks for directorship appointments.

14.2.4 GOK female representation

Gender GOK representatives female ranged between 2 and 1 female members sometimes even none. The dispersion of the number of women representing GOK on the board from the mean is low compared to that of male representation. The under-representation of women

has also been caused by the requirement in many companies that one has to have served on a board of which most women have not. Slow and marginal as the advance of women may be, women need to groom themselves to take up the top jobs. In their findings, Simpson *et al* (2010) observed that results of analysis did not support the business case for inclusion of women and ethnic minorities on corporate boards. However, they found no evidence of any negative effect either. Accordingly that evidence implies that decisions concerning the appointment of women and ethnic minorities to corporate boards should be based on criteria other than future financial performance.

14.2.5 Other organizations male representation

On the issue of gender representatives from other organizations male ranged between 1 and 2 members. However it is still higher than the female representation from the other organization

14.2.6 Other organizations female representation

On the issue of women representation from other organizations, this ranged between 0 and 1 female member. Their roles in the boardrooms are, however, muted and the bulk of company secretaries have no vote in board deliberations despite the fact that they can be held liable in the same way as a company director for breach of a company's fiduciary duties. The bottom-line is that while these women sit in the boardrooms, they have little say in the decisions being made and can therefore not be said to be enhancing the flow of fresh ideas in the boards.

A study by global consultancy firm McKinsey in 2007 found that companies with significant numbers of women in senior management did better on a range of criteria, including leadership, accountability and innovation. These attributes were associated with higher operating margins and market capitalization. Such findings have led corporate regulators like the Capital Markets Authority (CMA) to push for a quota system that would break male domination of the corporate world's most important decision making organ – the boardroom. Proponents of the quota system say it helps to break the vicious cycle by increasing the number of women at the top, who in turn invite other women into the boardrooms. In seeking the quota system, Kenya will be following in the footsteps of some European countries that have used similar laws to bridge gender gaps. Norway, for instance, gave its public companies two years in 2005 to raise the number of women in their boards to 40 per cent.

In Kenya recently one of the CSC Kenya Power has shaken up its boardroom to meet the constitutional requirement for women directorship quotas. The power firm has appointed two women as directors, pushing the share of women directors to a third in the nine-member board. Kenya Power, which is owned 50.08 per cent by the government, dropped two men as directors. The law, which came into force on August 27, 2010, requires that no gender should occupy more than two-thirds of boardroom seats in State-owned companies or in firms where the government's stake is more than half.

Kenya Power has been in breach since it had only one female director. Other State-owned firms aligned to the Energy ministry including Kenya Electricity Transmission Company (Ketraco), KenGen and Geothermal Development Company (GDC) is among the few with boards that meet gender diversity limit. The number of women in boardrooms of State-owned companies' stands at less than 15 per cent, according to the Institute of Directors (Kenya), reflecting the influence that old-boy networks have had on directors appointments.

The Kenya Power board shake-up comes at a time that women's role in the boardrooms of Nairobi bourse-listed firms remains muted.

A study by Kenya Institute of Management (KIM) shows that 34 per cent of the 57 companies it examined at the Nairobi bourse do not have a woman on their boards at a time that the capital markets regulator is pushing for mandatory gender caps. KIM blames the reliance on old-boy networks for directorship appointments since boards have traditionally been made up of retired men of similar backgrounds who recruit from a network of friends. The under-representation of women at the top level of big business has also been caused by the requirement that one has either previous boardroom or executive experience, especially that of CEO and chief financial officer. At present, only two women are chief executive officers in publicly quoted companies.

15.0 Directors holding more than one position

On the issue of whether the directors hold any other directorships in other corporations 13% agreed that they hold other directorships while 87% do not hold any other directorships.

According to the Capital Markets Authority Corporate governance guidelines (2011) limit an individual from holding more than five directorship positions and two chairmanships in publicly quoted companies. To enforce this, the regulator has made public its intention to include the guidelines in the new Companies Act that Parliament is expected to enact by end of the year.

However the current situation in the NSE shows that this is further reinforced by the fact that three male directors are chairmen of more than one listed firm. In contrast, four male CEOs serve in the boards of other listed firms.

16.0 Board Composition appointments

On the issue on how board members are appointed in the CSC it was observed that all of them were nominated. However, on the issue of what considerations are used in the appointment of board members shows that 23% based on experience and qualification, 22% based on experience qualification and skills, 18% on qualifications, 12% qualification and skills, 10% based on skills, 9% based on experience, 5% based on experience and skill and 1% based on other considerations. According to the business daily (2013) Kenyan women, it seems, are no longer waiting to be allocated a proportion of the jobs on offer. Instead, in every corner of the private sector, they are entering in greater numbers, and then capturing the top jobs because they are qualified and have so far proven to be outstanding. But the survey also shows that old habits are dying only slowly and about a third or 22 firms listed at the Nairobi bourse do not have female directors in their boards yet. Male dominance on boards is blamed on old boy networks for directorship appointments. This is further reinforced by the fact that three male directors are chairmen of more than one listed firm No female chairman or chief executive heads another company's board, but three women have directorships in multiple firms.

In contrast, four male CEOs serve in the boards of other listed firms. It appears the few women who break into the directorship league are used by several firms, meaning that while more companies may have female representation, the trajectory is towards the emergence of a special club of boardroom girls. The under-representation of women has also been caused by the requirement in many companies that one has either previous boardroom or executive experience, especially that of CEO and chief financial officer to serve in a board. Slow and marginal as the advance of women may be, women need to groom themselves to

take up the top jobs. In Kenya to get a directorship position involves a lot of networking, in the boardroom unity is valued more than diversity and companies rarely appoint directors they do not fully understand." However this will change with the new constitution dispensation.

17.0 Recommendations

Based on the findings of this study the following recommendations, were derived:

1. The study concludes that composition in terms of size, gender balance and representation has an impact on performance of commercial state corporations.
2. Splitting of the roles of chairman and chief executive, optimal mix of inside and outside directors, proportion of outside directors, executive remuneration, number of non-executive directors, participation of outside directors and the number of board of directors affected the financial performance of the corporations.
3. The study also recommends that state owned enterprises should adopt governance systems in the appointment of board representatives as they enhance the financial performance.
4. The study therefore recommends that policy makers of state owned enterprises should take serious notice of the board representation since the type of directors that are brought on board do have an effect on performance.

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