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The Mediating Effect of Strategy Implementation on the Relationship Between Corporate Governance and Performance of Firms Listed on the Nairobi Securities Exchange

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Abstract
The purpose of the study was to establish the effect of strategy implementation on the relationship between corporate governance and performance of firms listed on the Nairobi Securities Exchange (NSE) The study developed a corporate governance index as a proxy for corporate governance based on the seven provisions of the recently revised Capital Markets Authority (CMA) draft code of corporate governance practices for public listed companies in Kenya, namely; board operations and control, rights of shareholders, stakeholder relations, ethics and social responsibilities, accountability, risk management and internal audit, transparency and disclosure and supervision and enforcement. The survey questionnaire was the main tool of data collection and was distributed to 56 CEOs and corporation secretaries. The response rate was 87.5%. The study found that strategy implementation mediates the relationship between corporate governance and non-financial performance of firms listed on the Nairobi Securities Exchange. The results have diverse implications for policy, practice and research.
Keywords: Corporate Governance, Mediation, CGI_ Score, Strategy Implementation, Firm Performance

1. Introduction

While the concept of corporate governance and its effect on performance has received considerable attention and is a stable of discussions in corporate board rooms, academic meetings and policy circles, different scholars have conceptualized corporate governance and assessed the constructs differently resulting to different measurements and firm performance implications. In addition, research findings have been contradictory and mixed. Equally, limited literature is available on other variables that affect the relationship between corporate governance and performance. The specific relationships between strategy implementation and firm performance have not been delineated explicitly. These inconsistent findings highlight the need to identify the nature of this relationship more so in the Kenyan context.

The reality of strategy resides in its strategic actions (implementation), rather than its strategic statements. Minztberg (1985) defines strategy implementation as the manner in which an organization should develop, utilize and amalgamate organizational structure, control systems and culture to follow strategies that lead to competitive advantage and better performance. The best-formulated strategies may fail to produce superior performance if they are not well implemented. Although formulating a good strategy is a difficult task, Thompson and Strickland (2003) have stressed that the strategy implementing task is the most complicated and time consuming part of strategic management.

2. Literature Review

2.1Theoretical Framework

The resource dependence theory has been used by researchers as both a compliment as well as a contrast to agency theory (Davis, Schoorman & Donaldson, 1997). It suggests that the institution of internal corporate governance such as the board is not only necessary for ensuring that the managers are effectively monitored but also serve as an essential link between the firm and the critical resources that it needs to maximize its performance. Board and non-executive directors can offer essential resources including expertise both in the form of specific skills as well as advice and counsel in relation to strategy formulation and implementation (Haniffa & Hudaib, 2006).

Directors bring reputation, critical business contacts facilitate access to business information and offer an essential link to a firm's external environment and significant stakeholders including creditors, suppliers, customers and competitors (Haniffa & Hudaib, 2006). These relational resources can be both practical and symbolic. The association of particular individuals with a company has the potential to enhance the reputation or perceived legitimacy of an executive team.

2.2 Corporate Governance

Corporate governance is concerned with the systems used to balance the rights and obligations of the owners and those of non-owner managers. Cadbury (1999) for example defines corporate governance as the system by which organizations are directed and controlled and mainly concentrates on how key internal governance mechanisms interact to maximize shareholder value. Solomon and Solomon (2004) define corporate governance as a system of checks and balances which ensures that companies discharge their accountabilities to all their stakeholders.

Corporate governance gained prominence in the 1980s because this period was characterized by stock market crashes in different parts of the world and failure of some corporations due to poor governance practices. Prevention of corporate failure was not the only reason that led to adoption of the corporate governance ideals. On a positive note, there was a growing acknowledgement that improved corporate governance was crucial for the growth and development of the whole economy of a country (Clarke, 2004; Department of Treasury, 1997), and the realization that some companies had revenues that were several times larger than the GDP of many middle income countries hence the role these companies played in the global economic arena (International Monetary Fund, 2013). Other studies established strong links between the performance of corporations and the governance practices of their boards (Gregg, 2001; Hilmer, 1998; Kiel & Nicholson, 2002; OECD, 1998). Moreover, a study carried out in the United States by Gompers, Ishii and Metrick (2003) found a strong correlation between good corporate governance practices and superior shareholder performance. The study also revealed that two-thirds of investors were prepared to pay more for shares of companies that had good corporate governance practices.

The studies are in agreement that corporate governance has an effect on strategy implementation which in turn leads to good firm performance. The specific relationship between strategy implementation and firm performance has not been delineated explicitly.

2.3 Strategy Implementation

Minztberg (1985) defines strategy implementation as the manner in which an organization should develop, utilize and amalgamate organizational structure, control systems and culture to follow strategies that lead to competitive advantage and better performance. The best-formulated strategies may fail to produce superior performance if they are not well implemented. Although formulating a good strategy is a difficult task, Thompson and Strickland (2003) have stressed that the strategy implementing task is the most complicated and time consuming part of strategic management.

The process of strategy implementation involves two major steps namely, operationalization of strategy and institutionalization (Pearce & Robinson, 1996). Operationalization of strategy involves breaking long-term corporate objectives to operational short-term objectives, strategies, action plans, policies to guide decision making, assigning responsibility and providing human resources and a budget. Institutionalization permeates daily decisions and actions in a manner consistent with long term strategic success and matching strategy with organizational structure and culture, selecting effective leadership, communicating strategic intentions, and designing effective reward systems (Sterling, 2003).

There were no systematic studies that had been undertaken on mediating effect of strategy implementation on relationship between corporate governance and performance. Researchers in this field have recognized the lack of empirical research linking the implementation process to performance (Andrews et al., 2011). This research therefore relied on studies that established some linkages between corporate governance and performance, corporate governance and strategy implementation and corporate governance and performance. Jooste and Fourie (2009) and Jalali (2012) emphasized the connection between corporate governance and strategy implementation.

2.4 Firm Performance

Firm performance has been the debate of practitioners and academicians for years, but it is also the ultimate dependent variable of interest for scholars of management who seek to identify variables that produce variation in performance. Firm performance is conceptualized and measured differently by different authors and draws different expectations from employees, shareholders, investors and the general public (Kaplan & Norton, 2005). Past research has used many variables to measure organizational performance and included profitability, gross profit, return on assets (ROA), return on investment (ROI), return on equity (ROE), revenue growth, stock price, liquidity and operational efficiency.

Doyle (1994) argued that profitability was the most used measure of performance by most business organizations while Schendel (1991) supported use of ROA, ROE, earnings per share (EPS) and profit margin as the most common measures. Hoskisson, Johnson & Mossel. (1994) opine that financial measures are inadequate for decision making and need to be supported by other measures such as customer satisfaction and operational efficiency.

2.5 Firms Listed in the Nairobi Securities Exchange

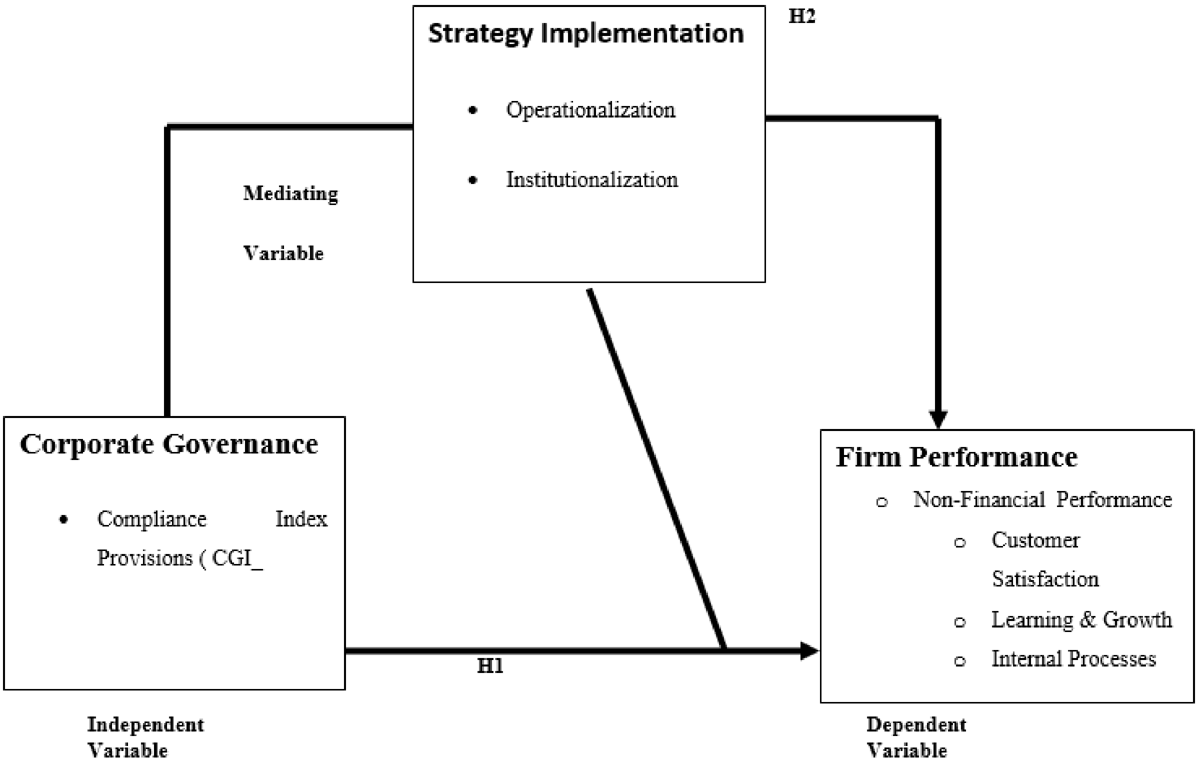
Firms that are listed on the Nairobi Securities Exchange (NSE) play a major role in promoting a culture of thrift and savings (Capital Markets Authority, 2012). Firms generally tend to improve their management standards and efficiency in order to satisfy the demands of their diverse shareholders and the more stringent rules for public corporations imposed by public stock exchanges and the government thereby improving the quality of corporate governance. Ownership by the public is important for NSE as a show of good governance and transparency.

The Government of Kenya aims to achieve and sustain an economic growth rate of 10% in order to realize the Kenya vision 2030 goals (Government of Kenya, 2007). This has made the Government to strengthen the NSE so that it can enhance its role as a robust securities market. The NSE on its part expects the listed firms to enhance their efficiency and competitiveness. Adherence to good corporate governance is one tool at its disposal (Capital Markets Authority, 2014). The listed firms have to adhere to the revised code of corporate governance practices for public companies in Kenya. The revised code is more stringent than the previous one. The previous one required companies to conform or explain reasons why they can not conform, while the revised draft code requires companies to conform or explain steps that will be taken to conform. It should be noted that firms listed on the NSE compete for the same investors with other securities exchanges worldwide.

3. Conceptual Framework

The conceptual model Figure 1 presents a schematic picture of the researchers presumed perceptions of existing relationship among the various variables of the study. The schematic diagram captures the linkage in the literature. The model suggests relationship between corporate governance – as independent variable, strategy implementation as mediating variable and firm performance as the dependent variable.

Figure 1: Conceptual model showing the relationship between Corporate Governance, Strategy Implementation and Firm Performance.



As shown in figure 1 above, corporate governance has influence on firm performance. Its influence is however mediated by strategy implementation. The extent of success of implementing strategy which influences performance is defined by the extent to which leadership encourages contribution to corporate strategies by departments through development of short term objectives and provision of resources and the extent to which the leadership provides a culture that supports strategy implementation through staff placement and linking rewards to objectives. The study was undertaken to assess whether the relationship between corporate governance and firm performance was direct or indirect through strategy implementation.

Hypothesis

The following hypothesis was derived from the conceptual model above.

H2: Strategy implementation mediates the relationship between corporate governance and non- financial performance.

4. Methodology

The research design adopted for this study was a cross sectional descriptive survey of all firms listed on the Nairobi Securities Exchange. The descriptive design was the most appropriate for the study because it allowed the researcher to establish level of compliance of corporate by different firms, and make specific predictions on how much change was caused by predictor variable and whether the effect was significant. This was achieved through a simple multiple regression analysis. Cross sectional design was preferred because the data was collected at one point in time across all 56 NSE listed firms. Each respondent, either the CEO or corporation secretary filed the questionnaire once during the entire data collection period.

Instrument validation was achieved in several ways. A pre test was done by administering the instrument to 10 conveniently selected corporation secretaries. The 10 corporation secretaries were requested to evaluate the relevance, meaning and clarity. On the basis of their response, the instrument was adjusted appropriately. Content validity involved the examination of the content to determine whether it covered a representative sample of the measured items. Validity according to Kerlinger (2002) can be assessed by using expert opinion and informed judgment.

Cronbach Alpha was calculated to test reliability. The Cronbach's Alpha coefficient was used to measure the internal consistency of the measurement tool, which is commonly used in social sciences to establish the internal consistency of items or factors within and among variables of study. Nunnally (1967) argues that an Alpha coefficient of 0.7 and above is an acceptable measure. The Cronbach Alpha coefficients for corporate governance, strategy implementation and performance in the conceptual framework were reliable registering scores of 0.835, 0.924 and 0.908 respectively. This indicates that the data collected using the data collection instrument was reliable for analysis. The tests were conducted using SPSS.

5. Results

The objective of the study was to establish whether strategy implementation mediates the relationship between corporate governance and firm performance of firms listed on the Nairobi Securities Exchange. Based on this objective data was collected using twenty four (24) corporate governance items measuring corporate governance provisions contained in the Capital Markets Authority revised code of corporate governance practices for public listed companies in Kenya, ten (10) items measuring strategy implementation and fourteen (14) measuring firm performance. The items in the corporate governance scale consisted of statement that measured the extent to which organizations complied with revised code of corporate governance practices for public listed companies in Kenya in the seven provisions that comprised the corporate governance index.

The respondents rated the extent to which itemized corporate governance provisions were complied with on a scale of 1 to 5 where 1 represented "Strongly Disagree" and 5 represented "Strongly Agree". Performance consisted of statements that represented the extent which they applied to the firm on a scale of 1 to 5, where 1 represented, "very low" and 5 " very high". The hypothesis focused on establishing whether the relationship between corporate governance and firm performance is direct or through strategy implementation.

The hypothesis was tested using path analysis proposed by Baron and Kenny (1986). The paths comprise three simple and one multiple regression models. The four paths, referred to as steps are outlined below;

Step one: non-financial performance was regressed on corporate governance.

Step two: Strategy implementation was regressed on corporate governance.

Step three: non-financial performance was regressed on strategy implementation.

Step four: non-financial performance was regressed on both corporate governance and strategy implementation.

The results in the first three steps are significant and in step four, corporate governance is not significant while strategy implementation is significant. Partial mediation is inferred when all or some of the first three steps are significant or when, in step four, the effect of corporate governance and strategy implementation on performance is not significant but the value of the effect of strategy implementation on performance is above zero.

The results from the tests at the four steps are presented in tables 1, 2 and 3 below.

Table. 1 Regression Results for the Mediation of Strategy Implementation in the Relationship Between Corporate Governance and Non-financial Performance

Step	R	R^2	Adjusted R^2	Standard Error of the Estimate	R^2 Change
Step 1	0.586	0.343	0.329	0.5431	-
Step 2	0.578	0.334	0.320	0.48667	-0.009
Step 3	0.814	0.663	0.656	0.39386	0.329
Step 4	0.826	0.683	0.669	0.38646	0.02

[a]) Predictors: Corporate Governance
b) Predictor: Corporate Governance
c) Predictors: Strategy Implementation
d) Predictors: Corporate Governance, Strategy Implementation
Dependent Variable: Firm performance (non-financial performance)

Step 1 shows the results of simple linear regression analysis when only corporate governance is entered in the equation. These results indicate that corporate governance explained 34.3 % of the variance in non-financial performance (R^2=0.343). In step 2, corporate governance becomes the dependent variable, and strategy implementation the predictor variable. The results indicate that corporate governance explained 33.4 % of the variance in strategy implementation (R^2 =0.334). The R^2 changes from 0.343 in step 1 to 0.334 in step 2 (R^2 change= -0.009). In step 3, the relationship between the mediator and dependent variable is tested and the results show that strategy implementation accounted for 66.3% of the variance in non-financial performance (R^2= 0.663). There was a change in R^2 from 0.334 to 0.663 in step 3 (R^2 change=0.329).

In step 4, multiple regression analysis was performed to assess whether the relationship between corporate governance and firm performance is direct or indirect through strategy implementation. Strategy implementation added significantly to non-financial performance as the variation changed from 0.663 in step 3 to 0.683 in step 4 (R^2 change=0.002).

Further, a comparison between step 1 when only the predictor variable and the criterion variable were entered in the analysis and the step 4 when the mediating variable was controlled, indicate that the variance in non-financial performance explained by corporate governance changed from 34.3% in step 1 to 68.3% in step 4 that is when strategy implementation was introduced (R^2 change= 0.34). These results indicate that 34% of the variance in non-financial performance was explained by strategy implementation. The results were further analyzed using ANOVA to confirm the statistical significance of the overall model. The results of analysis of variance for the four models are presented in table 2

Table 2 Results of Analysis of Variance (ANOVA) for the Mediating Effect of Strategy Implementation in the Relationship Between Corporate Governance and Non-Financial Performance

Step		Sum of Squares	df	Mean Square	F	Sig	F Change
Step 1	Regression	7.347	1	7.347	24.528	.000a	
	Residual	14.079	47	0.300			
	Total	21.426	48				
Step 2	Regression	5.468	1	5.464	23.069	.000b	-1.459
	Residual	10.895	46	0.237			
	Total	16.359	47				
Step 3	Regression	14.043	1	14.043	90.526	.000[c]	67.457
	Residual	7.136	46	0.155			
	Total	21.179	47				
Step 4	Regression	14.458	2	7.229	48.402	.000[d]	-42.124
	Residual	6.7721	45	0.149			
	Total	21.179	47				

a) Predictors: Corporate Governance
b) Predictor: Corporate Governance
c) Predictors: Strategy Implementation
d) Predictors: Strategy Implementation, Corporate Governance
Dependent Variable: Firm Performance (non-financial)

From the results in Table 2, step 1 shows that with only one predictor variable, corporate governance had a significant contribution to non-financial performance (F=24.528, $p<0.05$). In step 2 which involves mediator (strategy implementation), the results show that corporate governance had a significant contribution to change in non- financial performance (F=23.067, $p<0.05$). In step 3, strategy implementation had a significant contribution to change in non- financial performance (F=90.526, $p<0.05$. There was an observed change in F from 23.069 in step 2 to 90.526 in step 3 (F change=67.457).

Finally in step 4, when controlling for strategy implementation corporate, F changes from 90.526 in step 3 to 48.402 in step 4, there is a meaningful reduction in F (F change= -42.124) but the overall model was statistically significant (F=48.402, p<0.05).

The next criteria involve checking for regression coefficient and the t-statistics. The results of regression coefficients of the four models are presented in Table 3.

Table 3: Results of Regression Coefficients for the Mediating Effect of Strategy Implementation in the Relationship between Corporate Governance and Non-Financial Performance

Model		Unstandardized Coefficient		Standardized Coefficient Beta	t	Sig	Collinearity Statistics	
		B	Std Error				Tolerance	VIF
Step 1	Constant Corporate Governance	1.170 .670	.555 .135	 .586	2.109 4.953	.040 .000	1.00 1.00	1.00 1.00
Step 2	Constant Corporate Governance	1.874 .518	.462 .103	 .578	4.053 4.803	.000 .000	1.00 1.00	1.00 1.00
Step 3	Constant Strategy Implementation	.384 .830	.374 .087	 .814	1.025 9.514	.311 .000	1.00 1.00	1.00 1.00
Step 4	Constant Strategy Implementation Corporate Governance	.018 .729 .195	.428 .105 .117	 .715 .172	0.042 6.950 1.667	.067 .000 .102	 .666 .666	 1.502 1.502

Predictors: (Constant): corporate governance
b. Predictors: (Constant): corporate governance
c. Predictors: (Constant): strategy implementation
d. Predictors: (Constant): strategy implementation, corporate governance
Dependent Variable: non-financial performance

The results in Table 3, step 1 show that with only one predictor variable, corporate governance had a significant contribution to non-financial performance (β=0.670 t=4.953, p<0.05). Results in step 2 indicate that corporate governance had a significant contribution to strategy implementation (β=0.518, t=4.803, p<0.05). The inclusion of strategy implementation in step 3 contributed significantly to non-financial performance (β=0.830, t=9.515, p< 0.05). Finally in step 4 when controlling for strategy implementation, corporate governance became statistically non significant (β=0.195, t=1.667, p>0.05). Notably, when controlling for strategy implementation, the beta coefficient declines from β= 0.670 in step 1 to β=0.195 in step 4 (β change=0.475). Thus, the reduced value of the regression coefficient for effect of corporate governance on non-financial performance in the presence of strategy implementation supported the hypothesis that the strategy implementation mediates the relationship between corporate governance and firm performance.

The results in Table 3 reveal that all the Betas (β) for step 1, 2, 3 are statistically significant and met the criteria for a mediation effect proposed by Baron and Kenny. In step 4, the initial predictor variable (corporate governance) loses its significance when mediator (strategy implementation) was added into the model. Table 4 presents a summary of mediated effect of strategy implementation.

Table 4: Summary of Mediation of Strategy Implementation in the Relationship between Corporate Governance and Non-Financial Performance

Steps	**Regression**	**Visual Depiction**
Step 1 Non-financial Performance on Corporate Governances	Conducted a simple regression analysis with X predicting Y to test path c alone. Y (Non-financial) =1.170+0.670 CG	$X \xrightarrow{C} Y$
Step 2 Strategy implementation on corporate governance	Conducted a simple regression analysis with X predicting M to test path a. M=1.874+ 0.518 CG	$\mathbf{X} \xrightarrow{\mathbf{a}} \mathbf{M}$
Step 3 Non-financial performance on strategy implementation	Conducted a simple regression analysis with M predicting Y as shown by path b alone Y=0. 384+ 0.830 SI	$\mathbf{M} \xrightarrow{\mathbf{b}} \mathbf{Y}$
Step 4 Non-financial performance on strategy implementation and corporate governance	Conducted multiple regression analysis with X and M predicting Y. *Y=0.018+ 0.729 SI + 0.195 CG	$\mathbf{X} \xrightarrow{\mathbf{C}} \mathbf{Y}$ $\mathbf{M} \xrightarrow{\mathbf{b}} \mathbf{Y}$

Template adapted from Byron & Kenny (1986)
*Y (Non-financial Performance, CG (Corporate Governance), M (Mediator), SI (Strategy Implementation)

The results in Table 4 provide a summary of the four steps in testing for mediation as provided. Step 1, 2, 3 were statistically significant and thus proceeded to step 4. In step 4, mediation was supported since corporate governance became statistically non significant in the presence of the mediator (strategy implementation).

6. Discussion

The study set out to determine whether the relationship between corporate governance and firm performance was direct or indirect through strategy implementation. The first step involved testing the relationship between corporate governance and non-financial measures of performance. The second step tested the relationship between corporate governance and strategy implementation. Assuming corporate governance as independent variable and strategy implementation as dependent variable a simple regression analysis was performed. There were no systematic studies known to the researcher that had been undertaken on the mediating effect of strategy implementation on relationship between corporate governance and performance. Researchers in this field have recognized the lack of empirical research linking the implementation process to performance (Andrews et al., 2011). This research therefore relied on studies that established some linkages between corporate governance and performance, corporate governance and strategy implementation and corporate governance and performance. Jooste & Fourie (2009) and Jalali (2012) emphasized the connection between corporate governance and strategy implementation.

The results were statistically significant reaffirming the position of other scholars (Jalali, 2012), Li et al (2008) and Njagi and Kombo (2014) that alluded to the significance of corporate governance in predicting strategy implementation. Although formulating a consistent strategy is a difficult task for any management team, making that strategy work – implementing it throughout the organization – is even more difficult (Hrebiniak, 2006). Brenes et al. (2008) maintain that successful strategy implementation is not merely a bundle of strategic initiatives and activities resulting from analysis and diagnoses which must be carried out by different individuals in the company. Rather, implementing strategy has to do with building competitive advantage by consciously and orderly managing a number of dimensions and components, both inside and outside the firm, which will end up by changing it.

According to Brenes et al. (2008) these dimensions are the process of formulating the strategy, its systematic execution, strategy control and follow-up, the CEO's leadership of suitable, motivated managers and employees, together with corporate governance leading the change. The results of this study not only support the argument of the importance attached to strategy implementation but the interplay of strategy formulation and implementation by recognizing the two phases which attempt to incorporate implementation issues in the formulation process namely; strategy operationalization and strategy institutionalization. By delineating the first order constructs of strategy formulation; vision, mission and the first order constructs of strategy formulation; goals, structure and human resources Isaac et. al., (2016) found that strategy implementation mediates the relationship between strategy formulation and performance.

7. Conclusion

The objective of the study was to determine whether the relationship bet ween corporate governance and performance was direct or indirect through strategy implementation.

The results were statistically significant reaffirming the position of other scholars (Jalali, 2012), Li et al. (2008), Njagi and Kombo (2014) that alluded to the significance of corporate governance in predicting strategy implementation. The results of this study do not only support the argument of the importance attached to strategy implementation but the interplay of strategy formulation and implementation by recognizing the two phases which attempt to incorporate implementation issues in the formulation process namely; strategy operationalization and strategy institutionalization. By delineating the first order constructs of strategy formulation; vision, mission and goals and the first order constructs of strategy formulation; strategy, structure and human resources, Isaac et al. (2016) found that strategy implementation mediates the relationship between strategy formulation and performance.

For good performance to be realized managers must appreciate the fact that strategy formulation and implementation as two phases of the same process as oppose to two distinct processes. To succeed implementation issues must be incorporated in to the planning (formulation) process and supported by able leadership, resources and staff with the right skills who are equally rewarded and a culture that supports the strategy. This study adds to the debate of studies that confirm the factors that have a mediating effect on corporate governance and performance. The mediating relationships will help scholars understand the processes further which might be supportive in discovering further mediation at different levels of analysis.

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