THE EFFECT OF BOARD STRUCTURE ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN SOMALIA: THE CASE OF MOGADISHU

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A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS OF THE AWARD OF THE DEGREE OF MASTER OF SCIENCE IN FINANCE, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

NOVEMBER 2017
DECLARATION

This project is my original work and has not been presented for the award of a degree or any other award in any University.

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D63/81578/2015

This project has been submitted for examination with my approval as the University supervisors.

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ACKNOWLEDGEMENT

The MSc-Finance programme has been long and challenging, the successful completion has been as a result of determination, concerted effort and support from many people. My sincere gratitude to the Almighty God for seeing me through the entire process. Special thanks to my supervisor Dr. Cyrus Iraya for his advice, guidance, availability and positive criticism and suggestions during the entire research period. I also thank the teaching, administrative and the support staff of the University of Nairobi for their support through the entire course period. Many thanks to my classmates for supporting me throughout the course especially in group work and revisions.
DEDICATION

This paper is dedicated to my Mother Mrs. Faduma Khalif, my uncle Muse Karar my brothers and sisters, my wife Warda Mohamed who has been a source of inspiration and support during the course of my studies.
# TABLE OF CONTENTS

DECLARATION.............................................................................................................ii  
ACKNOWLEDGEMENT................................................................................................. iii  
DEDICATION................................................................................................................ iv  
LIST OF TABLES ........................................................................................................ viii  
LIST OF FIGURES ....................................................................................................... ix  
LIST OF ABBREVIATIONS .......................................................................................... x  
ABSTRACT .................................................................................................................. xi  

CHAPTER ONE: INTRODUCTION .............................................................................. 1  

1.1 Background to the Study ..................................................................................... 1  
   1.1.1 Board Structure .......................................................................................... 2  
   1.1.2 Financial Performance .............................................................................. 4  
   1.1.3 Effect of Board Structure on Financial Performance ............................. 5  
   1.1.4 Commercial Banks in Somalia ................................................................. 7  

1.2 Research Problem ............................................................................................. 9  
1.3 Objective of the Study ...................................................................................... 10  
1.4 Value of the Study ............................................................................................ 10  

CHAPTER TWO: LITERATURE REVIEW ............................................................... 11  

2.1 Introduction ....................................................................................................... 11  
2.2 Theoretical Review ......................................................................................... 11  
   2.2.1 Agency Theory ......................................................................................... 11  
   2.2.2 Stewardship Theory ................................................................................ 12  
   2.2.3 Stakeholder Theory .................................................................................. 13  
2.3 Determinants of Bank Performance ................................................................. 13  
   2.3.1 Number of Branches .............................................................................. 14  

v
2.3.2 Bank Size ................................................................. 15
2.3.3 Bank Location .......................................................... 15
2.3.4 Board Structure ...................................................... 16
2.4 Empirical Review ....................................................... 16
2.5 Conceptual Framework ............................................. 19
2.6 Summary of Literature Review .................................. 20

CHAPTER THREE: RESEARCH METHODOLOGY .................... 21
3.1 Introduction .............................................................. 21
3.2 Research Design ....................................................... 21
3.3 Population .............................................................. 21
3.4 Data Collection ........................................................ 21
3.5 Data Analysis ............................................................ 22
  3.5.1 Conceptual Model .................................................. 22
  3.5.2 Analytical model ................................................... 23
  3.5.3 Test of Significance ............................................... 23
  3.5.4 Measurement of variables ..................................... 24

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND INTERPRETATION 25
4.1 Introduction .............................................................. 25
4.2 Descriptive Statistics ................................................ 25
4.3 Regression Analysis .................................................. 28
  4.3.1 Regression Coefficients ........................................ 29
  4.3.2 ANOVA ............................................................. 30
  4.3.3 Model Summary .................................................. 31
4.4 Discussion of Research Findings .................................. 32
CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS ........34

5.1 Summary ..................................................................................................................34
5.2 Conclusions .............................................................................................................34
5.3 Recommendations to Policy and Practice .................................................................35
5.4 Limitations of the Study ..........................................................................................36
5.5 Suggestions for Future Studies ...............................................................................36

REFERENCES ..................................................................................................................37

APPENDICES ..................................................................................................................44

Appendix I: List of Commercial Banks in Somalia .......................................................44
Appendix II: Regression Data .........................................................................................45
LIST OF TABLES

Table 4.2.1: Descriptive Statistics .................................................................25

Table 4.3.1.1 Regression Coefficients ..............................................................29

Table 4.3.1.2 ANOVA ................................................................................30

Table 4.3.3.3 Model Summary ........................................................................31
LIST OF FIGURES

Figure 2.1: Conceptual framework (Author, 2017) ......................................................... 19

Figure 4.2.2.1: ROA ........................................................................................................... 26

Figure 4.2.2.2: Board size ............................................................................................... 27

Figure 4.2.2.3: Number of Board Meetings ................................................................. 27

Figure 4.2.2.4: Ownership ............................................................................................... 28
### LIST OF ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>ANOVA</td>
<td>Analysis of Variance</td>
</tr>
<tr>
<td>BS</td>
<td>Board Size</td>
</tr>
<tr>
<td>BC</td>
<td>Board Composition</td>
</tr>
<tr>
<td>BOD</td>
<td>Board of Directors</td>
</tr>
<tr>
<td>CBS</td>
<td>Central Bank of Somalia</td>
</tr>
<tr>
<td>CG</td>
<td>Board Structure</td>
</tr>
<tr>
<td>GOS</td>
<td>Government of Somalia</td>
</tr>
<tr>
<td>IC</td>
<td>Independent Committees</td>
</tr>
<tr>
<td>ROA</td>
<td>Return on Asset</td>
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<tr>
<td>SPSS</td>
<td>Statistical Packages for Social Sciences</td>
</tr>
</tbody>
</table>
ABSTRACT

Board structure has basis on creating credibility, safeguarding transparency and accountability in addition to ensuring an effective information disclosure channel that fosters commendable corporate financial performance. Further, board structure develops trust in addition to sustaining confidence among groups within an organizational. The study aimed at determining the effect of board structure on financial performance of commercial banks in Somalia. To achieve this objective, the study explored the theories guiding the study including: Agency theory, Stewardship theory and Stakeholder theory which all explain how board structure impact on the financial performance of commercial banks in Somalia. It adopted a descriptive research design from secondary data, which was covering 5 years from 2012-2016. Data analysis was through descriptive statistics which comprised of the arithmetic mean, variance and standard deviation. The results revealed strong Positive association between the Directors independence, Ownership and the returns of banks during the study period. The results also show negative relation to foreign directors and Board size. The study concluded that performance of commercial banks in Somalia is significantly influenced by Directors independence, board meetings, ownership, foreign directors and board size. The study recommends that for improved performance of commercial banks to be realized in Somalia, effectiveness of the board has to improve through increasing the number of foreign ownership in commercial banks in the country who will in turn bring the experience and skills necessary to improve their performance.
CHAPTER ONE: INTRODUCTION

1.1 Background to the Study

Board structure is a comprehensive description of a composition of members who make critical decisions on procedures, laws, policies, customs, and establishments that direct ways in which organizations and corporations perform, manage and regulate their processes (Khan, 2011). Board structure involves administering a firm in a manner that guarantees a fair return on owners/ stakeholder’s investment. The administration process forms a linkage between shareholders, board, management, staff, customer and the community at large (Adenkule, 2014). Board structure is vital in the growth of the businesses as it advocates for good management which is significant for the growth of the financial sector (Khan, 2011). Financial performance is an independent estimation of best ways in which an organization can utilize its assets from a primary mode of business besides generation of revenues (Ochola, 2013).

The research is founded on “Agency Theory”, “Stewardship Theory”, and “Stakeholder Theory”. These three theories differently strengthen insights and approaches to board structure (Sarbah & Xiao, 2015). Agency theory together with other mechanisms of board structure advocates that firm performance is improved by good board structure (Wepukhulu, 2016). Diverse interest and fight amongst the ownership and regulator as main representative as the decision-making authority brings about the agency problem (Khan, 2011). Agency theory effect is that agency problem can only get mitigated if the board consists largely of non-executive directors with the ability to control managerial activities and henceforth optimize shareholder’s income (Ogege & Boloupremo, 2014). Resource dependence theory offers the ideas that environmental demands in addition to pressures can impact on board structure
whose differences can bring about various firm performance levels (Nguyen, 2015). Stewardship theory has a focus on empowering systems that merge functions of CEO and chairman of the company that enhance effectiveness leading to achievement of superior performance (Wepukhulu, 2016). This study is aimed at establishing how board structure affects financial performance of commercial banks in Somalia.

1.1.1 Board Structure

This refers to the way the board is structured in terms of the diversity in the members of the board on gender, committee as well as the total number of the board members (Zahra & Pearce, 1989). The primary duties of the board include: setting the goals of the firm, developing the firms short and long term target of the firm as well as ensuring the operations of the firm comply with the companies act (Monks & Minow, 2004).

Hermalin and Weisbach (1998) suggest that for the board to perform its duties to the full capacity, there have to be in place an operational board structure. Brennan (2006) found out that the functions performed by the board are numerous but board structure is vital as it improves the efficiency with which the board performs its duties through providing diversity in the board which gives it an edge to its competitors. The performance of a board mainly depends on the factors outside the organization but it may be influenced by other factors such as the director independence, board diversity, board meetings and committee structures.

The proxy used to measure the board size is the total number of board members. Jensen (1993) denotes that large boards are less effective as compared to small ones as they can be controlled with ease. Yermack (1996) and Eisenberg et al. (1998) supported this notion by claiming that firms with low board members report high
turnover due to the efficiency with which they operate. Conversely, there are other studies which support the idea of large board members by claiming it provides the board with options of various committees which improve its performance. Dalton et al. (1999) on his study claimed there is an existence of direct correlation linking number of board members to their efficiency.

Director independence is the number of nonexecutive members on the board. Hermalin and Weisbach (1998) on their study found weak correlation linking the number of nonexecutive members to on firms’ performance. Agrawal and Knoeber (1996) found an inverse correlation as nonexecutive directors leads to decline on firm valuation.

Foreign directors refer to those directors who are not nationals of the country in which the entity is registered. Foreign directors might bring new ideas of firm management from the countries they come from especially if they come from developed nations which are much ahead in terms of board structure and firms’ management hence improving banks performance. Oxelheim and Randoy (2003) on his study where he sampled boards with North-American origin where they found out that organizations with foreign board members are associated with high turnover as compared to those without. Berger et al. (2006) pointed out in his study where he revealed an improved performance is directly correlated to foreign board members that organizations should increase the number of foreigners on their board who will lead to better performance. Black et al. (2006) who conducted a study on the impact of foreign directors on organizational performance where the results revealed a direct correlation linking the two variables.
Gender diversity on the other hand is proportion of female members on board. Gender diversity has gained momentum in the recent years with board required to meet a certain proportion consisting of both genders. This is due to the diversity which it creates in the board improving its efficiency which has a direct link to bank performance (Robinson & Dechant, 1997). However, the results revealing its impact are ambiguous.

Frequent board meetings are an indication of the activeness of the board. Frequent board meetings indicate close monitoring of the firm’s management as well as monitoring of both short and long term goals of the firm. Moreover, this industry is characterized by still completion and high volatility hence frequent board meetings are vital (Weir et al, 2002).

1.1.2 Financial Performance

Financial performance involves monetary measurement of results associated with an organization’s policies and operations. The measurement is based on apportioned resources to highly feasible investment projects with the possibility to generate maximum returns on investment (Ochola, 2013). Productivity, growing clients’ satisfaction and revenue generation are some of the attributes used to measure financial performance. Organization’s performance (OP) is partly dependent on its technology, processes, systems and employees. It is concerned with efficiency and effectiveness of operations (San & Heng, 2011).

There has been progression in financial-measures’ performance models. Profitability ratios including ROA and ROE are the mostly used criteria for measuring bank performance (Hajer & Anis, 2016). Return on equity (ROE) reveals amount of profit generated by the bank using common stock holders invested money to estimate a
bank’s profitability (Vintila & Gherghina, 2012). ROA is a percentage which measures the net income earned on assets (Wepukhulu, 2016). ROA allows users to assess how well firms’ board structure mechanisms are assisting it in securing and monitoring the efficiency of the management in utilizing assets to generate profits (Mohammad & Shahid, 2012).

1.1.3 Effect of Board Structure on Financial Performance

The dominant policy agenda for more than two decades in developed market economies has been board structure. Board structure is gradually shifting to the top of Africa’s policy agenda. Conditions including Asian crisis and poor board structure especially among the states in the African continent pave way for board structure to remain a tagin development debate (Sarbah & Xiao, 2015). The good board structure practices among developing states has greater points in comparison to the average of all firms in Asia (Mukhopadhyay, Mallik, & Dhamodiwala, 2012). Financial innovation and globalization force management to adopt rigorous re-evaluation of board structure principles (Ben-Bouheni, Ammi, & Levy, 2016). Different studies highlight mixed association linking board structure to financial performance. A review arrived at no consistent and significant, that is, positive and significant; positive but not significant; and no significant correlation linking financial performance to board structure methods (Azim, 2012).

Concept of board structure in very large firms including banks has remained for over decade precedence on developed countries’ policy agenda (Wepukhulu, 2016). Research in finance is primarily focused on board structure since it majors on individuals’ accountability through reducing the principal-agent problem in an organization (Khan, 2011). Banks put in to practice some board structure mechanisms to protect shareholders and other stakeholders’ interests (Rao & Kerebih-Desta,
Remarkably comprehensive board structure practice blocks significant shareholders’ control of an organization and inspires improved decision making to improve corporate performance (Ogege & Boloupremo, 2014). Board of directors (BOD) is a vital determinant of internal board structure mechanisms.

According to the resource dependence theory, size increase and multiplicity of BOD improves the security of firms’ vital resources and the link with other firms, in addition to external environment (Nguyen, 2015). Prior studies established negative association between corporate performance and board size. An increase in board size makes eases CEO’s capacity to control and influence BOD’s resolutions (Ben-Bouheni, Ammi, & Levy, 2016). Large board size is associated with a negative influence on performance as hypothesized by the ‘agency cost’ (Mamatzakis & Bermpei, 2015). The agency theory asserts that the BOD monitoring function mitigates principal-agent conflicts which eventually affect firm performance (Nguyen, 2015). US banks over the 2000–2012 period established that large board size (higher than ten members) negatively affected performance in terms of the ‘agency cost’ (Mamatzakis & Bermpei, 2015). Board size and gender diversity in the board had no effect on financial performance of commercial banks (Rao & Kerebih-Desta, 2016).

Ownership structure is also central in board structure. From studies, there exists a direct and mixed correlation linking firms’ performance and CEO ownership. Excessive or negligible CEO's ownership in a firm leads to less alignment of CEO’s and shareholders’ interests (Ben-Bouheni, Ammi, & Levy, 2016). Unswerving from the ‘stewardship’ hypothesis, CEO’s power positively affects performance. Increased ownership of a bank by the board negatively impacts on bank’s performance. Board ownership above the threshold with value positively impacts on performance and
gives an indication of aligned shareholders’ and managers’ incentives (Mamatzakis & Bermpei, 2015).

Implementation of best practices in governance is highly concomitant to enhanced access to external financing. This is as a result of increased investors’ knowledge of an organization’s strategies, lesser capital cost, better operational performance due to added efficiency in management and improved asset allocation (Mukhopadhyay, Mallik, & Dhamodiwala, 2012). Good board structure heightens the value of a firm as a result of increased investor confidence. Investors highly value well-governed organizations since they apply a lesser expected rate of return and are much less risky. In addition, operations in such organizations are more efficient hence greater expected future stream of cash-flow (Ochola, 2013). Good board structure fosters long-term profitability (Eisenhofer & Levin, 2005).

Incentive pay is a governance mechanism (Ben-Bouheni, Ammi, & Levy, 2016). The association between performance and operational complexity is negative (Mamatzakis & Bermpei, 2015). Capital structure of an organization is a central internal board structure mechanism whose influence on firm’s value can depress over-investment of free cash flow by managers (Nguyen, 2015). Capital structure did not affect commercial banks’ financial performance (Rao & Kerebih-Desta, 2016).

1.1.4 Commercial Banks in Somalia

An internationally recognized government of Somalia was formed in 2012 after a political disorder since 1991 (Maryam, 2016). Most companies in Somalia die before completing one year of operation. This is a clear example of the need for good board structure to undo this trend (Barre, 2016). The gross domestic product (GDP) of
Somalia is $5.896 billion thus well-thought-out as a low-income country by the World Bank.

The concept of board structure is still in its infant stages thus this means there is still no developed system in terms of governance codes and principles in Somalia (Ahmed, 2015). There are some few cases whereby board structure has been implemented by firms and non-governmental organizations (NGOs) in Somalia e.g. National Energy Corporation of Somalia Most of the international NGOs that are operating in Somalia portray the use of board structure in their organizations but this is due to the fact that they are foreign registered companies. Majority of local organizations and banks are struggling a lot to execute local obligations let alone to apply board structure due to their limited capability (Meme, 2012).

There were no functioning banks in Somalia as there was no fiscal legislation over the period of civil war (Maryam, 2016). Somalia/Somaliland lacked an effective central bank since collapse of the last known government in 1991. Besides, weak governance structures, and absent or ineffective government agencies exacerbated the condition in Somalia (Owour, 2013). The financial legislation in Somalia stipulates that banks or hawalas should initially obtain a license from the existing Central Bank to operate. Currently, there are six banks and nine hawalas licensed to offer banking services (Maryam, 2016). Different banks including Islamic Community Bank, Kenya Commercial Bank and Equity Bank from neighbor countries articulated their intention to establish branches in Somalia to offer regular and Sharia compliant services once the necessary business structures are in place (Owour, 2013).
1.2 Research Problem

Board structure has basis on creating credibility, safeguarding transparency and accountability in addition to ensuring an effective information disclosure channel that fosters commendable corporate performance. Further, board structure develops trust in addition to sustaining confidence among groups within an organizational.

Majority of local organizations including banks in Somalia are struggling a lot to execute local obligations let alone to apply board structure due to their limited capability (Meme, 2012). Efforts to establish a central bank in Somali are ongoing. However, there is lacks information on specified time-frame due to not-fully-stable political situation (Owour, 2013). Previous studies in Somalia on board structure have mainly been conducted in NGOs and telecommunication industry.

The effect of weak legal systems on economic activities majorly defines types of board structure practices that are effectively applicable across Sub-Saharan Africa (Ruparelia, 2016). In most developing countries, poor governance is progressively quoted as a vital causal factor to poor economic performance (Ongore & Owoko, 2011).

Good corporate board structure is clearly needed in Somalia since most companies die before completing one year of operation (Barre, 2016) implying that commercial banks in Somalia are subjects to the risk of closure. The concept of board structure is still in its infant stages with no developed systems in terms of governance codes and principles (Ahmed, 2015). As highlighted by Mohamud (2014), it is necessary to research and understand how board structure practices impact on performance of commercial banks and in other profit organizations in Somalia. Therefore, this study will avail a solution to the question what is the effect of board structure on financial performance of commercial banks in Mogadishu Somalia?
1.3 Objective of the Study

The objective of this study was to determine the effect of board structure on financial performance of commercial banks in Somalia.

1.4 Value of the Study

This study availed the comprehensive evidence on financial performance and board structure strategies adopted by commercial banks in Somalia. Besides, the study also elaborated association linking financial performance to board structure among commercial banks. The study findings made specific contributions to the domain of knowledge, policy and literature.

The government of Somalia and stakeholders in the banking sector appropriately inform policy for sustainability of commercial banks. Banks’ management can use the findings to make informed decisions and strategies on bank’s board structure which improve financial performance and positively impact on service delivery. Future scholars will benefit from study findings that fill an existing knowledge gap that exists on the topic under study.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The critical literature review will be addressed on the (study purpose). The sections are based on the main research variables including determinants of bank performance. Further, this chapter contains work done by other researchers, theories pertaining to topic and diagrammatic representation.

2.2 Theoretical Review

There are a number of theories explaining the topic under study. These include; the Agency theory, stewardship theory and stakeholder theory.

2.2.1 Agency Theory

Theory above is anchored on the thought that agency costs related with conflict resolution between owners and agents in a contemporary corporation is an outcome of distinction of management from ownership (Jensen & Meckling, 1976). This theory recognizes agency relationship, that is, the principal/ company, assigns the role to a different member. Agency theory envisages use of board structure mechanisms in monitoring and minimizing conflicts in principal - agent relationships in corporate setting (Jensen & Meckling, 1976). The above principle views the presence of diverging interests of the firm’s management and shareholders which emanates from split-up shareholders control in contemporary firms (Hoskisson, Hitt, Wan, & Yiu, 1999).

The agency theory “the systems whereby the investors ensure their finances which are managed by the agents are safe and secure” (Shleifer & Vishny, 1986). Agency theory identifies the dominant poor running of corporate through principal’s warrant executives to act in shareholders’ interests and their own (Pastoriza & Ariño, 2008).
Agency theory is mainly concerned with effective monitoring that is realized when there are members of the board who are not managers of the firm. There should be a distinction between the office bearers in composition of the board. Retaining this will ensure protection of shareholders’ interests through alignment of CEOs and shareholders’ interests using an appropriate incentive scheme, for instance, a long-term compensation system in addition to CEOs basic salary. Long-term compensation aligns interests and envisions shareholder’s benefit loss which would otherwise present as an outcome of dual role (Donaldson & Davis, 1991).

2.2.2 Stewardship Theory

This theory deems agents to be steward managing own firms conscientiously to advance their performance (Donaldson & Davis, 1994). Stewardship theory further considers directors and managers as firm stewards basically presumed to be reliable and entrusted with resources which create monitoring redundancy (Muth & Donaldson, 1998). Managers are good corporations’ stewards who work diligently with an aim to achieve maximum revenues from the resources available to shareholders (Donaldson & Davis, 1994).

The stewardship theory assumes that the basis of principal-steward relationship is a choice. In the event that both parties work as stewards with their primary aim to safe guard the owner’s assets, it puts forward an emphasis of focusing on maximizing corporate revenue maximization since it’s understood all members are dedicated to a similar goal (Eddleston, 2007). Protagonists of stewardship and agency theories view the theories as contradicting one another (Chogii, 2009). Breaking rule is beneficial and does not bring forth the adversative consequences feared for corporate performance and shareholders’ returns (Donaldson & Davis, 1994).
2.2.3 Stakeholder Theory

This theory defines firm as “business organization operating for the purpose of making profit in a given society through their larger systems which acts as the provider of legal and physical infrastructure for efficient operation” (Clarkson, Starik, Cochran, & Jones, 1994). The stakeholder theory explains the role of board structure by stressing on dissimilar constituents of a firm (Coleman, Hacking, Stover, Fisher-Yoshida, & Nowak, 2008). Corporations should consider the interests of stakeholders, individuals and groups with possibilities of affecting or being affected by the corporations in designing of their corporate strategies in line with stakeholder theory (Hannan & Freeman, 1984).

The stakeholder theory contends that to improve business efficiency in the market place then trade unions, trade associations, political groups, governmental bodies, associate companies, competitors, potential workers, potential suppliers, communities as well as the whole population (Yusoff & Alhaji, 2012). The implications of stakeholder theory tests corporate leaders to reconsider management approaches. The theory advocates for managers to shift business primary focus toward long-term success through recognition of organization’s values; and stakeholders’ relationships (Donaldson & Preston, 1995).

2.3 Determinants of Bank Performance

Financial performance refers to extent a firm accomplishes its financial objectives. Financial performance is a procedure to assess monetary outcomes of a firm's policies and operations (Mohamud, 2014). Determinants of commercial banks’ financial performance consist of internal and external factors that highly influence and shape an organization’s financial position. Internal factors including financial statement variables and nonfinancial statement variables are controlled by the bank management
Financial statement variables include decisions that are unswervingly comprised of items in income statement and balance sheet. Non-financial statement variables do not directly relate to financial statements and include bank size and location; number of bank branches; status of branches, that is, unit branch or multiple branches, limited or full-service branch (Otieno, 2012). Bank management has no control over external variables including inflation, market share, competition, concentration, money supply, ownership, scarcity of capital, regulation and size (Otieno, 2012). Financial performance of banks is measured using ratios which focus on the; profitability; assets employed; return on capital employed (Muiruri, 2014) and cost-efficiency (Hajer & Anis, 2016).

2.3.1 Number of Branches

The spread of commercial banks branches networks eases accessibility of financial services by the population. Accessing financial services backs development and enhances clients’ capacity to borrow and save. This further enables improved management of cash flows and encourages vulnerability-reducing and income-enhancing investments (Michael, 2008). There are many challenges that make it difficult for most commercial banks to effectively spread their branch network the most noted ones include increased operational costs and financial risks. Factors that amplify transaction costs comprise of aloofness and poor infrastructure, lesser demand for financial services as a result of lesser income and economic activity levels, and fewer transactions (Musyoka, 2011). Huge branch networks offer vicinity convenience attributable to more deposits. However, operating cost of large branch networks impacts negatively on financial performance when economies of scale are not exploited (Salim, 2012).
2.3.2 Bank Size

In the banking industry, the size of a bank is used to capture economies and diseconomies of scale (Kagethia, 2014). A study on profit persistence and factors determining bank profitability in Croatia within the period 2002 to 2010 established strong direct correlation on bank size and profitability (Pervan, Pelivan, & Arnerić, 2015). These results suggest that banks should make use of their size to exploit cost advantages whose realization together with improved management would contribute to further increases in efficiency which would result into higher profitability. Large institution size banks possess superior access to huge comprehensive deposits. Besides, they possess more power to control cost of deposits and lending rates. However, cost efficiency has to accompany the large institution size banks process in order to achieve the benefits that can be translated into good financial performance (Salim, 2012).

2.3.3 Bank Location

Developments in computing and telecommunications resulted in key modifications in banks operations and allowing for their dramatic upsurge in size and geographic coverage (Musyoka, 2011). Branches occupy key positions in banking organizations and their locations reflect important strategic decisions and operating policies. The rationale for developing a branch network, beyond the significant effect it has on banks’ market shares is threefold: diversification of risk, customer convenience and market knowledge. Branching facilitates geographic diversification allowing banks to vary own assets through increased access to dissimilar industries with different responses to shocks (Musyoka, 2011).
As for geographical diversification in banking numerous theories advocate that geographic diversity augments efficiency, spread particular risks, lessen agency costs, and increases corporate valuations. Jensen and Meckling (1976), corporate insiders have better chance to acquire private benefits from geographically spread firms with antagonistic effects on firm valuations. A bank entering a new market can suffer higher risk due to adverse preference to a magnitude that prevailing intermediaries keep away from riskiest and least profitable clients (Brighi, Venturelli, & Finanza, 2014).

2.3.4 Board Structure
Banks form backbone of economies; economies should ensure strong and flexible banking system with effective board structure practices (Ogege & Boloupremo, 2014). Disclosure and transparency measure accountability, guard shareholders’ rights, and construct shareholder’s sureness in investment. High levels of corporate disclosure are concomitant to high shareholders’ trust and better financial performance (Mwesigwa, Nasiima, & Suubi, 2014).

2.4 Empirical Review
An analysis of south Europe banks between years 1986-2000 to establish the influence of poor economic performance on governance interventions including chair and CEO dismissal, amalgamation, takeovers, and director turnover. The analysis further analyzed if the interventions were associated with ownership structure of bank. The analysis established negative correlation on banks revenue generation and interference from the state authority(Crespi, Garcia-Cestona, & Salas, 2004).
Al-Hawary (2011) investigated Jordanian commercial banks to establish how performance was influenced by governance mechanisms including board size, ration of board members not involved in management, CEO duality, sufficiency in capital, proportion of high number of shares owned. This study tested the effect of governance and established that percentage of nonexecutive directors and CEO duality significantly positively have impact on the revenue maximization; while proportion of financing had a strong and inverse impact on resource utilization. The study was recognized as effective determinants on banking performance (Al-Hawary, 2011).

A study in Malaysia to establish the correlation between transparency and profitability of commercial banks in Asian countries in the economic downturn which covered a ten-year period from mid-90’s to year 2005. The study found out strong direct correlation between the two phenomena’s. The study revealed that transparency in commercial banks was more established in multinational banks operating in the country as compared to the banks which were operating locally (Kim & Rasiah, 2010).

A study was conducted in Uganda to determine how good governance, transparency and taking responsibility influence the profitability of banks in the country. The aim of conducting the study was influenced by losses incurred by banks despite the various intercessions by the stakeholders. The results from the study revealed the vital factor influencing the profitability of domestic banks was good governance and accountability. Other factors found to be major influence of banks performance were transparency and proficiency. The study proposed that for the commercial banks to experience good performance they have to ensure good governance and accountability (Mwesigwa, Nasiima, & Suubi, 2014).
An examination of the effects of good practices to ensure profitability among the commercial banks in Kenya which applied a cross sectional and analytical research design that involved banks registered by central bank of Kenya. The results from the study revealed that good practices are vital for banks profitability especially when the industry is experiencing financial difficulties (Otieno, 2012).

Mandu (2010) examined correlation of measures of board independence and the profitability of the domestic private banks in Kenya sing a cross-sectional survey that involved 45 commercial banks in Kenya operating within Nairobi. Financial performance was measured using ROA; while board structure was measured based on boards’ independence along with some control variables. The study found out that CEO tenure had direct and strong influence on profitability of small firms. The study also established that board composition affected performance of smaller firms. The study recommended the need to carry out more research on board independence especially for large firms to establish what board characteristics determine their performance (Mandu, 2010).

The impact of good board structure and profitability was carried out in Ethiopian commercial banks not listed at the stock exchange. The results indicated a strong and positive correlation between board composition and internal control system and profitability of commercial banks in the country (Ashenafi, Kelifa, & Yodit, 2013).

In Somalia, the available literature was carried out to investigate the impact of good board structure and profitability of commercial banks was done among INGOs. The study recommended establishment of good board structure practices including sub committees to boost the performance of firms in the country. The results however revealed a week correlation between the two phenomena’s (Meme, 2012).
However, after critique in empirical review of the previous researchers there are inverse correlations due to interference of corporate structure and performance, also negative association could be due to having hand over and train new management team.

2.5 Conceptual Framework
Different scholars have carried out studies to establish the influence of transparency and accountability on profitability of firms. In this study, financial performance refers to return on assets (ROA). Board structure will be assessed using board size, independence, Number of board meetings, foreign directors and Ownership (Figure 2.1).

![Conceptual framework](Author, 2017)

**Independent variable**
- Board structure
  - Size
  - Independence
  - Ownership
  - Foreign directors
  - Number of board meetings

**Dependent variable**
- Financial performance
  - Return on assets (ROA) of commercial banks

Figure 2.1: Conceptual framework (Author, 2017)
2.6 Summary of Literature Review
The literature review contains theoretical review, empirical literature and determinants of banks performance. Theoretical review highlights the agency theory, stewardship theory and stakeholders’ theory to analyze the statement of the study objective. Empirical review indicates strong impact of board structure on profitability of commercial banks as indicated by many researchers. Empirical review does not however give consistent information on board structure factors that affect financial performance. This review highlights need for research on effect of board structure on performance among profit organizations including commercial banks in Somalia. The conceptual framework gives the relationship and measurable attributes of board structure and financial performance.
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter defined the entire methodology used to carry out this study. Sections included are study design; target population, sample and sampling criteria; data collection and data analysis techniques. Besides, quality assurance techniques and research ethics is also covered.

3.2 Research Design

This study used cross-sectional descriptive survey design. Qualitative and quantitative research methods were applied in a case study. The design is more appropriate for this study as it tested the degree of association between board structure and financial performance at the time of study (Best & Kahn, 2006).

3.3 Population

A population is the total number of items from which an inference is made (Cooper & Schindler, 2006). This study used census of the six banks licensed to perform banking activities (Maryam, 2016).

3.4 Data Collection

The study used secondary data extracted from published and unpublished reports, bank annual inspection reports, and other publications that highlight information on board structure and financial performance. The researcher extracted information on boards’ structures including their size, independence, and activity; and banks’ net income earned on assets.
3.5 Data Analysis

Data analysis includes manipulation of data to develop summaries, identify patterns and application of appropriate statistical techniques to extract useful information (Cooper & Schindler, 2006). Financial performance measurement involved ratios; board size measured by total number; while independence and activity evaluated on a Likert scale. Factor analysis was used to condense dimensions of independent and activity variables for inferential analysis.

3.5.1 Conceptual Model

This study sought to establish how the various board structure variables affect financial performance of banks. The study conceptually utilized the model shown below:

\[ Y_i = f(X_1, X_2, X_3, X_4, X_5) \]

Where

\( Y_i \): The Dependent Variables (ROA)

\( X_1 \): Board size - the number of directors in a board

\( X_2 \): Director Independence - whether executive or non-executive director

\( X_3 \): Number of board meetings held in a year

\( X_4 \): Foreign directors – proportion of non-Somali directors in the board

\( X_5 \): Ownership – a control variable on whether the bank is publicly, privately or foreign owned.
3.5.2 Analytical model

The study utilized linear regression model to test the relationship between the board structure and financial performance is expressed as:

\[ Y_i = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon \]

Where:

- \( Y_i \): Dependent variable - financial performance (ROA),
- \( Bi \): Regression coefficients of \( X_i \) attributes of the independent variables
- \( X_1 \): Board size - the number of directors in a board
- \( X_2 \): Director Independence - whether executive or non-executive director
- \( X_3 \): Number of board meetings held in a year
- \( X_4 \): Foreign directors – proportion of non-Somali directors in the board
- \( X_5 \): Ownership – a control variable on whether the bank is publicly, privately or foreign owned
- \( \varepsilon \): The error term

3.5.3 Test of Significance

It’s a term used in the study to determine the study variables under study. It’s vital in regression equation tested using the F-test statistics. The significance of the independent variables carried out using the t-test statistics at 95\% confidence level.
### 3.5.4 Measurement of variables

<table>
<thead>
<tr>
<th>Variable symbol</th>
<th>Definition</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>$Y_i$</td>
<td>Financial performance</td>
<td>$\text{ROA} = \frac{\text{Profit before tax}}{\text{total Assets}}$</td>
</tr>
<tr>
<td>$X_1$</td>
<td>Board size</td>
<td>Total number of board members</td>
</tr>
<tr>
<td>$X_2$</td>
<td>Director Independence</td>
<td>Number of non-executive members on the board divided by total number of board members</td>
</tr>
<tr>
<td>$X_3$</td>
<td>Number of board meetings</td>
<td>Number of board meetings held in a year</td>
</tr>
<tr>
<td>$X_4$</td>
<td>Foreign directors</td>
<td>Proportion of non-Somali directors in the board</td>
</tr>
<tr>
<td>$X_5$</td>
<td>Ownership</td>
<td>Local public commercial banks + Local private commercial compared to Foreign commercial banks</td>
</tr>
</tbody>
</table>
CHAPTER FOUR: DATA ANALYSIS, RESULTS AND INTERPRETATION

4.1 Introduction

This chapter provides an analysis of the research findings and discussions of the study findings. The chapter outlines the descriptive statistics, the graphical presentations of the variables, correlations, the paired sample tests and an interpretation of the findings.

4.2 Descriptive Statistics

Descriptive statistics entails the paired samples test and the graphical presentations of the considered variables. The main objective of the study was to determine the effect of board structure on financial performance of commercial banks in Somalia. To respond to this objective, the study did analysis of: Return on Assets, Board size, Directors independence, Number of board meetings and ownership.

Table 4.2.1: Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>30</td>
<td>.46</td>
<td>2.71</td>
<td>1.3213</td>
<td>.69969</td>
</tr>
<tr>
<td>Board size</td>
<td>30</td>
<td>.85</td>
<td>1.23</td>
<td>1.0077</td>
<td>.09641</td>
</tr>
<tr>
<td>Directors Independence</td>
<td>30</td>
<td>.65</td>
<td>.89</td>
<td>.7957</td>
<td>.05776</td>
</tr>
<tr>
<td>Board meetings</td>
<td>30</td>
<td>.78</td>
<td>1.32</td>
<td>1.1193</td>
<td>.14280</td>
</tr>
<tr>
<td>Foreign directors</td>
<td>30</td>
<td>.00</td>
<td>.85</td>
<td>.4796</td>
<td>.31047</td>
</tr>
<tr>
<td>Ownership</td>
<td>30</td>
<td>.42</td>
<td>.84</td>
<td>.6597</td>
<td>.13900</td>
</tr>
<tr>
<td>Valid N (listwise)</td>
<td>30</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The results on table 4.2.1 above show that the average return on assets was 1.3213 with minimum and maximum for the sampled variables being 0.46 and 2.71 respectively. The results also indicate that average value of board size was 1.0077 with a minimum and maximum board size of 0.85 and 1.23 respectively. The results indicate that the mean value of directors’ independence was 0.7957 with minimum and maximum being 0.65 and 0.89 correspondingly. The results also show that average board meetings were 1.1193 with minimum and maximum value of 0.78 and 1.32 respectively.

4.2.2 Graphical Presentations

Figure 4.2.2.1: ROA

The figure below schematizes the trends the Return on assets, in Somalia commercial banks from the year 2012 to 2016. It shows the trends and relationship between the variables under study. Figure 4.2.2.1 shows that return on Assets sharply declined between 2012 and 2014 but a sharp increase was witnessed in 2015 than a gradual fall in Return on Assets in the year 2016.
Figure 4.2.2.2: Board size

Figure 4.2.2.2 above shows the trend of board size in Somalia commercial banks. According to the figure, board size in commercial banks increased gradually from 2012 to 2014 before declining sharply in 2015 where it remained constant through to the year 2016.

Figure 4.2.2.3: Number of Board Meetings
Figure 4.2.2.3 above shows the trend in the number of board meetings of commercial banks in Somalia from 2012 to 2016. The figure shows that the commercial banks experienced a steady decline in the number of board meetings from the year 2012 to 2014 before it started to rise gradually from the year 2014 to 2015 thereafter rising sharply in the year 2016.

Figure 4.2.2.4: Ownership

Figure 4.2.2.4 above shows a gradual and consistent rise in the commercial banks ownership in Somalia from year 2012 to 2016. It experienced a steady decline from the year 2012 to 2013 before increasing steadily from the year 2013 to 2015 while experiencing a decline in 2016.

4.3 Regression Analysis

The regression model was used to determine the effect of board structure on financial performance of commercial banks in Somalia. The regression results generated the model summary, the ANOVA results and the regression coefficients.

The regression model was as follows:

\[ Y_i = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon \]
Where:

$Y_i$: Dependent variable - financial performance (ROA),

$B_i$: Regression coefficients of $X_i$ attributes of the independent variables

$X_1$: Board size - the number of directors in a board

$X_2$: Director Independence - whether executive or non-executive director

$X_3$: Number of board meetings held in a year

$X_4$: Foreign directors- Proportion of non-Somali directors in the board

$X_5$: Ownership – a control variable on whether the bank is publicly, privately or foreign owned

$\varepsilon$: The error term

The study involved a multiple regression analysis to test the level of influence among predictor variables. The research used the statistical package for social sciences (SPSS V20) to code, enter and compute the measurements of the multiple regressions.

### 4.3.1 Regression Coefficients

**Table 4.3.1.1: Regression Coefficients**

<table>
<thead>
<tr>
<th>Coefficients$^a$</th>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td></td>
<td>-1.888</td>
<td>2.823</td>
<td>-.669</td>
<td>.510</td>
</tr>
<tr>
<td>Board size</td>
<td></td>
<td>-2.555</td>
<td>1.782</td>
<td>-.352</td>
<td>1.434</td>
</tr>
<tr>
<td>Directors Independence</td>
<td></td>
<td>2.061</td>
<td>1.831</td>
<td>.170</td>
<td>1.126</td>
</tr>
<tr>
<td>Board meetings</td>
<td></td>
<td>2.505</td>
<td>.690</td>
<td>.511</td>
<td>3.631</td>
</tr>
<tr>
<td>Foreign directors</td>
<td></td>
<td>-.560</td>
<td>.595</td>
<td>-.248</td>
<td>-.940</td>
</tr>
<tr>
<td>Ownership</td>
<td></td>
<td>2.437</td>
<td>.892</td>
<td>.484</td>
<td>2.733</td>
</tr>
</tbody>
</table>

a. Dependent Variable: ROA
According to the analysis, the equation for the regression line transformed to:

\[ Y_i = -1.888 - 2.555X_1 + 2.061X_2 + 2.505X_3 - 0.560X_4 + 2.437X_5 + \varepsilon \]

Where: \( Y_i = \) Return on Assets of commercial banks in Somalia, \( X_1 = \) Board size, \( X_2 = \) Director Independence, \( X_3 = \) Number of board meetings, \( X_4 = \) Foreign directors, \( X_5 = \) Ownership

From the above regression equation, it can be concluded that, holding the Board size, Directors independence, board meetings, foreign directors and ownership constant, return on assets of commercial banks in Somalia amounts to 1.888 units of influence. Variances in Board size would trigger a decrease in Return on assets of commercial banks in Somalia by 2.555 units. Variances in Directors Independence would trigger an increase in return on assets of commercial banks in Somalia by 2.061 units. Variances in Number of board meetings would trigger an increase in return on assets of commercial banks in Somalia (Mogadishu) by 2.505 units. Variances in foreign directors would trigger a decrease in Return on assets of commercial banks in Somalia by 0.56 units. Variances in bank ownership would trigger an increase in return on assets of commercial banks in Somalia by 2.437 units.

4.3.2 ANOVA

Table 4.3.1.2: ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>9.001</td>
<td>5</td>
<td>1.800</td>
<td>8.314</td>
<td>.036</td>
</tr>
<tr>
<td>Residual</td>
<td>5.197</td>
<td>24</td>
<td>.217</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>14.198</td>
<td>29</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: ROA
b. Predictors: (Constant), Ownership, Directors Independence, Board meetings, Board size, Foreign directors
Analysis of variance (ANOVA) is a method of testing the null hypothesis that several group means are equal in the population, by comparing the sample variance estimated from the group means to that estimated within the groups. Sum of squares measures the variability of a data set. Given our regression model on the sum of squares of 9.001, is bigger than residual of 5.197, we can conclude that our model sufficiently accounts for most of the variation on the dependent model, which means most of the variation on financial performance of commercial banks in Somalia results from Board size, Directors independence, Number of board meetings, foreign directors and ownership. We use the F statistic and significance level to measure if the regression model fits well. Pegging the significance level at 5%, the critical value was smaller than the calculated p (2.4< 8.314) we see that Board size, Directors independence, Number of board meetings, foreign directors and ownership significantly determine the levels of performance of commercial banks in Somalia.

4.3.3 Model Summary

Table 4.3.3.3 Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.796*</td>
<td>.634</td>
<td>.855</td>
<td>.46532</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Ownership, Directors Independence, Board meetings, Board size, Foreign directors

R is the correlation coefficient whose output shows the relationship between the study variables. R output of 0.796 indicated in the table above exhibits a strong positive relationship between the study variables. R Square shows the goodness of fit that is how well the independent variable explains the dependent variable. Adjusted R
squared is the coefficient of determination which tells us the variation in the dependent variable due to the changes in the independent variable. \( R^2 \) of 0.855 implied that a variation of 85.5% on financial performance of commercial banks in Somalia is determined by fluctuations in Board size, Directors independence, Number of board meetings, foreign directors and ownership, at 95% confidence interval. 14.5% variations on financial performance of commercial banks in Somalia are determined by variations of other variables outside this model. This is a good fit because it explains satisfactorily, between the variables. A good fit takes values between 0.75- 1.

4.4 Discussion of Research Findings

From the regression equation of \( Y_i = -1.888 - 2.555X_1 + 2.061X_2 + 2.505X_3 - 0.560X_4 + 2.437X_5 + \epsilon \), it can be concluded that, holding Board size, Directors independence, Number of board meetings, foreign directors and ownership constant, financial performance of commercial banks in Somalia amounts to 1.888 units of influence. Variances in board size would trigger a decrease in financial performance of commercial banks in Somalia by 2.555 units. Variances in directors’ independence would trigger an increase in financial performance of commercial in Somalia by 2.061 units. Variances in Number of board meetings would trigger an increase in financial performance of commercial banks in Somalia by 2.505 units. Variances in ownership would trigger a decrease in financial performance of commercial banks in Somalia by -0.560 units.

The beta coefficients indicated the relative importance of each of the independent variables (Board size, Directors independence, Number of board meetings, foreign directors and ownership) in influencing the dependent variable financial performance of commercial banks in Somalia. Board size was the most important factor
influencing the performance of commercial banks in Somalia with a beta coefficient of -2.555 followed by number of board meetings 2.505, Ownership 2.437, director’s independence 2.061 and foreign directors at -0.560. The high beta coefficient for board size indicates financial performance of commercial banks in Somalia is hugely affected by the independence of the directors. In conclusion, all these factors affect the profitability of commercial banks in Somalia. This is in line with study by (Ashenafi, Kelifa, & Yodit, 2013) which indicated a strong and positive correlation between board composition and internal control system and profitability of commercial banks.
CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The research findings indicated that board structure had an influence on bank’s performance in the study period. The co-relation findings indicated strong inverse correlation linking board size and returns of banks in the study period. The ROA were also found to have a negative relation to foreign directors.

The research revealed an existence of a strong positive correlation linking directors’ independence to financial performance of commercial banks. This therefore meant that as the board independence increase; the returns by banks were increasing. However, the co-relation between commercial bank ROA and foreign directors was also an inverse one. This translates to negative movements in ROA as a result of increments in number of foreign directors in the country’s commercial banks board.

5.2 Conclusions

The objective was to determine the effect of board structure on financial performance of commercial banks in Somalia. The study variables were; Board size, Directors independence, Number of board meetings and ownership on the financial performance of commercial banks in Somalia from 2012 to 2016.

From the research findings, the study concluded the results were ambiguous as some variables had positive correlation to Somalia commercial banks ROA while others had negative correlation in the study period. The returns on Assets were observed to be low throughout the study period and fluctuating. This is mainly contributed by the country’s political instability which has rocked the nation for almost three decades which has affected the performance not only of commercial banks but the entire
economy. The researcher also concludes that the number of foreign director in the country as well as board size was increasing over the years.

With regards to the number of board meetings, the conclusions are that the number of board meetings has been increasing yearly over the entire study period. The relationship however between foreign directors was negative and hence it negatively impacted on banks performance. Board size on the other hand had a strong, positive relationship with returns on assets. The study concludes that board size has been increasing over time. The study therefore concludes that the number of board members, board meetings as well as foreign ownership has been increasing in the recent years since the country started gaining some political stability due to the AMOSOM intervention to bring stability in the country which has experienced political instability for a long period. This therefore translated to improved returns by banks since the economy has been performing better in the last couple of years.

This study concludes that the African union should do more in an attempt to bring stability to Somalia as it has huge potential due to the numerous resources it’s endowed with. It should promote peace so as to spur economic growth and consequently improve the country’s economic performance. This would translate to a more stable economy which will attract foreign investors in the country.

5.3 Recommendations to Policy and Practice

Based on the findings of this study, for improved performance of commercial banks to be realized in Somalia, effectiveness of the board has to improve through increasing the number of foreign ownership in commercial banks in the country who will in turn bring the experience and skills necessary to improve their performance.
In view of the findings that commercial banks in Somalia have the board which has an inverse impact on their performance, hence the researcher recommends individual banks should be pegged on the bank’s capital tier group whereby banks in the same capital tier have similar board size. Institutional shareholders should engage in business with banks should be closely monitored.

5.4 Limitations of the Study
The study aimed at how board structure impact on commercial banks performance in Somalia. While the Variables covered were vital, other variables like managerial ownership, family ownership, remuneration committee, capital structure and disclosure that could not be included hence should be considered in future studies.

5.5 Suggestions for Future Studies
Further studies should be done to address the challenges that are faced by commercial banks in Somalia in their attempts to mitigate against those challenges. This study recommends the instruction of a diverse board membership from different origins to ensure they share unique ideas which will drive the bank’s profitability to optimal levels. additional research on the effect of board structure on financial performance on commercial banks in Somalia. The study also recommends an additional research on the other qualitative and no qualitative factors that affect board structure on financial performance of commercial banks in Somalia.
REFERENCES


Mohammad, B. M., & Shahid, U. (2012). Board structure and Bank Performance: Evidence from Bangladesh. *Corporate Board: Role, Duties and Composition, 8(1).*


APPENDICES

Appendix I: List of Commercial Banks in Somalia

1. Amal Commercial Bank
2. Dalsan Bank
3. Premier Bank
4. Salaam Bank of Somalia
5. Somalia Commercial Bank
6. Somalia National Bank
## Appendix II: Regression Data

<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>ROA</th>
<th>Board size (log)</th>
<th>Directors Independence</th>
<th>Number of Board meetings (Log)</th>
<th>Foreign directors (Log)</th>
<th>Owners hip</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amal bank</td>
<td>2012</td>
<td>1.73</td>
<td>1.00</td>
<td>0.8</td>
<td>1.32</td>
<td>0.48</td>
<td>0.52</td>
</tr>
<tr>
<td></td>
<td>2013</td>
<td>1.68</td>
<td>1.11</td>
<td>0.79</td>
<td>1.32</td>
<td>0.70</td>
<td>0.55</td>
</tr>
<tr>
<td></td>
<td>2014</td>
<td>1.33</td>
<td>1.11</td>
<td>0.86</td>
<td>1.28</td>
<td>0.70</td>
<td>0.67</td>
</tr>
<tr>
<td></td>
<td>2015</td>
<td>1.69</td>
<td>1.04</td>
<td>0.84</td>
<td>1.00</td>
<td>0.60</td>
<td>0.63</td>
</tr>
<tr>
<td></td>
<td>2016</td>
<td>1.75</td>
<td>1.00</td>
<td>0.82</td>
<td>1.11</td>
<td>0.48</td>
<td>0.69</td>
</tr>
<tr>
<td>Dalsan Bank</td>
<td>2012</td>
<td>0.78</td>
<td>1.18</td>
<td>0.65</td>
<td>1.23</td>
<td>0.85</td>
<td>0.68</td>
</tr>
<tr>
<td></td>
<td>2013</td>
<td>0.57</td>
<td>1.11</td>
<td>0.73</td>
<td>1.20</td>
<td>0.85</td>
<td>0.71</td>
</tr>
<tr>
<td></td>
<td>2014</td>
<td>0.46</td>
<td>1.08</td>
<td>0.76</td>
<td>1.20</td>
<td>0.78</td>
<td>0.69</td>
</tr>
<tr>
<td></td>
<td>2015</td>
<td>0.59</td>
<td>1.15</td>
<td>0.71</td>
<td>1.23</td>
<td>0.70</td>
<td>0.72</td>
</tr>
<tr>
<td></td>
<td>2016</td>
<td>0.65</td>
<td>1.23</td>
<td>0.78</td>
<td>1.28</td>
<td>0.85</td>
<td>0.76</td>
</tr>
<tr>
<td>Premier Bank</td>
<td>2012</td>
<td>1.28</td>
<td>1.08</td>
<td>0.8</td>
<td>1.11</td>
<td>0.78</td>
<td>0.78</td>
</tr>
<tr>
<td></td>
<td>2013</td>
<td>1.22</td>
<td>1.08</td>
<td>0.84</td>
<td>0.95</td>
<td>0.78</td>
<td>0.81</td>
</tr>
<tr>
<td></td>
<td>2014</td>
<td>1.20</td>
<td>1.04</td>
<td>0.78</td>
<td>1.00</td>
<td>0.78</td>
<td>0.77</td>
</tr>
<tr>
<td></td>
<td>2015</td>
<td>1.24</td>
<td>0.95</td>
<td>0.81</td>
<td>1.04</td>
<td>0.85</td>
<td>0.79</td>
</tr>
<tr>
<td></td>
<td>2016</td>
<td>1.28</td>
<td>0.95</td>
<td>0.86</td>
<td>1.15</td>
<td>0.85</td>
<td>0.83</td>
</tr>
<tr>
<td>Salaam bank of Somalia</td>
<td>2012</td>
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