EFFECT OF CORPORATE GOVERNANCE ON FINANCIAL PERFOMANCE OF COMMERCIAL BANKS IN KENYA

BY

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DECLARATION

I, the undersigned, declare that this is my original work and has not been presented to any institution or university other than the University of Nairobi for examination.

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

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DEDICATION

This work is dedicated to my family, primarily to my dear wife and best friend Jasmine, and my children Fidel and Victory. Thank you for your steadfast love and support. Your presence keeps me moving.

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LIST OF ABBREVIATIONS

ANOVA   Analysis of Variance

CBK   Central Bank of Kenya

CEO   Chief Finance Officer

CG   Corporate Governance

GDP   Gross Domestic Product

OECD   Organization for Economic Cooperation and Development

ROA   Return on Assets

SPSS   Statistical Package for Social Sciences

ABSTRACT

Kenyan banks have in the recent past experienced a number of corporate failures which are said to be related to corporate governance structures in place. The fall of Imperial bank which is now under statutory management and the collapse of Chase bank in March 2016 is an indication that the industry is still facing issues of poor governance and management practices. Corporate failures are usually preceded by financial hardship and declining firm performance. In general, successful turnarounds are rare in Kenya, which begs the question whether or not proper and timely response are employed by the board when the first signs of impending trouble are detected. This study sought to determine the effect of corporate governance on financial performance of the commercial banks in Kenya. The study's population was all the 42 commercial banks operating in Kenya. Data was obtained from 41 out of the 42 banks giving a response rate of 97.62%. The independent variables for the study were corporate governance as measured by board size, board diversity, board independence, number of committees and number of meetings held annually. The control variables were liquidity as measured by the current ratio, firm size as measured by natural logarithm of total assets and capital adequacy as measured by ratio of loans and advances to assets total. Financial performance was the dependent variable which the study sought to explain and it was measured by ROA. Secondary data was collected for a period of 5 years (January 2012 to December 2016) on an annual basis. The study employed a descriptive cross-sectional research design and a multiple linear regression model was used to analyze the association between the variables. Data analysis was undertaken using the Statistical package for social sciences version 21. The results of the study produced R-square value of 0.432 which means that about 43.2 percent of the variation in the Kenyan commercial banks' performance can be explained by the eight selected independent variables while 56.8 percent in the variation of financial performance of commercial banks was associated with other factors not covered in this research. The study also found that the independent variables had a strong correlation with dividend payout ratio (R=0.657). ANOVA results show that the F statistic was significant at 5% level with a p=0.000. Therefore the model was fit to explain the relationship between the selected variables. The results further revealed that board independence, number of committees, number of meetings, liquidity and bank size produced positive and statistically significant values for this study. The study found that board size, board diversity and capital adequacy are statistically insignificant determinants of financial performance of commercial banks. This study recommends that measures should be put in place to enhance board independence, number of committees, number of meetings, liquidity and bank size as this will improve financial performance of commercial banks in Kenya.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Corporate governance issues have received many researchers' attention over the past three decades as a result of increasing economic difficulties and run downs firms experience all over the globe (Danoshana & Ravivathani, 2013). In a firm corporate governance mechanism define and guide how a firm is governed and its related control mechanisms (Korent, Dundek & Calopa, 2014). Sound corporate governance assist safeguard investor invested amounts and investments and the anticipated commensurate returns. Companies that have more than average corporate governance mechanisms are transparent in their operations and communicate easily with investors thereby enabling them to access the competitive financial markets on relatively favourable terms (Okiro, Aduda & Omoro, 2015).

Several theories have emerged expounding on corporate governance. The agency theory advanced by Berle and Means (1932) characterizes the association between the agent and the principal to be that of mistrust and competing interests. Conversely, the Stewardship theory replaces mistrust with goal congruence. It suggests that managers' need for achievement and success can only be realized when the organization performs well. The Stakeholders theory (Clarkson, 1994) recognizes existence of other stakeholders including suppliers, customers, other organizations, employees and the community. The Resource dependence theory (Pfeffer, 1972) introduces organization's accessibility to resources in addition to separation of ownership. Information resource and strategic linkages with other organizations through the Board are considered to be critical resources for a firm's good performance.

Kenyan Commercial banks are long-faced with varied complicated risks in their regular operations that are exposed to credit risks, liquidity risks, interest rates, exposure concentration risk, exchange rates risk, settlement and internal operations risks. Business banks' reliance on soul confidence of the clientele, the maturity mismatches between their assets and liabilities and their comparatively high indebtedness renders them vulnerable (Kibugi, 2008). Inadequate managerial policies for risk mitigation can negatively affect the individual banking institutions as well as the entire banking sector. This shows that low performance of a particular bank has a potential to affect the performance of other institutions in the same industry. The broader economy is additionally in danger from any prolonged and vital disruption to the economic system (Kibugi, 2008).

1.1.1 Corporate Governance

According to Julian (2005), corporate governance is defined as the system where business corporations are directed and controlled, the rights and responsibilities among different players are distributed and employees in the business, as well as corporate affairs rules and procedures for making decisions , as laid down under the corporate governance structures. Corporate governance as defined by Humera (2011) is the processes, policies, customs, laws and institutions in which organizations are directed and how their operations are operated, administered and controlled. It enables organizations to achieve their goal, manages the relationship among different stakeholders who include the board of directors and the shareholders as well as dealing with employees and other stakeholders through a process by which the principal–agent problem in the organization is reduced.

Good practices of corporate governance are those whereby the environment in which the business operates is fair, processes are transparent and companies held responsible for their actions. Weak corporate governance practices on the other hand usually leads to waste, mismanagement and higher levels of corruption in those organizations. According to Nabil and Ziad (2014), the aim of corporate governance practices is to ensure there is a balance in power sharing among different shareholders, management as well as directors in order for shareholder value to be enhanced and ensure the interests of other shareholders is protected. Nabil and Ziad (2014) noted that investor confidence is improved by effective structures of corporate governance which ensure that the corporate entity is accountable, reliable and quality of public financial information is enhanced and that the capital markets integrity and efficiency is enhanced.

Corporate governance is a multi-faceted subject (Otieno, 2012). Bermpei & Mamatzakis (2015) observe that existing body knowledge on banking is aimed at various aspects of corporate governance and administration viz.: the structure of the board of directors, compensation of the executives in the banks, perks and allowances drawn by senior managers, the power of the chief executive officer, and how complex operations are. Olick (2015) summarizes that the key corporate governance and administration aspects are structure of the board and its committees, composition of the board of directors, processes and procedures guiding the board, how independent the board is, auditing aspects, and how corporate information is disseminated and disclosed.

1.1.2 Financial Performance

The range by which objectives of the firm and in this case financial objectives will be met or have been met is referred to as financial performance (Yahaya & Lamidi, 2015). A company's financial performance is subject to how effectively a firm uses its assets from its principal role of conducting business and its subsequent generation of revenues. Financial performance can also refer to the general well-being of a firm as far as finance is concerned over a certain period of time. Financial performance can as well be used to gauge or measure firms from the same industry or across different industries for comparison purposes. Financial performance, in summary, is a crucial objective that firms especially the profit oriented firms desire or aim at to achieve (Kajirwa, 2015).

Financial performance focuses more items that affect the financial statements or reports of a firm directly. The financial performance analysis can deal with items such as dividend growth, sales turnover, capital employed, asset base among others about the firm (Omondi & Muturi, 2013). The financial performance is a crucial indicator or measure of some economic units' success for example on achievement of set goals and objectives (Xu & Wanrapee, 2014). Firms stakeholders are mostly interested in the firm's performance as far as finance is concerned (Nyamita, 2014).

The measurement of financial performance is usually based on financial ratios such as liquidity ratios, activity ratios, profitability ratios, and debt ratios (Bouba, 2011). Financial performance can be measured from various perspectives including: solvency, profitability, and liquidity (Mwangi & Angima, 2016). Performance measurement for a company can be done through accounting-based measures

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calculated from firm's financial statements such as Return on Equity (ROE), Return on Assets (ROA), and Gross profit margin (Mwangi & Murigu, 2015).

1.1.3 Corporate Governance and Financial Performance

Good CG acts as a preventive measure to ensure that the firm does not expose itself to future financial distress. The way a firm is governed affects how it responds to external factors and this in turn will influence the financial performance of the firm (Donaldson, 2010). In this respect, there has been an observation that firms that are well managed always record improved performance compared to those with poor or no CG structures. Davis (2012) observed that a good and solid corporate governance structure helps a business become attractive to investors hence assisting in raising funds that form a good foundation for firm financial performance while the opposite will result in the firm being less profitable or even its collapse.

Corporate governance is considered as the most efficient way of supervising the operations of a firm and ensuring the main goal of a firm to maximize shareholders' wealth is taken care of. Corporate governance can also be used to reduce misconduct by organizations and enforcement of policies and decisions aimed at securing rights of shareholders and other stakeholders (Gompers et al., 2003). Good corporate practices have a positive effect of reduction in agency costs and inefficiencies which result from conflicting interests between managers, owners and stakeholders, improved competitive advantage by firms in comparison to their counterparts, and fulfillment of their corporate social responsibilities towards the communities they operate in (OECD, 2004).

A well-constituted corporate governance structure with the required number of directors is effective in driving enhancement of value for shareholders and monitoring

the management. The number of board directors greatly influence a company's performance. OECD (2004) identified five positive arguments for the diversity of board members in a framework of principal agent. The board members diversity helps in the formulation of more diverse decisions due to the acknowledgement of many alternatives as compared to a homogeneous board since they understand better the market in which the firm operates thus they come up with more creative decision.

Firms can tremendously improve their performance by strengthening their governance practices. Jensen and Meckling (1976) concluded that good financial performances are attributed with companies with good corporate governance as opposed to those with poor corporate governance. This is in line with the perception that better governed firms might have better operations, leading to higher profits. It is a common belief that good corporate governance helps to generate investor trust and confidence.

1.1.4 Commercial Banks in Kenya

Currently, In Kenya the number of licensed commercial banks is 42 and there is one mortgage finance company. Out of these, commercial banks amounting to 39 and the mortgage finance institution are owned by private investors while the remaining 3 commercial banks are the only banks which Kenya Government holds a controlling ownership. Out of the 39 banks which are owned by private investors and1 mortgage finance, 25 are owned locally (i.e. their major shareholders are citizens in Kenya) while 14 have foreign ownership. The rest of the local commercial banks are largely family owned (CBK, 2015). Commercial banks in Kenya receive deposits from individuals then lend these funds in form of loans to other customers at higher interest rates thereby earning a profit.

Kenya's system of corporate governance in the financial sector was to a great extend influenced by: lessening of the rules governing the licensing of banks in 1982 and by the procedure governing privatization which began in the 1980's and became dominant in the 1990's. Due to this, there was a significant growth in the number of banks that did not implement proper governance structures with the resultant effect of poor governance and management culture in the industry (Mwangi, 2002). A significant case in 1984 is when the Rural Urban Credit Finance was put under provisional liquidation. The Kenyan Government made changes in the Central Bank act and the banking act through the Central Bank to control instability in the banking sector. This was done through the raising of the regulatory capital and by creating of the Depositors Protection Fund.

Despite the many attempts to assimilate the banking sector, most banks have been placed under receivership or liquidated. The factors responsible for their collapsing were attributed to weakness in internal control systems, inefficient management practices and poor governance. An example is the Continental Bank of Kenya which collapsed in 1986 as well as the Continental Credit Finance Ltd and in 1987 Capital Finance collapsed. Seven banks that had collapsed were integrated by the Government of Kenya forming the Consolidated bank (Nambiro, 2007). Recently, corporate governance in Kenya has been an issue which has led to the loss of investor's wealth in the tune of Kshs. 264billion. The companies affected include Chase Bank, CMC, Imperial Bank, Uchumi, Mumias, Kenya Airways, National Bank and Trans Century (Cytonn Investment, 2015). The fall of Imperial bank which is now under statutory management and the collapse of Chase bank in March 2016 is an indication that the industry is still facing issues of poor governance and management practices.

The Centre for Corporate Governance (2004) has outlined various reasons that might explain the collapsing of various banking institutions in Kenya. This includes; cases of insider lending and conflicting of various stakeholders' interests, regulatory and supervisory systems which are weak, risk management strategies which are poor, weak internal controls and practices of governance which are poor. This resulted to the Central Bank of Kenya outlining bolder and more detailed measures to prevent these negative effects and make stronger its major roles that it carries in the industry.

1.2 Research Problem

Various theories have indicated that the objectives pursued by shareholders and corporate managers tend to differ and are contradictory with regards to their individual interests and this has given rise to corporate governance which is said to minimize the spill over. According to Lamport et al., (2011), existing studies on firms with good corporate governance practices support that there is a positive impact to the performance of such companies. It's vital for companies to embrace good practices of corporate governance as this helps in preventing scandals, fraud as well as enhancing the image of an organization in the eyes of the public as a company that is worthy of shareholder and debt holder capital. It also becomes essential for companies to improve firm performance, ensures investor rights, enhances investment atmosphere as well as encourages economic development (Braga & Shastri, 2011).

Kenyan banks have in the recent past experienced a number of corporate failures which are said to be related to corporate governance structures in place. The fall of Imperial bank which is now under statutory management and the collapse of Chase bank in March 2016 is an indication that the industry is still facing issues of poor governance and management practices. Corporate failures are usually preceded by

financial hardship and declining firm performance. In general, successful turnarounds are rare in Kenya, which begs the question whether or not proper and timely response are employed by the board when the first signs of impending trouble are detected.

Several studies have been undertaken in a bid to find out if there is somewhat a connection between CG principles and a firm's financial performance. Olick (2015) also in a research study concluded that the board size (in terms of membership numbers) has a positive and significant impact on the return on assets ratio. Batool and Gohar (2015) found that larger boards of directors inversely influence the financial performance of firms but also have a positive effect on corporate social responsibility image and reputation. Carty and Weiss (2012) found no correlation between bank failure and CEO duality while the study results by Al-Shammari and Al-Saidi (2013) indicate that CEO-board chair responsibility duality positively impacts performance by a bank. Zhaoyang and Udaya (2012) concluded that the firms' size of the board and composition of non-executive directors in the whole board structure revealed a negative correlation to the value of the firm, also the effect of non-executive directorship on the financial performance of the firm was negative.

Locally, Ogega (2014) and Rotich (2015) studied the effect of ownership structure on financial performance of commercial banks in Kenya and therefore concentrated only on one element of corporate governance, that is, ownership structure. The various form of ownership structure was investigated. They include government ownership, domestic ownership, corporate ownership and individual ownership. Adhiambo (2014) concentrated on board size and found that a large board size tends to impact performance negatively. Kalungu (2012) study on the impact of corporate governance on financial performance of commercial banks of Kenya narrowed down on a few

variables of corporate governance practices. It concentrated on three board elements; board size, board composition and board monitoring. There are many other elements of corporate governance that were not considered. On the basis of these gaps, the researcher intends to conduct the study to investigate the effects of various elements of corporate governance on financial performance of commercial banks in Kenya. The study will therefore, attempt to answer the following research question; Does board size, board diversity, board independence, number of meetings and number of committees affect the financial performance of commercial banks in Kenya?

1.3 Objective of the Study

To determine the effect of corporate governance on the financial performance of commercial banks in Kenya

1.4 Value of the Study

The study's findings will be used by future researchers, students and scholars who may want to undertake studies in the similar or correlated field as reference. The study will also be beneficial to researchers and scholars in the identification of further research areas on other subject matters by highlighting related topics that need further studies and undertaking a review of the empirical literature to establish the study gaps.

The study will be beneficial to the commercial banks by understanding the linkage between corporate governance and performance, which is paramount to the need of having a strong team of decision makers with a broad range of perspectives and abilities crucial to the financial success and in building trust among companies' stakeholders. The findings of the study will also be used by the policy makers to gain more understanding on the structures of corporate governance which will lead to the

growth of the private sector and contribute to national economic growth and stability at large.

This study will also be of importance to all institutions both public and private who have adopted corporate governance practices in Kenya since they will acquire knowledge on the ideal application of corporate governance. It will also empower chief executive officers and board of directors of private sector organizations with knowledge on practices of corporate governance.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the theoretical framework applied in the study and reviews previous studies done on corporate governance and financial performance of firms. It contains the theoretical review, determinants of firms' financial performance, empirical review, conceptual framework and summary of literature review.

2.2 Theoretical Framework

Literature review basically identifies and examines the work done by other researchers and scholars concerning corporate governance. This review will provide detailed knowledge of what has been done and act as a basis upon which the study findings will be interpreted and also to overcome the previous studies' limitations. The following section will describe and discuss different theories such as agency theory, stakeholder theory and stewardship theory.

2.2.1 Agency Theory

Agency theory was developed by Jensen and Meckling in 1976. This theory argues that a relationship exists between the principals who are the company's shareholders and the agents who are the managers and executives of the company. Meckling's and Jensen's proposition on agency theory commend that the segregation between ownership and management may result in agency problems being experienced in many modern organizations (Jensen & Meckling, 1976).

The principal, who gives the agent some decision-making authority, incurs agency costs arising from the divergence of shareholders' interests with those of company

managers. Meckling and Jensen defined agency costs as the summation of bonding cost, monitoring cost, and residual loss. Despite monitoring and bonding costs inquired, residual loss will still occur as a result of managers and shareholders interest not being fully aligned. Alignment of interests occurs when there is harmony between objectives of agents acting within an organization and those of the organization as a whole (Jensen & Meckling, 1976).

Incentives such as stock options, bonuses, and profit related pay can be used as a method of aligning interests of the agent with those of the principal since these are directly related to how well the result of management decision serves the shareholder decisions. Agency theory advocates for self-interest by the managers and employees. This calls for the agents to conduct their duties while keeping the interests of the principals in mind. The agents are governed by rules made by the principals, with the maximizing of shareholders value as the main objective. Hence in this theory a more individualistic view is applied (Nambiro, 2007).

2.2.2 Stakeholder Theory

This theory was developed gradually by Freeman (1984) who advocated for the inclusion of corporate accountability to the different types of stakeholders. In essence, stakeholder theory views the firm as an input-output model by involving the various stakeholders of a firm such as employees, suppliers, customers, dealers, governmental bodies and the larger society into the mix. Stakeholder theory has been defined a stakeholder as an individual or group whose actions can affect the attainment of the firm's objectives or can affect the achievement of those objectives (Fernando, 2009).

Stakeholder theorists argue that an organization's managers have associations with: the suppliers, employees and business partners to whom they are responsible and

affect their activities both internally and externally. These groups of relationships are of greater importance than the relationship between the owner and the manager as suggested by agency theory (Freeman, 1999). Sundaram (2004) noted that the theory addressed the wider range of stakeholders and that the firm system is composed of many stakeholders and each organization's main aim is to generate wealth for its stakeholders.

Freeman (1984) argues that the relationship of the firm with the various groups of stakeholders affects the decision making process as this theory is focused on the type of these associations for the outcome of the firm activities. This theory is mainly interested in the nature of these relationships in regarding both processes and outcomes from the firms and the firm's stakeholders as these groups can affect decision making processes (Wanyama & Olweny, 2013).

2.2.3 Stewardship Theory

Davis and Donaldson (1997) define a steward as one whose aim is to shield and maximizes shareholders wealth through the efficient running of the firm. By doing so, the steward's value are enhanced in an organization, stewards are the managers and executives working for shareholders. They guard and make profits on behalf of the shareholders and are therefore gratified and motivated with the achievement of organizational success.

Stewardship theory stresses on the top management's role of being stewards thereby integrating these roles to be part of the organization. This theory recognizes the structures are important in that they empower the stewards thereby giving them maximum control which builds the stewards trust and eventually minimizes monitoring costs. Executives and directors will work in such a manner as to maximize

financial performance by increasing the wealth and profits of the shareholders so as to ensure their reputation is protected as organizations decision makers (Daily et al., 2003). In doing this, they aim at being seen as stewards who are effective of their organization thereby protecting their careers (Fama, 1980).

2.3 Determinants of Financial Performance

The performance of firms can be influenced by elements either external or internal to the firms that define the level of output. The internal factors are different for each firm and determine its financial performance. These factors result from managerial decisions together with the board. The internal factors include corporate governance, firm size, financial leverage, liquidity, management efficiency, capital, market power among others. External factors often relate to macro-economic variables and they include exchange rate volatility, interest rates, inflation, political stability among others (Athanasoglou, Brissimis & Delis, 2005).

2.3.1 Corporate Governance

Many studies that look at the performance of an organization would never fail to mention corporate governance. This is due to believe that the quality corporate governance structure of an organization affects its performance. Corporate governance influence decisions related to capital structures which influence the firm's performance (Friend & Lang, 1988).Weak practices of corporate governance lead to poor financial performance and contribute to economic slowdown (Claessens et al., 2002).

The corporate governance concept is fundamental in the achievement of economic growth and efficiency because top level management consider it as a device for the reduction of misconduct or mismanagement in the management of an organization

(Gomper et al., 2003). When good corporate practices are observed, the agency costs incurred by a firm and inefficiencies experienced due to conflict of interest between managers, stakeholders and owners are reduced leading to improved competitive advantage of a firm over other firms thus firms are able to fulfill their social responsibilities in the communities in which they are based (OECD, 2004).

2.3.2 Liquidity

Liquidity is defined as the degree in which an entity is able to honor debt obligations falling due in the next twelve months through cash or cash equivalents for example assets that are short term can be quickly converted into cash. Liquidity results from the managers' ability to fulfill their commitments that fall due to policy holders as well as other creditors without having to increase profits from activities such as underwriting and investment and as well as their ability to liquidate financial assets. (Adam & Buckle, 2003)

According to Liargovas and Skandalis (2008), liquid assets can be used by firms for purposes of financing their activities and investments in instances where the external finance is not forthcoming.). Firms with higher liquidity are able to deal with unexpected or unforeseen contingencies as well as cope with its obligations that fall due in periods of low earnings. Almajali et al., (2012) noted that firm's liquidity may have significant effect on financial performance of insurance companies; therefore he suggested that insurance companies should aim at increasing their current assets while decreasing their current liabilities. However, Jovanic (1982) noted that an abundance of liquidity may at times result to more harm. He therefore concludes that the effect of liquidity on financial performance of firms is ambiguous.

2.3.3 Firm Size

Burca and Batrinca (2014), asserts that the relationship existing between size and financial performance is positive in the sense that more resources are available in larger firms, better risk diversification strategies, complex information systems and are able to manage expenses well compared to small firms. This may have an impact on the financial performance of insurance companies in different ways for example large firms may be advantaged compared to smaller firms as they can be able to exploit economies of scale and scope and as such they are more efficient in their operations and as a result reap higher level of profits..

According to Almajali et al., (2012), the firm's size may have an impact on its financial performance. The relationship between performance and size is positive due to the fact that there are efficiencies in operating cost that result to increased output and economies of scale. Insurers of large companies are able to diversify their risks hence are able to quickly respond to any changes that may occur in the market. Yuqi (2007) noted that in firms that are exceptionally large, there could be a negative performance in relation to its size due to bureaucratic and other costs implications.

2.3.4 Capital Adequacy

Vong (2009) defined capital adequacy as the proportion of a commercial institution's prime capital (assets less liabilities) to the assets (investments and loans) of the institution expressed as a percentage. These are the institution's funds which are available to fund the bank and perform as a cushion in case of hostile situations. Banks use capital adequacy to measure their financial strength and stability. The Capital Adequacy Standard contends that banks must have a principal capital base which is equivalent at least to 8 percent of their total assets. Sangmi and Nazir (2010)

noted that capital is among the elements that are bank specific that have an impact on the bank profitability level.

This capital adequacy factor is measured using different variables including the log of total assets, provisions for impaired loans and advances to total loans and advances, and shareholders' equity to total assets. All these measures aim to measure capital adequacy in banking firms from different perspectives (Murerwa, 2015). Capital adequacy therefore is reflected in the level of capital required to be maintained by respective banks to empower and facilitate them to absorb and be able to withstand various risks from the environment and to absorb probable or actual losses and safeguard the bank's debtors and creditors interests (Ongore & Kusa, 2013).

2.3.5 Macro-Economic Variables

The macroeconomic impact variables on bank risk have been of importance under corporate governance. Using GDP growth to control cyclical output effects, which are likely to positively influence the profitability of banks, as the rate of growth in the GDP declines, more especially during recession, banks experience negative returns caused by the lowering of credit quality and increases in defaults (Flamini et al., 2009).

Macroeconomic variables that impact on the performance of banks include legislative laws, inflation rate, interest rate, economic growth level measured using Gross Domestic Product (GDP). Athanasoglou et al., (2005) argues that the GDP trend influences the demand for bank's assets. A decline in the GDP growth reduces the credit demand which has a negative impact on the banks' profitability. Additionally, a growing economy with positive GDP growth has a high economic growth 3depending

on the prevailing business cycle. There is high demand for credit during boom as opposed to recession.

2.4 Empirical Review

There are numerous empirical studies both locally and internationally to support the relationship between corporate governance and financial performance, but these studies have produced mixed results.

2.4.1 Global Studies

Beltratti and Stulz (2012) undertook a study on the effect of corporate governance on performance by banks. A study sample of 164 international banks was collected. Data on size of boards, independence, composition of committees, and transparency is used in the study. Beltratti and Stulz (2012) found that banks characterized by more shareholder-friendly structures registered a poor performance during the crisis than other banks and their stability risk was higher than before the escalation of the crisis. The evidence found is consistent with the view that banks which performed poorly during the crisis used a shareholder friendly board structures but suffered major losses during the crisis. The study addressed the effect of board structures during crisis in developed countries and therefore left a gap on developing countries.

Ujunwa (2012) in Nigeria sampled data from 122 listed firms in the country between 1991 and 2008. The research findings showed that the board size, duality of the CEO and the diversity of board was negatively correlated to the firm performance, while nationality of the board, ethnic diversity of the board and the number of board members who had doctorate qualification had a positive influence on the performance of the firm. Duality of the board was also linked to this good performance of the board. This study addressed the major components of corporate governance and their

relationship to the performance of a firm but did not take into account firms that are not listed and the different observations across industries.

Danoshana and Ravivathani (2013) undertook a research study to assess the influence corporate governance has on Sri Lankan listed firm performance. The researchers used ratio of net income to equity, ratio of net income to assets to define and measure the performance of a firm, and size, frequency of board meetings, and board audit committee as the variables to measure corporate governance. Studied population comprised all thirty three listed firms; twenty five firms were sampled using cluster sampling. Secondary data was obtained from audited and published financial reports of the targeted firms and from the exchange's periodic publications and website for the period 2008-2012. Using correlation, regression, and descriptive statistics to undertake data analyses, the study findings indicate that size of the board of directors and size of the audit committee both have positive effect on performance while frequency of meetings has a negative impact.

Marashdeh (2014) also undertook research study to determine whether corporate governance affects firm performance by the Jordanian industrial and services companies during the years 2000 to 2010 employing the agency theory in undertaking the study. Population of study comprised all the firms listed in the Amman Stock Exchange; from which a sample of one hundred and fifteen firms was obtained using cluster sampling. Secondary data was collected from published annual reports of firms and multiple regression panel data analysis used to analyze the data. The study failed to reveal any significant impact of size of board of directors on firm performance; however, CEO duality, foreign and managerial ownership have positive effects on

firm performance, while ownership concentration and non-executive directors (NEDs) indicate a negative impact on firm performance.

Bermpei and Mamatzakis (2015) in a research study assessed impact of the corporate governance on listed investment banking firms' performances in United States of America over 2000–2012 period, used secondary data from annual reports and regulatory filings of the major 23 investment banks sampled. Descriptive statistics and regression analysis were used in data analysis. The research results show size has a negative effect on performance particularly for banks having board sizes with more than ten members; negative inverse relationship between operational involvedness and performance; the chief executive officer power positively influences performance; increasing board members ownership stakes has negative performance impact within some levels while above certain levels the said ownership impacts performance positively, this could be seen as incentives of both parties (managers and owners) become more aligned.

2.4.2 Local Studies

In a study conducted by Wanyama and Olweny (2013) on effects of Corporate Governance on Financial Performance of Insurance Firms listed at the NSE in Kenya, He noted that a strong relationship exists between the corporate governance variables under study (board size, CEO duality, board composition, and leverage) and the firm's financial performance. It was observed that a negative relationship existed between board size and impact on the financial performance of the insurance companies listed at the NSE. Wanyama and Olweny (2013) also noted that there exists a positive relationship that existed between board composition and financial performance of firms.

Muiruri (2014) undertook a research study that examined the effect of corporate governance practices (number of nonexecutive directors, board size and board diversity gender) on performance. The census study used an exploratory design and gathered data from secondary sources and regression analysis used in data analysis. The study found that NEDs and board size affects performance while gender diversity in board did not have any significant effect. The study however does not indicate the study period covered.

Adhiambo (2014) undertook a census research study and utilized cross sectional design and all 43 banks operating in Kenya was the population, and obtained secondary data from the audited financial reports for the period from 2009 to 2013. Data were analyzed using multiple regression analysis. The researcher finds that negative performance stems from large board sizes. Positive upward financial trends emanate from composition of boards, remuneration (compensation) of the members of boards and the level of academic and educational qualifications held by the members of the boards.

Muigai (2014) also did a research study to determine the relationship between selected corporate board dynamics (board size, composition of executive and non-executive members and the gender diversity in corporate boards) and financial performance. The census research utilized a descriptive design and population of forty three licensed commercial banks in Kenya and obtained secondary data for the five years from 2009 to 2013. Data were analyzed using multiple regression and descriptive statistics. The research study found a strong negative correlation of composition of board and performance and no positive significant relationship

between gender diversity among directors and firm performance, while there is negative correlation between the board size and performance.

Olick (2015) in a study examined the effect of firm governance and administration practices (proportion of NEDs, board size and gender diversity) on the financial performance of microfinance firms. The study was undertaken in the context of Kenya. The census study was based on cross-sectional descriptive research design and data gathered from secondary sources of the 9 licensed micro finance banks' annual reports for the period 2010-2014. A multiple linear regression model was used in data analysis and analysis of variance to test significance. The study found size of board has significant positive effect on ROA, proportion of NEDs has positive insignificant effect; gender diversity showed significant negative effect on performance.

2.5 Conceptual Framework

A major issue in the banking sector is financial efficiency, if bank performs well in this regard, then it will be able to obtain required resources to attain the corporate objective and manage to survive in today's competitive market. Several studies have been done on how corporate governance structures relate with corporate performance and majority have found that high financial performance is as a result of good corporate governance. This study seeks to research on this assertion.

Corporate governance in this study was the independent variable with five measures. The number of directors was measured using the natural logarithm to determine the size factor of the board. Board diversity was measured by the extent to which a board is constituted comprise a broad range of backgrounds and interests for example, people from different cultural groups, minorities, gender, age, socio economic status, experience, values as well as disability. Board sub-committees was measured by the

natural logarithm of their number while board meetings the natural logarithm of the number of meetings held per year and the independence of the board measured by the quotient of the non-executive directors to the total number of board of directors. The control variables were liquidity as measured by the current ratio, firm size as measured by natural logarithm of total assets and capital adequacy as measured by ratio of loans and advances to assets total. Financial performance was the dependent variable which the study sought to explain and it was measured by ROA.

Figure 2.1: The Conceptual Model

Corporate Governance	
Board size	
Board independence	
Board diversity	
Board meetings	
Number of board committees	**Financial Performance**
	Return on Assets
Control Variables	
Liquidity	
Firm Size	
Capital adequacy	
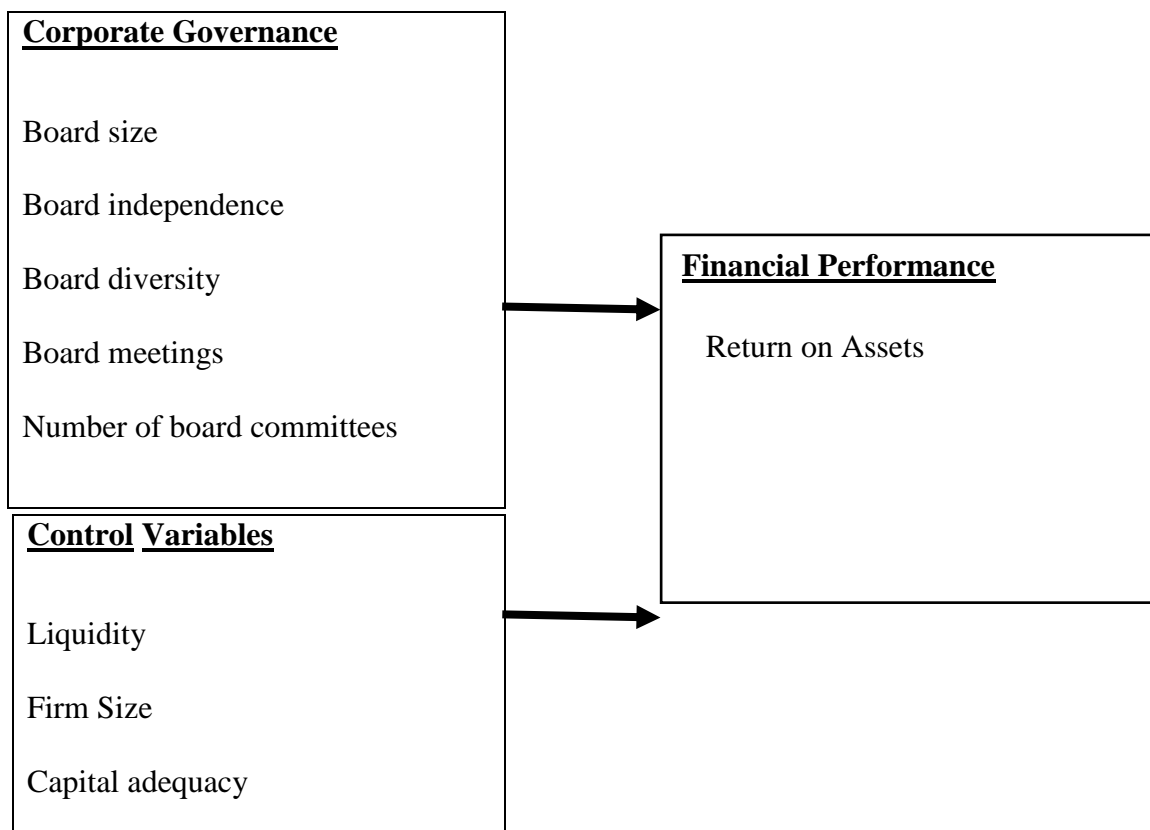
Independent variables   **Dependent Variable**

Source: Researcher (2017)

2.6 Summary of the Literature Review

Various theoretical frameworks have attempted to explain the concept of corporate governance. Three theories have been discussed in this theoretical review. The theories are namely: agency theory, stakeholder theory and stewardship theory. Some of the key determinants of financial performance have also been discussed in this section. Several empirical studies have been conducted both internationally and locally on corporate governance and financial performance. These studies' findings have also been discussed in this chapter.

The empirical studies reviewed show corporate governance effect on financial performance remains unsettled. From the studies, both local and foreign, the findings are split as to the effect of board diversity, board size, and independence of the board, number of committees and number of meetings held annually on financial performance. Foreign studies reviewed indicate chief executive officer role duality parameter leads to positive performance (Marashdeh, 2014; Bermpei & Mamatzakis, 2015); few local studies have analyzed this parameter. On the basis of these gaps, the researcher intends to conduct the study to investigate the effects of various elements of corporate governance on financial performance of commercial banks in Kenya. The study will therefore, attempt to answer the following research question; Does board size, board diversity, board independence, number of meetings and number of committees affect the financial performance of commercial banks in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes methods of research applied to objectively establish the influence of corporate governance on financial performance. It also shows the population of study, research design, diagnostic tests, criterion used in the collection and analysis of data.

3.2 Research Design

Descriptive cross sectional design was adopted for the study. A descriptive study involves a description of all the elements of the population. It allows estimates of a part of a population that has these attributes. Identifying relationships among various variables is possible, to establish whether the variables are independent or dependent. Cross-sectional study methods are done once and they represent summary at a given timeframe (Cooper & Schindler, 2008).

3.3 Population and Sample

Population refers to all observations of interest in an entire collection like people or events as described by a researcher (Burns & Burns, 2008). The population of the study comprised of all the 42 commercial banks operating in Kenya as at 31st December 2016 (See appendix I).

3.4 Data Collection

Data was exclusively collected from a secondary source. The researcher consulted the annual financial reports of commercial banks in Kenya over a period of five years (2012-2016). The reports were obtained from the Central Bank Website and banks

annual reports. The end result was information detailing the independent variables and dependent variable for the 42 commercial banks in Kenya.

3.5 Diagnostic Tests

Linearity show that two variables X and Y are related by a mathematical equation Y=bX where c is a constant number. The linearity test was obtained through the F-statistic in ANOVA. Normality is a test for the assumption that the residual of the response variable are normally distributed around the mean. This was determined by Shapiro-walk test or Kolmogorov-Smirnov test. Autocorrelation is the measurement of the similarity between a certain time series and a lagged value of the same time series over successive time intervals. It was tested using Durbin-Watson statistic (Khan, 2008).

Multicollinearity is said to occur when there is a nearly exact or exact linear relation among two or more of the independent variables. This was tested by the determinant of the correlation matrices, which varies from zero to one. Orthogonal independent variable is an indication that the determinant is one while it is zero if there is a complete linear dependence between them and as it approaches to zero then the multicollinearity becomes more intense (Burns & Burns, 2008).

3.6 Data Analysis

The data was inputted into the SPSS and examined using descriptive, correlation and regression analyses. In descriptive statistics, the study used mean and standard deviation. In inferential statistics, the study used multivariate regression analysis to determine the relationship between the study variables.

3.6.1 Conceptual Model

The study applied a conceptual model of the form:

$Y = f (X_1, X_2, X_3, X_4, X_5, X_6, X_7, X_8)$

Where:

Y= Financial performance of banks

X_1 = Board size

X_2= Board diversity

X_3= Board Independence

X_4= Number of Committees

X_5=Number of meetings held annually

X_6=Bank Liquidity

X_7=Bank Size

X_8=Bank Capital Adequacy

The importance of a regression model is to provide a basis for estimating the relationship between variables, specifically the relationship between corporate governance and financial performance.

3.6.2 Analytical Model

The study applied the following regression model:

$Y= \beta_0 + \beta_1X_1+ \beta_2X_2+ \beta_3X_3+\beta_4X_4+ \beta_5X_5+ \beta_6X_6+ \beta_7X_7+ \beta_8X_8+ \beta_5X_5+\varepsilon.$

Where;

Y= Financial performance of banks as measured by ROA

β_0 = Constant Term

β_i = Beta Coefficient of variable i which measures the change Y to change in i

X_1 = Board size

X_2 = Board diversity

X_3 = Board Independence

X_4 = Number of Committees

X_5 = Number of meetings held annually

X_6 = Bank Liquidity

X_7 = Bank Size

X_8 = Bank Capital Adequacy

ε = Error term

3.6.3 Operationalization of Study Variables

Financial performance	Return on Assets (ROA)
Board size	total members forming the board of directors
Board diversity	Number of professions represented in the board.
Board Independence	Percentage of the non-executive directors in proportion to the total number of directors.
Number of committees	Number of board committees
Board meetings	Number of meetings held annually
Bank liquidity	Current ratio

Bank size	Natural logarithm of total assets
Capital adequacy	ratio of loans and advances to assets total

3.6.4 Tests of Significance

To test the statistical significance the F- test and the t – test were used at 95% confidence level. The F statistic was utilized to establish a statistical significance of regression equation while the t statistic was used to test statistical significance of study coefficients.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND INTERPRETATION

4.1 Introduction

This chapter focused on the analysis of the collected data to establish the effect of corporate governance on financial performance of the Kenyan commercial banks. Using descriptive statistics, correlation analysis and regression analysis, the results of the study were presented in table forms as shown in the following sections.

4.2 Response Rate

This study targeted all the 42 commercial banks in Kenya as at 31st December 2016. Data was obtained from 41 banks representing a response rate of 97.62%. From the respondents, the researcher was able to obtain secondary data on corporate governance, bank size, liquidity, capital adequacy and financial performance of banks.

4.3 Diagnostic Tests

The researcher carried out diagnostic tests on the collected data. The research assumed a 95 percent confidence interval or 5 percent significance level (both leading to identical conclusions) for the data used. These values helped to verify the truth or the falsity of the data. Thus, the closer to 100 percent the confidence interval (and thus, the closer to 0 percent the significance level), the higher the accuracy of the data used and analyzed is assumed to be.

4.4 Descriptive Analysis

Descriptive statistics gives a presentation of the average, maximum and minimum values of variables applied together with their standard deviations in this study.

Table 4.2 below shows the descriptive statistics for the variables applied in the study. An analysis of all the variables was obtained using SPSS software for the period of five years (2012 to 2016) for all the 41 banks that provided data for this study. The mean, standard deviation, minimum and maximum for all the variables selected for this study are as shown in the table below.

Table 4.1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	205	-.05320	.06700	.0239179	.01928597
Board Size	205	5	14	8.51	1.825
Board Diversity	205	2	10	5.34	1.712
Board Independence	205	.286	1.000	.73882	.147930
No. of Committees	205	2	9	4.66	1.442
No. of Meetings	205	4	33	6.74	3.505
Liquidity	205	.054	.948	.38940	.142114
Bank Size	205	6.794	8.703	7.68560	.534062
Capital Adequacy	205	.079	.480	.21682	.070264
Valid N (listwise)	205				

Source: Research Findings (2017)

4.5 Correlation Analysis

The association between any two variables used in the study is established using correlation analysis. This relationship ranges between (-) strong negative correlation

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and (+) perfect positive correlation. Pearson correlation was employed to analyze the level of association between the commercial banks' financial performance and the independent variables for this study (Board size, Board diversity, Board Independence, Number of Committees, Number of meetings held annually, Bank Liquidity, Bank Size and Bank Capital Adequacy).

The study found out that board size, board diversity, number of committees, liquidity and bank size have a positive and statistically significant correlation with the commercial banks' financial performance as shown by (r = . 201, p = .004; r = . 162, p = .020; r = . 170, p = .015; r = .306, p = .000; r = .530, p = .000) respectively. The study also found out that a positive and insignificant correlation exists between board independence and capital adequacy with financial performance as evidenced by (r =. 018, p = .798) and (r = .092, p = .189) respectively. Number of meetings was found to have a negative and negligible association with the commercial banks' financial performance as evidenced by (r = -.036, p = .604). Although the independent variables had an association to each other, the association was not strong to cause Multicollinearity as all the r values were less than 0.70. This implies that there was no multi-collinearity among the independent variables and therefore they can be used as determinants of dividend payout ratio in regression analysis.

Table 4.2: Correlation Analysis

Correlations					
	ROA	Board Size	Board Diversity	Board Independence	No. of Committees

ROA	Pearson Correlation	1	.201[**]	.162[*]	.018	.170[*]
	Sig. (2-tailed)		.004	.020	.798	.015
	N	205	205	205	205	205
Board Size	Pearson Correlation	.201[**]	1	.451[**]	.035	.180[**]
	Sig. (2-tailed)	.004		.000	.619	.010
	N	205	205	205	205	205
Board Diversity	Pearson Correlation	.162[*]	.451[**]	1	-.112	.335[**]
	Sig. (2-tailed)	.020	.000		.110	.000
	N	205	205	205	205	205
Board Independence	Pearson Correlation	.018	.035	-.112	1	.130
	Sig. (2-tailed)	.798	.619	.110		.064
	N	205	205	205	205	205
No. of Committees	Pearson Correlation	.170[*]	.180[**]	.335[**]	.130	1
	Sig. (2-tailed)	.015	.010	.000	.064	

	N	205	205	205	205	205

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Correlations						
		ROA	No. of Meetings	Liquidity	Bank Size	Capital Adequacy
ROA	Pearson Correlation	1	-.036	.306**	.530**	.092
	Sig. (2-tailed)		.604	.000	.000	.189
	N	205	205	205	205	205
No. of Meetings	Pearson Correlation	-.036	1	-.041	.141*	-.120
	Sig. (2-tailed)	.604		.562	.043	.085
	N	205	205	205	205	205
Liquidity	Pearson Correlation	.306**	-.041	1	.117	.411**
	Sig. (2-tailed)	.000	.562		.096	.000
	N	205	205	205	205	205
Bank Size	Pearson Correlation	.530**	.141*	.117	1	-.251**
	Sig. (2-tailed)	.000	.043	.096		.000
	N	205	205	205	205	205

Capital Adequacy	Pearson Correlation	.092	-.120	.411**	-.251**	1
	Sig. (2-tailed)	.189	.085	.000	.000	
	N	205	205	205	205	205
**. Correlation is significant at the 0.01 level (2-tailed).						
*. Correlation is significant at the 0.05 level (2-tailed).						

Source: Research Findings (2017).

4.6 Regression Analysis

Financial performance was regressed against eight predictor variables; board size, board diversity, board independence, number of committees, number of meetings held annually, bank liquidity, bank size and bank capital adequacy. The regression analysis was executed at a significance level of 5%. The critical value obtained from the F − table was measured against the one acquired from the regression analysis.

The study obtained the model summary statistics as shown in table 4.4 below.

Table 4.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.657ᵃ	.432	.409	.01482641	1.503

a. Predictors: (Constant), Capital Adequacy, No. of Committees, No. of Meetings, Board Independence, Bank Size, Board Diversity, Liquidity, Board Size

b. Dependent Variable: ROA

R squared, being the coefficient of determination indicates the deviations in the response variable that is as a result of changes in the predictor variables. From the outcome in table 4.4 above, the value of R square was 0.432, a discovery that 43.2 percent of the deviations in financial performance of commercial banks is caused by changes in board size, board diversity, board independence, number of committees, number of meetings held annually, bank liquidity, bank size and bank capital adequacy. Other variables not included in the model justify for 56.8 percent of the variations in financial performance of the Kenyan financial performance. Also, the results revealed that there exists a strong relationship among the selected independent variables and the financial performance as shown by the correlation coefficient (R) equal to 0.657. A durbin-watson statistic of 1.503 indicated that the variable residuals were not serially correlated since the value was more than 1.5.

Table 4.4: Analysis of Variance

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	.033	8	.004	18.647	.000[b]
1	Residual	.043	196	.000		
	Total	.076	204			

a. Dependent Variable: ROA

b. Predictors: (Constant), Capital Adequacy, No. of Committees, No. of

Meetings, Board Independence, Bank Size, Board Diversity, Liquidity, Board

Size

The significance value is 0.00 which is less than p=0.05. This implies that the model was statistically significant in predicting how board size, board diversity, board independence, number of committees, number of meetings held annually, bank liquidity, bank size and bank capital adequacy affects the Kenyan commercial banks' financial performance.

Coefficients of determination were used as indicators of the direction of the association between the independent variables and the commercial banks' financial performance. The p-value under sig. column was used as an indicator of the significance of the association between the dependent and the independent variables. At 95% confidence level, a p-value of less than 0.05 was interpreted as a measure of statistical significance. As such, a p-value above 0.05 indicates that the dependent variables have a statistically insignificant association with the independent variables. The results are indicated in table 4.6

Table 4.5: Model Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.178	.020		-9.105	.000
	Board Size	.000	.001	.014	.197	.844
	Board Diversity	-.001	.001	-.065	-.924	.357
	Board Independence	.019	.008	.143	2.453	.015
	No. of Committees	.003	.001	.215	3.610	.000
	No. of Meetings	-.001	.000	-.134	-2.315	.022
	Liquidity	.033	.009	.241	3.533	.001
	Bank Size	.021	.003	.589	8.087	.000
	Capital Adequacy	.030	.018	.111	1.706	.090

a. Dependent Variable: ROA

Source: Research Findings (2017).

From the above results, it is evident that board independence, number of committees, number of meetings, liquidity and bank size produced positive and statistically significant values (high t-values, $p < 0.05$). Board size, board diversity and capital adequacy were found to be statistically insignificant for this study as evidenced by (t= .197, p= .844), (t= -.924, p= .357) and (t= 1.706, p= .090) respectively.

The following regression equation was estimated:

$$Y = -0.178 + 0.000X_1 - 0.001X_2 + 0.019X_3 + 0.003X_4 - 0.001X_5 + 0.033X_6 + 0.021X_7 + 0.030X_8$$

Where,

Y = Financial performance measured by ROA

X_1 = Board size

X_2 = Board diversity

X_3 = Board Independence

X_4 = Number of Committees

X_5 = Number of meetings held annually

X_6 = Bank Liquidity

X_7 = Bank Size

X_8 = Bank Capital Adequacy

On the estimated regression model above, the constant = -0.178 shows that if selected dependent variables (board size, board diversity, board independence, number of committees, number of meetings held annually, bank liquidity, bank size and bank capital adequacy) were rated zero, the commercial banks' financial performance would be -0.178. A unit increase in board size, board independence, number of committees, bank liquidity, bank size and bank capital adequacy will result in an increase in financial performance as indicated by positive coefficients while a unit increase in board diversity and number of meetings held annually would lead to a decrease in financial performance of the Kenyan commercial banks as indicated by coefficients with negative values.

4.7 Discussion of Research Findings

The study sought to determine the association between corporate governance and

financial performance of the Kenyan commercial banks. Corporate governance in this study was the independent variable with five measures. The number of directors was measured using the natural logarithm to determine the size factor of the board. Board diversity was measured by the extent to which a board is constituted, comprise a broad range of backgrounds and interests for example, people from different cultural groups, minorities, gender, age, socio economic status, experience, values as well as disability. Board sub-committees was measured by the natural logarithm of their number while board meetings the natural logarithm of the number of meetings held per year and the independence of the board measured by the quotient of the non-executive directors to the total number of board of directors. The control variables were liquidity as measured by the current ratio, firm size as measured by natural logarithm of total assets and capital adequacy as measured by ratio of loans and advances to assets total. Financial performance was the dependent variable which the study sought to explain and it was measured by ROA.

The Pearson correlation coefficients between the variables revealed that board size, board diversity, number of committees, liquidity and bank size have a positive and statistically significant correlation with financial performance of commercial banks The study also found out that there was a positive and insignificant correlation between board independence and capital adequacy with financial performance Number of meetings was found to have a negative and insignificant association with financial performance of commercial banks.

The model summary revealed that the independent variables: board size, board diversity, board independence, number of committees, number of meetings held annually, bank liquidity, bank size and bank capital adequacy explains 43.2% of

changes in the dependent variable as indicated by the value of R^2 which implies that there are other factors not included in this model that account for 56.8% of changes in the commercial banks' financial performance. The model is fit at 95% level of confidence since the F-value is 18.647. This shows that the overall multiple regression model is statistically significant and is an adequate model for predicting and explaining the influence of the selected independent variables on the Kenyan commercial banks' financial performance.

The findings of this study are in line with Muiruri (2014) who undertook a research study that examined the effect of corporate governance practices (number of nonexecutive directors, board size and board diversity gender) on performance. The census study used an exploratory design and gathered data from secondary sources and regression analysis used in data analysis. The study found that NEDs and board size affects performance while gender diversity in board did not have any significant effect. The study however does not indicate the study period covered.

This study is also in agreement with Muigai (2014) who also did a research study to determine the relationship between selected corporate board dynamics (board size, composition of executive and non-executive members and the diversity in gender in corporate boards) and financial performance. The population of forty three licensed commercial banks in Kenya was used from 2009 to 2013. The research study found a strong negative correlation of composition of board and performance and no positive significant relationship between gender diversity among directors and firm performance, while there is negative correlation between the board size and performance.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the findings of the previous chapter, conclusion, limitations encountered during the study. This chapter also elucidates the policy recommendations that policy makers can implement to achieve the expected financial performance of the Kenyan commercial banks. Lastly the chapter presents suggestions for further research which can be useful to future researchers.

5.2 Summary of Findings

The study sought to examine the impact of selected corporate governance on the Kenyan financial bank's financial performance. The independent variables for the study were board size, board independence, board diversity, number of committees, number of meetings held annually, bank liquidity, bank size and bank capital adequacy. The descriptive cross-sectional research design was employed in the study. Secondary data was obtained from the Central Bank of Kenya and was analyzed using SPSS software version 21. The study used annual data for 41 commercial banks covering a period of five years from January 2012 to December 2016.

From the results of correlation analysis, board size, board diversity, number of committees, liquidity and bank size have a positive and statistically significant correlation with the commercial banks' financial performance. The study also found out that there was a positive and insignificant correlation between board independence and capital adequacy with financial performance. Number of meetings was found to

have a negative and insignificant association with financial performance of commercial banks.

The co-efficient of determination R-square value was 0.432 which means that about 43.2 percent of the variation in financial performance of the Kenyan commercial banks can be explained by the eight selected independent variables while 56.8 percent in the variation of financial performance was associated with other factors not covered in this research. The study also found a strong correlation between the independent variables and the commercial banks' financial performance (R=0.657). ANOVA results indicate that the F statistic was at 5% significance level with a p=0.000. Therefore the model was fit in explaining the association between the selected variables.

The regression results show that when all the independent variables selected for the study have zero value the financial performance of commercial banks will be -0.178. It is also noted that a unit increase in board size, board independence, number of committees, bank liquidity, bank size and bank capital adequacy would result to higher financial performance as indicated by positive coefficients while a unit increase in board diversity and number of meetings held annually would lead to a decrease in financial performance of commercial banks in Kenya as indicated by coefficients with negative values.

5.3 Conclusion

It can be concluded from the findings that the Kenyan commercial banks' financial performance is significantly affected by board independence, number of committees, number of meetings, liquidity and bank size. The study therefore concludes that a unit increase in this variables leads to a significant increase in financial performance of

commercial banks. The study found that board size, board diversity and capital adequacy are statistically insignificant determinants of financial performance and therefore this study concludes that these variables do not influence to a large extent the Kenyan commercial bank's financial performance

This study concludes that independent variables selected for this study board size, board diversity, board independence, number of committees, number of meetings held annually, bank liquidity, bank size and bank capital adequacy influence to a large extent financial performance of commercial banks in Kenya. It is therefore sufficient to conclude that these variables significantly influence financial performance of commercial banks as shown by the p value in anova summary. The fact that the eight independent variables explain 43.2% of changes in financial performance imply that the variables not included in the model explain 56.8% of changes in financial performance of commercial banks in Kenya.

This finding concurs with Muigai (2014) who also did a research study to determine the relationship between selected corporate board dynamics (board size, composition of executive and non-executive members and the gender diversity in corporate boards) and financial performance. The population of forty three licensed commercial banks in Kenya was used from 2009 to 2013. The research study found a strong negative correlation of composition of board and performance and no positive significant relationship between gender diversity among directors and firm performance, while a negative correlation exists between board size and performance.

5.4 Recommendations

The study established a positive and significant influence of board independence on the Kenyan commercial bank's financial performance. This study recommends that

measures should be put in place to enhance board independence as this will improve financial performance. The study found out that number of committees in a board has a significant positive influence on financial performance of the Kenyan Commercial banks. The study recommends that boards should have several committees to enhance financial performance.

The study found out that the number of meetings held in a year has a significant influence on financial performance although their influence is negative. The study recommends that firms should make important decisions regarding the number of meetings as it has been found to influence financial performance. The study found out that a positive relationship exists between financial position and liquidity position. This study recommends that a comprehensive assessment of a bank's immediate liquidity position should be undertaken because level of liquidity has been found to influence financial performance.

The study found out that a positive relationship exists between financial performance and size of a bank. This study recommends that banks' management and directors should aim at increasing their asset base by coming up with measures and policies aimed at enlarging the banks' assets as this will eventually have a direct impact on financial performance of the bank. From the findings of this study, big banks in terms of asset base are expected to perform better than small banks and therefore banks should strive to grow their asset base.

5.5 Limitations of the Study

The scope of this research was for five years 2012-2016. It has not been determined if the results would hold for a longer study period. Furthermore it is uncertain whether

similar findings would result beyond 2016. A longer study period is more reliable as it will take into account major economic conditions such as booms and recessions.

The biggest limitation in the study is the quality of the data. It is difficult to conclude from this research whether the findings present the true facts about the situation. The data that has been used is only assumed to be accurate. There is also a great inconsistency in the measures used depending on the prevailing conditions. Secondary data was employed in the study which was already existent as opposed to primary data which was raw information. The study also considered selected determinants of and not all the factors affecting financial performance of commercial banks mainly due to limitation of data availability.

For data analysis purposes, the researcher applied a multiple linear regression model. Due to the shortcomings involved when using regression models such as erroneous and misleading results when the variable values change, the researcher cannot be able to generalize the findings with certainty. If more and more data is added to the functional regression model, the hypothesized relationship between two or more variables may not hold.

5.6 Suggestions for Further Research

This study focused on corporate governance and financial performance of commercial banks in Kenya and relied on secondary data. A research study where data collection relies on primary data i.e. in depth questionnaires and interviews covering all the 42 commercial banks registered with the Central Bank of Kenya is recommended so as to compliment this research.

The study was not exhaustive of the independent variables affecting financial performance of commercial banks in Kenya and this study recommends that further

studies be conducted to incorporate other variables like management efficiency, growth opportunities, industry practices, age of the firm, political stability and other macro-economic variables. Establishing the effect of each variable on financial performance will enable policy makers know what tool to use when controlling the financial performance.

The study concentrated on the last five years since it was the most recent data available. Future studies may use a range of many years e.g. from 2000 to date and this can be helpful to confirm or disapprove the findings of this study. The study limited itself by focusing on financial institutions. The recommendations of this study are that further studies be conducted on other non-financial institutions operating in Kenya. Finally, due to the inadequacies of the regression models, other models such as the Vector Error Correction Model (VECM) can be used to explain the different associations between the variables.

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APPENDICES

Appendix I: List of Commercial Banks in Kenya as at 31st December 2016

1. African Banking Corporation Ltd.

2. Bank of Africa Kenya Ltd.

3. Bank of Baroda (K) Ltd.

4. Bank of India

5. Barclays Bank of Kenya Ltd.

6. CFC Stanbic Bank Ltd.

7. Chase Bank (K) Ltd.

8. Citibank N.A Kenya

9. Commercial Bank of Africa Ltd.

10. Consolidated Bank of Kenya Ltd.

11. Co-operative Bank of Kenya Ltd.

12. Credit Bank Ltd.

13. Development Bank of Kenya Ltd.

14. Diamond Trust Bank (K) Ltd.

15. Dubai Bank Kenya Ltd.

16. Ecobank Kenya Ltd

17. Equatorial Commercial Bank Ltd.

18. Equity Bank Ltd.

29. Family Bank Ltd

20. Fidelity Commercial Bank Ltd

21. GTB Ltd

22. First community Bank Limited

23. Giro Commercial Bank Ltd.

24. Guardian Bank Ltd

25. Gulf African Bank Limited

26. Habib Bank A.G Zurich

27. Habib Bank Ltd.

28. Housing Finance

29. Imperial Bank Ltd

30. Investment & Mortgages Bank Ltd

31. Jamii Bora Bank.

32. Kenya Commercial Bank Ltd

33. Sidian Bank Ltd

34. Middle East Bank (K) Ltd

35. National Bank of Kenya Ltd

36. NIC BANK

37. Oriental Commercial Bank Ltd

38. Paramount Universal Bank Ltd

39. Prime Bank Ltd

40. Standard Chartered Bank (K) Ltd

41. Trans-National Bank Ltd

42. UBA Kenya Bank.