THE EFFECT OF CORPORATE GOVERNANCE STRUCTURES ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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DECLARATION

This management project is my original work and has not been presented for a degree in any other University.

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D61/60060/2010

Signed .......................... Date 08/11/2012

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

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DEDICATION

This study is dedicated to my loving family for their support, encouragement and patience during the entire period of my study and continued prayers towards successful completion of this course.

May God bless you all.
ABSTRACT

The research sought to analyze how corporate governance structures affect the financial performance of commercial banks in Kenya. The research focused on all the commercial banks listed in the Nairobi Securities Exchange. The general objective of this research was to determine how corporate governance structures affect the financial performance of commercial banks in Kenya. The research was to determine how corporate governance structures affect the financial performance of commercial banks in Kenya by answering the following research questions: Is there a positive relationship between bank performances of the preceding year and frequency of board meetings? Is there a positive relationship between the bank performances and the percentage of Institutional investors share ownership? Is there a positive relationship between executive compensation and bank performance? Is there a positive relationship between the ratio of outside directors to total directors and Banks’ performance? Typically corporate governance structures adopted by firms experiencing declining performance results in changes in; board meeting frequency; board composition insider share ownership and executive compensation.

The research was conducted using a Cross-sectional survey that sought to identify differences in corporate governance’s structures between listed banks facing a decline in values and those with appreciating values, and those with stable value on calendar years 2005, 2006, 2007, 2008, 2009 and 2010. The study targeted nine banks in Kenya listed in the NSE for the period of six years (2005 to 2010). In order to establish the relationship between corporate governance structure and the performance of banks listed on the Nairobi Stock Exchange, secondary data sources were used. The study employed Tobin Q as proxy for financial performance.

The study established the price-to-book value of the listed commercial banks. The price to book value was a function of the ratio of market capitalization to the net asset values of the banks. Price to book value measures the portion of a company that can be claimed by the shareholders if the company is liquidated at that time. According to the finding of the study, the price-to-book values of the banks were above 1 meaning that the market values of the banks’ equity were greater than the value of the net of their total recorded assets. The study established that that
while there is a positive relationship between remuneration and revenue/profitability, there is a negative relationship between Tobin’s Q and remuneration. The regression results showed that when value of the corporate governance indicators/measures used in the study (board size, composition, meetings and executive meetings) were zero, then the market value of the banks’ assets relative to their book value becomes lower. The results also showed that board size negatively affected firms market performance while board composition affected market performance positively the most and a unit increase in executive remuneration had the least positive influence.

The study reviewed the corporate governance practices adopted by the commercial banks in Kenya by looking at the frequency of boards meetings, size and composition of the board, number of board committees at the banks and average salary and benefits that the board members earn per year.

The research carried out on this study led to identification of the crucial aspects of corporate governance that should be emphasized in the governance matrix so as to boost financial performance of commercial banks in Kenya.
# TABLE OF CONTENTS

DECLARATION .............................................................................................................................. ii

ACKNOWLEDGEMENT ........................................................................................................... iii

DEDICATION ............................................................................................................................ iv

ABSTRACT ................................................................................................................................ v

TABLE OF CONTENTS ........................................................................................................ vii

LIST OF TABLES ................................................................................................................ xi

ABBREVIATIONS/ACRONYMS .............................................................................................. xii

CHAPTER ONE ....................................................................................................................... 1

INTRODUCTION ..................................................................................................................... 1

1.1 Background to the Study ................................................................................................. 1

1.1.1 Corporate Governance Structures ......................................................................... 3

1.1.2 Financial Performance ............................................................................................. 4

1.1.3 Relationship between Corporate Governance and Financial Performance ....... 5

1.2 Statement of the Problem ............................................................................................... 7

1.3 Objective of the Study .................................................................................................... 9

1.4 Research Questions ....................................................................................................... 9

1.5 Importance of the Study ............................................................................................... 9
3.1 Introduction ......................................................................................................................... 30
3.2 Research Design .................................................................................................................. 30
3.3 Population and Sample ....................................................................................................... 30
3.4 Sample ................................................................................................................................ 31
3.5 Data Collection .................................................................................................................. 31
3.6 Data Analysis and Presentation .......................................................................................... 31
3.6.1 Variable Definition ........................................................................................................ 31
3.6.2 Computation of Tobin’s Q ............................................................................................ 32
CHAPTER FOUR ......................................................................................................................... 33
DATA ANALYSIS, INTERPRETATION AND PRESENTATION .................................................. 33
4.1 Introduction ......................................................................................................................... 33
4.2 Commercial Banks Performance as indicated by the Tobin’s Q and Price-to-Book Value 33
4.3 Commercial Banks Corporate Governance Scores .......................................................... 37
4.4 Relationship between Performance and Frequency of Board Meetings ......................... 42
4.5 Board Composition and Bank Performance ...................................................................... 44
4.6 Relationship between CEO Remuneration and Bank Performance .................................. 47
CHAPTER FIVE .......................................................................................................................... 49
DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS ............................................ 49
5.1 Introduction ......................................................................................................................... 49
5.2 Summary and Conclusion................................................................. 49
5.3 Limitations of the Study ................................................................. 52
5.4 Suggestion for Further Research................................................... 52

REFERENCES ..................................................................................... 54

Appendix I: Registered Commercial Banks ......................................... 62
Appendix II: Listed Commercial Banks ............................................... 65
# LIST OF TABLES

Table 4.1: Tobins Q of Commercial Banks in Kenya.................................................. 33

Table 4.2: Variations in the Tobin Q........................................................................ 34

Table 4.3: Price-to-Book Value of Commercial Banks.............................................. 35

Table 4.4: Model Summary..................................................................................... 37

Table 4.5: Barclays' Corporate Governance Score............................................... 38

Table 4.6: NIC Banks Ltd Corporate Governance Score......................................... 39

Table 4.7: NBK Corporate Governance Score....................................................... 40

Table 4.8: Standard Chartered Corporate Governance Score................................ 41

Table 4.9: Diamond Trust Bank Ltd Corporate Governance Score...................... 41

Table 4.10: KCB Corporate Governance Score.................................................... 42

Table 4.11: Relationship between Performance and Frequency of Board Meetings... 43

Table 4.12: Model Summary................................................................................... 43

Table 4.13: Board Composition.............................................................................. 44

Table 4.14: Board Composition and Bank Performance (Diamond Trust Bank)...... 45

Table 4.15: Board Composition and Bank Performance (KCB).............................. 45

Table 4.16: Board Composition and Bank Performance (Barclays Bank Ltd)......... 46

Table 4.17: Board Composition and Bank Performance (Standard Chartered Bank Ltd) 46
ABBREVIATIONS/ACRONYMS

CEO  Chief Executive Officer

BCBS  Basel Committee on Banking Supervision

TRI  Total shareholder Return Index (TRI)

CVA  Cash Value Added
CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Corporate governance practices, principles and structures have recently gained popularity in developing world. Corporate governance specifies the rights and obligations of the various claimants on the cash flow of big enterprise. Corporate governance issues arise because of the existence of agency problems that cannot be resolved through contractual solutions due to high transaction costs (Petra, 2005). These agency costs manifest themselves in the form of conflict between investors and other claimants on cash flow on one hand, and the managers and the directors who have the discretion over the cash flow are used, on the other. This follows from the dominant model of corporate governance in law and economics which considers a corporation as a compelled web of contractual relationship among the various claimant to the cash flow of enterprise. Claessens et al (2002) maintain that better corporate frameworks benefit firms through greater access to financing, lower cost of capital, better performance and more favorable treatment of all stakeholders.

Among the many claimants on firm’s cash flows, equity shareholders have always claimed a special attention may be because of the residual nature of their claims. Parker (2007) paradigm of the separation of shareholder ownership and management’s control explained that agency problem occurs when the principal (Shareholders) lacks the necessary power/information to monitor and control the agent (manager) and when the compensation of the principal and the agent is not aligned.

Given the existing problem inherent in the corporate firm, performance will be function of the quality of the corporate governance structures of the company (McKinsey and Co. 2005). In an efficient capital market, investors will discount the price they are willing to pay for a company’s shares by the expected level of managerial agency costs. It is therefore assumed that for a
company to prosper it will choose a corporate governance that is efficient in minimizing agency costs. It has also been argued that in the end it is a country's political framework which determines the quality of its corporate governance practices (Roe, 2003).

Corporate governance is defined as a field in economics that investigates how to secure or motivates efficient management of corporations by the use of incentives mechanism, such as contracts, organization design and legislation (Brown and Caylor, 2004). Abor, (2007) defines corporate governance as the system by which companies are directed and controlled. It also refers to as the way in which corporations are handled by corporate boards and officers. Moyoncho (2004) observes that good governance ensures that stakeholders with the relevant interest in the company business are fully taken into account. Brown and Caylor (2004) also shares the foregoing views seeing corporate governance as the relationship among various participant in determining the direction and performance of the companies consistent with the public good.

Corporate governance can be defined as the set of institutional arrangements affecting corporate decision making (Carter and Lorsch, 2004). Evans and Loh (2002) describe corporate governance as "rules governing board structures, managers and board’s incentive compensation, decisions rights by the board and the Chief Executive Officer (CEO), session of the board and Chief Executive Officer, shareholding voting, debt/equity finance decisions as well as disclosure during take-over.

During the last decade, the study of original decline and turn around has been the subject of renewed interest. In their paper on corporate failures, Gemmill and Thomas (2004) reported that annual failure rate of large US firms grew from 1% during 1967 to 1982 period to over 3% since 1985. In Kenya, Wambua (2003) documented in general, the actions taken by companies facing rapid performance declines, he reported that employee lay-offs was popular and was taken by 60 % of the companies sampled.

Mululu (2005) carried out research on corporate governance structures and performance on all listed firms in the stock exchange. He found that board activity is related to a number of
corporate variables such as board size, the number of executive directors, the number of shares held by largest shareholders, number of shares by unaffiliated block holders, and the number of other directorships held by outside directors. He reported that board increase the frequency of their meetings during financial crises.

1.1.1 Corporate Governance Structures

Corporate governance structures can be defined as the systems or mechanisms designed to monitor managers and improve corporate transparency (Tsui, 2000). Typically corporate governance structures adopted by firms experiencing declining performance results in changes in: board meeting frequency (Klapper and Love, 2003); board composition (McCord, 2002) insider share ownership (Morck, Shleifer, and Vishny, 1998); and executive compensation (Monks and Minow, 2004). Board meeting frequency potentially carries important governance implication as it is less costly for a firm to adjust the frequency of its board meeting to attain better governance of the firm, than to change the composition of its board or ownership structures. Vafeas (1999) found that meeting frequency was influential in improving operating performance in a manner consistent with the agency theory.

Studies on firm performance as a function of board composition yield mixed results (Baysinger and Butler, 2005). MacAvoy and Millstein (2003), for example, found that the proportion of outside directors is significantly lower on boards of banks in state that restrict banking acquisitions, suggesting that outside directors play a role in evaluating takeover proposals. Weisbach reports that CEO turnover is more highly correlated with firm performance in corporations having a majority of outside directors than firms that have predominantly insider board. Further, Hermelin and Weisbach (1998) find that outsiders are more likely to join a board after a firm performs poorly or leaves an industry. Once inference may be the need for additional outside guidance in companies undergoing strategic shifts.
Abor (2007) commented that where managers hold little equity in the firm and the share holders are too dispersed to enforce value maximization, corporate assets may be deployed to benefit managers rather than shareholders. According to MacAvoy and Millstein, (2003) the costs of deviation from value maximization decline as management ownership rises because of converging interests. Consistent with the above, Mak and Yuanto (2003) found an inverted U-shaped relationship between Tobin’s Q and managerial ownership. Numerous studies have identified a positive relationship between executive compensation and firm performance although debate continues as to the exact size of this function.

1.1.2 Financial Performance

Firm’s general performance is the measure of standard or prescribed indicators of effectiveness, efficiency, and environmental responsibility such as, cycle time, productivity, waste reduction, and regulatory compliance. Performance also refers to the metrics relating to how a particular request is handled, or the act of performing; of doing something successfully; using knowledge as distinguished from merely possessing it. It is the outcome of all of the organization’s operations and strategies. It is also the extent to which an individual meets the expectations regarding how he should function or behave in a particular context, situation, job or circumstance. Weissenreader (1997) is of the view that performance is what people do in relation to organizational roles.

The financial performance of institutions is usually measured using a combination of financial ratios analysis, benchmarking, measuring performance against budget or a mix of these methodologies. The common assumption, which underpins much of the financial performance research and discussion, is that increasing financial performance will lead to improved functions and activities of the organizations. The subject of financial performance and research and its measurement is well advanced within finance and management fields. It can be argued that there are three principal factors to improve financial performance for financial institutions; the institution size, its asset management, and the operational efficiency (Fama et al, 1980).
1.1.3 Relationship between Corporate Governance and Financial Performance

Research has shown that companies with a higher corporate governance (based on developed indices) were performing better and had higher market value or Tobin's q (Baysinger and Butler, 2003). Moreover, a portfolio of companies with better corporate governance delivered a 2.1 per cent higher return as compared with companies of poor corporate governance (Baysinger and Butler, 2003). Shleifer et al. (1986) conducted on the sample of 242 of Europe's largest corporations listed in the FTSE Eurotop 300 index shows that companies with stronger corporate governance performance (measured by over 300 corporate governance rating variables) are on average also valued higher in terms of Tobin's q. These results indicating positive relationship between good corporate governance and firm performance were supported by international research conducted on a sample of 526 Korean companies. Additionally, research conducted on firm-level data of corporate governance ratings across 14 emerging markets (not covering transition countries) reveals that better corporate governance is correlated with better operating performance and market valuation (Klapper and Love, 2002).

Corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments (Shleifer and Vishny, 1986). If these mechanisms did not exist or did not function properly, outside investors would not lend to firms or buy their equity securities. Overall, economic performance would likely suffer because many good business opportunities would be missed and temporary financial problems at individual firms would spread quickly to other firms, employees and consumers. Previous evidence suggests that corporate governance has a positive influence over corporate performance. For example, based on industry-level view, Mwangi (2003) find that firms in industries that require large amounts of external financing grow faster in countries with high scores on their measures of financial development. Thus, corporate governance (measured through better accounting standards, stronger legal protection of investors, and a stronger rule of law) appears to matter for financial performance. In addition, Weir et al. (2002) concluded in their respective studies that there is a positive relationship between good corporate governance practices and firm value. A widely accepted statement is that good corporate governance results in a lower cost of capital. One
explanation is that good corporate governance will lead to lower firm risk and subsequently to a lower cost of capital.

Another research stream relies on the hypothesis that greater disclosure enhances stock market liquidity, thereby reducing the cost of capital (Weisbach, 1988). The commitment of management teams to increase the level of disclosure should lower the information asymmetry between managers and shareholders and lower the cost of capital. As a result of a reduced cost of capital, firm valuation will increase. If these relationships hold, greater disclosure of financial information and corporate governance topics will reduce information asymmetry and thereby lowering uncertainty and reducing the cost of capital. The main idea behind disclosure of corporate information and corporate governance is that it reduces information asymmetries between managers and shareholders and lowers its risk. Conventional wisdom on corporate governance predicts that good corporate governance increases firm valuation and firm performance and reduces the cost of capital and financial fraud. However, there may be important empirical and theoretical reasons why these relationships do not hold.

In theory, good corporate governance should be related to high-corporate valuation. A number of empirical studies have found that investors are willing to pay a premium averaging 10-12 percent for good corporate governance (Monks and Minow, 2004). The correlation of the governance index with performance could be explained in several different ways. One explanation, suggested by the results of other studies, is that inefficient governance directly causes additional agency costs. If the market estimates these additional costs, then stock returns will. An alternative explanation is that good governance is a signal or symptom of lower agency costs – a signal not properly incorporated in market prices (Baysinger and Butler, 1985). Each of these explanations has different economic implications for the source of agency problems and different policy implications for the regulation of governance. It would be interesting to see whether higher corporate valuations are associated with better-governed US companies, measured by our measure of corporate governance index (Baysinger and Butler, 1985).
Though the issue of whether directors should be employees of or affiliated with the firm (inside directors) or outsiders has been well researched, no clear conclusion is reached. On the one hand, inside directors are more familiar with the firm's activities and they can act as monitors to top management especially if they perceive the opportunity to advance into positions held by incompetent executives. On the other hand, outside directors may act as “professional referees” to ensure that competition among insiders stimulates actions consistent with shareholder value maximization (Fama, 1980). John and Senbet (1998), argue that boards of directors are more independent as the proportion of their outside directors increases. Though it has been argued (Fama and Jensen, 1983) that the effectiveness of a board depends on the optimal mix of inside and outside directors, there is very little theory on the determinants of an optimal board composition. The current study reviews the relationship between corporate governance and financial performance with a focus on separation of ownership and control, board size and composition and financial performance, independence of directors and independence of committees.

1.2 Statement of the Problem

The association between quality of corporate governance structures and firms' profitability is quite major focus in corporate governance studies, but one cannot predict much on the direction as prior literatures show mixed results. Jensen and Meckling (1990) have proven that firms with better governance structures might have more efficient operations, resulting in a higher expected future cash-flow stream. Recent scandals, such as the city group's $8 billion scandal in generated charges, have focused attention on corporate governance issues in the financial sector.

Kenyan banks have in the recent past experienced a number of corporate failures related to corporate governance structures in place. In 2007, Charter bank was placed under statutory management amidst suspicions of money laundering and fraud. 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 will differ from that done by Mululu (2005) in one important aspect. While he considered all the listed companies, this study will only concentrate on quoted banks in Kenya in the financial sector of the Nairobi stock exchange. Banks are considered more sensitive as they hold depositors monies, and for their effect or role on Kenya’s economy in regulating the amount of money supply.

1.3 Objective of the Study

To determine how corporate governance structures affect the financial performance of commercial banks in Kenya.

1.4 Research Questions

i) Is there a positive relationship between bank performances of the preceding year and frequency of board meetings?

ii) Is there a positive relationship between the bank performances and the percentage of Institutional investors share ownership?

iii) Is there a positive relationship between executive compensation and bank performance?

iv) Is there a positive relationship between the ratio of outside directors to total directors and Banks' performance?

1.5 Importance of the Study

The study will have implications for:

Academics and researchers: the results of the study should serve as a point of departure for further investigations in governance structures and systems for academics and researchers in general. This study will be an eye opener in research in developing markets.

Regulators of financial markets: the study will help regulators of the banking industry to identify the crucial aspects of corporate governance structures that should be emphasized in the governance matrix. Given the many scams and financial fraud reported in many corporations and the vast sums of wealth of shareholders destroyed thereby, findings of the study should help regulators play their role effectively.
Management and boards of banks: The study will be of benefit to management boards of listed and unlisted banks by giving guidelines on the key value aspects of corporate governance structures. Boards act on behalf of shareholders, endeavoring always to report comprehensively, accurately and on a timely basis. This study would go some way in helping them play their oversight role.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The specific areas covered here are theoretical review, concept of corporate governance structures including board composition, executive compensation, board meeting frequency, large block holders, insider share ownership, take-over and large creditors (debt financing); relationship between corporate governance and firm performance and measures of firm performance.

2.2 Theoretical Review

2.2.1 Agency Theory

Corporate governance is based on agency theory, which is the relationship between agents and principals. Agency theory explains how best the relationship between agents and principals can be tapped for purposes of governing a corporation to realize its goals. Interest on agency relationships became more prominent with the emergence of the large corporation. There are entrepreneurs who have a knack for accumulation of capital, and managers who had a surplus of ideas to effectively use that capital. Since the owners of capital (principals) have neither the requisite expertise nor time to effectively run their enterprises, they hand them over to agents (managers) for control and day-to-day operations, hence, the separation of ownership from control, and the attendant agency problems. In an agency relationship, principals and agents have clearly defined responsibilities: Principals are select and put in place governors (directors and auditors to ensure effective governance system is implemented, while agents are responsible for the day-to-day operations of the enterprise.
Historically, definitions of corporate governance also took into consideration the relationship between the shareholder and the company, as per “agency theory”, i.e. director-agents acting on behalf of shareholder-principles in overseeing self-serving behaviors of management. However, broader definitions of corporate governance are now attracting greater attention (Solomon and Solomon, 2004). Indeed, effective corporate governance is currently understood as involving a wide number of participants. The primary participants are management, shareholders and the boards of directors, but other key players whose interests are affected by the corporation are employees, suppliers, customers, partners and the general community. Therefore, corporate governance, understood in these broadening social contexts, ensures that the board of directors is accountable not only to shareholders but also to non-shareholder stakeholders, including those who have a vested interest in seeing that the corporation is well governed. Some corporate governance scholars (Denis et al, 1986; Leblanc and Gillies, 2005) also argue that at the heart of good corporate governance is not board structure (which receives a lot of attention in the current regulations), but instead board process (especially consideration of how board members work together as a group and the competencies and behaviors both at the board level and the level of individual directors). As a result, the current scholarly discourse about the nature of corporate governance has come to reflect this body of research.

2.2.2 Stakeholders Theory

There are two main theories of stakeholder governance: the abuse of executive power model and the stakeholder model. Current Anglo-American corporate governance arrangements vest excessive power in the hands of management who may abuse it to serve their own interest at the expense of shareholders and society as a whole (Hart, 1989). Supporters of such a view argue that the current institutional restraints on managerial behaviour, such as non-executive directors, the audit process, the threat of takeover, are simply inadequate to prevent managers abusing corporate power. Shareholders protected by liquid asset markets are uninterested in all but the most substantial of abuses. Incentive mechanisms, such as share options, are means through which managers can legitimise their abnormal overpayment (viewed by some as a symptom of the breakdown of governance (Keasey et al., 1997). The abuse of executive power is particularly
embedded in the problem of executive overpay since executive remuneration has risen far faster than average earnings and there is at best a very weak link between compensation and management performance (Conyon et al 1997). The only restraint on executive pay seems to be the modesty of executives themselves, and the creation of so-called independent remuneration committees by large companies is not effective. What is worse is that it legitimizes self-serving managerial behaviours. The independence is generally a sham, not for restraining excess of pay, but for justifying it. The supporters of this model do not believe that the main lines of corporate governance reform, such as non-executive directors, shareholder involvement in major decisions and fuller information about corporate affairs, are suitable monitoring mechanisms (Macavoy at al 2003). Instead, they propose statutory changes in corporate governance, under which hostile takeovers are not possible to effect, since ownership of shares no longer brings the right to appoint executive management. The basic objective of corporate governance in this guise is "managerial freedom with accountability", to allow executive management the power to develop the longer term business, while holding them rigorously responsible to all stakeholders involved in the business.

2.3 Concept Corporate Governance Structures

The corporate governance structures have been of great importance when determining the value of the firm. It has been argued and debated that firms (banks) that practice good governance have reported increased wealth or value.

In Kenya, the Centre of Corporate Governance and the Capital Market Authority as well as the provisions of the Banking Act (chapter 488) make provisions for publicly listed companies in Kenya to comply with corporate governance best practices which involve sound corporate governance structures. The Central Bank of Kenya together with the Nairobi stock exchange has set corporate governance guidelines for listed banks to comply with (CBK annual report 2007).
The Basel Committee on Banking Supervision (1999) state that from the banking perspective, corporate governance involves the manner in which the business and affairs of individual institution are governed by their board of directors and senior management, affecting how banks set corporate objectives; run the day to day operation of the business; consider the interest of recognized stakeholders; align corporate activities and behaviors with the expectation that the banks will operate in safe and sound manner, and in compliance with the applicable laws and regulations and; protect the interest of the depositors.

Laporta, (2000) in a report (Corporate Governance in listed companies, 1997) emphasized the importance of corporate governance in the banks for the following reasons; Banks have a dominant position in developing economy financial systems, and are extremely important engine of economic growth; as financial markets are usually underdeveloped, banks in developing economies are typically the most important source of finance for the majority of firms; as well as providing a generally accepted means of payment, banks in developing countries are usually the main depository for economy’s savings; many developing economies have recently liberalized their banking systems through privatization/disinvestment and reducing the role of economic regulation. Consequently, managers of banks in these economies have obtained greater freedom in how they run their banks.

The subject of corporate governance which is well developed in the concept of agency theory, as expounded by Jensen and Meckling (1993), ensures that systems are put in place to not only ensure management does not act in their own selfish interests. It also endeavors to ensure maximization of the shareholders value.

Jensen and Meckling (1993) applied the logic of agency theory to issues of minimizing the intra-corporate conflicts, while at the same time taking cognizance of the role the political process plays in resolving potential complications, by focusing on the important concept of exploiting self-interest in the attainment of corporate goals.

Listed banks just like any listed company have governance structures that can be used to change the performance of such firms. According to Tsui and Gul (2000), corporate governance
structures are designed to monitor managers and improve corporate transparency. A number of corporate structures have been identified analytically and empirically.
According to Agrawal and Knoeber (1996), the structures may be broadly classified as internal and external as summarized below:

i) **Determined by outsiders**

   - Institutional shareholding
   - outside block holding
   - turnover activity

ii) **Determined by insiders**

   - Insider holdings
   - board size, composition
   - Committees, chief executive
   - debt
   - financing
   - market for
   - managerial skills
   - Officer compensation

(Source: Adaptation from rendering of Agrawal and Knoeber, 1996 classification)

Agrawal and Knoeber (1996) identified seven control structures for the shareholders and management agency conflict. The control structures were divided into two namely; internal and external i.e. the internal, means the internal decision makers while external refereed to outside partners.
Further, the structures can be distinguished by the source of monitoring that takes place. The use of debts is internally determined and relies on the capital market for monitoring. On the other hand, market for the manager are externally determined and relies on prospective employers; the market for corporate control is determined externally and relied on prospective acquires; insider shareholdings is determined internally and relies on insider owners; institutional shareholding is externally determined and relies on institutional owners; block holding relies on large outside shareholders; and use of outside directors and on the board is internally determined and relies on these board members.

Agrawal and Knoeber (1996) consider control structures as alternatives, which can be used in substitution. This implies that the use of structures is negatively related but the relation is possible. Agrawal and Knoebe (1996) give example of greater insider holdings assisting the market for corporate control by making insiders less obstructive. Similarly corporate control activity can be boosted by outsider representation on board since outside directors can facilitate take-overs. Greater institutional and block holding may reduce transaction costs and eliminate the free rider problem and thus facilitate take-overs. The common governance structures include the following:

2.2.1 Board Composition

Fama (1980) argued that for the board to play its oversight role of effective monitoring, it should be composed of majority of outside directors. He argued that outside directors will exhibit considerable independence from top management. Martin (1991) reported that poor proposals or performance will be opposed by outside directors. Weisbach (1993) found out that outside dominated boards are significantly likely to respond to poor performance by dismissing the chief executive officer. Brickley et al (1991) also find evidence that outside directors’ act on in the shareholders interest in their decision in the adoption of the poison pill provision. Brickley et al (1987), further, found that the proportion of outside directors is significantly lower on boards of banks in state that restricts banking acquisitions.
Weisbach (1988) found that outsiders are more likely to join the board after the firms performs poorly or leaves an industry, reflecting the need to inject new blood to procure expertise in the new industry. Warner, Watts, and Wruck (1998) examine the extent to which board discipline managers found out that poor firm performance increases the likelihood of change in top management team. However, the relationship between firm performance and CEO turnover has been found to be fairly weak (Jensen and Meckling, 1993; Hermalin and Weisbach, 1988).

In the Jebet (2001), he carried out a research on how the corporate governance structures affect the firm performance (listed). Board composition was noted to be a quality/fixation of firm performance. He sampled the various listed companies in the Nairobi Stock Exchange and found that the firms with high number of outside directors performed well as compared to those with less representation from outside directors. This study seeks to verify if the bank’s performance is related to outside directorship.

### 2.2.2 Executive Compensation

Owing to the problem of separation of ownership and management; the agency theory argues that in the modern corporations, where ownership is dispersed and managers have access to superior information, managers typically end up with residual rights of control, giving them enormous latitude for self–interested behavior. In order to counter such pursuits, one way is to grant managers a highly contingent, long-term incentive contracts ex-ante to align his interest of investors. Incentive contracts can take a variety of forms, including share ownership, stock options, or a threat of dismissal if income is low (Fama, 1980). The optimal incentive contract is determined by manager’s risk aversion, the importance of his decisions, and his ability to pay the cash flow ownership upfront (Stiglitz, 1975; Homstrom, 1979).

Jensen and Meckling (1993) arrived at a striking number that executive pay rise by about $3 per every $1000 change in the wealth of shareholders. Kaplan (1994) showed that the sensitivity of pay (and dismissal) to performance is similar to all companies in the united state. Several studies have identified a positive relationship between executive pay and firm performance. Izan, Sidhu, and Taylor (1998) both supported a positive pay–performance relationship.
2.2.3 Board Meeting Frequency

Jensen et al (1993) argues that boards of well run companies should be relatively inactive and exhibit few conflicts. Frequently scheduled meeting generate opportunity costs in the form of management time consumed, and cash costs in form of traveling allowances and sitting allowance fee for the board members. Yet real benefits can be derived from such meetings as directors have an opportunity to confer, set strategy and monitor management. Vafeas (1999), for instance found that meeting frequency was influential in improving operating performance in a manner consistent with the agency theory.

Mululu (2005) shows that board increase the frequency of their meeting following poor performance and consequence of such increase the performance of firm improves as captured by the increase in firm value giving support to Jensen et al (1993) and Vafeas (1999) that the role boards becomes increasingly important during crises, when share holders’ interest are in visible danger. However, the association between meeting frequency and firm value remains unclear, and the linkage between the board activity and monitoring difficult to establish.

2.2.4 Large Block Holders

The most direct way to align cash flow and control rights of outside investors is to concentrate share holdings. This can mean that one or several investors in the firm have substantial minority ownership stakes, such as 10 or 20%. A substantial minority shareholder has the incentive to collect information and monitor the management, thereby avoiding the traditional free-rider problem. He also has enough voting control to put pressure on the management in some cases, or perhaps even to oust the management through a proxy fight or a take-over (Shleifer and Vishny, 1986). Large shareholders thus address the agency problem in that they both have a general interest in profit maximization, and control over the asset of the firm to have their interest respected.

Evidence on the role of large shareholders in exercising corporate governance is commencing to accumulate. According to Germany, Kaplan (1994), large shareholders are associated with
higher turnover of directors. Kaplan (1994) established that firm with large share holders are most likely to replace managers in response to poor performance than firms without them. In United States, Shivdasani (1993) showed that large outside shareholders increase the likelihood that firm is taken over.

Claessen et al. (2002) found that firm value increases with the cash-flow ownership of the largest shareholder, consistent with a positive incentive effect, for their sample of publicly trade firms in eight East Asian economies in 1996. However, firm value falls when control rights exceeded cash-flow rights for the dominant shareholder (entrenchment effect). Finally, they find that the separation of ownership and control in general, and not any mechanism in particular (pyramidal structures, dual-class shares, cross-holdings) is responsible for value discount.

2.2.5 Insider Share Ownership

Berle and Means commented that where managers hold little equity in the firm and the shareholders are too dispersed to enforce value maximization, corporate assets may be deployed to benefit managers rather than, shareholders. Managers in such situations may shirk, consume large amount of perquisite, engage in empire building or make sub optimal investment and distribution decisions. To induce management not to engage in opportunistic behavior, measures need to be taken to align their interests with those of shareholders by making them part owners of the firm (Jensen and Meckling, 1993).

Morck, Shleifer and Vishny (1988) estimate a piecewise linear relation between board ownership and performance as measured by Tobin’s Q and finds that Tobin’s Q increases with managerial ownership. Kitonga (2002) finds evidence that equity holdings are positively correlated to firm performance where at least one outside director owns 2% of the firm equity. Mallete, Middlemist and Hopkins (1995) argue that ‘active defense of shareholders’ interest may depend on the existence of directors whose personal interest compels them to actively monitor management activities.
Hermalin and Weisbach (1988) also noted a non-linear effect of insider shareholdings in the course of an analysis of the board composition on firm performance. While these findings are mixed, the weight of the evidence implies that firms perform better when managers own a non-trivial fraction of the firm’s shares.

In McCord (2002) management group own on average 30% of firms and are the largest block holders in 2/3 of their sample, while non-management block holder owns 20% of voting rights. He uses a cross sectional sample of 1433 public firms from 18 emerging markets, for year 1995. For robustness tests he uses a two simultaneous equation model to account for endogeneity between ownership and firm value (firm value is lower as a result of expected costly agency problems/ if a manager expects lower cash-flow he would tend to increase the discrepancy between his voting rights and his cash-flow rights). He finds support for the managerial entrenchment hypothesis and concludes that the costs of the private benefits of control are capitalized into share prices in emerging markets. Additionally, he finds evidence that large non-management block holders can reduce the valuation discount associated with expected managerial agency problems as a partial substitute for missing institutional governance mechanisms. He also shows that firm value declines as the separation of management group control and cash-flow rights gets larger.

2.2.6 Take-Over

Takeover can be defined as ‘rapid fire mechanism for ownership concentration’ (Shleifer and Vishny, 1999). In a typical hostile takeover, a bidder makes a tender offer to the dispersed shareholders of the target firm, and if they accept this offer, acquires control of the target firm, and so can replace, or at least control, the management.

Substantial theory and evidence supports the idea that takeover address governance problems (Jebet 2001). Palepu (1986) shows that takeover target are often poorly performing firms and their managers are removed once the takeover succeeds (Servaes and McConnell, 1990). Jensen et al (1993) argues takeover can solve the free cash flow problem, since they are usually lead to distribution of the firm’s profit to investors over time. Takeovers are widely interpreted as the
critical governance structure in the USA, without which managerial discretion cannot be effectively controlled.

2.2.7 Large Creditors (Debt Financing)

Significant creditors have large investment in the firm, and want to see returns on their investment materialize. Their power comes in part because of a variety of control rights they receive when firm defaults or violate debt covenants and in part because they typically lend short term, so borrowers have to come back at regular short intervals for more funds.

Kaplan (1994) documents the higher incidence of management turnover in response to poor performance in companies that have a principal banking relationship relative to companies that do not. Gibson (1990) points to a significant governance role played by Morgan partners in the companies Morgan invested in the early 20th century.

Weir, Laing and McKnight (2002) hypothesizes that debt financing is an internal governance structure whereby increased debt reduces free cash flow and so limits managerial discretion. Debt requires managers to use any excess funds to service company’s debt rather than engage in negative net present value project.

2.2.8 Board Composition

It is suggested that higher proportion of non-executive directors in the board helps to reduce the agency cost. John et al (1998) support this view by showing that higher level of non-executive directors on the board weakens the negative relationship between the firm’s investment opportunities and firm’s performance. However, Gibson (1990), Fama et al (1983), and Weir et al. (2002) dispute it by stating that there is no significant relationship between non-executive directors’ representation and performance. In contrast, in the UK, Weir and Laing (2000) find a negative relationship between non-executive director representation and performance. In addition, Yermack (1996) present that small boards have a higher market valuation.
Stronger support for the positive impact of non-executive directors comes from event study analysis. The studies by Schleifer et al (1997) show that the appointment of non-executives directors increases company value.

2.4 Measures of Firm Performance

Several metrics are available for measuring the creation or destruction of shareholders value. Four of the most used metrics are Tobin’s Q, Total shareholder Return Index (TRI), Economic Value Added (EVA), and Cash Value Added (CVA).

**Tobin’s Q:** This is the second measure applied in the measurement of a firm financial performance.

Theoretically, if a firm’s investment opportunities earn a rate of return, \( r \), equal to its cost of capital, \( k \), (i.e. \( r = k \)), Tobin’s Q ratio would be 1.0. That is, investors are indifferent in their expectations regarding the firm’s growth opportunities. However, if \( r \) is greater than \( k \), Tobin’s Q would be greater than 1.0 indicating that the investors have a positive outlook for the firm’s future growth opportunities. The market prices of a firm’s shares are based on management’s ability to generates sustainable real returns on investments that exceed firm’s real discount rate.

Tobin’s Q compares the market value of the firm with the replacement costs of the assets implying that the greater the real return on investments the greater the value of Q. In contrast to the book-to-Market (B/M) ratio, the impact of inflation is mitigated in the Q calculation by the use of the replacement cost of assets measured in constant shillings to measure the value created by the firm. The attractiveness of the Q ratio results from its ability to provide the estimate of a firm’s intangible assets such as the goodwill, future investment opportunities, market power and quality of management. Ranking firms on their Q values is similar to ranking them on the basis of changes in expected future cash flows.

**Tobin’s q** = \( \frac{MV + D}{TA} \)

Where:
MVS = Market value of all outstanding shares, i.e. the firm’s Stock Price * Outstanding Shares

TA = Firm’s assets, i.e. cash, receivables, inventory and plant book value

D = Debt defined as:

\[ D = (AVCL - AVCA) + AVLTD \]

Where:

AVCL = Accounting value of the firm’s Current Liabilities = Short Term Debt + Taxes Payable

AVLTD = Accounting value of the firm’s Long Term debt = Long Term Debt

AVCA = Accounting value of the firm’s Current Assets = Cash + Inventories + Receivables

Total Return Index (TRI): The index is a measure of the combined capital gain and dividend yield to investors. TRI is driven by a firm’s free cash flow, asset growth and changes in profitability, all of which are prime determinants of firm’s performance. TRI is constructed using an annualized yield as follows (see Evans, and Loh, 2002).

Economic Value Added: This model was popularized by Stern Stewart & Company and is based on a company’s accounts. Its mechanism which is accounting based simplifies to the following relationship:

\[ EVA = Sales - Operating expenses - Tax - Financial requirements \]

Where “Financial requirements” is calculated as defined capital multiplied with a suitable weighted average cost of capital (WACC)

Stewart has identified several errors made in Accounting from investors’ perspective. He advises that the errors be adjusted to stimulate cash flow. Examples of situations requiring adjustment
are inventory costing and valuation, depreciation, revenue recognition, and capitalization and amortization of R&D, marketing, restructuring charges and acquisition premiums.

**Cash Value Added (CVA).** Cash value added represents value creation (destruction) from the shareholders point of view. Weissenrieder (1997) expresses it as an index as follows;

\[
\text{CVA index} = \frac{\text{Operating cash flows}}{\text{Operating cash flows demand arg}}
\]

Weissenrieder splits CVA index into four margins (in relation to sales)

\[
\text{CVA Index} = \text{operating surplus margin} - \text{Wcmargin-nr non strategic investment arg in}
\]

\[
\text{Operating cash flows demand arg in}
\]

**2.5 Empirical Review**

Previous empirical studies have provided the nexus between corporate governance and firm financial performance (Yermack, 1996). Others Weissenreader (1997) have shown that well-governed firms have higher firm performance. The main characteristic of corporate governance identified in these studies include board size, board composition, and whether the CEO is also the board chairman. Weir et al. (2002) showed that the market rewards firms for appointing outside directors. Brickley et al. (1994) found a positive relation between proportion of outside directors and stock-market reactions to poison pill adoptions. However, Franks et al. (1994) found no relation between the proportion of outside directors and various financial performance measures. Fama et al. (1983) found no significant relationship between board composition and financial performance. Yermack (1996) also showed that, the percentage of outside directors does not significantly affect firm financial performance.

Agrawal and Knoeber (1996) suggest that boards expanded for political reasons often result in too many outsiders on the board, which does not help financial performance. Some recent empirical papers appear to focus on the relationship between corporate governance ratings and firm financial performance: Ciancanelli et al. (2000), Brown and Caylor (2004), for the USA;
considered the relationship between corporate governance systems and sustainable development of DJSI leading companies.

Baysinger et al. (2003) argued whether good corporate governance leads to higher common stock returns, firm value or operating performance using a sample of 269 firms from the FTSE Eurotop 300 over the period 2000-2001. The authors used Deminor's corporate governance ratings in order to measure the firms' quality of corporate governance. Deminor's rating can be attributed to four categories: shareholder rights, takeover defenses, disclosure on corporate governance and board structure and functioning. They argue that good corporate governance will increase investor trust and subsequently lower corporate risk and a lower expected rate of return; furthermore a lower expected rate of return leads to a higher firm valuation. However, they found an insignificant relationship between corporate governance and firm valuation. Finally, the relationship between corporate governance and firm performance is statistically negative.

Empirical evidence on the association between outside independent directors and firm financial performance is mixed. Studies have found that having more outside independent directors on the board improves financial performance (Dyle, 1994), while other studies have not found a link between independent NEDs and improved firm financial performance (Hermalin and Weisbach, 1988). The point that can be made from these studies is that there is no clear benefit to firm financial performance provided by independent NEDs. Petra (2005) argues that the mixed results may be reflective of a corporate culture wherein corporate boards are controlled by management and the presence of independent NEDs has no discernable impact on management decisions. As for the association between role duality and financial performance, Roe (2003) documented that Malaysian companies with role duality seem not to perform as well as their counterparts with separate board leadership based on accounting performance measurement.

Locally several studies have been done on the effect of corporate governance on financial performance. Mburu, (2004) studied the relationship between corporate governance mechanisms and performance of firms quoted on the NSE and found that the size and the composition of the
board of directors together with the separation of the control and the management have the greatest effect on the performance.

Ngugi (2007) did a study on the relationship between corporate governance structures and the performance of insurance companies in Kenya and found that inside directors are more familiar with the firm's activities and they can act as monitors to top management especially if they perceive the opportunity to advance into positions held by incompetent executives. The study also found that the effectiveness of a board depends on the optimal mix of inside and outside directors concluding that an optimal board composition lead to better performance of the companies.

Gatauwa (2008) studies the relationship between corporate governance practices and stock market liquidity for firms listed on the Nairobi Stock Exchange. The study found that greater disclosure enhances stock market liquidity, thereby reducing the cost of capital. The commitment of management teams to increase the level of disclosure also lower the information asymmetry between managers and shareholders and lower the cost of capital. Mburu (2004) also conducted a study on the relationship between corporate governance practices and performance the case of banking industries in Kenya. The study found that good corporate governance will lead to lower firm risk and subsequently to a lower cost of capital. The study also found that separation of ownership and control maximizes shareholders wealth.

2.6 Conclusion

Good Corporate Governance is of paramount importance in all organizations regardless of their industry, size or level of growth. Even the best run organizations it was further observed need good Corporate Governance as it sets the ‘Tone at the Top’ which in turn influences what transpires at the lower levels. A good practice that organizations including SACCOs should consider adopting is the conduct of regular Corporate Governance Audits. Good Corporate Governance has a positive economic impact on the Institution in question as it saves the organization from various losses e.g. those occasioned by frauds, corruption and similar irregularities. Besides it also spurs entrepreneurial enabling the organization to better seize the
economic opportunities that come its way. The main corporate governance themes that are currently receiving attention are adequately separating management from the board to ensure that the board is directing and supervising management, including separating the chairperson and chief executive roles; ensuring that the board has an effective mix of independent and non-independent directors; and establishing the independence of the auditor and therefore the integrity of financial reporting, including establishing an audit committee of the board.

Good Corporate Governance aims at increasing profitability and efficiency of organizations and their enhanced ability to create wealth for shareholders, increased employment opportunities with better terms for workers and benefits to stakeholders. Indicators of Good Corporate Governance identified in the study include independent directors, independence of committees, board size, split chairman/CEO roles and the board meetings. Thus, the main tasks of corporate governance refer to: assuring corporate efficiency and mitigating arising conflicts providing for transparency and legitimacy of corporate activity, lowering risk for investments and providing high returns for investors and delivering framework for managerial accountability.

The research conducted on firm-level data of corporate governance ratings reveals that better corporate governance is correlated with better operating performance and market valuation. Corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments evidence suggests that corporate governance has a positive influence over corporate performance. The literature also establishes that good corporate governance results in a lower cost of capital. One explanation is that good corporate governance will lead to lower firm risk and subsequently to a lower cost of capital. Good governance is a signal or symptom of lower agency costs – a signal not properly incorporated in market prices.

Several mechanisms can be used to overcome the problems associated with separation of ownership and control: alignment of shareholders' interest with managerial interests (compensation plans, stock options, bonus schemes); board monitoring by large shareholders and lenders; legal protection of (minority) shareholders from managerial expropriation through shareholder rights and the market for corporate control as an external device. The number board
of directors is assumed to have an influence on performance. The board is vested with responsibility for managing the firm and its activities. The studies cited in the literature mostly concentrate on the developed countries whose strategic approach and CG systems are not similar to that of Kenya. The studies have also been done on other companies other than the mobile service providers in Kenya. To the best of the researchers’ knowledge, no study has been done to investigate the relationship between corporate governance and financial performance of the commercial banks in Kenya. This study seeks to fill this gap by investigating the relationship between corporate governance and financial performance of the commercial banks in Kenya.
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter involves a blueprint for the collection, measurement and analysis of data. This section is an overall scheme, plan or structure conceived to aid the researcher in answering the raised research question. Therefore in this section the study identifies the procedures and techniques that will be used in the collection, processing and analysis of data. Specifically the following subsections are included: research design, data collection instruments, data collection procedures and finally data analysis.

3.2 Research Design

The research was conducted using a Cross-sectional survey that sought to identify differences in corporate governance’s structures between listed banks facing a decline in values and those with appreciating values, and those with stable value on calendar years 2005, 2006, 2007, 2008, 2009 and 2010.

The study used four governance structures favored by banks in sustained financial crises as earlier mentioned which include: frequency of board meeting, board composition, insider share ownership and executive compensation.

3.3 Population and Sample

The population of study included all the forty three registered banks by the central Bank of Kenya for a period of six years (2005 to 2010). See attached appendix I.
3.4 Sample

The sample size included banks listed in the NSE (nine in number) in the stated period. The study focused only on the listed banks as a result of ease of data availability at the Nairobi Stock Exchange. The sampled banks were as highlighted in the appendix II.

3.5 Data Collection

In order to establish the relationship between corporate governance structure and the performance of banks listed on the Nairobi Stock Exchange, secondary data sources were used where by internal secondary research i.e. information acquired within an organization where research is being carried out. Secondary data is information gathered for purposes other than the completion of a research project while secondary data research is the research which is based on gathering the information from the findings of other researchers (Vogt, 1994). Secondary data collection has the advantage of being less expensive and less time consuming.

Data was derived from the annual reports of the banks listed in the NSE and their books of account. Past five years information of the banks collected on number of board meetings held in the year, board size, board composition, insider share ownership and executive composition.

3.6 Data Analysis and Presentation

3.6.1 Variable Definition

Several metrics were available for measuring creation or destruction of shareholder value. The most commonly used metric include discounted cash flow (DCF) represents the net present value (NPV) of projected cash flows available to all providers of capital, net of the cash needed to be invested for generating the projected growth. The concept of DCF valuation is based on the principle that the value of a business or asset is inherently based on its ability to generate cash flows for the providers of capital. To that extent, the DCF relies more on the fundamental expectations of the business than on public market factors or historical precedents, and it is a more theoretical approach relying on numerous assumptions. A DCF analysis yields the overall
value of a business (i.e. enterprise value), including both debt and equity. Return on investment capital (ROIC) is expressed as a percent and measures how well a company utilizes the capital invested in the business. It is similar to return on equity but takes debt into account. Tobin’s Q, Total shareholder Return Index (TRI), Economic Value Added (EVA) is an internal management performance measure that compares net operating profit to total cost of capital, and Cash Value Added (CVA). The study employed Tobin Q as proxy for financial performance.

3.6.2 Computation of Tobin’s Q

To compute values for Q, where Q is defined as the market value of firm divided by the replacement costs of the firm’s assets, the methodology of Vogt (1994) will formed by first defining the variables as follows:

\[ Q = \frac{\text{Market Value}}{\text{Replacement Cost}} \]


Replacement Cost of Assets = Replacement Value of Plant and Equipment + Replacement Value of Inventory

The following model was developed:

\[ Q_{it} = \beta_1 \log(\text{meetings})_{it} + \beta_2 \log(\text{Outside})_{it} + \beta_3 \log(\text{CEO Rem})_{it} + \beta_4 \log(\text{Insider Ownership})_{it} + \beta_0 \]

\[ Q_{it} = \text{Tobins Q for bank i for year t.} \]

\[ \log(\text{meetings})_{it} = \log \text{of number of meetings held in year t.} \]
CHAPTER FOUR

DATA ANALYSIS, INTERPRETATION AND PRESENTATION

4.1 Introduction
This chapter presents the data findings and analysis there-to on the relationship between corporate governance structures and performances of commercial banks listed at the NSE. The study targeted all the commercial banks that had consistently operated from 2005 to 2010. Although there were 9 commercial banks listed at the NSE, only six were considered. This is because Corporative Bank Limited and Equity Bank were listed in late 2008 and 2006 which technically makes them inappropriate for this study. CFC/Stanbic bank was also not considered following the merger of CFC Holdings Ltd and Stanbic Bank Ltd within the study period which would bring inconsistency in the analysis since before 2008 they operated as two entities.

4.2 Commercial Banks Performance as indicated by the Tobin’s Q and Price-to-Book Value
To determine the commercial banks’ performance during the study period (2005 to 2010) the study calculated their Tobin Q ratio using market value of firm calculated as their market capitalization divided by the replacement costs of the firm’s assets, that is, asset value of the banks and the data findings presented in the table below.

Table 4.1: Tobin’s Q of Commercial Banks in Kenya

<table>
<thead>
<tr>
<th>Bank</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Mean</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>NBK</td>
<td>0.1030</td>
<td>0.1236</td>
<td>0.1765</td>
<td>0.3211</td>
<td>0.2258</td>
<td>0.1827</td>
<td>0.1888</td>
<td>0.1030</td>
<td>0.3211</td>
</tr>
<tr>
<td>NIC Bank</td>
<td>0.3412</td>
<td>0.2476</td>
<td>0.2002</td>
<td>0.3225</td>
<td>0.1976</td>
<td>0.0725</td>
<td>0.2303</td>
<td>0.0725</td>
<td>0.3412</td>
</tr>
<tr>
<td>Stan Chart</td>
<td>0.7366</td>
<td>0.4944</td>
<td>0.5190</td>
<td>0.6882</td>
<td>0.6148</td>
<td>0.4422</td>
<td>0.5825</td>
<td>0.4422</td>
<td>0.7366</td>
</tr>
<tr>
<td>DTB</td>
<td>0.3204</td>
<td>0.2492</td>
<td>0.2445</td>
<td>0.4661</td>
<td>0.4280</td>
<td>0.2033</td>
<td>0.3186</td>
<td>0.2033</td>
<td>0.4661</td>
</tr>
</tbody>
</table>
According to table 4.1 above, the Q-ratio of all the companies were below 1. Since the Tobin's q is less than 1, then the market value is less than the recorded value of the assets of the company which suggests that the market may be undervaluing the banks. Among the banks, Barclays banks of Kenya has the highest Q-ratio which stands at 1.1356, followed by standard chartered bank at 0.5825, then diamond trust bank at 0.3186, KCB at 0.3019, NIC Bank Ltd at 0.2303 and lastly National Bank of Kenya at 0.1827. However, only Barclays bank of Kenya had a Q-ratio which was more than 1 in 2007 (3.9087) suggesting that in that year market value was greater than the value of the company's recorded assets.

Taking a look at the variations in the Q ratio listed above so as to group the banks into 3 groups: losers, winners and mixed. Losers comprise of banks with negative Tobin Q variation over the previous year; winners comprise of banks with positive variations in the performance metric over the previous year while mixed comprise of banks whose direction of Tobin Q variation over the previous year will not be consistent at the end of the year according to their performance.

Table 4.2: Variations in the Tobin Q

<table>
<thead>
<tr>
<th>Bank</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>STDEV</th>
<th>Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>NBK</td>
<td>-</td>
<td>0.0205</td>
<td>0.0529</td>
<td>0.1447</td>
<td>-0.0954</td>
<td>-0.0431</td>
<td>0.0783</td>
<td>Mixed</td>
</tr>
<tr>
<td>NIC</td>
<td>-</td>
<td>-0.0936</td>
<td>-0.0474</td>
<td>0.1224</td>
<td>-0.1249</td>
<td>-0.1251</td>
<td>0.0980</td>
<td>Mixed</td>
</tr>
<tr>
<td>Standard Chartered</td>
<td>-</td>
<td>-0.2422</td>
<td>0.0246</td>
<td>0.1692</td>
<td>-0.0734</td>
<td>-0.1726</td>
<td>0.1161</td>
<td>Mixed</td>
</tr>
<tr>
<td>Diamond</td>
<td>-</td>
<td>-0.0713</td>
<td>-0.0047</td>
<td>0.2216</td>
<td>-0.0381</td>
<td>-0.2247</td>
<td>0.1071</td>
<td>Mixed</td>
</tr>
<tr>
<td>Barclays</td>
<td>-</td>
<td>-0.2065</td>
<td>3.5250</td>
<td>-3.0205</td>
<td>-0.2077</td>
<td>-0.3178</td>
<td>1.3725</td>
<td>Mixed</td>
</tr>
</tbody>
</table>
Table 4.2 above shows that the variations in the companies Tobin Q were both positive and negative which points out that the companies could only fit in the mixed group meaning that the market valuation of the banks fluctuated over the years and were not consistent in neither direction nor magnitude.

The study further sought to establish the price-to-book value of the listed commercial banks. The price to book value was a function of the ratio of market capitalization to the net asset values of the banks. Price to book value measures the portion of a company that can be claimed by the shareholders if the company is liquidated at that time. The information processed was presented in table 4.3 below:

**Table 4.3: Price-to-Book Value of Commercial Banks**

<table>
<thead>
<tr>
<th>Year</th>
<th>Barclays</th>
<th>Diamond Trust Bank</th>
<th>KCB</th>
<th>NBK</th>
<th>NIC</th>
<th>Standard Chartered</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>5.18</td>
<td>2.06</td>
<td>1.44</td>
<td>1.24</td>
<td>1.46</td>
<td>7.33</td>
</tr>
<tr>
<td>2006</td>
<td>3.27</td>
<td>1.94</td>
<td>1.49</td>
<td>1.44</td>
<td>1.56</td>
<td>5.47</td>
</tr>
<tr>
<td>2007</td>
<td>30.92</td>
<td>2.42</td>
<td>2.24</td>
<td>1.78</td>
<td>1.51</td>
<td>3.94</td>
</tr>
<tr>
<td>2008</td>
<td>7.04</td>
<td>3.53</td>
<td>4.14</td>
<td>3.01</td>
<td>2.77</td>
<td>5.5</td>
</tr>
<tr>
<td>2009</td>
<td>6.11</td>
<td>2.81</td>
<td>4.31</td>
<td>1.88</td>
<td>1.3</td>
<td>5.13</td>
</tr>
<tr>
<td>2010</td>
<td>7.34</td>
<td>2.45</td>
<td>4.76</td>
<td>1.9</td>
<td>2.4</td>
<td>5.02</td>
</tr>
<tr>
<td>Average</td>
<td>9.98</td>
<td>2.54</td>
<td>3.06</td>
<td>1.88</td>
<td>1.83</td>
<td>5.40</td>
</tr>
<tr>
<td>Minimum</td>
<td>3.27</td>
<td>1.94</td>
<td>1.44</td>
<td>1.24</td>
<td>1.3</td>
<td>3.94</td>
</tr>
<tr>
<td>Maximum</td>
<td>30.92</td>
<td>3.53</td>
<td>4.76</td>
<td>3.01</td>
<td>2.77</td>
<td>7.33</td>
</tr>
</tbody>
</table>

According to the table, the price-to-book values of the banks were above 1 meaning that the market values of the banks’ equity were greater that the value of the net of their total recorded assets.
The study further regressed price-to-book values against corporate governance and presented the data in table 4.2.

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>19.29881</td>
<td>14.04255</td>
<td>1.37431</td>
<td>0.400456</td>
</tr>
<tr>
<td>Frequency of Board Meetings</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Std. Error</td>
<td>0.743081</td>
<td>0.186248</td>
<td>0.919489</td>
<td>3.989738</td>
</tr>
<tr>
<td>Board Size</td>
<td>-2.53231</td>
<td>2.865508</td>
<td>-0.54578</td>
<td>-0.88372</td>
</tr>
<tr>
<td>Board Composition</td>
<td>2.645539</td>
<td>19.81538</td>
<td>0.09976</td>
<td>0.133509</td>
</tr>
<tr>
<td>Executive Remuneration</td>
<td>4.64E-07</td>
<td>8.57E-07</td>
<td>0.483821</td>
<td>0.540684</td>
</tr>
</tbody>
</table>

The regression equation was:

\[
\text{Tobin } Q = \beta + \beta \text{ Board Size} + \beta \text{ Board Composition} + \beta \text{ Board Meetings} + \beta \text{ Executive Remuneration}
\]

Whereby board size was the number of board members, board composition was the ratio of non-executive directors to the total number of board members; board meeting was the number of board meetings in a year while the executive remuneration was the average amount of salary and allowances given to an individual board member in a year. The study thus determined the regression equation to be:

\[
\text{Tobin } Q = 19.3 -2.53 \text{ Board Size} + 2.64 \text{ Board Composition} + 0.743 \text{ Board Meetings} + 4.64E-07 \text{ Executive Remuneration}
\]

The regression results shows that when value of the corporate governance indicators/measures used in the study (board size, composition, meetings and executive meetings) are zero, then the market value of the banks’ assets relative to their book value becomes 19.3. The results also
shows that board size negatively affects firms market performance while board composition affects market performance positively the most and a unit increase in executive remuneration has the least positive influence. The model summary presented in table 4.3, shows that the relationship was strong as the R square value was 0.95. However the model was insignificant for prediction as the f significance was 0.33 meaning that the model might be 33% wrong in its prediction.

Table 4.4: Model Summary

<table>
<thead>
<tr>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
<th>Durbin-Watson</th>
</tr>
</thead>
<tbody>
<tr>
<td>.975a</td>
<td>0.949985</td>
<td>0.749923</td>
<td>1.578726</td>
<td>1.270923</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<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>4</td>
<td>11.835</td>
<td>4.748</td>
<td>.330a</td>
</tr>
<tr>
<td>Residual</td>
<td>1</td>
<td>2.492</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>2.492</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.3 Commercial Banks Corporate Governance Scores

The study sought to establish the corporate governance practices adopted by the commercial banks in Kenya by looking at the frequency of boards meetings, size and composition of the board, number of board committees at the banks and average salary and benefits that the board members earn per year.
 Barclays banks had on average 6 board meetings per year over the 2005 to 2010 period, had an average board size of 10 members of which 7 were non-executive directors, had 3 board committee and paid an annual average monthly remuneration of Ksh 5,436,124.
Table 4.6: NIC Banks Ltd Corporate Governance Score

<table>
<thead>
<tr>
<th>Year</th>
<th>Frequency of Board Meeting</th>
<th>Board size</th>
<th>Non-executive director</th>
<th>Remuneration</th>
<th>No of Committees</th>
<th>Average Salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>4</td>
<td>10</td>
<td>8</td>
<td>35,359,000</td>
<td>4</td>
<td>3535900</td>
</tr>
<tr>
<td>2006</td>
<td>4</td>
<td>10</td>
<td>8</td>
<td>42,496,000</td>
<td>4</td>
<td>4249600</td>
</tr>
<tr>
<td>2007</td>
<td>4</td>
<td>10</td>
<td>8</td>
<td>52,234,000</td>
<td>5</td>
<td>5223400</td>
</tr>
<tr>
<td>2008</td>
<td>5</td>
<td>10</td>
<td>8</td>
<td>41,480,000</td>
<td>5</td>
<td>4148000</td>
</tr>
<tr>
<td>2009</td>
<td>7</td>
<td>10</td>
<td>8</td>
<td>52,042,000</td>
<td>5</td>
<td>5204200</td>
</tr>
<tr>
<td>2010</td>
<td>5</td>
<td>10</td>
<td>8</td>
<td>71,225,000</td>
<td>5</td>
<td>7122500</td>
</tr>
<tr>
<td>Average</td>
<td><strong>4.83</strong></td>
<td><strong>10</strong></td>
<td><strong>8</strong></td>
<td><strong>49139333.3</strong></td>
<td><strong>4.66666667</strong></td>
<td><strong>4913933.3</strong></td>
</tr>
</tbody>
</table>

According to table 4.6 above, NIC Bank Ltd had on average 5 board meetings per year, composed of an average of 10 directors of which 8 were non-executive directors. The bank had on average, 5 board committees and each board member was remunerated Ksh 4,913,933 annually.
Table 4.7: NBK Corporate Governance Score

<table>
<thead>
<tr>
<th>Year</th>
<th>Frequency of Board Meeting</th>
<th>Board Size</th>
<th>Non-Executive director</th>
<th>Remuneration</th>
<th>No Of Committees</th>
<th>Average Salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>12</td>
<td>8</td>
<td>5</td>
<td>18,294,000</td>
<td>6</td>
<td>2286750</td>
</tr>
<tr>
<td>2006</td>
<td>12</td>
<td>8</td>
<td>6</td>
<td>22,934,000</td>
<td>6</td>
<td>2866750</td>
</tr>
<tr>
<td>2007</td>
<td>12</td>
<td>10</td>
<td>7</td>
<td>29,622,000</td>
<td>5</td>
<td>2962200</td>
</tr>
<tr>
<td>2008</td>
<td>13</td>
<td>10</td>
<td>7</td>
<td>44,540,000</td>
<td>5</td>
<td>4454000</td>
</tr>
<tr>
<td>2009</td>
<td>13</td>
<td>10</td>
<td>7</td>
<td>44,540,000</td>
<td>5</td>
<td>4454000</td>
</tr>
<tr>
<td>2010</td>
<td>22</td>
<td>10</td>
<td>7</td>
<td>49,797,000</td>
<td>5</td>
<td>4979700</td>
</tr>
<tr>
<td>Average</td>
<td>14</td>
<td>9.3</td>
<td>6.5</td>
<td>34954500</td>
<td>5.3</td>
<td>3667233.3</td>
</tr>
</tbody>
</table>

According to table 4.7, National Bank of Kenya had an average of 14 board meetings, an average of 9 member corporate governance board of which 7 were non-executive director. The number of board’s committee was 5 on average and each board member was remunerated, annual, salary and benefits amounting to Ksh 3,667,233.
At standard chartered banks, the board meetings were 5 per year, a board composed of 11 directors of which 6 were non-executive. The number of board committee was 3 and each board member earned a salary and benefits amounting to Ksh 11,477,047.

Table 4.9: Diamond Trust Bank Ltd Corporate Governance Score

<table>
<thead>
<tr>
<th>Frequency of Board Meeting</th>
<th>Board Size</th>
<th>Non-executive director</th>
<th>Remuneration</th>
<th>No of Committees</th>
<th>Average Salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>9</td>
<td>12</td>
<td>10</td>
<td>15,618,000</td>
<td>1301500</td>
</tr>
<tr>
<td>2006</td>
<td>10</td>
<td>12</td>
<td>11</td>
<td>20,743,000</td>
<td>1728583</td>
</tr>
<tr>
<td>2007</td>
<td>9</td>
<td>12</td>
<td>11</td>
<td>16,548,000</td>
<td>1379000</td>
</tr>
<tr>
<td>2008</td>
<td>8</td>
<td>9</td>
<td>8</td>
<td>19,253,000</td>
<td>2139222</td>
</tr>
<tr>
<td>2009</td>
<td>5</td>
<td>9</td>
<td>8</td>
<td>2597778</td>
<td></td>
</tr>
</tbody>
</table>

At standard chartered banks, the board meetings were 5 per year, a board composed of 11 directors of which 6 were non-executive. The number of board committee was 3 and each board member earned a salary and benefits amounting to Ksh 11,477,047.
Diamond Trust Bank Ltd had a board composed of 11 directors, 9 of whom were non-executive directors and met 8 times annually. The number of annual committee were 5 and the directors individual salary and benefits amounted to Ksh 2,074,162

Table 4.10: KCB Corporate Governance Score

<table>
<thead>
<tr>
<th>Year</th>
<th>Frequency of Board Meeting</th>
<th>Board Size</th>
<th>Non-Executive Director</th>
<th>Remuneration</th>
<th>No of Committees</th>
<th>Average Salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>12</td>
<td>12</td>
<td>10</td>
<td>58574000</td>
<td>5</td>
<td>4881167</td>
</tr>
<tr>
<td>2006</td>
<td>12</td>
<td>11</td>
<td>9</td>
<td>57529000</td>
<td>4</td>
<td>5229909</td>
</tr>
<tr>
<td>2007</td>
<td>12</td>
<td>11</td>
<td>9</td>
<td>75082000</td>
<td>5</td>
<td>6825636</td>
</tr>
<tr>
<td>2008</td>
<td>16</td>
<td>11</td>
<td>9</td>
<td>92920000</td>
<td>6</td>
<td>8447273</td>
</tr>
<tr>
<td>2009</td>
<td>12</td>
<td>11</td>
<td>9</td>
<td>113769000</td>
<td>6</td>
<td>10342636</td>
</tr>
<tr>
<td>2010</td>
<td>10</td>
<td>11</td>
<td>9</td>
<td>98227000</td>
<td>7</td>
<td>8929727</td>
</tr>
<tr>
<td>Average</td>
<td>12.33</td>
<td>11.17</td>
<td>9.17</td>
<td>82683500</td>
<td>5.5</td>
<td>7442724.75</td>
</tr>
</tbody>
</table>

Table 4.10 above presents the corporate governance score for KCB Bank Ltd. The bank had a 11 board membership composed of 9 directors and 12 meetings a year. The number of board committee was established at 6 and the directors' individual salary and benefits averaged Ksh. 7,442,724.

4.4 Relationship between Performance and Frequency of Board Meetings

The study sought to establish the relationship between performance and frequency of board meetings by evaluating the following equation:

\[
\log (\text{meetings})_t = \delta + \beta Q_t + \beta_2 \log (\text{Board size})_t
\]
Whereby:

\[ \delta = \text{Constant} \]

\[ \log (\text{meetings})_t = \log \text{ of number of meetings held in year } t \]

\[ Q_t = \text{Tobin’s Q of bank } i \text{ for year } t. \]

\[ \log (\text{board size})_t = \log \text{ of board size.} \]

Table 4.11: Relationship between Performance and Frequency of Board Meetings

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>1.2852</td>
<td>1.5340</td>
<td>0.8378</td>
<td>0.4636</td>
</tr>
<tr>
<td>Tobin Q</td>
<td>-0.2459</td>
<td>0.2801</td>
<td>-0.4522</td>
<td>-0.8780</td>
</tr>
<tr>
<td>Board Size</td>
<td>-0.0283</td>
<td>0.1476</td>
<td>-0.0987</td>
<td>-0.1916</td>
</tr>
</tbody>
</table>

According to the figure above, the equation was found to be:

\[ \log (\text{meetings})_t = 1.2852 - 0.2459Q_t - 0.0283 \log (\text{Board size})_t \]

According to Table 11, there is a negative relationship between banks’ market performance and frequency of board meetings. There is also a negative relationship between board size and board meetings.

Table 4.12: Model Summary
4.5 Board Composition and Bank Performance

The study sought to establish the relationship between bank performance and board composition. Board composition was taken as the ratio between members of the board who are non-executive directors and those who are executive directors. The study further grouped the banks into three groups based on the board composition; insider dominated (if the ratio of non-executive to executive directors is less that 40%), mixed board (if the ratio is between 40% and 65%) and outsider dominated (if the ratio is more than 65%). The data analyzed is presented in table 13. According to the table, Diamond Trust Bank Ltd had the highest ratio of non-executive to executive directors (89%), followed by KCB (82%), then NIC Bank Ltd (80%). It thus follows that NIC, National Bank of Kenya, Diamond Trust Bank, Barclays and KCB’s board were outsider dominated while Standard Chartered Bank Ltd was mixed board.

Table 4.13: Board Composition

<table>
<thead>
<tr>
<th>Bank</th>
<th>Board Composition</th>
<th>Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Bank of Kenya Ltd</td>
<td>0.7</td>
<td>Outsider dominated</td>
</tr>
<tr>
<td>NIC Bank Ltd</td>
<td>0.8</td>
<td>Outsider dominated</td>
</tr>
<tr>
<td>Standard Chartered Bank Ltd</td>
<td>0.55</td>
<td>Mixed Board</td>
</tr>
</tbody>
</table>
To test the board composition and banks performance, by taking the case of the first two banks that had the highest ratio of non-executive to executive directors in the board (Diamond Trust Bank and KCB) and the last two (Standard Chartered Bank and Barclays Bank Ltd). The study used the following equation:

\[ Q_{it} = \beta_1 + \beta_2 \log (\text{outside})_{it-1} \]

Where,

Where \( Q_{it} = \) Tobin’s Q of Bank i for year t.

\( \log (\text{outside})_{it-1} = \) ratio of outside non-executive directors to the total No. of directors lagged one year.

Table 4.14: Board Composition and Bank Performance (Diamond Trust Bank)

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients (B)</th>
<th>Std. Error</th>
<th>Standardized Coefficients (Beta)</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>3.895</td>
<td>3.183</td>
<td></td>
<td>1.223</td>
<td>0.309</td>
</tr>
<tr>
<td>Board Composition</td>
<td>-3.965</td>
<td>3.529</td>
<td>-0.544</td>
<td>1.124</td>
<td>0.343</td>
</tr>
</tbody>
</table>

According to table 4.14 above, there is a negative relationship between board composition and banks’ performance.

Table 4.15: Board Composition and Bank Performance (KCB)
Table 4.15 further shows that there is a negative relationship between board composition and performance (Tobin Q) as the coefficient is -19.0025.

Table 4.16: Board Composition and Bank Performance (Barclays Bank Ltd)

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients (B)</th>
<th>Std. Error</th>
<th>Standardized Coefficients (Beta)</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>15.95558</td>
<td>13.41551</td>
<td></td>
<td>1.189</td>
<td>0.32</td>
</tr>
<tr>
<td>Board Composition</td>
<td>-19.0025</td>
<td>16.32038</td>
<td>-0.55789</td>
<td>-1.164</td>
<td>0.328</td>
</tr>
</tbody>
</table>

Table 4.16 presents the relationship between Barclay’s performance and its board composition. The findings reiterate the earlier findings that showed board composition be negatively relate with performance.

Table 4.17: Board Composition and Bank Performance (Standard Chartered Bank Ltd)

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients (B)</th>
<th>Std. Error</th>
<th>Standardized Coefficients (Beta)</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>0.506</td>
<td>0.330</td>
<td></td>
<td>1.533</td>
<td>0.223</td>
</tr>
<tr>
<td>Board Composition</td>
<td>0.080</td>
<td>0.572</td>
<td>0.081</td>
<td>0.140</td>
<td>0.897</td>
</tr>
</tbody>
</table>
However, on analysis of the relationship between board composition and standard chartered bank performance, the study found that a positive relationship as shown in table 4.17 above.

4.6 Relationship between CEO Remuneration and Bank Performance

The study sought to establish the relationship between executive remuneration and banks’ performance by regressing remuneration against Tobin’s Q and annual revenue in the following equation:

\[(\text{CEO Rem})_{it} = \beta_1 Q_{it} + \beta_2 (\text{Revenue})_{it}\]

Whereby,

\[(\text{CEO Rem})_{it} = \log \text{ of executive remuneration (Salary + Bonus)}\]

\[Q_{it-1} = \text{Tobin’s Q}\]

\[(\text{Revenue})_{it-1} = \log \text{ of annual revenue.}\]

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients (B)</th>
<th>Std. Error</th>
<th>Standardized Coefficients (Beta)</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>0.501</td>
<td>1.490</td>
<td></td>
<td>0.336</td>
<td>0.759</td>
</tr>
<tr>
<td>Tobin Q</td>
<td>-0.339</td>
<td>0.202</td>
<td>-0.477</td>
<td>-1.674</td>
<td>0.193</td>
</tr>
<tr>
<td>Revenue</td>
<td>0.693</td>
<td>0.169</td>
<td>1.170</td>
<td>4.109</td>
<td>0.026</td>
</tr>
</tbody>
</table>

The study established that while there is a positive relationship between remuneration and revenue/profitability, there is a negative relationship between Tobin’s Q and remuneration. The equation thus formed is:

\[\text{Remuneration} = 0.501 - 0.339 Q_{it} + 0.693 (\text{Revenue})\]

\[\log (\text{outside})_{it} = \text{Ration of outside non-executive directors to the total No. of directors lagged in year } t.\]

47
\[
\text{Log (CEO Rem)}_t = \text{Log of executive remuneration (Salary + Bonus) for year t.}
\]

\[
\text{Log (Insider ownership)} = \text{Percentage of Insider Ownership for bank i for year t.}
\]

\(\beta_1, \beta_2\) = Regression coefficients of the independent variables.

\(\beta_0\) = Vertical intercepts.
CHAPTER FIVE

DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

From the analysis and data collected, the following discussions, conclusions and recommendations were made. The responses were based on the objectives of the study. The researcher had intended to determine the relationship between corporate governance structure and the performance of banks listed on the Nairobi Stock Exchange.

5.2 Summary and Conclusion

The commercial banks' performance during the study period (2005 to 2010) the study calculated their Tobin Q ratio using market value of firm calculated as their market capitalization divided by the replacement costs of the firm’s assets, that is, asset value of the banks and the data findings presented in the table below. From the findings, the study established that, the Q-ratio of all the companies were below 1. Since the Tobin's q is less than 1, then the market value is less than the recorded value of the assets of the company which suggests that the market may be undervaluing the banks. Among the banks, Barclays banks of Kenya has the highest Q-ratio which stands at 1.1356, followed by standard chartered bank at 0.5825, then diamond trust bank at 0.3186, KCB at 0.3019, NIC Bank Ltd at 0.2303 and lastly National Bank of Kenya at 0.1827. However, only Barclays bank of Kenya had a Q-ratio which was more than 1 in 2007 (3.9087) suggesting that in that year market value was greater than the value of the company's recorded assets.

From the findings, the variations in the Q ratio so as to group the banks into 3 groups: losers, winners and mixed. Losers comprise of banks with negative tobin Q variation over the previous year; winners comprise of banks with positive variations in the performance metric over the previous year while mixed comprise of banks whose direction of Tobin Q variation over the previous year will not be consistent at the end of the year according to their performance. The
variations in the companies Tobin Q were both positive and negative which points out that the companies could only fit in the mixed group meaning that the market valuation of the banks fluctuated over the years and were not consistent in neither direction nor magnitude.

The studies established the price-to-book value of the listed commercial banks. The price to book value was a function of the ratio of market capitalization to the net asset values of the banks. Price to book value measures the portion of a company that can be claimed by the shareholders if the company is liquidated at that time. According to the finding of the study, the price-to-book values of the banks were above 1 meaning that the market values of the banks' equity were greater than the value of the net of their total recorded assets.

Whereby board size was the number of board members, board composition was the ratio of non-executive directors to the total number of board members; board meeting was the number of board meetings in a year while the executive remuneration was the average amount of salary and allowances given to an individual board member in a year.

The regression results shows that when value of the corporate governance indicators/measures used in the study (board size, composition, meetings and executive meetings) are zero, then the market value of the banks' assets relative to their book value becomes 19.3. The results also shows that board size negatively affects firms market performance while board composition affects market performance positively the most and a unit increase in executive remuneration has the least positive influence. The model summary presented in table 3, shows that the relationship was strong as the R square value was 0.95. However the model was insignificant for prediction as the f significance was 0.33 meaning that the model might be 33% wrong in its prediction.

The study established the corporate governance practices adopted by the commercial banks in Kenya by looking at the frequency of boards meetings, size and composition of the board, number of board committees at the banks and average salary and benefits that the board members earn per year. Barclay's banks had on average 6 board meetings per year over the 2005 to 2010 period, had an average board size of 10 members of which 7 were non-executive directors, had 3 board committee and paid an annual average monthly remuneration of Ksh
The NIC Bank Ltd had on average 5 board meetings per year, composed of an average of 10 directors of which 8 were non-executive directors. The bank had on average, 5 board committees and each board member was remunerated Ksh 4,913,933 annually. National Bank of Kenya had an average of 14 board meetings, an average of 9 member corporate governance board of which 7 were non-executive director. The number of board’s committee was 5 on average and each board member was remunerated, annual, salary and benefits amounting to Ksh 3,667,233. At standard chartered banks, the board meetings were 5 per year, a board composed of 11 directors of which 6 were non-executive. The number of board committee was 3 and each board member earned a salary and benefits amounting to Ksh 11,477,047. Diamond Trust Bank Ltd had a board composed of 11 directors, 9 of whom were non-executive directors and met 8 times annually. The number of annual committee were 5 and the directors individual salary and benefits amounted to Ksh 2,074,162.

From the above discussion the study found that Q-ratio of all the companies were below 1. Since the Tobin's q is less than 1, then the market value is less than the recorded value of the assets of the company which suggests that the market may be undervaluing the banks. Among the banks, this suggests that in that year market value was greater than the value of the company's recorded assets, the study thus concludes that there is a positive relationship between corporate governance structure and bank performances of the preceding year.

The study found that there was a variation on Tobin Q over the previous year and they were not consistent at the end of the year according to their performance. The variations in the companies Tobin Q were both positive and negative, thus the companies could only fit in the mixed group meaning that the market valuation of the banks fluctuated over the years and were not consistent in neither direction nor magnitude.

The price-to-book value of the listed commercial banks, the price to book value is a function of the ratio of market capitalization to the net asset values of the banks. Price to book value measures the portion of a company that can be claimed by the shareholders if the company is liquidated at that time, the price-to-book values of the banks were above 1 meaning that the
market values of the banks’ equity were greater than the value of the net of their total recorded assets.

This study also concludes that board size negatively affects firm’s market performance while board composition affects market performance positively the most and a unit increase in executive remuneration has the least positive influence. The study concludes that corporate governance practices adopted by the commercial banks in Kenya by looking at the frequency of boards meetings, size and composition of the board, number of board committees at the banks and average salary and benefits that the board members earn per year has effect on the market performance of the banks.

From the above discussion, conclusion of the study recommends that for banks to have better market performances should adopt better corporate governance practices since corporate governance practices affects the market performance of the banks positively. The study also recommends that board size of the banks should be small and there should be less executive remuneration as this affects banks performance negatively

5.3 Limitations of the Study

A limitation for the purpose of this research was regarded as a factor that was present and contributed to the researcher getting either inadequate information. The main limitations of this study were: The researcher was faced with a challenge of accessing information required from the banks for the completion of the study. The small size of the sample could have limited confidence in the results and this might limit generalizations to other situations or generalization of the status in all the banks. Time- Due to official duties time was a major concern.

5.4 Suggestion for Further Research

The study suggests that further studies should be done on other institutions listed in the NSE such as insurance companies so as to establish the relationship between their corporate governance structures and their performance.
Further, a similar study should be done on the effect of the governance structures on the performance of all the banks in Kenya so as to establish the overall effect and allow for generalization on the effect of the structures on the bank performance.
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Appendix I: Registered Commercial Banks

1. Bank of Africa (K) Ltd.
2. Bank of India
3. Citibank N.A. Kenya
4. Habib Bank A.G. Zurich
5. Habib Bank Ltd.
6. Bank of Baroda (K) Ltd.
8. Diamond Trust Bank Kenya Ltd.
10. Standard Chartered Bank (K) Ltd.
11. Ecobank Ltd
12. Gulf Africa Bank (K) Ltd
13. First Community Bank
18. Savings and Loan Kenya Ltd.
19. CFC Stanbic Bank Ltd.
20. African Banking Corporation Ltd.
21. City Finance Bank Ltd.
22. Commercial Bank of Africa Ltd.
24. Credit Bank Ltd.
25. Charterhouse Bank Ltd.
26. Chase Bank (K) Ltd.
27. Dubai Bank Kenya Ltd
28. Equatorial Commercial Bank Ltd.
29. Equity Bank Ltd.
30. Family Bank Ltd.
31. Fidelity Commercial Bank Ltd.
32. Fina Bank Ltd.
33. Giro Commercial Bank Ltd.
34. Guardian Bank Ltd.
35. Imperial Bank Ltd.
36. Middle East Bank (K) Ltd.
37. NIC Bank Ltd.

38. Oriental Commercial Bank Ltd.

39. Paramount Universal Bank Ltd.

40. Prime Bank Ltd.

41. Southern Credit Banking Corporation Ltd.

42. Trans-National Bank Ltd.

43. Victoria Commercial Bank Ltd.

Source: CBK, (2009)
Appendix II: Listed Commercial Banks

1. Barclays Bank of Kenya Ltd (BBK)

2. CFC Stanbic Holdings Ltd - merger

3. Diamond Trust Bank Kenya Ltd (DTB)

4. Equity Bank Ltd – listed in 2006

5. Kenya Commercial Bank Ltd (KCB)


7. NIC Bank Ltd

8. Standard Chartered Bank Ltd (StanChart)