EFFECTS OF CORPORATE GOVERNANCE PRACTISES ON THE
FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

BY

JACKSON SAIDIMU TENIK

D61/70851/2014

A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILLMENT OF THE
REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTERS OF
BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS
UNIVERSITY OF NAIROBI

OCTOBER, 2018
DECLARATION

I declare that this research project is my original work and has not been presented for a degree award in any other university.

Signature……………………………… Date …………………………………

Jackson Saidimu Tenik
Reg. No: D61/70851/2014

This project is submitted for examination with our approval as the university supervisors.

Mr Patrick Kiragu
Lecturer, Department of Finance and Accounting
School of Business, University of Nairobi

Signature……………………………… Date …………………………………

Mr. James Ng’ang’a
Lecturer, Department of Finance and Accounting
School of Business, University of Nairobi
ACKNOWLEDGEMENT

I would like to sincerely record my appreciation to all people who support of any sort to me when undertaking this research study. Exceptional thanks goes to my research supervisors Patrick Kiragu and James Ng’ang’a for your intellectual guidance.
DEDICATION

I devote this assignment to my relatives. To my father, Jeremiah Rompo, you did not labor in vain. To my mother, Esther Rompo your teachings and ceaseless support is always cherished. To my wife Lucy Retet and son Mark Leshan you are the pillar that I will always lean on, with your enormous support, love and patience this project was a success.
TABLE OF CONTENTS

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

CHAPTER ONE .............................................................................................................. 1
INTRODUCTION .......................................................................................................... 1
1.1 Background of the study .......................................................................................... 1
  1.1.1 Corporate Governance Practices ................................................................. 2
  1.1.2 Financial Performance .................................................................................. 3
  1.1.3 Corporate Governance Practices and Financial Performance .................... 4
  1.1.4 Commercial Banks in Kenya ......................................................................... 6
1.2 Research Problem .................................................................................................. 7
1.3 Research Objective ............................................................................................... 8
1.4 Value of the Study ................................................................................................. 9

CHAPTER TWO .......................................................................................................... 10
LITERATURE REVIEW .............................................................................................. 10
2.1 Introduction .......................................................................................................... 10
2.2 Theoretical Review .............................................................................................. 10
  2.2.1 Agency Theory .............................................................................................. 10
  2.2.2 Stewardship Theory ...................................................................................... 12
  2.2.3 Resource Dependency Theory ....................................................................... 13
2.3 Determinant of Financial Performance of Commercial Banks ....................... 14
  2.3.1 Internal Factors ............................................................................................. 14
    2.3.1.1 Capital Adequacy .................................................................................... 15
    2.3.1.2 Asset Quality .......................................................................................... 15
    2.3.1.3 Management Efficiency .......................................................................... 16
5.5 Limitations of the Study ................................................................. 41
5.6 Suggestions for Further Research ................................................... 42
REFERENCES ......................................................................................... 44
APPENDICES ......................................................................................... 51
APPENDIX 1: LIST OF COMMERCIAL BANKS IN KENYA ...................... 51
# LIST OF TABLES

Table 4.1: Descriptive Statistics ................................................................. 29  
Table 4.2: Correlation Analysis ................................................................... 31  
Table 4.3: Model Summary .......................................................................... 32  
Table 4.4: Analysis of Variance .................................................................. 33  
Table 4.5: Model Coefficients ..................................................................... 34
LIST OF FIGURES

Figure 2.1: Conceptual Framework ........................................................................... 22
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BOD</td>
<td>Board of Director</td>
</tr>
<tr>
<td>CAMEL</td>
<td>Capital Adequacy, Asset Quality, Management Efficiency, Earning Ability, Liquid Management</td>
</tr>
<tr>
<td>CBK</td>
<td>Central Bank of Kenya</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CMA</td>
<td>Capital Market Authority</td>
</tr>
<tr>
<td>CMA</td>
<td>Capital Market Authority</td>
</tr>
<tr>
<td>NBFI</td>
<td>Non Banking Financial Institutions</td>
</tr>
<tr>
<td>NYS</td>
<td>National Youth Service</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
</tr>
<tr>
<td>ROE</td>
<td>Return on Equity</td>
</tr>
<tr>
<td>ROI</td>
<td>Return on Investment</td>
</tr>
<tr>
<td>SME</td>
<td>Small Medium Enterprises</td>
</tr>
</tbody>
</table>
ABSTRACT

Of late Kenyan banks have encountered a number of corporate disasters which are associated to corporate governance. The fall of Imperial bank which is now under statutory management and the collapse of Chase bank in March 2016 is an indication that the industry is still facing issues of poor governance and management practices. Corporate failures are normally heralded by financial adversity and decreasing performance. Generally, positive improvements are unusual in Kenya, hence inquiry if timely and proper reaction is in use by the board when the initial signs of imminent distress is noticed. The study sought to determine the outcome of corporate governance practices on financial performance of the commercial banks in Kenya. The study’s population was entirely the 42 banks operating in Kenya. Data was obtained from 41 out of the 42 banks giving a response rate of 97.62%. The independent variables for the study were corporate governance practices as deliberated by, board size and independence, number of committees and number of meetings held annually. The control variable was bank size. Financial performance was the dependent variable which the study sought to make clear. It was measured by ROA. Secondary data was collected annually for 5 years. Multiple linear regression and descriptive cross-sectional research design was used to explore the association between the variables. Analysis of data was carried out by the SPSS version 22. The results of the study produced R-square value of 0.344 meaning that about 34.4 percent variation in the Kenyan commercial banks’ performance can be elaborated by the 5 selected independent variables while 65.6 percent in disparity of financial performance of commercial banks was associated with other factors not covered in this research. The study also found that the independent variables had a strong correlation with dividend payout ratio (R=0.587). ANOVA results showed the F statistic was significant at 5% level with a p=0.000. Therefore the model was fit to explain the connection between the selected variables. The results further revealed that board independence, number of committees and bank size produced positive and statistically significant values for this study. The study found that board size and board meetings are statistically immaterial factors of financial performance. This study commends that actions should be put in place to improve board independence, number of committees and bank size as this will advance financial performance of commercial banks in Kenya.
CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Business failure is a main concern amongst firms in 3rd world and developed countries which can be attributed to poor corporate practices (Wanyama, 2013). Corporate governance touches on the process, system, procedures and practices that directs firms to achieve their objective these has not been the case with most public companies, government institution, banking sector and other financial institution in Kenya (Gakeri, 2013). The banking industry has witnessed turbulence in recent times culminating in the collapse of several institutions, corporate governance has been at the center of these development which largely affected two financial entities namely imperial bank and chase bank. Pillars of trust and integrity which hold the sector together were badly shaken. It resulted to deposit flight thereby affecting bank that are in the second tier, mid-tier and below (Langat, 2016).

Sir Adrian Cadburry a former chairman of Cadbury Schweppes describes corporate governance, as building the balance between social, economic, communal as well as individual goal. This target to align the interest of individuals, society and corporations. Corporate governance is an enhancement of management performance and ensuring accountability of management to shareholder and stakeholder (Cadbury, 2000). The meaning of corporate governance is clearer by the capital market authority Cap 485, formation used to guide and direct corporate dealings of the company geared to

Other scholars also captured the concept of corporate governance in different ways. According to Staff (1999), how corporate governance structure is supposed to work is contained within the formal organization, the way it actually works will be found in the informal organization (Diett, 1998). Further observes that corporate governance will have cost if managers disregard investors best interest. The stakeholders may aim at maximizing investment on the other hand managers may opt maximize their personal wealth at investors’ expense. These will result in conflict of interest hence governance cost which includes agency and non-diversification costs. The capital market authority Act Cap 485A together with various regulations gazette notices and governance guide helps us to understand the legal framework here in Kenya. This borrows heavily from work undertaken from other jurisdiction and regional bodies. That includes common wealth association for business governance (OECD, 1999). This organization has worked on promoting policy of best control practices in Kenya.

1.1.1 Corporate Governance Practices

It comprises the way through which operations and activities belonging to body or a particular institution are undertaken. It guides the establishment and setting of a firm’s vision and goals and the mission that shall assist realize the set goals and objective, and any control or monitoring efforts there from are established (CBK, 2016). Adams and Megan (2003) describe business control as "the mechanism through which stakeholders (shareholders, creditors, employees, clients, suppliers, the government and the society, in
general) monitor the management and insiders to safeguard their own interests."

Therefore, the structure through which businesses are managed is corporate governance.

Fourier (2010) defines corporate governance as a trend towards greater responsibility in managing companies and ensuring that businesses are conducted according to standard ethical principles. Abu-Tapanje (2011) explains that corporate governance as a means of ensuring business is conducted in fair, efficient and transparent manner. As such, it is believed to be the structure of controlling and directing corporate undertakings of a business that will increase firm’s financial performance, its market value and also improve shareholders’ long-term value and wealth.

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

1.1.2 Financial Performance

Alam et al., (2011) argued that firm’s performance consists of four multidimensional elements. These dimensions include customers-focused performance, product or service performance, human resources performance, organizational effectiveness, including innovation, supply chain flexibility, financial and market performance.
The performance of the firm’s is the key indicator appraisal tool used by external parties (Bonn, 2000). The level of attainment of the firm’s objectives defines its performance (Achrol, 2003). Financial performance is the results attained from achieving external and internal objectives of a firm (Lin, 2008).

Financial performance of a firms is measured by various method putting organizational objectives in mind. The methods can be measured using non-financial as well as financial terms (Bagorogoza, 2010). Grant, 1988), argued that many firms prefer to use financial as an indicator of growth. Tavitiyaman et al., (2012) postulated the most common indicators were, return on investment (ROI) and return on assets (ROA), and Bagorogoza (2010) argued that the other common indicators were profitability, growth, productivity, shareholder’s satisfaction and market share.

Krager (1996) argued that the financial elements are not sufficient pointer to performance; there is a need to merge with non-financial measure in order to encompass external and internal environments. Supporting this opinion, Rubio (2009) argued that business performance can be divided into four dimensions namely, human relation, rational goals, open systems and internal processes. These dimensions can be measured by changes in its own variables.

1.1.3 Corporate Governance Practices and Financial Performance

Numerous studies exist on the connection between corporate governance practices and companies financial performance. A better association amongst, executive and shareholders would improve profitability and efficiency (Thomson, 2006). Daily (1992) found out that the likelihood of bankruptcy is related to meager corporate governance
practices. As in the case with the Kenyan Banking institutions in the 1990s and early 2000s. Firms were expected to have improved performance by strengthening their governance practices.

As pointed out by Bowen (2004) ignoring corporate governance can lead to doubtful inferences on firm performance. Firms that observe good corporate practices exhibit improved operating performance as compared to those with poor corporate governance practices (Black, 2005). Jensen (1976) argued that the better governed firms also enjoyed higher expected returns due to efficient operations.

Studies have shown good corporate governance helps to spur investor goodwill and confidence. This affected the Kenyan economy in the 1990s with a string of banks collapsing with depositor’s money. The association between banks performance and corporate governance practices can be examined from the experiences of the large number of banking institutions that collapsed in the last two decades and more recently in the year 2016. According to (Matengo, 2008) systematic failures of the banking industry in Kenya and other African countries in the 1990s were attributed to moral hazards which include, insider lending, high interest rates to the riskiest sector in the economy.

The scale of collapses across the country in the late 1990’s and the ramifications for the rest of the economy was so devastating. Banks that posted good results gradually post huge losses due to credit risk which that turned sour, interest rates going up among other macro-economic factors. Vibrant financial institutions like the Trust Bank collapsed in 2001 and Euro Bank that collapsed with billions of shillings of depositors’ money. Maiko (2003) explained that these banks were known as a conduit for money laundering and had
strong political connections which kept the banks open. The banks in Kenya that collapsed had poor corporate governance practices as this was evidenced when political power changed hands.

Good corporate governance in Kenyan Financial Institutions is required to restore market confidence, attract foreign direct investment or private capital inflows and investments that will propel the institutional performance. That can be could be attained by increasing, accountability of directors, financial transactions and transparency of corporate structures (Kilonzo, 2008). Good corporate governance practices increase chances of financial access to external borrowing. This in turns lead to big investment, greater employment creation and higher growth. Good governance will lead to improved resource allocation which leads to efficient operational performance and optimal wealth creation. Yurtogtu (2012) postulated that good governance lead to minimal financial risk hence avoid larger economic and social costs.

1.1.4 Commercial Banks in Kenya

CBK (2016) notes that the key participants in the Kenyan banking industry include commercial banks as well as 1 mortgage. Statutes regulating the industry include the Kenyan constitution, the banking act, and policies issued by the central banker and Companies Act Chapter 487 and Capital Markets Authority (CMA).

Three banks were closed down by the regulator in 2016 Dubai bank which when through operational difficulties arising from diminishing liquidity and capital ratios, increased provisions for bad loans, weak corporate governance and administration mechanisms. Imperial and chase banks were place under receivership after discovery by CBK of
unethical practices that flouted regulatory rules, this included under capitalization, loan extended to unviable project, non-performing loans, insider lending to directors ,over investment in speculative property market, (CBK, 2016). The Kenyan banking sector, as a whole, has registered sustained growth over the past ten years.

1.2 Research Problem

The notion of companies governance practice in commercial banks and firms in other sectors of the economy has dominated policy agenda of most developed countries for a while now (Uwuigbe, 2012). Garcia-Maro (2008) postulated that healthier business governance acts to improve performance.

Banking crisis has occurred in the recent time, the collapse of Dubai bank, imperial bank and the recent near collapse of chase bank. Several Kenyan individual including prominent personalities have been named. The manner in which the company was able to make right issue just before being placed under receivership raised question in the eyes of the public as to how certain pertinent issue were not brought to the attention of the public and hence aid in better decision making of whether to buy and sell a stake in a company near collapse.

Several Kenyan bank faced probed for handling stolen national youth funds, The NYS cash was moved through commercial bank into individual pockets and ultimately was used to buy personal asset with cash withdrawals of ksh 1 Million being made per day by a single individual, contrary to the prudential guideline that requires all financial institution to report all transactions that may be of money laundering nature to CBK. This lead to flight to quality and liquidity preference amongst the banks. Banks that perceive
themselves vulnerable shun longer or risky loan leading to a credit squeeze whose effects were felt by SMEs. This caused a decline in the profitability of most commercial banks (CBK, 2016).

Among the Kenyan studies. Nyarige (2013) established that board size disrupts business performance of banks listed at the NSE negatively while board independence upsets performance of these banks positively, Okiro, Aduda and Omoro (2015) established a affirmative significant influence of goals achievement on firm performance &. Otieno (2012) also found out that administration plays a vital role on operational and financial stability in a bank as a going concern and its liquidity position amid erratic market turbulence.

Due to the inconclusive outcome on the various studies, investors have not expanded their insight regarding the policies to be implemented to improve their returns. The limitation of these studies is none of them provides a comprehensive examination of effects of corporate governance practice on the financial performance, thus the question: What is the effect of corporate governance practices on financial performance of commercial banks in Kenya?

1.3 Research Objective

To ascertain the effect of corporate governance practices on the financial performance of commercial banks in Kenya
1.4 Value of the Study

It will benefit policy maker, specifically those charged with the implementation of the year 2030 strategic plan. As the country aim at becoming a developed country some way of achieving this is to attract investment by making Kenya a safe and secure destination offering competitive returns, increased employment and better social and economic state one indicator of this is the way corporate governance practices is administered and made to work.

Academicians and researchers may use the finding to compare the level of corporate governance practices in the privately owned bank with other sector of the economy in order to derive the best practices across the whole economy. By examining the existing relationships amongst the directors, shareholders, management and the other stakeholders, the study attempted to identify existing gaps that requires to be addressed so as to enhance the governance of banking institutions in Kenya. The study also offered a body of knowledge to the academicians for further research on corporate governance and reference to scholars and practicing professionals.

The administration of Kenyan banks will benefit from conclusion of the study, this will help them enhance responsible governance the study will help commercial banks to identify the best practices both locally and worldwide. This study will offer an opportunity to provide a detailed knowledge of banking failure beyond the regulatory framework. This will assist bank board of directors and management in appreciating importance of corporate governance in enhancing bank performance.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Commercial governance is about ensuring that those in position of trust do the right thing, it’s about leadership and responsibility that goes with it. In a scenario of weak corporate governance structure in any market, capital will experience a run-off in the market within a short span of time the reverse is also true. investor have also continued to alert on the way the company in which they own is run, constitution of director is closely watched in terms of their qualification, experienced and competence with a change in the board or chief executive sometime leading to changes in share prices (Levitt, 2001).

2.2 Theoretical Review

The sector presents a view of theories touching on corporate governance practices on commercial banks performance in Kenya. This study will major on three theories; they include;

2.2.1 Agency Theory

Mithick and Ross came up the agency theory in 1972; Ross was credited on the source of economic model of agency theory and Mithick on the institutional theory. Although the basis concept underlying these approaches is similar empirical theories in corporate government have been based on agency theory perspective. This is because corporate governance has root in agency theory (Filatotebev, 2011). The agency relationship originates when a principal hires an agent to carry out a service on his behalf (Jensen,
Managers are agents of shareholder who adopt that the principle guiding them are geared toward maximization of shareholder wealth. However, there are three factors that disturb this relationship. In the first place there is conflict of interest between the principals. Secondly, the presence of high level information asymmetry amongst agent and principal with a likelihood that the agent can take gain of this information asymmetry to enrich him or herself. The divergence behavior between the interests of those of the agent gives rise to agency cost. The aim agency theory is to select the most suitable mechanism that will regulate the relationship between the two parties in a manner that will ensure conformity of the concern parties, leading to reduction of agency cost. There are four areas which are problematic to agency relationship; these are risk aversion moral hazard, earning retention, and time horizon. Moral hazard relates to a situation whereby an agent may deliberately fail to perform as per contractual terms. Manager incentive to consume increases when he or she does not own share in a company or when his or her share ownership declines (McOlgan, 2001).

Manager of companies who are risk averse prefer higher equity financing in their company’s capital structure than debt. This is because debt increases the risk of default and bankruptcy that may expose their weakness. In the absence of sufficient equity, they would prefer use of retained earnings in their financing plans. Despite the fact that retain earning as a source of financing, reduces need for external financing in case the manager requires more fund for investment purposes they have to go to the external markets where they have to incur floatation cost. Jensen (1993), argue that firm manager prefers earning retention and may invent them for purposes of diversifying the firm risks. Whereas
shareholders prefer future string of cash flow, the management of a company may be interested in cash flow produced within their term in office. Leading to a rise of time horizon agency conflict that make them incline toward high return short term investment in place of long-term positive valued projects. Manager in a firm are bound to avert risk when their interest and those of the shareholder are well aligned and when cash flow hedging is properly used. In this case, the sufficient funds will be available to finance positive net present value project of that are available hence increasing shareholder wealth. The proponents of agency theory emphasized on the control mechanism on managerial behaviour. Donaldson (1990) argued categorically on the individualism, methodology and disregarded other researcher’s ideological framework. The emphasis was on rational economic model of human behaviour. However, he noted that workflow of every organization activity should not be construed as daily activity. This then signify a vital critic of structuralism.

2.2.2 Stewardship Theory

It was established by Donaldson (1993). The theory discusses the existing relationship between management and ownership of company. Stewardship theory comes in handy as an substitute theory. It replaces absence in trust of agency theory Clarke, 2004). What drives manager to complete their jobs is emphasized in their drive satisfactorily perform their duty, manager is conjured up as being driven by the achievement, and gain inherent fulfillment by performing difficult task and the need to exercise responsibility and authority. This in turn makes them achieve recognition from their peers and seniors (Donaldson, 1991). Davis (1997) contend that manager who have autonomy will be accountable steward of the company’s assets under their control stewardship theorist
further argues that there is need for organization to put in place structure that allow harmonization of objective that manager and shareholder of firms need to achieve if superior performance is to be realized.

Stewardship theory does not only focuses on the CEO motivation but rather on facilitative structures that fusion the incumbency chairman’s role and the company CEO that enhances effectiveness leading to achievement of superior performance. Stewardship theory argues that lesser board size enhances contribution and collective cohesion while larger board size hinders the board capability to arrive at an agreement on important decision (Math, 1998). Though the theory takes care of shortcomings of agency theory, it’s considered to be too static, as its only considers the association between the agent and the principal at one point in time without taking into account learning due to interaction.

2.2.3 Resource Dependency Theory

This theory was established in the 1971s he postulates were on exterior control of organization, a resource necessity viewpoint by Jeffrey Pfeiffer and Gerald R. Salanik. The proponent of resource dependency theory argues that there is need to have environmental linkages amongst the firm and outside resources (Wan, 2012). These environmental linkages can help the firm reduce the level of transaction cost associated with environmental interdependency (Williamson, 1985). The theory strongly emphasizes the board role in providing the much required resource to move a firm to a higher level. It also recognizes the role administrative arms act as a bridge between a company and the resources needed to accomplish its goal (Tricker, 2012).
Resource dependency theory further points to the fact that organizations have a tendency to minimize the risk of outside influence hence ensure a pool of resources for their competitiveness, survival, and growth. The executive and non-executive director’s efficiency is not essential to company financial performance, what is important is existence of executive on the board of many other companies. This enables the companies to establish relationships that can help them access information that can be used to their advantage. Taking into account that substantial amount of resources available in a country are either directly or indirectly controlled by the government, appointing directors to the company’s board who are influential and have access to major policy makers and government offices is an essential milestone to a company’s survival and profitability (Pfeffer, 1978). The theory suffers from the assumption that organizations’ behavior and structures are controlled primarily by material forces. It ignores the role of cultural, institutional, and ideological forces.

### 2.3 Determinant of Financial Performance of Commercial Banks.

Corporate governance practices affect commercial banks’ performance by affecting their capacity to generate and sustain positive returns on investments presently and in the future. There are other factors that affect the financial results.

#### 2.3.1 Internal Factors

Internal factors are unique bank specific characteristics that affect banks’ financial performance. They basically are affected by decisions taken by internal firm players who include bank managers and the board of directors; they therefore are able to be controlled by a bank or manipulate them and that they vary among different banks. They include:
asset quality capital adequacy, management efficiency (measured as operational cost to income ratio), earnings ability and liquidity management. These factors are abbreviated CAMEL (Ongore, 2013).

2.3.1.1 Capital Adequacy

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

Current monetary emergencies have exposed significance of bank regulations in hedging the high risk attributed to disparities in banks’ balance sheets. Unnecessary regulations could negative effects; also they serve as prudential measures (Kongiri, 2012).

2.3.1.2 Asset Quality

The cost of a bank’s held resources affects financial performance of banks. Assets include among others loans and advances availed to customers, prepayments, property and equipment, and intangible assets. Total loans and advances made and held by a bank is a major balance sheet item which contributes highly on the bank’s revenue. The quality of outstanding loans and advances portfolio influences the viability and eventual financial results of banks, hence a straight behavior on bank profitability. Non-performing loan
best measures of a book’s asset quality. Banks that register and maintain a relatively good or high quality assets and lower impaired loans outperform and return better profits and returns when compared with others (Ongore, 2013).

Asset quality is calculated by the ratio of proportion of non-performing credit to gross loans which can be accredited to risk management program undertaken by banks which has enhanced credit appraisals and administration standards, however in the past two year banks have experience a decline in profit caused by high number of non-performing loans, poor company governance practices and capping of interest rate laws (CBK, 2016).

2.3.1.3 Management Efficiency

Management efficiency is also an internal variable that affects bank performance; it varies from firm to firm, as each firm has a unique team of management and staff. Management efficiency relates to a bank doing the right things. Financial ratios, such as profit to income, expense to asset ratios, assist to gauge a bank’s level of efficiency. It is among important internal variables or conditions that influence bank profitability; it assists indicate how managements is able to maximize revenue at minimum costs (Ongore, 2013). Bank efficiency is determined by the cadre of management running the affairs as they are accountable for daily running of bank operations and activities and are also the ones who develop policies that affect the performance of the other CAMEL variables (Kongiri, 2012).

The administration of banking organizations, as well as the supervisor of other firms, determines its process through decisions. Agency problem and moral hazard may
manifest itself through too much risk taking in their bid to exploit depositor value (Apostolos et al., 2011).

2.3.1.4 Earnings Ability

Earnings include income derived from daily activities and operations, non-routine extraordinary streams. According to Kongiri (2012) earnings are based on the dividend policy maintained by a bank, the bank can over time increase its level of capital through retained earnings or reserves, thus building up ability to seize the usually infrequent opportunities as they arise, for instance using retained profits to finance an adoption of technology that will increase operational efficiency.

A bank should endeavor to generate earnings sufficient to cover potential losses, provide adequate capital and be able to sustain dividends. Adequate budgetary objectives, organizational planning and management of revenues and expenses, growth trends in major revenue streams, and under reliance on non-routine revenues and nontraditional income streams also indicate a strong earnings ability by a bank (Langat, 2014).

2.3.1.5 Liquidity Management

Liquidity is indicated by the ability of the bank to fulfill its due and potential future obligations, mainly of depositors. Banks that manage to profitably deploy their very liquid resources are able to obtain revenues or incomes that add or boost bottom line. Commercial banks are the major players in the Kenyan financial sector thus liquidity management is key in efficiently and effectively playing the duty and role of financial intermediations. There should be an optimal balance between assets maturities and obligations falling due over a given time period without incurring insupportable losses.
Liquidity management thus plays a significant and often key contribution in bank performance; a lack of it means resorting to, among others, costly interbank overnight borrowing so as to discharge due obligations (Ongore, 2013).

It is the mandate of the respective board of directors of each institution to enact, implement and maintain, and enforce a liquidity management strategy and policies that are appropriate for the smooth running operations and activities of the institution to ensure that it has sufficient liquidity at hand and available to effectively to honour its demands or obligations as and when they are due. Strategy and liquidity policies and guidelines should be communicated to executive and senior top management and all other appropriate staff members for execution. The statutory prescribed minimum liquidity requirement is twenty percent of deposit liabilities (CBK, 2016).

2.3.2 External Factors

External factors are either industry specific or macroeconomic factors. Industry factors include degree of competition, maturity of the firms (banks) and industry concentration; macroeconomic ones include changing consumption behaviors, economic growth and the volatility of the exchange rate. Fluctuations on these and related factors affect financial output and goals attainment (Murerwa, 2015). The macroeconomic stability or level of turbulence influence macroeconomic variables movement and in effect firm performance (Ongore, 2013).

2.4 Empirical Studies

Supposed improved corporate governance is associated to improved performance of the firm, better governed firm should perform well than poorly governed firms. Caylour
argued that efficient corporate governance ensure that managers control rights are capped hence managers invest in project with positive net present values. Choi and Yeung (2005) using ordinary least square for the period 1998-2002, studied effects of ownership and business governance on performance of Korean Banks. They found out that one foreign board director improved bank performance but multiple foreign director does not improve bank performance.

Bermpei and Mamatzakis (2015) in a research study on assessed impact of the corporate governance on listed investment banking firms’ performances in United States of America over 2000–2012 period, secondary data was used. Regression analysis and descriptive statistics and were used analyzing data. Research results showed size of board has a negative outcome on performance particularly for banks having more than ten members; negative inverse relationship between operational involvedness and performance; the chief executive officer power positively influences performance. Increasing board member’s ownership stakes has negative performance impact within some levels while above certain levels the said ownership impacts performance positively, this could be seen as incentives of both parties (managers and owners) become more aligned.

Shakier and Padgeit (2005) when investigating whether commercial governance compliance matters on performance. The study used regression analysis and descriptive statistics. They found out existence of a link between compliance and market driven measures on performance, thus increasing compliance lead to an increase in total shareholder return from the sampled companies. Tandelilin (2007) using a sample of fifty-one banks between 1999 and 2004, studied the correlation between corporate
governance, bank performance and risk management. The study used triangle gap model with primary and secondary data. The study showed that ownership structure disturbs both the relationship of company governance and bank performance.

Masulis (2007), studying a section of Fortune 500 companies association linking CEO duality and organization performance in Africa, established that corporation headed by independent chair had higher return, profit margins, and profit on investment. Kiel (2003) studied on board composition and corporate governance. Using 348 of Australian Public listed companies he investigated the corporate performance in relation to board demography. The conclusion of the research was an upbeat relationship amongst the section of internal director and performance.

Susoiu (2014) studied the influence of governance variables on financial performance. Twenty three (23) companies listed in the German Stock Index DAX30 were sampled; information were obtained from audited annual reports for the period 2009-2013. The study found that board size affects performance negatively.

Kiruri (2013) studied the effects of ownership organization on bank profitability in Kenya; he obtained statistics from report available from commercial banks website. The finding indicated that ownership concentration and state ownership negatively affected bank profitability however; domestic and foreign ownership depicted a significant positive effect. Findings resolved that higher absorption and state ownership leads to lesser profitability while advanced domestic and foreign tenure lead to higher profitability amongst profitable banks. Kiruri (2013) used profitability as a measure of
profit, use of profit as a measure of profit is not a proper guide to decision making because profit is a result of various factors.

Nyarige (2012) pursued how commercial governance structure of commercial banks affects economic performance. The attention of the study was on commercial bank listed at the NSE board meeting, board size and supervisory compensation were adopted as independent variable. Tobin Q ratio was used. The researched used cross sectional survey Findings showed that board size negatively upsets the bank market performance while board independence affects the bank market performance. However association among business governance and Tobin’s Q is uncertain, the uncertainty sets in since decision concerning to scale as well cost discipline having counterweighing effects on the Tobin’s Q.

Ngugi (2007) deliberated on the association among company governance structure and the insurance companies’ performance in Kenya. The conclusion was that firm’s activities were more familiar to internal directors and hence they can monitor topmost board specially if they observe the opening to advance into position occupied by incompetent executive. It concluded that board efficiency depends on the optimum mix of internal and external directors. Barako (2006) studied the connection between ownership structure characteristics and bank performance. Conclusion of the research noted an existence of a significant adverse link between board and regime ownership and performance. Muriithi (2008) studied corporate governance and financial performance of State Corporation, an event study of KCC, he found out that the board of KCC adopted practices of good corporate governance that were studied and upgraded overtime. Certain
corporate practices identified included corporate communication and performance of the board.

2.5 Conceptual Framework

The research study conceptual framework is represented by the figure below:

Figure 2.1: Conceptual Framework

![Conceptual Framework Diagram]

Source: Author (2017)

2.6 Summary of Literature Review

An evaluation of corporate governance based on various theoretical perspective, the agency view, stewardship view and human resource dependency view has reveal that corporate practices affects the financial performance of commercial banks. Variables such as board composition, and firm value have been closely associated with corporate governance practices. Responsibility and transparency would help commercial bank in Kenya achieve shareholder and investor confidence to the effects that these banks are run
well. (Morck, 2005). In today’s market environment, business process and procedures should focus on other critical factors such as culture, Legislation and institutional context. Corporate governance is also evolving. The changes are driven by both external and environment dynamics. Corporate governance for various commercial banks varies due to its cultural value, political and historical circumstance in this sense it’s important to revisit corporate practice from a fresh angle.
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The chapter sketches the overall methodology used to conduct the research. It involves, research design, data collection methods, target population, diagnostic tests and analysis of data.

3.2 Research Design

Descriptive cross sectional scheme was. It comprises an explanation of all the elements of the population. Permits estimations of apart of residents that has these powers. Identifying contacts amid various variables, to institute whether the variables are dependent or independent. Cross-sectional methods are done once and they represent summary at a given timeframe (Cooper & Schindler, 2008).

3.3 Target Population

A Population is a set of individual’s actions or items having similar characteristic around which information is desired (Saunder, 2003). Target population for this study include all forty-two banks, as per appendix 1.

3.4 Data Collection

The research used secondary source of data. It was collected from annual report submitted to the CBK by bank from the CBK website. Annual financial reports were analyzed from the period 2013-2017 which is the study period. The type of data collected
included return on asset, long and short term debt and total asset, of the company as well as reviewing various financial ratios.

3.5 Diagnostic Tests

Linearity show that variables Y and X are linked by a scientific equation Y=bX where c is a constant number. The trial was obtained through the F-statistic in ANOVA. Familiarity is a test for the supposition that the remaining of the response variable are normally distributed about the mean. This was determined by Shapiro-walk test or Kolmogorov-Smirnov test. Autocorrelation is the dimension of the similarity between a certain time series and a wrapped value of the same series over succeeding time intervals. It was tested using Durbin-Watson statistic (Khan, 2008).

Multicollinearity is said to occur when there is a nearly exact or exact linear relation among two or more of the independent variables. This was tested by the determinant of the correlation matrices, which varies from zero to one. Orthogonal independent variable is an indication that the determinant is one while it is 0 if there is a complete linear dependence amongst them and as it approaches to zero then the multicollinearity becomes intense (Burns & Burns, 2008).

3.6 Data Analysis

The study was conducted by used of descriptive and inferential measurements. The descriptive statistics used included standard deviations and mean scores. The inferential statistics used were both regression and correlation analysis. Multiple regression analysis used to set up relationship between independent variables and the dependent variables in the study model.
3.6.1 Analytical Model

The analytical model is as below;

\[ Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon \]

Where:

Y = Financial performance.

\( \alpha \) = Constant

\( \beta_1 \) – \( \beta_5 \) = Beta coefficients which will measure the effect of each independent variable

X1 = Board Size

X2 = Board independence

X3 = Number of committees

X4 = Board meetings

X5 = Firm size

\( \epsilon \) = Error term.
### Table 3.1: Definition of the Model Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Operationalization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Y</td>
<td>Financial performance – measured using return on assets which is net income divided by total assets</td>
</tr>
<tr>
<td>X&lt;sub&gt;1&lt;/sub&gt;</td>
<td>Board size – The natural logarithm of total number of directors serving in the board.</td>
</tr>
<tr>
<td>X&lt;sub&gt;2&lt;/sub&gt;</td>
<td>Board independence – independent board members fraction of the total board.</td>
</tr>
<tr>
<td>X&lt;sub&gt;3&lt;/sub&gt;</td>
<td>Number of committees – Natural logarithm of the total number of board committees</td>
</tr>
<tr>
<td>X&lt;sub&gt;4&lt;/sub&gt;</td>
<td>Number of meetings – Natural logarithm i.e total number of meetings held annually</td>
</tr>
<tr>
<td>X&lt;sub&gt;5&lt;/sub&gt;</td>
<td>Firm size – Normal logarithm of total assets of the company.</td>
</tr>
</tbody>
</table>

Source: Author (2018)

### 3.6.2 Test of Significance

F- test and the t – test were used at 95% confidence level. The F statistic was applied to institute a statistical significance of regression equation while the t statistic was applied to test statistical significance of study constants.
CHAPTER FOUR
DATA ANALYSIS, FINDINGS AND INTERPRETATION

4.1 Introduction
This section focused on the scrutiny of the data collected from Central Bank of Kenya to institute the outcome of corporate governance practices on financial performance of the Kenyan commercial banks. Using regression analysis, correlation analysis and descriptive statistics, the results of the study were presented in table forms as shown in the following sections.

4.2 Response Rate
This study targeted all 42 commercial banks in Kenya. Data was attained from 41 banks representing a response rate of 97.62%. From the respondents, the researcher was able to obtain secondary data on corporate governance, bank size and financial performance of banks.

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

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

The table below shows descriptive statistics for the variables applied in the study. Examination of all the variables was acquired using SPSS software for a period of five years (2012 to 2016) for the 41 banks that provided data for this study. The standard deviation, mean, maximum and minimum for all the variables selected for this study.

Table 4.1: Descriptive Statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>205</td>
<td>-0.0532</td>
<td>0.0670</td>
<td>0.02391</td>
<td>0.0192897</td>
</tr>
<tr>
<td>Board Size</td>
<td>205</td>
<td>5</td>
<td>14</td>
<td>8.51</td>
<td>1.825</td>
</tr>
<tr>
<td>Board Independence</td>
<td>205</td>
<td>0.286</td>
<td>1.000</td>
<td>0.73882</td>
<td>0.147930</td>
</tr>
<tr>
<td>No. of Committees</td>
<td>205</td>
<td>2</td>
<td>9</td>
<td>4.66</td>
<td>1.442</td>
</tr>
<tr>
<td>No. of Meetings</td>
<td>205</td>
<td>4</td>
<td>33</td>
<td>6.74</td>
<td>3.505</td>
</tr>
<tr>
<td>Bank Size</td>
<td>205</td>
<td>6.794</td>
<td>8.703</td>
<td>7.68560</td>
<td>0.534062</td>
</tr>
<tr>
<td>Valid N (listwise)</td>
<td>205</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Research Findings (2018)
4.5 Correlation Analysis

The association between any two variables used in the study is established using correlation analysis. This relationship ranges between strong negative correlation and perfect positive correlation. Pearson correlation was employed to evaluate the levels of relationship concerning the commercial banks’ financial performance and the independent variables.

The study found out that board size, number of committees and bank size got a positive and statistically significant correlation with commercial banks’ financial performance as shown by \( r = .201, p = .004 \); \( r = .170, p = .015 \); \( r = .530, p = .000 \) respectively. The study also found out that a positive and insignificant correlation exists among board independence and financial performance as evidenced by \( r = .035, p = .619 \). Number of meetings was found to have a negative and negligible association with the commercial banks’ financial performance as evidenced by \( r = -.036, p = .604 \). Although the independent variables had an association to each other, the association was not strong to cause Multicollinearity as all the \( r \) values were less than 0.70. This implies there being no multi-collinearity among independent variables and therefore they can be used as determinants of financial performance in regression analysis.
Table 4.2: Correlation Analysis

<table>
<thead>
<tr>
<th></th>
<th>ROA</th>
<th>Board Size</th>
<th>Board Independence</th>
<th>No. of Committees</th>
<th>No. of Meetings</th>
<th>Bank Size</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ROA</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>1</td>
<td>.201**</td>
<td>.018</td>
<td>.170*</td>
<td>-.036</td>
<td>.530**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.004</td>
<td>.798</td>
<td>.015</td>
<td>.604</td>
<td>.000</td>
</tr>
<tr>
<td><strong>Board Size</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>.201*</td>
<td>1</td>
<td>.035</td>
<td>.180**</td>
<td>.331**</td>
<td>.500**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.004</td>
<td>.619</td>
<td>.010</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td><strong>Board Independence</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>.018</td>
<td>.035</td>
<td>1</td>
<td>.130</td>
<td>.059</td>
<td>-.254**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.798</td>
<td>.619</td>
<td>.064</td>
<td>.400</td>
<td>.000</td>
</tr>
<tr>
<td><strong>No. of Committees</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>.170*</td>
<td>.180**</td>
<td>.130</td>
<td>1</td>
<td>.127</td>
<td>.075</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.015</td>
<td>.010</td>
<td>.064</td>
<td>.070</td>
<td>.285</td>
</tr>
<tr>
<td><strong>No. of Meetings</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>-.036</td>
<td>.331**</td>
<td>.059</td>
<td>.127</td>
<td>1</td>
<td>.141*</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.604</td>
<td>.000</td>
<td>.400</td>
<td>.070</td>
<td>.043</td>
</tr>
<tr>
<td><strong>Bank Size</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>.530*</td>
<td>.500**</td>
<td>-.254**</td>
<td>.075</td>
<td>.141*</td>
<td>1</td>
</tr>
<tr>
<td>(2-tailed)</td>
<td></td>
<td>.00</td>
<td>.00</td>
<td>.28</td>
<td>.04</td>
<td></td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

Source: Research Findings (2018)

4.6 Regression Analysis

Financial performance was regressed against five predictor variables. Regression analysis was executed at a significance level of 5%. Critical value obtained from the F – table was measured against the one acquired from the regression analysis.
The study obtained the model summary statistics as revealed in table 4.4

Table 4.3: Model Summary

<table>
<thead>
<tr>
<th>Mode</th>
<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>1</td>
<td>.587a</td>
<td>.344</td>
<td>.328</td>
<td>.01581478</td>
<td>1.503</td>
</tr>
</tbody>
</table>

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

b. Dependent Variable: ROA

Source: Research Findings (2018)

R squared, being the coefficient of resolve indicates the deviations in reaction variable that is as results in changes in the predictor variables. As shown from outcome in table above, the value of R square is 0.34, a discovery of 34.4 percent of deviations in financial performance is caused by changes in independent variables. Other variables not integrated in the model validate for 65.6 percent of the variations in financial performance of the Kenyan commercial banks. Also results revealed that there exists a strong association among the selected independent variables and the financial performance as shown by the correlation coefficient (R) equal to 0.587. A durbin-watson statistic of 1.503 indicated that the variable were not serially associated since the value was greater than 1.527.
Table 4.4: Analysis of Variance

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>.026</td>
<td>5</td>
<td>.005</td>
<td>20.876</td>
<td>.000</td>
</tr>
<tr>
<td>Residual</td>
<td>.050</td>
<td>199</td>
<td>.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>.076</td>
<td>204</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: ROA

b. Predictors, Bank Size, No. of Committees, No. of Meetings, Board Independence, Board Size

The importance value is 0.00 which is less than p=0.05. Hence the model was statistically significant in predicting how board independence, board size, number of committees, number of meetings held annually and bank size affects the Kenyan commercial banks’ financial performance.

Coefficients of determination were used as indicators of the course of association amongst the independent variables and commercial banks’ financial performance. The p-value under sig. column was used as a pointer of the significance of the association between the independent and dependent variables. At 95% confidence level, P-value of less than 0.05 was taken as a ration of statistical significance. As such, P-value above 0.05 shows the dependent variables have a statistically insignificant association with the independent variables. Results are indicated in table 4.5
Table 4.5: Model Coefficients

<table>
<thead>
<tr>
<th>Model</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>-.163</td>
<td>.020</td>
<td>-8.314</td>
<td>.000</td>
</tr>
<tr>
<td>Board Size</td>
<td>-.001</td>
<td>.001</td>
<td>-.106</td>
<td>-1.496</td>
</tr>
<tr>
<td>Board Independence</td>
<td>.022</td>
<td>.008</td>
<td>.172</td>
<td>2.823</td>
</tr>
<tr>
<td>No. of Committees</td>
<td>.002</td>
<td>.001</td>
<td>.134</td>
<td>2.271</td>
</tr>
<tr>
<td>No. of Meetings</td>
<td>-.001</td>
<td>.000</td>
<td>-.118</td>
<td>-1.930</td>
</tr>
<tr>
<td>Bank Size</td>
<td>.023</td>
<td>.003</td>
<td>.633</td>
<td>9.066</td>
</tr>
</tbody>
</table>

a. Dependent Variable: ROA

Source: Research Findings (2018)
The above results show that board independence, number of committees and bank size produced positive and statistically important values (high t-values, $p < 0.05$). Board size and number of meetings were found to be statistically insignificant for this study as evidenced by $(t = -1.497, p = .136)$, and $(t = -1.930, p = .055)$ respectively.

The below regression equation was estimated:

$$Y = -0.163 + 0.022X1 + 0.002X2 + 0.023X3$$

Where,

$Y$ = Financial performance measured by ROA  
$X1$ = Board Independence  
$X2$ = Number of Committees  
$X3$ = Bank Size

The constant = -0.163 shows if selected dependent variables (board size, number of committees and bank size) were rated zero, the commercial banks’ financial performance would be -0.163. A unit increase in board independence, number of committees and bank size leads to an increase in financial performance of the Kenyan commercial banks as indicated by positive coefficients.

4.7 Discussion of Research Findings

This project study wanted to define the association among corporate governance practices and financial performance of commercial banks. Corporate governance in this study was the independent variable with five measures. The number of directors measured using the normal logarithm to determine size factor of the board. Board sub-committees was measured by ordinary logarithm of their sum while board meetings the natural logarithm
of total meetings held in a year, board independence calculated by the quotient of the non-executive directors to the total number of board of directors. The control variable was bank size.

The Pearson correlation coefficients between the variables revealed that size of board, bank size, and number of committees have a positive and statistically significant correlation. The study also found out existence of a positive and insignificant correlation among board independence and capital adequacy with performance.

The model summary revealed that the independent variables explains 34.4% of variations in the dependent variable as indicated by the value of $R^2$ which indicates that the are other factors not included in this model that account for 65.6% of changes in the commercial banks’ financial performance. The model is fit at 95% level of confidence since the F-value is 20.876. This shows that the overall multiple regression model is statistically significant and is an adequate model for predicting and explaining the influence of the selected independent variables on the financial performance of Kenyan commercial banks’.

The findings of this study are in line with Muiruri (2014) who undertook a research study that examined the effect of corporate governance practices (number of nonexecutive directors, board size and board diversity gender) on performance. The census study used an exploratory design and gathered data from secondary sources and regression analysis used in data analysis. The study found that NEDs and board size affects performance while gender diversity in board did not have any significant effect. The study however does not indicate the study period covered.
This study is also in agreement with Muigai (2014) who also did a study on the association between selected corporate board dynamics (board size, composition of non-executive and executive and members and diversity in gender in corporate boards) and financial performance. The population of forty three accredited commercial banks was used from 2009 to 2013. Research study found a strong negative correlation of composition of board on performance and no positive significant relationship between gender diversity and firm performance.
CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter captures the findings of the previous chapter. This chapter also elucidates recommendations that policy makers can implement to achieve the expected financial performance and lastly suggestions for further research.

5.2 Summary of Findings

The study sought to examine the impact of selected corporate governance on bank’s financial performance. Independent variables for the study were board independence, board size, number of committees, number of meetings held annually and bank size. Descriptive cross-sectional research design was employed. Secondary data was attained from the Central Bank of Kenya and analyzed using SPSS software version 22. Annual data for 41 commercial banks covering a period of five years from January 2013 to December 2017 was used.

The results of correlation analysis, board size, number of committees and bank size have a +ve statistically significant correlation with the commercial banks’ financial performance. It also found existence of a positive insignificant correlation between board independence and financial performance. Number of meetings was found to have a negative and insignificant connection with financial performance of commercial banks.

The co-efficient of determination R-square value was 0.344 which means that about 34.4% of variation in financial performance can be explained by the five selected independent
variables while 65.6 % variation was associated with other factors not covered in this research. The study also found a strong relationship amongst the independent variables and the commercial banks’ financial performance (R=0.587). ANOVA results showed F statistic was at 5% significance level with a p=0.000. Hence the model was fit in explaining the association between the selected variables.

The regression results indicated that when all the independent variables have zero value the financial performance of commercial banks will be -0.163. It is also noted that a unit increase in board independence, number of committees and bank size would result to higher performance of commercial banks in Kenya as indicated by positive coefficients.

5.3 Conclusion

Conclusion from the findings is that the Kenyan commercial banks’ financial performance is significantly affected by board independence, number of committees and bank size. The study therefore concludes that a component increase in this variables causes a significant raise in performance of commercial banks. The study found that board size and meetings are statistically insignificant determinants of financial performance and therefore this study concludes that these variables do not influence to a large extent the Kenyan commercial bank’s financial performance.

This study concludes that board size, board independence, number of committees, number of meetings held annually and bank size influence to a large extent financial performance of commercial banks in Kenya. Hence the variables significantly influence performance of commercial banks as shown by the p value in anova summary. The fact that the five independent variables explain 34.4% of changes in financial performance
imply that variables not included in the model explain 65.6% of changes in performance of commercial banks in Kenya.

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

5.4 Recommendations

The study established a positive significant effect of board independence on the Kenyan commercial bank’s financial performance. The study suggest that measures ought to be put in place to enhance board independence as this will improve financial performance. The study found out that number of committees in a board possess a significant positive influence on financial performance of the Kenyan Commercial banks. The study recommends that boards should have several committees to enhance financial performance.

The study established that number of meetings held in a year has a significant influence on financial performance although their influence is negative. The study recommends that firms should make important decisions regarding the number of meetings as it has been found to influence financial performance. A high number of meetings may help the board detect some trend that might not otherwise be detected in advance without the meetings.
The study establish that a positive relationship exists between financial performance and size of a bank. This study recommends that banks’ management and directors should aim at increasing their asset base by coming up with measures and policies aimed at enlarging the banks’ assets as this will eventually cause a direct influence on financial performance of the bank. From the findings of this study, big banks in terms of asset base are expected to perform better than small banks and therefore banks should strive to grow their asset base.

5.5 Limitations of the Study

The scope was for five years 2013-2017. It has not been determined if the results would hold for a longer period. Also it is uncertain whether similar findings would result beyond 2017. A longer study period is more reliable as it will take into account major economic conditions such as booms and recessions.

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

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

5.6 Suggestions for Further Research

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

It was not exhaustive of the independent variables affecting financial performance of
corporate banks in Kenya recommendation for further studies be conducted to
incorporate additional variables like growth opportunities, management efficiency,
industry practices, age of the firm, political stability and other macro-economic variables.
Establishing the effect of each variable on financial performance will enable policy
makers know what tool to use when controlling the financial performance.

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


# APPENDICES

## APPENDIX 1: LIST OF COMMERCIAL BANKS IN KENYA

<table>
<thead>
<tr>
<th>NO.</th>
<th>NAME</th>
<th>CLASSIFICATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Barclays Bank of Kenya Limited</td>
<td>Large</td>
</tr>
<tr>
<td>2.</td>
<td>Commercial Bank of Africa Limited</td>
<td>Large</td>
</tr>
<tr>
<td>3.</td>
<td>Co-operative Bank of Kenya Limited</td>
<td>Large</td>
</tr>
<tr>
<td>4.</td>
<td>Equity Bank Limited</td>
<td>Large</td>
</tr>
<tr>
<td>5.</td>
<td>Kenya Commercial Bank Limited</td>
<td>Large</td>
</tr>
<tr>
<td>6.</td>
<td>Standard Chartered Limited</td>
<td>Large</td>
</tr>
<tr>
<td>7.</td>
<td>Bank of Africa Kenya Limited</td>
<td>Large</td>
</tr>
<tr>
<td>8.</td>
<td>Bank of Baroda (Kenya Limited)</td>
<td>Medium</td>
</tr>
<tr>
<td>9.</td>
<td>Bank of India</td>
<td>Medium</td>
</tr>
<tr>
<td>10.</td>
<td>CFC Stanbic Bank Kenya Limited</td>
<td>Medium</td>
</tr>
<tr>
<td>11.</td>
<td>SBM bank Ltd</td>
<td>Medium</td>
</tr>
<tr>
<td>12.</td>
<td>Citibank N A</td>
<td>Medium</td>
</tr>
<tr>
<td>13.</td>
<td>Diamond Trust Bank Limited</td>
<td>Medium</td>
</tr>
<tr>
<td>14.</td>
<td>Eco Bank Limited</td>
<td>Medium</td>
</tr>
<tr>
<td>15.</td>
<td>Family Bank Limited</td>
<td>Medium</td>
</tr>
<tr>
<td>16.</td>
<td>Guaranty Trust Bank (Kenya) Limited</td>
<td>Medium</td>
</tr>
<tr>
<td>17.</td>
<td>I &amp; M Bank Limited</td>
<td>Medium</td>
</tr>
<tr>
<td>18.</td>
<td>Imperial Bank Limited</td>
<td>Medium</td>
</tr>
<tr>
<td>20.</td>
<td>NIC Bank Limited</td>
<td>Medium</td>
</tr>
<tr>
<td>21.</td>
<td>Prime Bank Limited</td>
<td>Medium</td>
</tr>
<tr>
<td>22.</td>
<td>African Banking Corp. Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>23.</td>
<td>Consolidated Bank of Kenya Limited</td>
<td>Small</td>
</tr>
<tr>
<td>24.</td>
<td>Credit Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>25.</td>
<td>Development Bank of Limited</td>
<td>Small</td>
</tr>
<tr>
<td></td>
<td>Bank Name</td>
<td>Size</td>
</tr>
<tr>
<td>---</td>
<td>-----------------------------------------------</td>
<td>-------</td>
</tr>
<tr>
<td>26</td>
<td>Equatorial Commercial Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>27</td>
<td>Fidelity Commercial Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>28</td>
<td>First Community Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>29</td>
<td>Giro Commercial Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>30</td>
<td>Guardian Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>31</td>
<td>Gulf African Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>32</td>
<td>Habib Bank AG Limited</td>
<td>Small</td>
</tr>
<tr>
<td>33</td>
<td>Habib Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>34</td>
<td>Jamii Bora Bank</td>
<td>Small</td>
</tr>
<tr>
<td>35</td>
<td>Sidian Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>36</td>
<td>Middle East Bank Kenya Limited</td>
<td>Small</td>
</tr>
<tr>
<td>37</td>
<td>Oriental Commercial Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>38</td>
<td>Paramount Universal Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>39</td>
<td>Trans-National Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>40</td>
<td>UBA Kenya Banks Limited</td>
<td>Small</td>
</tr>
<tr>
<td>41</td>
<td>Victoria Commercial Bank Limited</td>
<td>Small</td>
</tr>
<tr>
<td>42</td>
<td>Dubai Bank Kenya Limited</td>
<td>Small</td>
</tr>
</tbody>
</table>

Source: Central Bank of Kenya, 2016