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

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DECLARATION

This research project is my original work and has not been submitted for examination in any other university.

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The research project has been submitted for examination with my approval as the University Supervisor.

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DEDICATION

This project is dedicated to Lila; my precious heartbeat from whom I draw inspiration to be the best version of myself.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

BOA	Bank of Africa
BOI	Bank of India
BOD	Board of Directors
CACG	Commonwealth Association for CG
CBK	Central Bank of Kenya
CG	Corporate Governance
CLRM	Classical Linear Regression Model
CMA	Capital Markets Authority
CRO	Chief Risk Officer
CRR	Cash Reserve Ratio
DBK	Development Bank of Kenya
IARCP	International Association of Risk and Compliance Professionals
IFC	International Financial Corporation
KBA	Kenya Bankers Association
KCB	Kenya Commercial Bank
NBK	National Bank of Kenya
NSE	Nairobi Securities Exchange
PACRA	Pakistan Credit Rating Agency
PSE	Pakistan Stock Exchange
ROA	Return on assets
ROE	Return on equity
ROI	Return on Investment
UBA	United Bank of Africa

ABSTRACT

The relationship between CG and the financial performance still evokes much debate. Those in favour of having sound governance practices have brought forward their argument on performance and sound governance go hand in hand and seeing that this relates to banks; it ensures that there is economic stability. There are those who do not share a similar mind and as a result encouraged this study to appreciate whether there indeed exists an interrelationship between CG and performance. The study was carried out on the commercial banks licensed in Kenya due to the paucity of data that covers this field. The theories that supported the study included Agency theory, Stakeholder theory and Managerial hegemony theory. Reliance was placed on published financial reports of the licensed banks to analyse the data. The study used descriptive statistics in the study. The study used the statistical package for social science (SPSS) to carry out the analysis. The study found that there does indeed exist a relationship between CG practices and the financial performance of commercial banks. The variables being the board's composition showing favourability to having more NEDs in the boards as well as improvement in gender diversity. Independence of internal audit committee was found to impact performance by ensuring a direct reporting line to the BAC that is chaired by a NED. Attendance to board meetings was paramount to achievement of financial outcomes. It was recommended that further studies should be done in the field and using different industries in order to get conclusive results in the relationship between the two.

CHAPTER ONE

INTRODUCTION

1.1Background of the Study

The stable and steady performance of the sector can only be safeguarded by ensuring that the right policies and procedures govern the operations of the bank. The performance of banks cannot be isolated from their governance. A CG study by Ochieng (2011) showed that CG practices that included directors' effectiveness, management effectiveness, shareholder protection, transparency when it comes to information disclosed as well as undertakings have contributes to performance. CG influence on results of listed commercial banks was conducted by Kisare (2016) and the findings from the study was that CG practices significantly contributes towards their performance. The factors that were examined included the rights of the shareholders, transparency and disclosure and board operations. These factors accounted for 52.1% of the performance results.

The various CG theories that have contributed to this study are managerial hegemony theory, agency theory and stakeholder theories. The area of CG has been studied by various individuals with certain schools of thoughts challenging the commonly believed best practices and the role they play in the financial performance of institutions but majority of the research that has been done has supported the importance of CG best practices on the performance of institutions. The theories draw insights on the management of the companies' by highlighting the influence that executive management has over the board; the conflicting interest between owners of the firm with the executives of the banks and the interest that various stakeholders' groups have on an institution and their level of influence on the various institutions. The various governance practices shown in the different school of thoughts will offer some insights on the styles that can be used to manage an institution and the impact it has on the institution's performance.

The study aims to show the correlation between the variables under research. Other studies have been done to show the connection between the two variables. A study by Baghat and Black (2002) challenged the misconception that a monitoring board composed mostly by NEDs as an important component of good CG perform as it did not demonstrate that such firms performed better than other firms. This however does not discount the importance of CG practices on performance. While the study aims at demonstrating a positive correlation between the variables; an objective view of all the studies done previously is important to show the best practices that should be adopted by the financial institutions.

A study by Aebi et al (2011) investigating risk management CG best practices and in particular the BOD having a CRO as one of the executive directors and the reporting lines of the CRO. The study looked at the relationship between a CRO reporting lines whether it is to the board or to the CEO and the outcome of a bank during the financial crisis that impacted several markets. The results drew conclusions that banks in which the CRO's reporting line is directly to the BOD as opposed to the CEO resulted in favourable returns in the securities exchange hence a favourable ROE during the financial crisis. In contrast, stereotypical CG mechanisms did not improve a bank's performance in the financial crisis period.

1.1.1 CG Practices

CG can be viewed as the organisational processes, systems and controls that have been designed to run and control an organization to increase performance of the organization and maximise shareholder value (IARCP, 2021). This looks at the issuance of authority by which the dealings of a bank are executed by its appointed board as well as executive management. When looking at CG practices across various firm sizes; the focus is on the relationships among the management, BOD, shareholders with controlling ownership, minority shareholders as well as interested and influential stakeholders. The study will address performance and management of the BOD, the reliability of corporate reporting, risk management as well as internal control structures that have been institutionalised by the financial institutions. The role of the banking sector is crucial in any economy as it serves the primary function of obtaining funds from those in surplus i.e. the depositors and providing funds to those in deficiency i.e. borrowers. This activity is pivotal in enhancing economic growth. It's important to point out that since banks have a pivotal role in the economy, efficient CG supports economic stability of a country.

The Commonwealth describes the importance of CG as an engine in advancing economic and social progress. Therefore, it is of great importance for stakeholders to be able to hold corporations accountable as it promotes economic development and social progress. This role has taken global prominence. (CACG,1999). The OECD (2015) underscores the purpose of CG in creating an environment of trustworthiness, transparency and accountability therefore supporting stronger growth and more inclusivity. CG can thus be seen in summary to be the structures put in place for the appropriate functioning of an institution in relation to its stakeholders broadly while being categorical with shareholders. (Banks, 2004). The pillars of good CG as drawn from the Private Sector Initiative for CG (2001) includes having an efficient and capable body that will oversee the governance of the bank and is separate from and independent of management so as to promote accountability, effectiveness, probity, integrity and transparency of operations.

The governance approach should equally be all inclusive putting into considerations the rights of all stakeholders of the bank's operations whether internal or external and most importantly protects the rights of the minor shareholders. The institution must be governed based on the mandate provided by its owners as well as the expectations placed on it by the society for it to take on wider responsibilities that ensure sustainable prosperity. The institution's governance framework should be able to create a conducive environment for the utilisation of its resources to come up with innovative solutions to the needs of all interested parties of its prosperity. IARCP (2021)

1.1.2 CG Practices and Financial Performance

The importance of financial measurement is to maximise the value of a bank by demonstrating the performance using the performance indicators. The key aspect of financial management for a bank is risk management whether it is risk in business undertakings or financial risk as well as asset-liability management. This depth in financial analysis is usually supported by a framework of transparent disclosure. (Greunig&Bratanovic, 2009) This analysis will be supported by financial reports for purposes of measuring trend analysis over a given period across the financial institutions under review. The ratios in use are often inter-related and when analysed in combination, provide useful insights on financial performance as well as useful risk information. This will shed some light on financial performance as well as quantitative risk mitigation by commercial banks. Various indicators can be used to assess financial sustainability. The first category relates to profitability and efficiency measures. The ratios used include ROE obtained by comparing the net profit after tax in proportion to the total equity; ROA measured by obtaining the proportion the net profitability after tax to the total assets.

The second performance measurement category is the measurement of liquidity. This is measured dividing the liquidable assets equivalents to total assets. The other performance measure is the measurement of leverage which is done using two key ratios, debt in comparison to equity and capital ratio. Debt in proportion to equity is obtained the proportion of total debt liability by total equity ownership. The content of the study is a consolidation of all the variables discussed above and the correlation between them. The information discussed above has covered a broad understanding of CG and what it entails; the firm size under review and how the tier classification came about as well as the metrics used to assess CG practices and financial performance. The later chapters will evidence the relation between CG practices and contribution to performance based on findings obtained in the research.

1.1.4 Commercial Banks in Kenya

The structure of the sector drawn from The CBK annual report for 2021 shows that the sector was made up of 38 commercial banks. The banking sector has grown by 11.3% which signals recovery from the COVID-19 pandemic despite the continued risks of emerging variants. The sector growth in prior years had been driven by technological advancements to enhance deposit mobilization through recruitments of more consumers. These new accounts were driven by mobile phone platforms through agency banking model. Aggressive use of technology fostered enhanced financial inclusivity in the country thus elevating the depth of permeation that banks have over the overall economy in the country. This growth had been threatened by the pandemic, but this financial year has shown that the banking sector will remain stable and resilient. (CBK, 2021)

The banking sector analysis drawn from the Kenya Listed Banks report by Cytonn Financial Services research 2021 identified the below items as the key themes that shaped the banking sector and continue to shape the environment into 2021: The banking sector demonstrated recovery into the half of the year shown by an increase in their profitability in spite of difficulties brought about by the COVID-19 pandemic. There were measures that had to be taken to sail through the difficult pandemic such as loan restructuring for customers and as there is some form of pandemic recovery; the loans are being serviced hence banks are expected to earn some income from the interest payments. There is also diversification of revenue which is seen from the waiver on bank charges that was lifted. The CBK annual report 2020 showed that 67% of bank transactions were conducted on mobile compared to 55% before the pandemic hence the waiver of fees payment is expected to increase non-financial income. These changes post pandemic have forced banks to revolutionise their ways of working and operations such as embracing technological advancements to become cost efficient and becoming more open to consolidating in order to survive. With the different measures that will be put in place to guarantee survival and continued operations;

appreciating the implication that CG practices will have on the performance and ultimately the survival of commercial banks will be important.

1.2 Research Problem

In 2015, Dubai bank in Kenya was in bad light after it had emerged that the daily cash reserve ratios were lower than the regulator's requirement. This led to the bank being held under receivership by Kenya Deposit Insurance Corporation and depositors having to wait for more than a year to access their money. The Imperial bank was also placed under receivership; barely after Dubai bank after the CBK ruled that it had experienced unsafe and unsound business conditions in the bank. Chase bank underwent a similar fate in 2016 when there were irregularities were found in the institution's financial records. In 2018, The CMA fined the executives at National bank for what they had reported as misrepresentation of published financial information by recognising sale of certain assets prematurely amounting to KES 800M; deliberately having lower loan provisions and false criteria in recognising interest income. As a result, there was misstatement of performance by overstating the profit in the respective periods. (NBK enforcement action, 2018)

CG weaknesses in banks can cause translation of difficulty across the entire sector because of weakened consumer confidence, government bailouts which may result in austerity measures that will impact the country such as imposition of higher tax rates. This can be best shown by the banking crisis in Cyprus due to investments in Greek by two of the largest banks in the country. They had amassed a combined portfolio of 4.7B Euros in Greek bonds despite the initial default of loans by the Greek government and demonstrated risk of subsequent defaults. (Kouloudi, 2014). The impact of the decision was that due to the Greek default once again, Cyprus took a hit of the 4.7 billion and had to obtain a bailout from the European Union and IMF which came with strict austerity measures such as increase of corporate tax and a special contribution of 15-30% was to be paid out by depositors on the interest they received. The depositors had to pay a fee levied on them despite not being at fault or them having control over the decision of the banks' use of depositor funds. (Cyprus and Troika agreement, 2013).

CG plays a contributing role on resource allocation hence can affect the development as well as the functioning of capital markets. In this era that has seen increased globalisation and as a result, increase in the mobilisation of capital; CG has become an important framework affecting the competitiveness of industries as well as the economy of countries. A study done by Maher and Anderson (1999) of the OECD secretariat in their study on CG on the impact of firm performance to economic growth demonstrated a correlation between CG, firm performance, and its contribution towards economic growth. The study done by Mudashiru et al (2014) looked at performance of organizations by assessing various elements that included effective resource management, smarter decision making, strategic leadership positioning and growth of consumer's level of confidence. The study found out that embedding sound CG practices promotes accountability through the enhancement of the transparency of the operations of a company as a result this will make the firm more attractive resulting in an improvement in profitability.

With an emergence in a new normal and way of life post the COVID-19 pandemic, alternative channels of transactions have been adopted by many banks. As a result of remaining afloat during the pandemic; banks had to come up with contactless transactions and reduced front-office operations. Additionally, banks were also forced to consolidate; whereby larger banks leveraged on weak market valuations to consolidate with or buy-out smaller banks. 90% stake of Jamii Bora bank was acquired by Co-operative Bank of Kenya. (CBK,2021).

With all the emerging trends being demonstrated it will be important to appreciate the significance of CG in shaping the future of the banking industry. Given the risks that have been called out earlier on the impact of a failed banking system on the economy; a study on the implication that CG has on the financial outcome of commercial banks is warranted.

1.3 Research Objectives

The objective of the research was to study the effect of CG on performance outcomes of commercial banks in Kenya.

1.4 Value of the Study

The study adds onto the stewardship theory as it focuses on the CG practices by institutions tasked with safeguarding shareholder assets as well as individual deposits. The study can assist banks manage their performance better as it will identify weaknesses because of weak CG practices and the impact it has on the going concern of banks to remain competitive, compliant with oversight bodies and guarantee stakeholder confidence of the soundness and stability of the financial institutions. Investors will appreciate the study as they endeavour to appoint board members who are going to enable them to maximize their wealth as well as assess the effectiveness in conducting their responsibilities of the current members of their boards. Researchers and professionals in the field of academia can use this study for further studies to ensure that individuals and corporations become aware of evolving changes in CG so as to adjust their practices in order to be at pace with a continuously evolving global environment.

The contribution of the study to the existing theories will be to add to contribute to the current school of thought for managerial hegemony as it will showcase the influence executive directors have on performance and challenge the misconception that the board of directors have the largest stake or influence in the performance of the bank. It also addresses the misalignment of interests between management and the shareholders of the financial institutions which is called out in agency theory. When it comes to influence in policy and practice; the insights drawn from this study can be used by the regulatory bodies that is the CBK as well as the KBA in the formation of policies to govern and direct the operations of the commercial banks countrywide.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This section covers research done that demonstrates the impact that CG practices of firm sizes have on performance of banks. The sections that will be covered below include review of studies done by other scholars, assessment of the theories and literature on the topic under study and the conceptual framework.

The need to reconsider the existing CG came because of weakening of public confidence. This became a policy agenda to regain public faith and to deal with difficulties as a result of relationships between management and governance. (L'Huillier, 2014). The CG models are discussed below:

2.2 Theoretical Literature Review

This covers various schools of thought that touch on the aspects of CG and the various governance styles in place drawn from scholarly articles and other areas of research in line with the chosen topic for my study. Several principles have been put forth to explain the various styles of governance and are expounded on empirically.

2.2.1 Agency Theory

Agency theory is best defined as a contractual engagement between an individual the principal and the individual appointed to act on behalf of the principal the agent (Jensen and Meckling, 1976). The principal contracts the agent to act on their behalf. This will entail some form of decision-making authority for the agent. Potential difficulties that come about due to dissociation of owners and managers are discussed and the need for the curtailment of this problem is pointed out. This theory proposes the implementation of various governance mechanisms to control the agent's actions so as in corporations as they are custodians of the wealth of the principals. (Panda and Leepsa, 2017). As corporations have dispersed ownership this often result in separation of ownership and control. This thus raises a concern as to whether management will be acting by being mindful of what is best for the owners as theorists perceive agents as opportunistic in that they will rationally work towards their own self-interest being focused on extrinsic rewards even though it will be for the detriment of the principles.

The real problem that is called out in the agency theory is that the representative is most likely carrying out the wishes of different masters with opposing interests. Even if the agent can address his or her own self-interests, there is the matter of how to manoeuvre through the tangled loyalties he or she owes to many different principals and how to negotiate through their competing interests and sometimes irreconcilable differences. (Shapiro, 2005). The firm's operations are geared towards maximising its value and profitability using a structure that is perceived to be as a web of the firm's functions and operations that is complex and not easily understood. Jensen and Meckling (1976) drew out conclusions that the wealth maximisation of firms is achievable through alignment and teamwork amongst the various interested parties in a firm. This is however made difficult as the interested parties have conflicting interests but the realisation of the interests of the parties can be satisfied if the firm continues in its existence hence the interested parties are forced by circumstances to perform well to ensure the survival of the firm.CG provides for mechanisms to be in place to guarantee that agents are directed to realise the shareholder ambition. These mechanisms will involve the principles incurring agency costs such as having independent audits in a bid to ensure that banks are not susceptible to instability due to the information failure between management and shareholders.

In the case of banking firms, the primal roles they play are that of being custodians of the deposits contributed by individuals with surplus funds and shareholder wealth maximisation. Systemic crises impacting banks are extremely costly to taxpayers since they are forced to fund the restructuring and re-stabilisation through re-capitalisation of banks. Well managed banks tend to efficiently manage and allocate capital hence minimise likelihood of failure which provides them with the ability to aid in the monetary and financial stability of an economy. This is deemed as a positive outcome for any economy as it encourages investment and growth. Mullineux (2006) explores this in greater detail as the study done demonstrates that the interests of depositors is on seeking a safety net for their resources which is not equal to those of owners who hold a riskier asset through their stake of the bank's equity through purchase of shares with the expectation of a higher return. Managing a bank focussing on the interests of its owners while ignoring the interests of the depositors may result in taking more risk than its depositors would like. This therefore creates an agency conflict and the need to ensure that bank regulators moderate the risk-taking measures of banks to safeguard both the depositors as well as taxpayers.

2.2.2Managerial Hegemony Theory

Organisations are now being run by professional managers. This is what brings about the school of thought that is managerial hegemony. Managerial hegemony refers to the situation when the governing board of an organisation serves as a rubber stamp with all its strategic decisions being dominated and pre-empted by the professional managers. With that in mind, the organisation therefore inevitably resists increased board involvement in strategic decisions. (Hung, 1998). The board therefore ceases to become an oversight body that monitors management and provides strategic guidance which is its fiduciary duty to the shareholders. The board's involvement in effective performance evaluation is seen only during periods of a crisis. Other times the boards only make a superficial review of management's undertakings.

The support role of governing bodies is deemed because of objective as well as subjective factors. The subjective factors imply that the directors opt not to involve themselves due to several reasons. One is that most directors are appointed by the management and thus are subject to management discretion if they want continuation of their appointment. Secondly, they are co-opted in the organisation hence become easily influenced and lastly directors having accrued benefits from directorship tends to act as an incentive for their compliance. The objective factor that influences the Board's actions is that the board becomes constrained from making independent decisions as they will have to be reliant on information that is supplied to them by management. This research is supported by Mangel and Singh (1993) who drew conclusions on their study that the CEO is likely to have a hand on the appointment of outside directors and hence as a result of the same the directors tend to become malleable and sympathetic to the desires of the CEO. The shareholders appoint the board members on paper, but the individuals appointed have already been selected by the management bodies. (Hung, 1998)

This thus poses a risk on the management of the banks affairs as the theory tends to suggest that professional managers will favour persons with a proven record of not interfering in the activities and operations of the managers hence the role of the oversight body becomes one that is more for purposes of ticking a box as opposed to safeguarding investment of the shareholders as well as depositors money. Board members are expected to perform based on a fully informed impartial basis on account of their fiduciary duty towards shareholders; hence best practice CG principles dictate for the board to be objective and free from bias and influence in carrying out its mandate. This therefore creates a need to demonstrate whether managerial hegemony has an impact on the CG practices adopted by the banks under study and contribution towards performance.

2.2.3 Stakeholder Theory

Stakeholders are individuals that have legitimate interest in a firm's activities and whom the firm places reliance on to achieve its business objectives. The stakeholder perspective has been a competing perspective to the shareholder value maximisation perspective as the theory sees the importance of shareholders their value and argues that shareholders are not the only group that is important in running a successful business. Whereas value maximisation promotes the notion that the sole responsibility of management is maximisation of profits so that shareholders receive the highest return possible; stakeholder theory argues that the world is full of complexity and uncertainty hence successful business firms strive to offer value for all its stakeholders (Freeman et al, 2018).

The theory on governing boards relies on the assumption that there are many interested groups in the society besides owners and employees to whom the corporation is responsible for. The strategic and operational objectives of the corporation should be achieved by balancing the often-conflicting interests of these different groups. Only by incorporating the participation of stakeholders in the governing boards will the corporation respond to the needs of the society. (Hung, 1998). The stakeholders are described based on the interest they have in the corporation as contrary to the corporation having an interest in them. To reach organisational sustainability; the demands of stakeholders must be endlessly fulfilled by becoming an acceptable input for strategic management (Garvare & Johansonn, 2010). Hence good CG involves a management system that can have a sustainable balancing act with all stakeholder needs and requirements. In the case of banks this will entail fulfilment of the needs of depositors, regulators, shareholders, creditors, government, and the wider society at large. There is therefore a need to demonstrate whether there is an impact on performance with the banks under study that have adopted an all-inclusive approach in their CG practices through involvement of stakeholders in their operations.

2.3 Determinants of Financial Outcomes

The outcomes of a bank are largely impacted by micro and macro-economic factors in its operating environment. The internal elements that will impact the performance are capital requirements, asset quality, management, earnings as well as liquidity. Some of which will be discussed in greater detail. External factors would involve conditions beyond a banks' sphere of control such as political climate, economic conditions, social issues, and technological factors.

2.3.1 Firm Size

The size of the banks is largely based on its capitalisation levels. The Tier-1 banks being those that have a larger capital base structure and Tier-3 being the small sized banks. Capital provides a fund against which banks can hedge against unexpected losses. This thus acts as a safety net for equity as well as debt holders. This financial muscle provides the financial stability that banks need to ensure that they can become profitable and improve on their performance. There are regulatory incentives associated with well capitalised banks as there is a perception that the level of supervision is linked to the level of capitalisation due to the assumption that better capitalised banks receive less attention whereas undercapitalised ones are subjected to greater supervision as they are deemed to be riskier in terms of collapse. (Lastra,2004).

2.3.2 Capital Requirements

Capital requirements in banks are special due to their business' nature. Deposit which is a key contributor to the leverage position of banks is generally partially insured but, in most cases, not commensurate to the value of deposits. To safeguard from adverse impact in the event of bank failures; minimum capital requirements are a suitable safeguard with regulators requiring a baseline for capital in relation to assets to be maintained by banks. The CBK's requirement is for banks to maintain a capital base of KES 1 billion. The CBK's argument for the requirement was that the increase in the base is important for the stability of the sector and could result in cost reduction driven by benefits which will contribute to lower lending rates. (Gudmundsson et al, 2013)

The Basel Committee came up with capital standards in the late 1980s. These standards have been adopted universally with different countries tailoring them to suit their respective markets to accurately show a banks' risk profile. Higher resources encourages better supervision of loans which in turn is results in better profitability as well as market valuation.

(Ghosh, 2018). Performing banks with better growth indicators have demonstrated facing reduced costs of providing equity and which in turn also positions them as being less levered as they are able to reap the benefit of their prime valuation therefore there exists no need for them to obtain borrowed money for them to increase the return on investment.

2.3.3 Liquidity

This is the effortlessness in which an asset can be quickly acquired or disposed off in the market without affecting its price. The bank's financial resources is assessed by looking at a bank's total loans in comparison to its total deposits.

It is important to bear in mind liquidity risk as a factor in bank performance. This is the risk that a bank may be unable to meet obligations as the fund owners may call their deposits at an inconvenient time, causing an abrupt disposal of assets which will adversely bank's profitability as well as the impairment of its capital base. This risk will not only adversely affect performance; but will also impact the bank's reputation as depositors may lose confidence if funds are not provided to them in a timely manner. Additionally, the bank may also face penalties from the regulator. This is a risk that impacts all banks inclusive of a bank is seen as having sufficient capital, solid earnings and good asset quality because if it doesn't maintain adequate liquidity levels, it will fail. (Arif& Anees, 2012)

The CBK regulation dictates that the cash reserve requirement is maintained at 5.25% of the total currency deposit to overcome liquidity constraints by banks. They are statutorily required to keep a portion of their total deposits at the CBK. This portion of deposits is known as the CRR and are held at zero interest. (CBK, 2018)

2.3.4 Macro-economic Factors

External environmental factors in the operating environment that bank management has no control over influences the bank's overall outcome and hence should not be ignored.

The amended interest rates law in Kenya came into force and set the highest lending rate ceiling at 4% above the CBK base rate and the lowest interest rate granted on a deposit held to at least 7%. This cap came into force despite the country being a free market economy; but was a means to reduce credit cost and raise access to loans. The impact of the cap however saw the reverse of the intent as a number of borrowers were shunned by the banks in favour of government securities. The number of issued loans declined significantly with lower access provided to smaller loan seekers and more resource access to larger established firms.

As a result of the measures the bank took; the interest rate cap was not able to yield the intended fruits and as a result was repealed in November 2019. (African business, 2019)

The income generated by commercial banks has shifted drastically as the income seems to stem from non-interest income. This is witnessed across the wider commercial banks board. Tier-3 banks have the largest capital erosion after the interest rate threshold. This has been attributed to reduction in earnings hence impacting the capacity to build-up capital levels. Tier-2 banks have equally been affected and Tier-1 banks have maintained high capital build-up levels. In addition to erosion in capital, profit levels have equally declined which creates a risk on financial stability as there is a reduction in the capacity to build capita buffers that can absorb operational and external shocks by banks. (CBK, 2020).

2.4 Empirical Literature Review

A wide range of researchers have looked at the relationship that exists because of CG practices for various firm clusters in banks and the contribution towards performance. The empirical literature review covers a selection of research that has been done in that area by both international as well as local researchers. This aims at determining whether there is a link in the variables based on the work that has already been done.

Al-Tamimi (2012) investigated the correlation between CG and performance especially during periods that could be termed as distress on the financials of the banks in the UAE. The study covered 51 commercial banks in the UAE with the sample selected being the 23 national banks in the country. The areas of CG that were assessed covered transparency through disclosure of information, compensation packages paid to the executives, the relationship of the various financial institutions with their respective shareholders, governance principles and structures that had been set in place, policies and guidelines of the banks, compliance with regulatory bodies and board of directors. The research methodology that was adopted was the use of a modified questionnaire that was split into two sections, the first section covering disclosure and transparency, executive compensation, relationship with shareholders, governance structures, policies and compliance, stakeholders' relationship and board of directors. The second part dealt with performance and financial distress. The findings from the study were that there is a proven interrelationship between CG principles adopted by banks and disclosure, transparency, management's compensation, interrelation between stakeholders and shareholders and BOD and performance level and financial distress.

A research carried out by studying governance mechanisms' enhancement of the ROA, ROE and earnings earned for every share and dividend pay-out of the banks in Pakistan demonstrated a relationship between the study elements. (Sohail et al, 2017). The internal factors entailed sufficiency of the size and composition of the board, annual general meeting timeliness, structure of the ownership by management, institution's ownership and transparency. The external factors entailed legal framework institutionalised to safeguard minority shareholders. The study covered 30 banks on the PSE from2008-2014. The research methodology entailed use of data generated from published financial reports and the PACRA with the model used for the study being Hausman test for verification of the hypothesis. The result was that internal and external governance mechanisms have a substantial role in enriching performance and for a good governance structure to be in place both internal and external factors should be considered in the banking sector.

Inessa & Rachinsky (2015) researched the linkage between CG and performance of banks in Russia and Ukraine. They studied 157 banks that had been surveyed by IFC from 2003-2006. Their findings were there exists a significant though modest relationship between governance and the operating performance while a not significant link with other performance measures. The key insight from the finding was that voluntary CG structures implemented by banks are ineffective in countries that have a weak institutional climate. The researchers did point some caveats in their study; the potential unreliability of the financial as well as CG data. They also acknowledged that their study focused on one aspect of bank performance which was the operating financial performance measures that were captured in the form of NPL, ROA, ROE and net interest income. Though CG can influence other areas of performance as well such as liquidity which has an impact on the stability of banks.

An evaluation of CG and performance from listed companies in China done by Li and Tang in 2003. The methodology used was the use of expert scoring of the six principle factors that were considered of utmost relevance in terms of CG and the use of descriptive statistics to obtain the mean value that was obtained from the weighting of the factors. This was compared with the weighting in the previous years. A regressive model was also used to determine existence of a correlation between the indices used in the study. The findings showed that the index belonging to the governance of the board is inter-related to the stakeholder’s, management team, information transparency and the supervisor committee governance has a material impact. The study concluded that good CG mechanisms improve profitability, growth in stock value’s ability, operating efficiency as well as financial flexibility. The CG practices in place with regards to the study elements has a great influence on decision making as well as decision execution which in turn profoundly affects the performance as well as the value of the listed companies.

Muranda (2006) looked into financial distress and CG in Zimbabwean banks. The study was on the 41 banking institutions with the sample selected being the 8 banks there were facing financial distress at the point of the study since 2003. The research methodology used was a case study approach on all the 8 banks and the analysis was qualitative in nature. The conclusion drawn was that in all cases of financial distress there is evidence of disproportionate power in the board either by the CEO or the chairman therefore overshadowing the other directors and creating an imbalance in the board as well. A primary role played by legislative authorities contributes to the adherence to CG practices. This supports the claim that CG is not just a moral concept but is equally a regulatory matter. Weak internal systems are also seen as an impediment to bank performance as failure to have risk management institutions in place placed the board in apposition where decision making was made from a weak standpoint as key elements such as risks were not considered. The significance of independent executive directors was also highlighted as in the banks that faced financial distress; the independent executive directors were overshadowed by the executive directors despite them playing a key role in bringing an independent opinion that is meant to balance the board decisions.

Mwaura (2016) looked at unlisted financial institutions to see the influence of CG on outcome of performance. The study focused on the 31 unlisted banks from 2010-2015. The study focused on information disclosures, leverage, firm size, board committee and audit committee. The findings were that disclosure of information and firm size were significantly related to ROA while the composition of the board and its audit committee had no influence on the ROA of the unlisted banks.

Weke (2013) studied the CG practices by major commercial banks. The study focused on 6 tier-1 banks that had 70.3% of the market share. The methodology used was inductive analysis. This entailed the use of questionnaires that were tabulated and descriptive analysis of open-ended questions. The statistical techniques used included the mean, percentages and averages of the questionnaires. The results of the study was that the central system for CG lied with the board hence the manner of appointment and composition plays great significance.

Opondo (2012) desired to assess implication of CG practices on the performance of the unlisted insurance companies and banks. The study objectives was to determine the level of adoption of CG codes in order to ascertain whether a gap existed in the adoption of CG codes by the various institutions and to assess the impact of the adoption or lack thereof of the various codes. The primary data was collected from senior managers in these firms using a structured questionnaire. The findings drawn from the analysis of the study was that governance did not significantly influence corporate investment decisions as the relationship was positive. Additionally, the study found that the effect on firm value as well as the effect on firm performance, CG index did not have a significant effect on ROA.

Ndungu (2010) studied the link between embedded governance and performance results of banks listed on the NSE. The study covered the period from 2002-2007. The study was done using secondary data. The study concluded that a board's size adversely affects market performance while its composition impacts market performance favourably.

Nyarige (2012) studied financial outcomes of commercial banks based on their CG practices. The research focused on looking into relationship between the bank's outcome and the frequency of board meetings, percentage of institutional investors' share ownership, executive compensation and ration of Exec to non-exec directors. The study was based on 9 banks that were listed from 2005-2010. The findings based on the regression results showed that frequency of meetings, number and quality of diversity in the board and its committees along with remuneration of the members of the board affects market performance of the banks.

2.5 Conceptual Framework

The framework provides an overview of how the study will be carried out and outlines the connection between the variables in the study. Independent aspects in this study are firm size, board composition, regulatory compliance, risk management practices, transparency and disclosures. The dependent aspect is the financial outcome of the bank.

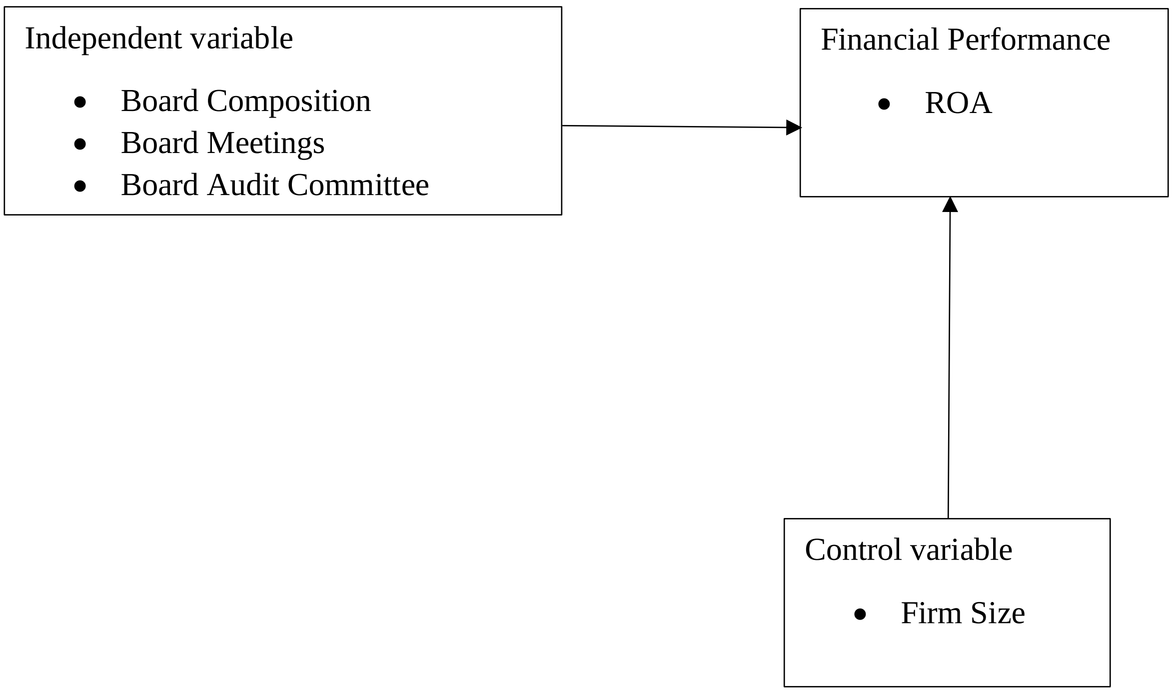


Figure 2.1: Conceptual Framework. Source: Author (2021)

2.6 Summary

The review of the existing literature reveals that there exists a wide variation of meaning of CG. There are those who view it from a controllership perspective which is agency theory, others from a support perspective which are the managerial hegemony theorists and the other school of thought of stakeholder theory views it from a coordinating role. The studies done on CG has shown that a linkage exists between the CG behaviours of various financial institutions and their performance. The gap identified for further studies is on the practices between the various classes of banks which in this case is the tiers; and the impact that has on the performance of the various tiers.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses sequence adopted for the study. It outlines the design of the research from the data gathering methods, data assessment and the data presentation methods that have been used. This provides enhanced clarity on the procedures and techniques that have been adopted to select, process and analyse information concerning the topic of study.

3.2 Research Design

Causal research was adopted as the design for the study. This type of research as it is a bid to test hypothesis about cause-and-effect relationships. Sachdeva, (2008) describes causal research as one where the researcher attempts to see whether changes in one variable; the independent variable affects another variable the dependent variable. The research attempted to explain a particular phenomenon. While the primary method that was used is a causal method; It's also important to point out that a secondary methodology was adopted which involves a descriptive research method. This is statistical research which describes the data and characteristics of the areas under study. This is because statistical calculations were used to explain the causal effects of the variables under study.

3.3 Study Population

Commercial banks that are approved by CBK constitutes the universe of the study. The study was restricted to banks licensed by the end of 31st December 2020. The census methodology was adopted as the universe of the banks to be used in the research was scalable and feasible.

3.4 Data Collection Method

Research by its nature entails gathering and examining data. The data collection method is usually implemented after a research argument has been identified and the research plan formulated. The research relied on existing data which as defined by Kothari, (2004) as being data that has been collected by another individual and taken through the statistical process. Secondary data was preferable due to their reliability. The data that was used was the audited reports of the banks under study. The data used for research purposes collected covered the period from January 2014 to December 2020.

Variable	**Measurement**
Dependent Variable	
Financial Performance ROA	Profitability in proportion to the total value of its assets
Independent Variable	
Corporate Governance Board composition (BC)	Proportion of organisational to non-organisational directors and gender composition in the Board
Board Meetings (BM)	Regularity of Board Meetings and frequency of meeting of the BAC
Board Audit committee (BAC)	Proportion of internal to outside directors in the BAC as well as independence of internal audit department
Control Variable	
Firm Size (FS)	Proportion of total financial obligations to total assets

Table 3.1: Summary of variables and terms of measurement. (Author, 2021)

3.5 Diagnostic Tests

3.5.1 Autocorrelation

To assess for correlation, the Wooldridge to test was preferable so as to account for existence of degree of similarity in the data. The approach was most preferable due to the ease of implementation since the model can be implemented using few assumptions to test the hypothesis.

3.5.2Heteroskedasticity

Heteroskedasticity is an important aspect of the data that is to be used that needs to be tested. A regression analysis was done for data analysis; data dispersion assessment was significant to ensure that the regression model was not biased by assuming a homoscedastic relationship of the data without validating it.

3.6 Data Assessment Techniques

The data collected was validated by assessing errors and omissions. The data was then assessed using a statistical package for social science. Linear regression and correlation are integral in the analysis. The model that tests the connection between CG practices and bank's performance was as follows:

$ROA = \beta_o + \beta_1 BC_{it} + \beta_2 BM_{itt} + \beta_4 BAC_{it} + \beta_5 FS_{it} \varepsilon_{it}$…………model 1

Where:

ROA is the dependent variables

3.6.1 Independent Variable

CG practices are measured using a CG index that measures composition of executive to outside directors (Board composition), Frequency of Board meetings and attendance of the meetings in line with the mandate provided by CBK (Board Meetings), Executive to independent directors proportion in the board audit committee as well as independence in the internal audit department based on reporting lines; whether it has a direct line to the BAC.

3.6.2 Significance Testing

The test of significance measures the probability of an existence of a link between the variables stated in the regression model if it does; how strong the relationship is. The study used a significance level of 0.1 to evaluate whether the coefficient of each independent variable was different from 0.

CHAPTER FOUR
DATA ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter provides insights on the statistical analysis performed on the data that has been collected on the banks under study from 2014 to 2020. The scope of banks under review were the 38 commercial banks using sample of 30 commercial banks that represent both private and public banks. The focus was on board characteristics in terms of size, gender composition, meeting frequency, meeting attendance for both the wider board as well as the BAC, number of NEDs and independence of the internal audit team in terms of direct reporting to the BAC and performance of a firm.

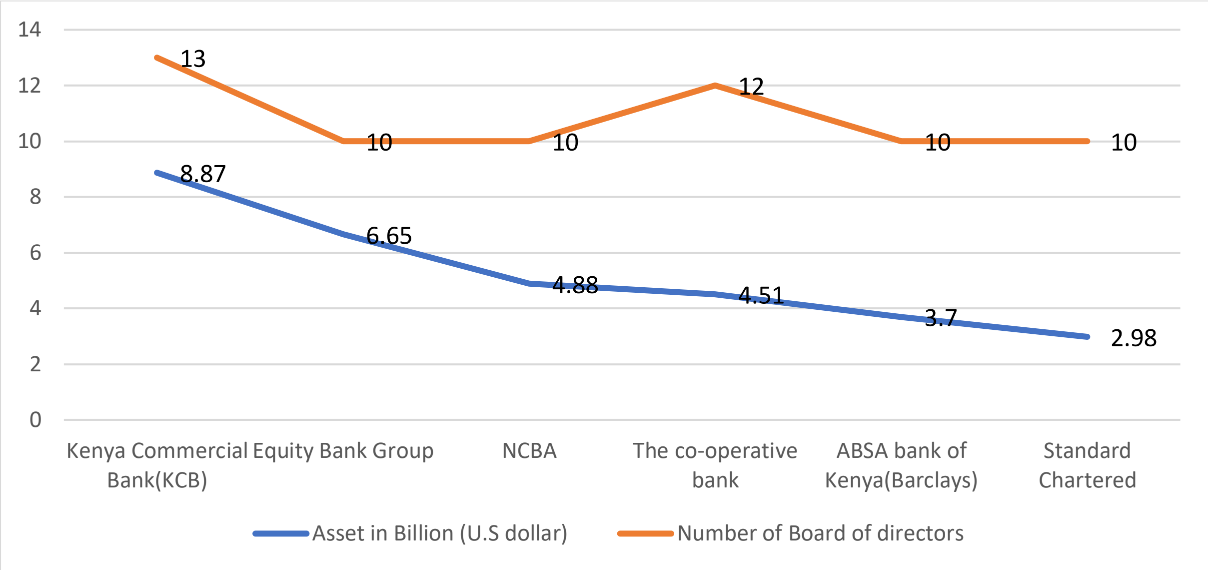
A comprehensive regression was done in the assessment of board features and significance of extrinsic and intrinsic factors relating to the expected returns on assets of commercial banks. Commercial banks are subdivided into three tiers according to the size and performance. The findings are presented using descriptive statistics and represented using tables and graphs organized according to the intention of the study.

4.2 Comparison between bank asset and cooperate governance

The Central Bank of Kenya has grouped banks into sub-categories known as based on a 3-tier system. This is based on an index weighted by capital and reserves held by CBK, net assets position, customer deposits held by the bank and the number of loan issue maintained at the bank. A large bank is one that has an index of > 5%. A medium bank has an index weighted in the rage of 1-5% whereas a small bank has a weighted index of <1%. Large banks have a larger market share as well as higher asset base. On the other hand, small banks have a challenge in acquiring customers thus the market share is smaller. The last two years has seen certain banks being placed under administration thus resulting in their customers and assets being taken over by a tier 1 bank. This has further strengthened the portfolio and asset base of the Tier 1 banks in the country.

Tier 1 comprises of high value performing banks in Kenya such as KCB, Equity Bank Group, NCBA, the Co-op bank, ABSA bank of Kenya formerly known as Barclays and Standard Chartered just to name a few. These are banks that have net assets above 1Billion USD. This is a strong indicator that in the event of an economic crisis, the bank can still operate using the assets in place to remain profitable and withstand any shocks in the market. On the other hand, given the sphere of influence these banks have on the economy the risk worth pointing out is that a failure in any of these banks may have a catastrophic impact in the economy of the Country. Reference can be made to the impact that the economy of Cyprus faced due to the collapse of two of their major banks. IMF bailouts as a result of banking collapse usually goes hand in hand with strict austerity measures imposed on a country.

Figure 4.1: Tier 1 Corporate governance and Assets of the Bank in USD Billion

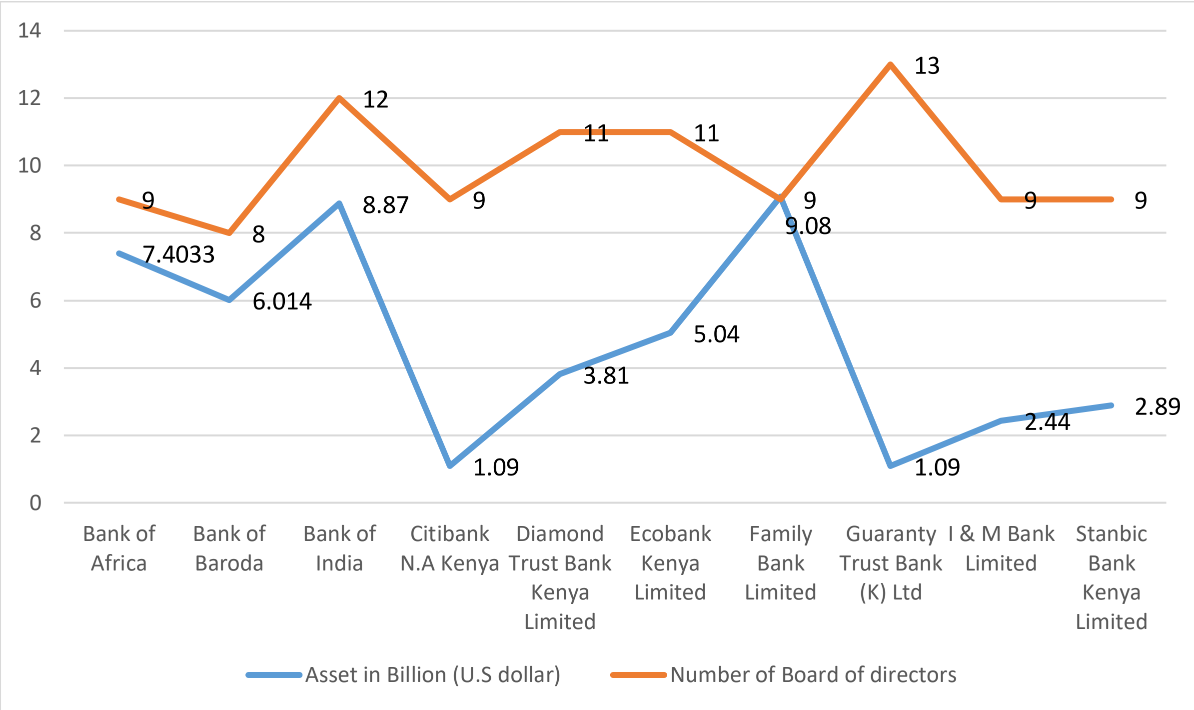


The above graph demonstrates the inter-relationship between asset and the number of board members in a bank. The expectation would be that banks with a higher asset base have more board members and vice versa but that is not the case. Some banks have a high board number with a high asset base while others with a lower asset base still have a high board number. KCB has the highest number of BOD (13 members) and the highest asset base (8.87billion). On the other hand, Standard Chartered has the mode representation of BOD yet has the lowest asset base (2.98billion) compared to the other tier one banks. The other outlier in the sample is Equity bank which has 10 BOD with an asset base of 6.65 USD. Cooperative bank has 12 board members with an asset base of 4.51USD. This supports the argument that an increase in BOD does not necessarily translate to an increase in the asset base that a bank will hold.

The bank net asset position is affected by among other things; regulation as the CBK has an expectation on the minimum capital reserves that should be held by each bank daily, investor confidence in a bank that will warrant a favourable valuation of listed banks hence increasing the value of a bank; risk mitigation appetite for banks i.e., political risk, inflation, liquidity ratio, insecurity thus influencing the amount of retained earnings in a bank from profits made. With a higher portfolio of assets to manage; greater investor confidence may necessitate a higher number of board members with diverse skills to manage the portfolio but it does not mean that the higher the board number the more effective the board will be and investor confidence in the board is not swayed by its board size.

The second group of banks is known as tier 2 which consist of the mid-sized lenders who control 41.7% of the market. They consist of FB, BOA, BOI, I&M Bank, Diamond Trust Bank, Ecobank, CFC Stanbic Bank, Prime Bank, Bank of Baroda, Citibank, Guaranty Trust Bank and National Bank.

Figure 4.2: Tier 2 Corporate governance and Assets of the Bank in US dollar Billion



The above graph shows that the highest number of board of directors are in Guaranty trust Bank that has 13 members despite being the bank with the lowest asset base in the sub-category (1.09 USD). Family bank limited has the highest asset base in tier 2 group with a mode representation for directors at 9 members. Diamond Trust Bank and Ecobank Limited have 11 directors each despite Eco bank’s asset base being close to 2 billion USD higher than that of Diamond Trust Bank. This is an indication that even in the second-tier classification of banks; a large board size does not necessarily influence the asset base.

The third group of banks are known as tier 3 make up 8.4% of the market share in the banking sector. These banks include, ABC bank, UBA, Credit Bank Limited, Consolidated Bank of Kenya Limited, DBK, Guardian Bank Limited, Jamii Bora Bank Limited and First Community Bank Limited. As these banks increase their asset base as well as their customer base, they are able to move to tier 2 status. Due to the competitive nature of the banking sector organic expansion by growing customer base is usually a big challenge for these banks and thus many of the tier-3 banks are usually faced with the only growth strategy being to merge with other banks to remain in the sector or ultimately being acquired by other banks. The most recent acquisition is that of Jamii Bora Bank by Co-operative bank. Merging and Acquisition in the banking sector has been a practice in Kenya since 1989 when 9 financial institutions merged to form the Consolidated Bank of Kenya.

Figure 4.3: Tier 3 Corporate governance and Assets of the Bank in US dollar Billion

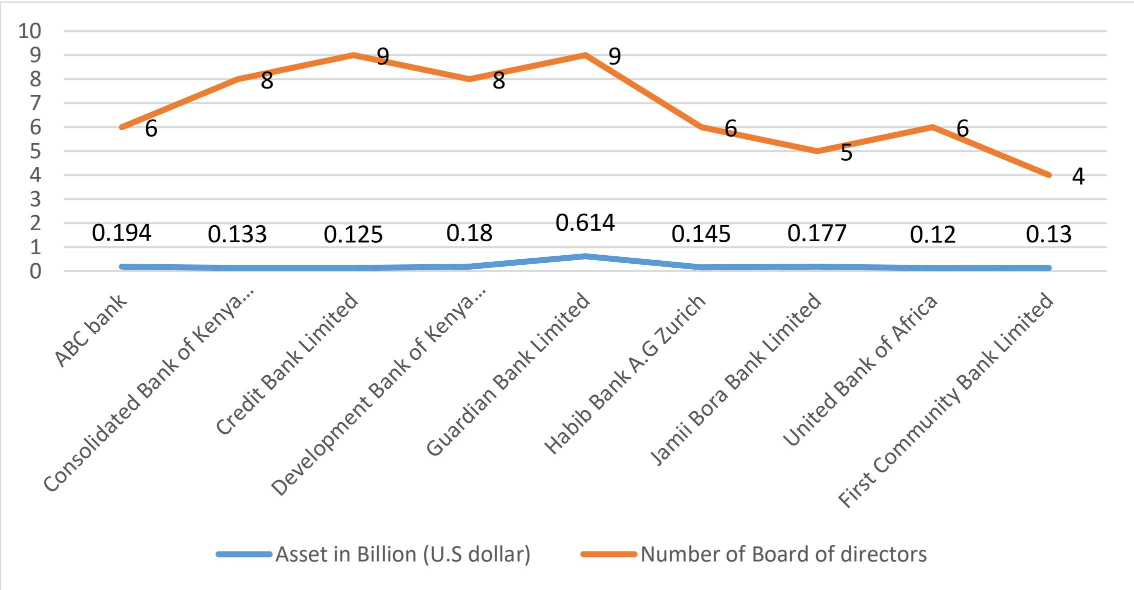


Figure 4.3 indicates the corporate performance with the relationship between asset of the banks in tier 3. The highest number of board members are in Credit bank limited and Guardian bank limited represented by 9members but both banks have a different the asset performance in that The Guardian bank has 0.614 billion USD whereas credit bank limited has 0.125 billion USD. This indicates that the same number of board member can attract different levels of investments and in return a different asset base.

4.3 Kenya's Banking Sector Performance

The sector recorded significant increase in both assets and profits between the years 2014 to 2020 as shown in figure 4.4.

Figure 4.4: Profits and Assets of the Banking Sector in Kshs. Millions

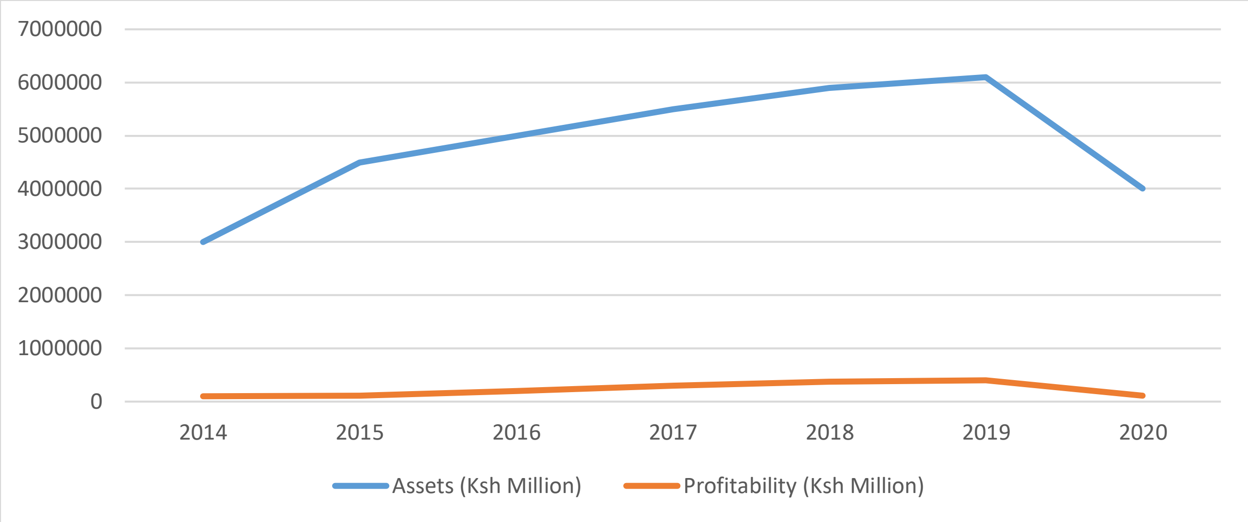


Figure 4.3 shows that the asset of commercial banks has been rapidly increasing thus resulting in greater profitability. This is because the bank has evolved it's operations by use of its assets to improve profitability through embracing new technology such as creation of secure mobile and online platforms for customers to use banking services compared to previous years where banks operated a brick-and-mortar system that was based on using cheques and a requirement to be physically present in a bank to receive any service. The ease in banking as well as greater financial inclusion through mobile money has made it easier for banks to acquire new customers as well as retain their customer base. The increase is also attributed to among other factors, robust economic growth that created demand for financial services such as loans and need for secure savings during the sample period as well as interventions by the government to improve financial inclusion. This has contributed to higher profitability in banks. (CBK, 2018). An exception should be made for the year 2020 as there was the global pandemic impact that shook the sector.

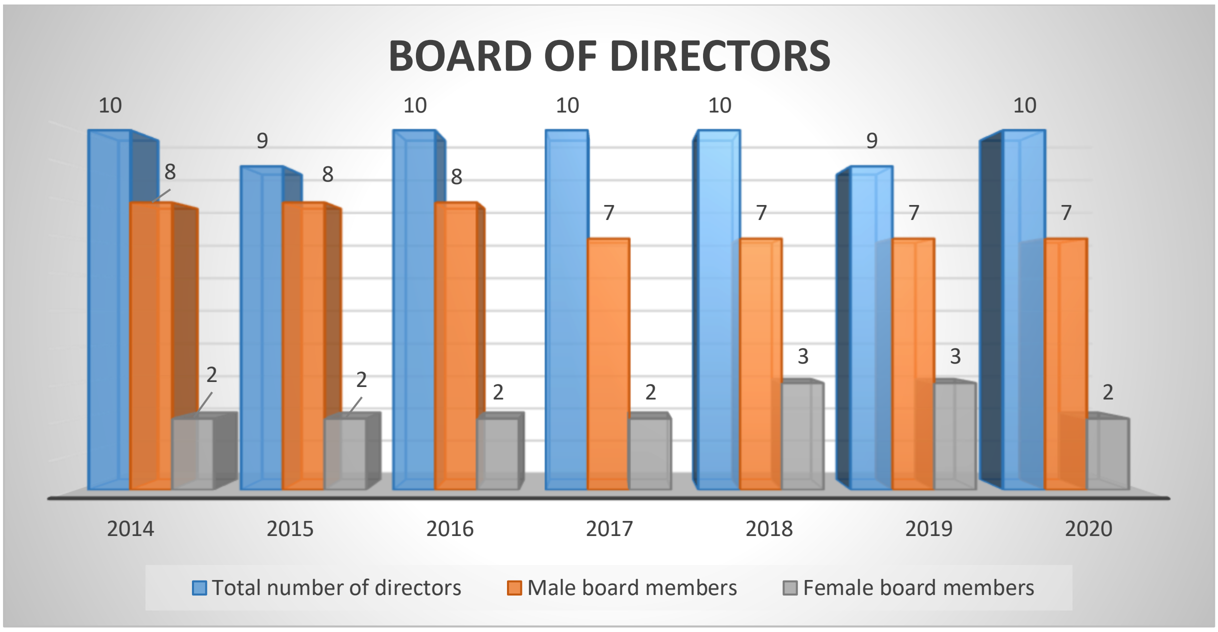
4.4 Descriptive Statistics

Figure 4.1 shows that total number of board members from 2014 to 2020 ranged between 9 and 10. It is worth noting that there is a higher male representation in the boards compared to females. The study found that only 20% of board members were females. This indicates that there is lack of gender diversity and quite a bit of work will need to go into place to improve the number of female representation in the boards. Women represent 50.5% of the country's population based on the 2019 census hence a strategic customer base for the banks. Seeing that banks rely on women's deposits a 20% representation of women in the boards is an under-representation as it is not an accurate representation of the banks' customer base. It was also noted that a large number of the CEOs in the commercial banks were male.

4.4.1 Number of Board of Directors

Gender disparities have been pointed out in many research projects over the years. This study shows banks still lag in influencing intrinsic sector changes on gender inclusion because they have the lowest representation of women on their boards among Kenyan companies. The latest Board Diversity and Inclusion Survey report showed that the female representation stood at 36% for Kenya. (KEPSA,2021) Therefore 20% for the banking sector points to a need in sectoral reforms to ensure that greater representation is effected. Figure 4.5 accurately illustrates board composition.

Figure 4.5 Board of directors



Source: Author (2021)

4.4.2 Number of Non-executive directors

NEDs are not active in the day-to-day operations but always take part in the policy making role and ensure that plans are laid down and executed. They monitor the executive directors and therefore without the NEDs the performance of the executive would not be independently monitored and evaluated.

Figure 4.6 Number of NEDs

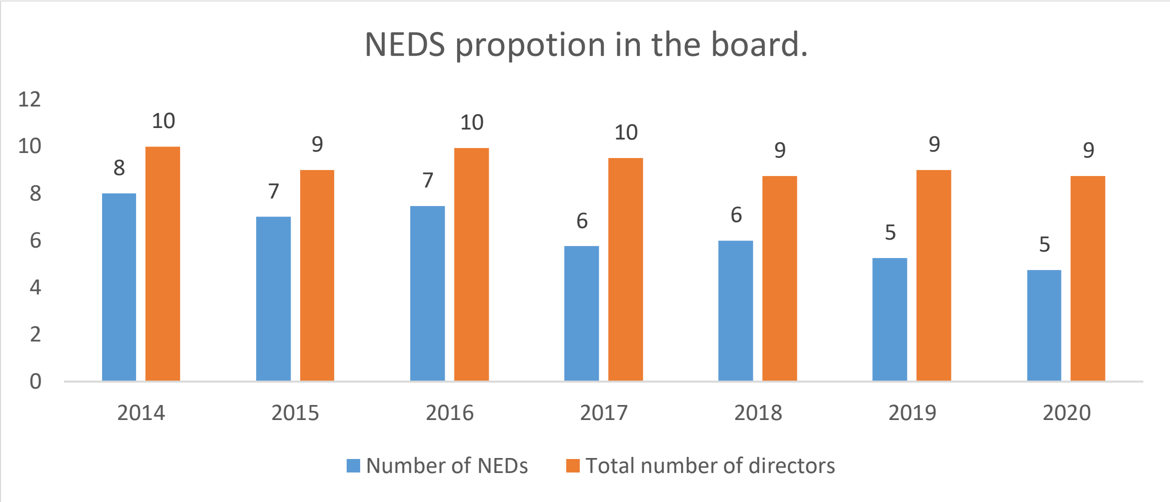
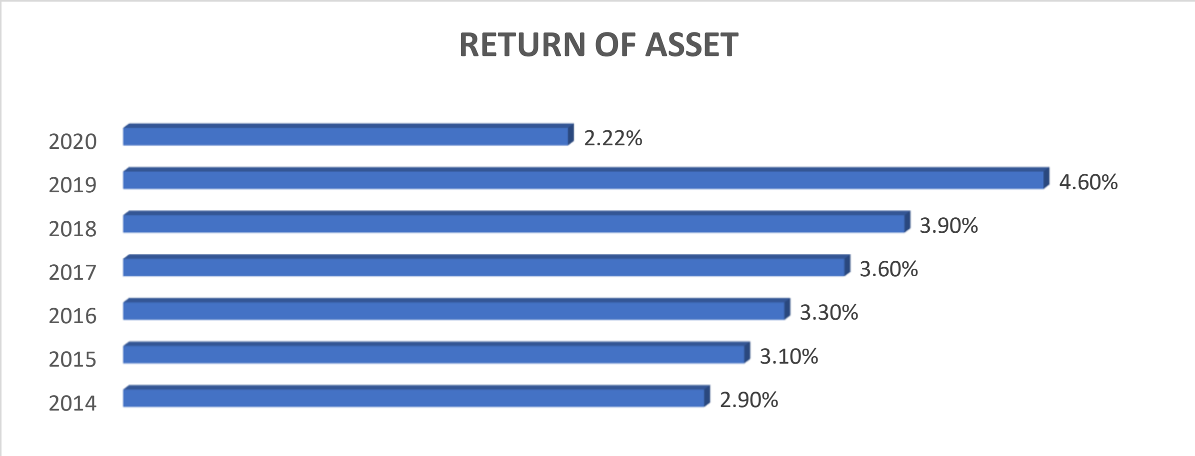


Figure 4.6 indicates the Non-executive directors from 2014 to 2020. This shows that the number of NEDs in 2014 was high but as the years have gone by it has decreased significantly from 80% in 2014 to 56% in 2020. The declined proportion of NEDs to the total number of directors could be an indicator of the dependence on the executive management in the decision making of the board. There have been various schools on thoughts on the ideal balance in the board with a lot of emphasis being placed on ensuring that managerial interests are not considered at the expense of shareholders and stakeholders. It is also important for the financial institution to uphold its independence as the board is responsible for the strategy of the institution hence guarantee its going concern and mitigating any risks that would hinder it's going concern. As such having a reduction on the number of NEDs would signal that the board has a lot of executive management influence as pointed out in the managerial hegemony theory with the NEDs serving to rubber stamp the strategic decisions and be dominated by the professional managers in decision making.

4.4.3 Return on Asset (ROA)

ROA indicates the profitability of the commercial banks. This is an indicator of the financial performance of Commercial banks. The mathematical approach of calculating it is dividing the net income with total assets. Globalization has resulted in economic growth for countries as well as adverse economic impacts should there be a global disruption as has been witnessed with the pandemic. This resulted in instability and high uncertainty in global capital markets with the financial sector being one of the most affected as bank market valuations dropped in all countries around the world. This is explained by Figure 4.7 where the return of asset in 2020 is the smallest representing a growth of 2.22% as gross income of the population was affected resulting in non-payment of services and products as well as loan defaults and loan restructuring.

Figure 4.7 Return on Asset



Source: Author (2021)

4.4.4 Summary Statistics

Summary descriptive statistics is used to describe the basic features of the data such as mean, mode, median, minimum, maximum, standard error, variance, percentage, standard deviation, range and sum. They provide simple summaries on the samples forming qualitative analysis of data. Descriptive statistics in this chapter was analyzed using mean and standard deviation of the factors represented in each variable in the research study. Descriptive statistics helped the researcher to summarize large amount of data into a simpler summary.

Table 4.1 Summary statistics

	Minimum	Maximum	Mean	Std. Deviation
Total number of directors	9	10	9.71	.488
Male board members	7	8	7.43	.535
Female board members	2	3	2.29	.488
Number of NEDs	5	8	6.86	1.069
Number of directors in BAC	4	4	4.00	.000
Proportion of NEDs in BAC	4	4	4.00	.000
BAC Meetings	4	5	4.57	.535
Is the BAC chaired by NED who isn't the Board chairman	No	Yes	-	-
Does Internal Audit report to BAC	No	Yes	-	-
Number of board meetings	6	10	6.71	1.496
Meeting attendance rate:	70.00%	95.00%	87.9748%	8.50055%

How many directors attended all meetings	6	7	6.29	.488
Number of least meeting attended	4	5	4.86	.378
ROA	2.22%	4.60%	3.3743%	0.76024%

Source: Author (2021)

The statistics summary is indicated in table 4.1 where the mean of the board of directors is represented by 9.71. This demonstrates that the average size of members ranges between 7 to 15 members of the board depending on the size and branches of the commercial bank. The mean of the male board members was 7.43 and that of female board members was 2.29 explaining that males are more in the board of directors compared to females. The Non-Executive committee comprises of 5 to 9 individuals as explained by a mean of 6.86. The number of directors have a mean of 4 as well as the proportion of NEDs in BAC. BAC meetings are held 5 times in a year as indicated by a mean of 4.57. The number of board meeting in a year are 7 as represented by a mean of 6.71. The average meeting attendance is represented by 87.98% which is akin to 6 directors attending in any given sitting. This also shows compliance with CBK prudential guidelines that members attend 75% of the board meetings. The mean of the seven years from 2014 to 2020 was 3.3743%. The analysis indicates that the maximum number of commercial banks the BAC chaired by NED who isn't the Board chairman and the internal audit report to BAC is conducted often.

According to the summary statistics, majority of the commercial banks' internal audit committee reports directly. However, a few banks have their internal audit report to the management team. This was noted with Imperial bank whereby the recruitment and directing of all staff in internal controls department was done in consultation with MD as shown in the Annual report for 2014. It is also worth pointing out that Imperial bank went under receivership due to non-compliance gaps that impacted its liquidity. The BAC is usually chaired by the NED who isn't the board chairman for enhanced independence and transparency.

Chase bank is another bank that indicates that poor management can result in failure of a bank. Chase bank was placed under receivership by KCB bank which later led to liquidation of its asset in the market. This was supported by regulatory issues, non-performing loans and competition caused by poor corporate governance. This shows that poor corporate governance in a bank can cause the collapse of a banking institution. This points to a lack of independence and strong managerial hegemony.

4.5 The implication of corporate governance practices on performance

The study used descriptive statistics to identify the contribution of each board member, gender diversity, meeting attendance rate and frequency of the meeting held annually in commercial banks in Kenya to measure financial performance. The statistics shows how variations across different commercial banks and the parameters explain this predisposition. In line with the study objective the assessed variables are analyzed with their stochastic nature in relation to financial implications. The conceptualized model was estimated by correlation analysis, regression analysis and t test analysis.

4.5.1 Correlation Analysis

Correlation analysis is used to establish the extent of the correlation of different pairs of variables under study. It measures and calculates the correlation coefficient between 1 and -1. This further predicts the presence or absence of multicollinearity which is considered to exist when there is perfect linear relationship between the variables under the study. The correlation matrix was used to determine if any pair of independent variables was highly collinear through the magnitude of the correlation coefficient of the pairs of variables established. This bias arises when one or more pairs of independent variables are perfectly correlated to each other.

Table 4.2 Correlation Matrix

		Total number of directors	Female members	Number of NEDs	BAC Meetings	Number of board meetings	ROA
Total number of directors	Pearson Correlation	1	.300	.228	.091	.898	.927
	Sig. (2-tailed)		.513	.623	.846	.835	.339
Female board members	Pearson Correlation	.300	1	.228	.548	.326	.787*
	Sig. (2-tailed)	.513		.623	.203	.475	.036
Number of NEDs	Pearson Correlation	.28	.228	1	.417	.074	.610
	Sig. (2-tailed)	.623	.623		.352	.874	.815
BAC Meetings	Pearson Correlation	.091	.548	.417	1	.595	.514
	Sig. (2-tailed)	.846	.203	.352		.158	.644

Number of board meetings	Pearson Correlation	.898	.326	.074	.595	1	.892
	Sig. (2-tailed)	.835	.475	.874	.158		.844
ROA	Pearson Correlation	.927	.787*	.610	.514	.892	1
	Sig. (2-tailed)	.339	.036	.815	.644	.844	

Source: Author (2021)

Correlation is the statistical measure that indicates the strength of the relationship between two or more variables, which can be either positive or negative. Table 4.2 shows that all the tables are positively related. A strong relationship of multicollinearity is said to be at 0.7 and above. Multicollinearity would be considered present if the correlation coefficient was equal to or above 0.5 as it may lead to spurious regression. As indicated in Table 4.2, the study found that majority pairs had a correlation of more than 0.5 (starred correlations) which is the threshold to permit retaining of those variables. Board meeting and total number of board members have a strong relationship represented by 0.898. This explains that the more the numbers of board members the more meetings are required for decision making.

Table 4.2 indicates the relationship between the independent and independent variable. The strongest relationship is between total number of directors and ROA represented by 0.927. This can be explained that number of directors influences the financial sustainability of companies listed in NSE. This was followed by 0.892 which indicated the relationship between number of board meeting and ROA. Financial sustainability is affected by the number of board meeting in companies listed in NSE. The smallest relationship was indicated by the lowest correlation which was 0.514 indicating the relationship between BAC meetings and ROA. This can be explained that BAC meeting has a significance in financial sustainability but compared to the other independent variable it does not strongly affect the financial sustainability. Majority of the relationship in the correlation matrix table demonstrates a positive inter-relationship in the attributes being studied thus explains existence of a relationship between CG, Board composition and board audit committee.

4.5.2 Normality Test

To proceed with estimation, this study applied the Shapiro Wilk test for normal data or distribution of the stochastic random error terms. Table 4.3 below revealed that at 0.05 significance level, overall residuals of the variables were normally distributed.

Table 4.3 Test for Normality

Shapiro-Wilk W test for normal data

Variable	Obs	W	V	z	Prob>z
cooperateg~e	7	0.63265	4.825	3.215	0.00065

Source: Author (2021)

The normality test illustrates that the p value was 0.00065 which is less than the confidence interval of 0.05. This show that the model is significant and assesses performance of the commercial banks. The Shapiro wild test was represented by 0.63265 demonstrating that the data was normally distributed.

4.5.3 Regression Analysis

Table 4.4: Analysis of R and R^2 for Financial performance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.616[a]	.823	.853	0.91645

a. Predictors: (Constant), Board composition, Board Audit committee, Cooperate governance

Source: Author (2021)

From table 4.4 the error was 0.91645 the adjusted R^2 was 0.853 showing that the relationship between the independent and dependents variable was close since 0.616 is not far from 1. R^2 was represented by 0.823 indicating that corporate governance practices affects financial performance in commercial banks by 82.3%. The remaining 17.7% was affected by factors outside this research study. The regression model strongly provides an explanation on the basis on factors such as macro improvement factors, capital sufficiency, asset position, income diversification and operational cost efficiency.

Table 4.5: Analysis of Variance for financial performance

ANOVA[a]

Model	Sum of Squares	df	Mean Square	F	Sig.

1	Regression	.108	4	. 027	.2009	.039[b]
	Residual	3.360	25	.1344		
	Total	3.468	29			

a. Dependent Variable: ROA

b. Predictors: (Constant), Board composition, Board Audit committee, Corporate governance

Source: Author (2021)

Table 4.5 shows that at 95% confident interval F calculated was 0.2009 while F critical was 0.039 at F ($_{0.05,4,29}$). Since the F test computed (0.2009) > the F critical (0.039) then the model is significant. Therefore, we accept the null hypothesis that state that CG principles and firm size on financial outcomes of commercial banks in Kenya. This supports that corporate governance analysis that there are other determinants of financial performance of commercial banks.

Table 4.6: Regression Model

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t
1	(Constant)	5.889	10.010		.588
	Corporate Governance	.374	.556	.011	.313
	Board Audit Committee	.468	.643	.047	.153
	Board Composition	2.541	8.602	-.162	-.295

Source: Author (2021)

Table 4.6 shows the coefficient of the regression equation model. Taking all the independent factors (Board composition, Board Audit committee, CG) constant the interrelationship between CG and financial performance in commercial banks in Kenya was 5.889. A unit change of cooperate governance will affect financial performance by 0.374, a unit change of process board audit committee will affect financial performance by 0.468 and a unit change of board composition will affect financial performance by 2.541. This indicates that board composition influences performance of banks significantly compared to other variables. It can be argued that all the independent variable affects the dependent variable. The error term is represented by 10.010. Thus, the equation for the cooperate governance in financial performance in commercial banks in Kenya model will be expressed as:

$$\mathbf{ROA = 5.889 + 0.374CG_{it} + 0.468BAC_{it} + 2.541BC_{it} + 10.010_{it}}$$

4.6 Chapters Summary

The chapter indicates the variables according to the objectives of the data which was analyzed to interpret the data. This chapter presented all the research data that was collected from various sources. In this chapter, interpretation of the data collected from the questionnaires was done and represented using pie charts and tables to represent the information one can interpret at first glance. The next chapter will present the discussion, conclusion, recommendations of the study and suggestions for further research.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This section conducts a review of the study findings in chapter four. Comprehensive conclusions are made with a key focus on the established linkage between corporate governance and financial. In this chapter the intention is to consolidate the study and bring all the relevant points and material together from all the qualitative and quantitative analysis presented in chapter 4. At the end of the chapter, relevant recommendations and disciplines for additional studies are provided.

5.2 Summary of the Study Findings

According to the literature review the shareholders' value is measured by the scale and diversity of board of directors in a firm. Therefore, they are considered to be the people who run and control the organization to increase the performance of the firm. According to the research, most of the banks have between 7 to 15 members on their boards who are determined by the shareholders following the rules and guidelines provided by CBK. A large number of boards members are not considered due to considerations on decision making and financial implication as boards tend to be additional costs to an organisation. The focus is on the relationships among the management, BOD, shareholders with controlling ownership, minority shareholders as well as interested and influential stakeholders. The study indicates that gender diversity should be considered since majority of the board members are men and women are lowly represented. The management of the BOD is usually monitored and audited internally and externally to provide assurance that risks are being mitigated and information communicated to shareholders is a true representation of operational and financial realities. The literature review indicates that there is an inter-relationship between the variables being studied. This means that financial impact is affected by board representation in terms of diversity and independence; board meetings in terms of frequency, attendance rate and compliance to CBK meeting guidelines, BAC in terms of meetings, committee independence and reporting lines of the internal audit department.

In summary, the board composition affected performance to a large extent. The number of non-executive directors affected the performance to a great extent. The operational directors were involved in making the internal corporate governance mechanisms to a great extent. The scale and attendance to meetings by the members also impacted performance to a great extent.

The study used mean and standard deviation where the meeting attendance rate was high indicating that majority of the board members attend the meetings. The mean of men to women was high and thus analyzing that men outweighed the women. Annually majority of the commercial banks tended to have seven meeting with the board of directors. The correlation analysis showed a relationship in the independence variable and dependent variable. This is the linkage between number of males in the board of directors and ROA which stipulates that there is a positive relationship. The regression analysis indicated that the model was insignificant and thus rejecting the null hypothesis. The study showed that the effect of corporate governance on financial performance was 82.3%. This shows the financial sustainability is strongly affected by CG and factors internally or externally in the commercial banks.

5.3 Conclusion of the findings

Implication of board composition on the financial performance of listed commercial banks is that various board diversity affects the financial performance of commercial banks materially. This is in terms of gender and operational independence. The correlation analysis shows that gender inequality influences the return of assets while the regression analysis, board diversity was found to negatively affect the financial performance of commercial bank. Meeting attendance and BAC independence positively influenced the financial performance of commercial banks to great extent therefore having an internal department with direct reporting lines to the board is very important and the adherence to CBK guidelines on attendance to a minimum of 75% of meetings has influenced financial performance. The number of meetings a board has also influences performance hence having many board meetings ensures that the board is able to respond to strategic threats and make informed decisions that safeguards the banks from any risks in going concerns whether that is market risk, competitive risks or operational risks. This guarantees investor confidence on the reported performance of the banks.

5.4 Recommendations based on the Study Findings

The study recommends that the commercial banks should ensures that gender equality is considered when it comes to the selection of the board members to promote diversity and inclusivity. Size and composition should not be ignored since they influence the performance outcomes of the banks. The number of non-executive directors needs to improve since they affect financial performance of the firms and reduce managerial hegemony. The study recommends that non-executive directors be empowered to ensure that their fiduciary duty is not compromised by the executive directors.

Lastly, the study recommends importance of monitoring thoroughly by the board to ensure that best CG principles are still being adhered to. Performance emphasis should not be the only factor to gauge institutional performance. Its governance is key as it provides confidence on future stability. This can be achieved by adopting conducting regular CG assessments and evaluations. Good CG has a positive economic impact on the institutions in question as it saves the organization from various losses e.g., fraud, reputational and going concern risk factors.

5.5 Limitations of the study

The types of approaches used in measuring CG and financial performance might provide limited results, and different research designs could produce different results given non-existence of a unitary approach when it comes to undertaking a research. The researcher encountered limitations particularly on time as the research was being undertaken in a short period with limited time for doing a wider research. Given that there were other obligations the researcher was involved in; the research duration took much longer than anticipated. Additionally, some of the private commercial banks did not have available data on CG in their websites and newer banks have results for current years but it was difficult to get data of the entire period under study. Other influencing factors such as market inflation, religion beliefs, magnitude of market competition and cultural beliefs could improve the reliability of the empirical results and further reduce the risk of measurement error. These variables couldn’t be included in this study at a time.

5.6 Suggestion for further study

For biasness in the data, analysis should be carries out for one particular year to consider the permanent economic factors that may affect the financial performance. This is because every year has its own economic factors that could impact the financial performance and as a result, we are unable to determine the ROA performance when combined.

Further study should also be undertaken on benefits that the banking sector would realize by increasing the female representation in its boards as well as having female CEOs in the sector. This is inspired by the notion that banks run by women may prove to be less vulnerable in the event of a crisis as purported by some studies. Additionally, a focus on the private banks should also be done given that the governance disclosures is not a requirement, but it is of great importance to be aware of the intricate details of their CG mechanisms seeing that the information shared by them is purely voluntary and may not disclose in the same breadth as listed institutions thus one cannot point out any gaps in their practices. The same study should be done for other financial sectors such as insurance companies and microfinance institutions to see what results will be realised as they also have an influence on the economy as well and bearing in mind these micro-finance institutions target a different class of consumers who form a material proportion of the population.

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APPENDIX I: LIST OF COMMERCIAL BANKS IN KENYA

1	ABC Bank (Kenya)
2	Bank of Africa
3	Bank of Baroda
4	Bank of India
5	Barclays Bank of Kenya
6	Chase Bank Kenya (In Receivership)
7	Citibank
8	Commercial Bank of Africa
9	Consolidated Bank of Kenya
10	Cooperative Bank of Kenya
11	Credit Bank
12	Development Bank of Kenya
13	Diamond Trust Bank
14	Dubai Islamic Bank
15	Ecobank Kenya
16	Equity Bank
17	Family Bank
18	First Community Bank
19	Guaranty Trust Bank Kenya
20	Guardian Bank
21	Gulf African Bank
22	Habib Bank AG Zurich
23	Housing Finance Company of Kenya
24	I&M Bank
25	Imperial Bank Kenya (In receivership)
26	Jamii Bora Bank (Acquired by Co-op Bank)
27	Kenya Commercial Bank
28	Mayfair Bank
29	Middle East Bank Kenya
30	National Bank of Kenya (Acquired by KCB Bank)
31	NIC Bank

32	Oriental Commercial Bank
33	Paramount Universal Bank
34	Prime Bank (Kenya)
35	SBM Bank Kenya Limited
36	Sidian Bank
37	Spire Bank
38	Stanbic Bank Kenya
39	Standard Chartered Kenya
40	Trans National Bank Kenya
41	United Bank for Africa
42	Victoria Commercial Bank

APPENDIX II: DATA FOR COMMERCIAL BANKS IN KENYA

	2014	2015	2016	2017	2018	2019	2020
Total number of directors	10	9	10	10	10	9	10
Male board members	8	7	8	7	7	7	7
Female board members	2	2	2	3	3	2	3
Number of NEDs	8	7	8	7	7	6	5
Number of directors in BAC	4	4	4	4	4	4	4
Proportion of NEDs in BAC	4	4	4	4	4	4	4
BAC Meetings	4	4	5	4	5	5	5
Is the BAC chaired by NED who isn't the Board chairman	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Does Internal Audit report to BAC	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Number of board meetings	6	7	6	10	6	6	6
Meeting attendance rate:	70%	91%	88%	87%	95%	90%	95%
How many directors attended all	6	6	6	7	6	6	7

meetings							
Number of least meeting attended	5	5	4	5	5	5	5
Compliance to CBK 75% meeting attendance	Yes	Yes	Yes	Yes	Yes	Yes	Yes
ROA	2.90%	3.10%	3.30%	3.60%	3.90%	4.60%	2.22%