THE INFLUENCE OF BOARD OF DIRECTORS COMPOSITION ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

BY

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A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF MASTER OF BUSINESS ADMINISTRATION DEGREE OF UNIVERSITY OF NAIROBI

SEPTEMBER 2013
DECLARATION

This research is my original work and has not been presented for award of any degree in any other university

Signature

Date

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D61/62736/2010

This research project has been submitted for examination with my approval as university of Nairobi supervisor.

Signature

Date

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DEDICATION

To God for His provision and making me who I am today.
ACKNOWLEDGMENTS

I would like to appreciate the several individuals that have contributed to this study by way of materials, guidance and motivation.

My appreciation to my supervisor Prof. Martin Ogutu for his guidance and support.

I also appreciate the company secretaries and financial analysts who were accommodative and supportive in giving me information on their banks.

Last but not least my heartfelt appreciation to my family, classmates, colleagues and friends who kept on encouraging and inspiring me to complete my studies.
ABSTRACT

The purpose of this study was to investigate the influence of board of directors composition on financial performance of 43 commercial banks in Kenya. The study was guided by the research objectives to establish the influence of board of directors composition on financial performance of commercial banks in Kenya. A cross sectional survey research method and the data obtained was analyzed using descriptive and inferential statistical analysis. Findings of the study revealed that board size, average tenure, ratio of female directors, occupational experience of the directors and ratio of non-executive could significantly predict only CAR, ROE and ROA. It was recommended that Banks should first engage in establishing which of the many performance measures to prioritize since composition of the board have varied significant influences on the different performance measures, only then will they be able to have an optimum board composition that would positively impact on firm financial performance.
ABBREVIATIONS AND ACRONYMS

CAR: Capital Adequacy Ratio
CG: Corporate Governance
CBK: Central Bank of Kenya
CRAR: Capital to Risk (Weighted) Assets
ROA: Return on Assets
ROE: Return on Net worth/Equity
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CHAPTER ONE

INTRODUCTION

1.1 Background of Study

In the middle of 2007 world economy faced the worst financial crisis, according to leading economists since the Great Depression of 1930. Failure of key businesses, decline in economic activity, bank solvency, decline in consumer wealth, losses on the global stock markets, mergers, acquisitions and bailouts are some of the effects of this credit crunch globally. Particularly the global banking system, which was the most profitable sector in 2006, it now faces severe difficulties that threaten global economy. Although many explanations exist for the potential cause of the credit crunch, many of the causal factors are linked to a failure in Corporate Governance (Moxey and Berendt, 2008). The purpose of this study is to contribute to the literature by examining corporate board composition who are the key mechanism to internal corporate governance and their influence on financial performance.

This study is based upon agency theory that argues that in the modern corporation, in which share ownership is widely held, managerial actions depart from those required to maximize shareholder returns (Berle and Means 1932; Pratt and Zeckhauser 1985). The relevance of banks in the economic system and the nature of the banking business make the problems involved in their corporate governance highly specific, as are the mechanisms available to deal with such problems. The complexity of the banking business increases the asymmetry of information and diminishes stakeholders’ capacity to monitor bank managers’ decisions.

Commercial Banks in Kenya are a key element in the payment system and play a major role in the functioning of economic systems. They are also highly leveraged
firms, due mainly to the deposits taken from customers. For all these reasons, banks are subject to more intense regulation than other firms, as they are responsible for safeguarding depositors’ rights, guaranteeing the stability of the payment system, and reducing systemic risk. Regulation presents several challenges in the field of corporate governance. Even though regulation can be considered an additional mechanism of corporate governance, in most situations it reduces the effectiveness of other mechanisms in coping with corporate governance problems. The Board is responsible for the governance of the Bank and is fulfils its fiduciary obligations to the shareholders by maintaining control over the strategic, financial, operational and compliance issues.

1.1.1 Corporate Governance

Shleifer and Vishny (1997) define corporate governance (CG) as a way in which suppliers of finance to corporations assure themselves of getting a return on their investment. The importance of CG arises in a firm because of the separation between those who control and those who own the residual claims (Epps & Cereola 2008). Furthermore, agency theory assumes an opportunistic behavior that is individuals want to maximize their own expected interests and are resourceful in doing so (McCullers & Schroeder 1982). Therefore, there will be a conflict of interest between managers and stakeholders.

Stakeholders hire managers to apply their investment in firm's activity, hence an information asymmetry occurs because management has the competitive advantage of information within the company over that of the owners (Zubaidah 2009). It can provide management with the opportunity to expropriate firm wealth in their benefit. Hence, agency theory suggests CG as a mechanism to reduce these conflicts by
monitoring managers' performance and competencies by aligning management's goals with those of the stakeholders (Brickley & James 1987).

1.1.2 Board of Directors Composition

The new Central Bank of Kenya (CBK) guidelines has called attention to the need to study, understand, and improve the corporate governance of financial entities. The CBK especially advocates a governance structure composed of a board of directors and senior management. The role of boards as a mechanism for corporate governance of banks takes on special relevance in a framework of limited competition, intense regulation, and higher informational asymmetries due to the complexity of the banking business. Thus, the board becomes a key mechanism to monitor managers’ behaviour and to advise them on strategy identification and implementation. Bank directors’ specific knowledge of the complexity of the banking business enables them to monitor and advise managers efficiently.

The Board is the heart of corporate governance where the outcome of a firm is often determined (Guerra et al., 2009; Yawson, 2006; Donaldson, 2003; Clarke, 2007; Fama and Jensen, 1983; Finkelstein and Hambrick, 1996; Adjaoud et al., 2007; Gillan, 2006). The central objective of corporate governance resides on the ability of board to monitor the management (Connelly and Limpaphayom, 2004). However, the effectiveness of the board of directors as shareholders’ monitoring mechanism can only be efficient if bounded with appropriate size, proportion of outside directors, gender diversity, average age, average board tenure and occupational expertise.

1.1.3 Commercial Banks in Kenya

In Kenya the 43 commercial banks dominate the financial sector. In a country where the financial sector is dominated by commercial banks, any failure in the sector has an
immense implication on the economic growth of the country. This is due to the fact that any bankruptcy that could happen in the sector has a contagion effect that can lead to bank runs, crises and bring overall financial crisis and economic tribulations. Despite the good overall financial performance of banks in Kenya, there are a couple of banks declaring losses (Oloo, 2011). Moreover, the current banking failures in the developed countries and the bailouts thereof motivated this study to evaluate the financial performance of banks in Kenya. Thus, the need to take precautionary and mitigating measures, there is dire need to understand the performance of banks and its determinants.

Commercial banks play a vital role in the economic resource allocation of countries. They channel funds from depositors to investors continuously. They can do so, if they generate necessary income to cover their operational cost they incur in the due course. In other words for sustainable intermediation function, banks need to be profitable. Beyond the intermediation function, the financial performance of banks has critical implications for economic growth of countries. Good financial performance rewards the shareholders for their investment. This, in turn, encourages additional investment and brings about economic growth.

1.2 Research Problem

In the context of recent corporate failures, the focus on the appropriate composition of board of directors that would efficiently manage corporate resources and give managers access to independent and valuable advice to cope with the complexity of strategic choices to run the firms successfully is of great importance. The relationship between composition of board of directors and firm financial performance is complex and researchers have struggled with multiple variables and often been disappointed in
searching for an optimum board composition that would positively impact on firm financial performance.

The main challenges facing the banking sector today include global financial crisis, cut-throat competition, inefficient risk management, fraud issues, hefty penalties by regulators, poor investment choices, reputational risks or even liquidation. Thus a competent board consisting of appropriate composition of board of directors is important to uphold shareholder and stakeholder confidence by playing a key role as a mechanism to good internal corporate governance. Board members with longer or shorter tenures or with gender diversity may have a material effect on the decision-making process, whereas proportions of outside directors help in monitoring certain actions that may have benefited corporate executives at the expense of shareholders and financial reporting. Boards with no banking background and experience can influence their understanding of complicated business transactions and bias their decisions. For instance, educators or lawyers are added to boards but their lack of bank business experience could impair their understanding of business intricacies and negatively sway their board contribution.

To date, there are many studies on the relationship between board of directors and firm performance (Andres and Valdelado, 2008; Bouaziz, 2010 and Obura, 2010) but there is no study that relates composition of board of directors to financial performance of commercial banks in Kenya. Andres and Valdelado (2008) studied the role of board of directors in a sample of 69 large commercial banks from six developed countries for the period 1995-2005 focusing on only two measures duality and the size of the board. However this study will expand from two to five measures of board composition, that is, gender diversity, board size, occupational expertise, tenure and proportion of outside directors by surveying all Commercial Banks in
Kenya, a developing country. Bouaziz (2010) studied the impact of board of directors on financial performance of a sample of 26 Tunisian companies listed on Tunisia Stock Exchange basing on three measures. Obura (2010) did a study on the relationship between board structure and board compensation on financial performance for companies listed at Nairobi Stock Exchange but still both studies do not the unique relationship between boards of commercial banks in Kenya and their influence on financial performance. It’s against this backdrop that this study will seek to investigate, does board of directors’ composition influence financial performance of commercial banks in Kenya?

1.3 Objectives of the Study

The study was guided by the following objectives:

i. To determine the composition of Board of Directors of Commercial Banks in Kenya

ii. To establish Financial Performance of Commercial Banks in Kenya

iii. To determine whether the composition of Board of Directors of Commercial Banks in Kenya influence their financial performance.

1.4 Value of the Study

The study can be extended in future research. One approach, data permitting, would be to build a framework to test empirically the relative importance of how board of directors composition influence performance in companies, organizations or institutions to better manage the upcoming county resources in Kenya.

The complexity of the banking business increases the asymmetry of information and diminishes stakeholders’ capacity to monitor bank managers’ decisions and in most cases resulting to economic scandals and the recent financial crisis. This paper
investigated the relationship between composition of board of directors and financial performance of commercial bank hence findings acts as a guide in choosing the appropriate board members that not only monitors managers efficiently, but also gives managers access to independent and valuable advice to run the banks successfully, given Kenya’s aspirations is to be a premier financial services hub pursuant to Vision 2030.

The relevance of banks to the economy and the complex nature of the banking business justify specific bank regulation. Financial regulation is the answer to the idiosyncratic nature of the banking industry, yet regulation entails fresh challenges for the corporate governance of banks, challenges that are less relevant in the corporate governance of other companies or institutions. Hence the research guides the regulators like Central Bank Kenya and Capital Markets Authority on policies regarding the best choice of board composition to manage corporate resources to deliver the best financial performance while minimizing corporate failures in future due to lack of proper policies and guidelines.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter discusses the literature on theoretical foundation, board of directors Composition and Firm Performance.

2.2 Theoretical Foundation.

Agency theory refers to a set of propositions in governing a modern corporation which is typically characterized by large number of shareholders or owners who allow separate individuals to control and direct the use of their collective capital for future gains. Adam Smith’s (1776) ‘Wealth of Nations’ is perhaps the major driving force for several modern economists to develop new aspects of organizational theory. Among other things, Smith predicts that if an economic firm is controlled by a person or group of persons other than the firm’s owners, the objectives of the owners are more likely to be diluted than ideally fulfilled. Berle and Means (1932) consider Smith’s (1776) concern to specifically examine the organizational and public policy ramifications of ownership and control separation in large firms. They argue that as ownership gets increasingly held by different individuals, the industry becomes consolidated and hence the checks to limit the use of power tend to disappear (McCraw, 1990, p. 582). Jensen and Meckling (1976) develop the concern of ownership-control separation into a fully fledged agency problem comprised within the economic ‘theory of the firm’. In their paper, Jensen and Meckling identify the costs of the agency problem and trace who bears the costs and why.

Though Jensen and Meckling (1976) mention the important role of monitoring in an agency relationship, they do not examine further how a large firm achieves efficient
monitoring. In other words, it seeks to find out how firms structure their corporate governance in order to control the agency problem created by the separation of ownership and control. Fama (1980) pursues this concern and finds that the agency problem is controlled efficiently by a large firm through internal devices established in response to competition from other firms. Further, Fama (1980, p. 288) claims that “individual managers within the firm are controlled by the market’s discipline and opportunities for their services both within and outside the firm”. The devices referred to in Fama (1980) is examined in greater detail in Fama and Jensen (1983, pp. 303-304). Fama and Jensen argue that firms typically segregate decision management from the decision control rights both at top (the board and managers) and lower levels (managers and workers) of the firm’s hierarchy. In a broad sense, decision management relate to carrying out a firm’s function while decision control relates to overseeing the performance of the decision management function. Decision management rights cover two rights, initiation and execution.

2.3 Board of Directors Composition

Corporate boards of directors have been the focus of a steady stream of management research for more than a century, providing a rich base to the governance literature. Perhaps the steadfast interest in board research is sustained by such issues as the important governance oversight role that boards are expected to play, the presumed frequency with which they are negligent in this role, and their association with high-profile corporate failures. While there is a strong believe that internal mechanism of corporate governance is vital to firm performance especially at board level, empirical evidences have not done pretty well in providing the much needed support in this. Some of the board composition reviewed here includes proportion of inside to outside directors, size, diversity, occupational expertise and tenure.
The proportion of inside directors who participate directly in the day to day management of the firm to outside directors who provide check and balances in ensuring that the shareholders interest are protected (O’Sullivan and Wong, 1998; Donaldson and Muth, 1998; Petrovic, 2008; Wan and Ong, 2005). Some researchers found positive relationship (Shleifer and Vishny, 1997; Perry and Shivdasani, 2005; Rhoades et al., 2000; Rosenstein and Wyatt, 1990; Jackling and Johl, 2009), others report either negative or no relationship between the board configuration and firm performance (Yermack, 1996; Dulewicz and Herbert, 2004; Dalton et al., 1998; Erickson et al., 2005; Bhagat and Black, 2000; Weir and Laing, 2001; Shivdasani and Zenner, 2002; Heracleous, 2001; Hsu, 2010; Daily and Dalton, 1992).

The board size represents the total head counts of directors seating on the corporate board. From the empirical perspective, studies on board size are to some extent lopsided as most findings showed clear negative or mix relationship (Eklund et al., 2009), which reflects the ambiguous nature of the proxy in explaining firm performance. The prominent among the studies is that of Yermack (1996) who investigated a sample 452 US industrial firms covering eight year period (1984 to 1991) and found recurring negative relationship between board size and firm performance.

Positive nexus were reported in some few quarters with respect to board size driving improved firm performance (Adam and Mehran, 2003; Wangner et al., 1998; Kiel and Nicholson, 2003 Jackling and Johl, 2009; Pearce and Zahra, 1992; Dalton et al., 1998). Conducted a meta-analysis on 29 previous empirical studies and reported that board size is vital in determining firm performance irrespective of board configuration.
Diversity of board involves having a well balanced board membership that is made of individuals not necessarily from different cultural background but those from different professional fields, gender and age group which create synergy that helps board in carrying out its statutory responsibilities (Carpenter and Westphal, 2001). Keeping a well diversified cognitive board create an in-house self reliance whereby everything that the firm requires ranging from effective monitoring, resource co-optation to quality decisions and sound corporate initiatives are all within reach (Watson et al., 1993). Further to the above, Carter et al., (2007), posited that a well diverse independent board is more vigorous in promoting corporate fair play. At the empirical level, different attributes of board diversity were subject of investigation but the result of findings as documented in literature remained mix and equivocal.

Some reported that board diversity is positively associated with improved firm performance (Erhardt et al., 2003; Carter et al., 2003; Richard, 2000; Roberson and Park, 2007; Shrader et al., 1997), while others found negative and even no relationship in several instances (Shrader et al., 1997; Zahra and Stanton, 1988; Dalton et al., 1998). In a meta-analysis based on data drawn from 85 previous empirical studies, Dalton et al., (1998) found no relationship. But while using data drawn from 127 large US companies, Erhardt et al., (2003), reported a positive association between women and minorities on board with improved firm performance. This finding was subsequently supported by Smith et al., (2006) results which showed similar outcome.
Average Board Tenure of the board members is important because every new task or responsibility has a learning curve. In the early stages of learning, decisions are generally tentative and often involve an incomplete analysis. Board scholars have suggested that the time required for a new director to acquire a sufficient understanding of the firm will range between three and five years (Kesner, 1988). Board tenure has been shown to have a material effect on the decision-making process. For example, there is a correlation between board tenure and resistance to greenmail (Kosnik, 1987).

Longer tenure also appears to increase director independence as it offers some insulation against social isolation for objecting to a course of action preferred by management and other directors (Westphal & Khanna, 2003). In theory, social pressures may keep directors in line with management objectives but directors with longer tenure appear less constrained. Interestingly, not only has longer tenure been shown to improve financial performance but also board members who share similar tenure tend to develop a sense of camaraderie and collectively they are better able to evaluate top management proposals (Kosnik, 1990). However, longer average tenure does not necessarily suggest that tenure homogeneity is most desirable. Heterogeneity of board tenure may ensure a greater influx of new ideas for dealing with previously unforeseen threats or new opportunities.

2.4 Firm Performance

Most studies have been done to evaluate the state of relationship between board dynamics and firm performance. Profit is the ultimate goal of commercial banks. All the strategies designed and activities performed thereof are meant to realize this grand objective. However, this does not mean that commercial banks have no other goals. Commercial banks could also have additional social and economic goals. However,
the intention of this study is related to the first objective, profitability. To measure the profitability of commercial banks there are variety of ratios used some of which are Return on Asset, Return on Equity and Net Interest Margin are the major ones (Murthy and Sree, 2003; Alexandru et al., 2008). The internal factors are within the scope of the bank to manipulate them and that they differ from bank to bank. These include capital size, size of deposit liabilities, size and composition of credit portfolio, interest rate policy, labor productivity, and state of information technology, risk level, management quality, bank size, ownership and the like. CAMEL framework often used by scholars to proxy the bank specific factors (Dang, 2011). CAMEL stands for Capital Adequacy, Asset Quality, Management Efficiency, Earnings Ability and Liquidity.

Capital is one of the bank specific factors that influence the level of bank profitability. Capital is the amount of own fund available to support the bank's business and act as a buffer in case of adverse situation (Athanasoglou et al. 2005). Banks capital creates liquidity for the bank due to the fact that deposits are most fragile and prone to bank runs. Moreover, greater bank capital reduces the chance of distress (Diamond, 2000). Capital adequacy is the level of capital required by the banks to enable them withstand the risks such as credit, market and operational risks they are exposed to in order to absorb the potential loses and protect the bank's debtors. According to Dang (2011), the adequacy of capital is judged on the basis of capital adequacy ratio (CAR). Capital adequacy ratio shows the internal strength of the bank to withstand losses during crisis. Capital adequacy ratio is directly proportional to the resilience of the bank to crisis situations. It has also a direct effect on the profitability of banks by determining its expansion to risky but profitable ventures or areas (Sangmi and Nazir, 2010).
The bank’s asset is another bank specific variable that affects the profitability of a bank. The bank asset includes among others current asset, credit portfolio, fixed asset, and other investments. Often a growing asset (size) related to the age of the bank (Athanasoglou et al., 2005). More often than not the loan of a bank is the major asset that generates the major share of the banks income. Loan is the major asset of commercial banks from which they generate income. The quality of loan portfolio determines the profitability of banks. The loan portfolio quality has a direct bearing on bank profitability. The highest risk facing a bank is the losses derived from delinquent loans (Dang, 2011). Thus, nonperforming loan ratios are the best proxies for asset quality. Different types of financial ratios used to study the performances of banks by different scholars. It is the major concern of all commercial banks to keep the amount of nonperforming loans to low level. This is so because high nonperforming loan affects the profitability of the bank. Thus, low nonperforming loans to total loans shows that the good health of the portfolio a bank. The lower the ratio the better the bank performing (Sangmi and Nazir, 2010).

Management Efficiency is one of the key internal factors that determine the bank profitability. It is represented by different financial ratios like total asset growth, loan growth rate and earnings growth rate. Yet, it is one of the complexes subject to capture with financial ratios. Moreover, operational efficiency in managing the operating expenses is another dimension for management quality. The performance of management is often expressed qualitatively through subjective evaluation of management systems, organizational discipline, control systems, quality of staff, and others. Yet, some financial ratios of the financial statements act as a proxy for management efficiency. The capability of the management to deploy its resources efficiently, income maximization, reducing operating costs can be measured by
financial ratios. One of this ratios used to measure management quality is operating profit to income ratio (Rahman et al. in Ilhomovich, 2009; Sangmi and Nazir, 2010). The higher the operating profits to total income (revenue) the more the efficient management is in terms of operational efficiency and income generation. The other important ratio is that proxy management quality is expense to asset ratio. The ratio of operating expenses to total asset is expected to be negatively associated with profitability. Management quality in this regard, determines the level of operating expenses and in turn affects profitability (Athanasoglou et al. 2005).

Liquidity is another factor that determines the level of bank performance. Liquidity refers to the ability of the bank to fulfill its obligations, mainly of depositors. According to Dang (2011) adequate level of liquidity is positively related with bank profitability. The most common financial ratios that reflect the liquidity position of a bank according to the above author are customer deposit to total asset and total loan to customer deposits. Other scholars use different financial ratio to measure liquidity. For instance Ilhomovich (2009) used cash to deposit ratio to measure the liquidity level of banks in Malaysia. However, the study conducted in China and Malaysia found that liquidity level of banks has no relationship with the performances of banks (Said and Tumin, 2011).
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction
This chapter presents the research design, population of study, data collection and data analysis that was used to carry out the research.

3.2 Research Design
This study adopted a cross-sectional survey research method to show the influence of board composition on financial performance of commercial banks in Kenya. According to Nissen (2005), survey method as one which involves getting feedback from participants on what their views are and what they have experienced. Survey method was useful since the researcher wanted to collect data on phenomena that could not be observed directly. Its advantage was that, it allowed the collection of large amounts of data from a whole population in a highly effective economical way using questionnaires (Burns and Groove 2001).

3.3 Population of the Study
The population of interest in this study consisted of all the 43 commercial banks in Kenya for the year 2010 to 2012 because of the in-depth nature of the study and the analysis of data required.

3.4 Data Collection
As previously stated the researcher intended to carry out a cross-sectional survey by relying on both primary and secondary data. The secondary data will be sourced from 43 banks’ published annual financial statements for the year 2010 to 2012 and Central Bank of Kenya database. The data comprised of capital adequacy, asset quality, Management Quality earnings and liquidity because these are the measures mandated

Primary data were sourced through questionnaires. The questionnaire was appropriate to be used in this research because it consisted of a series of questions and other prompts for the purpose of gathering information from respondents. Questionnaires had advantages over some other types of instruments in that they were cheap, did not require as much effort from the questioner as verbal or telephone surveys, and often had standardized answers that made it simple to compile data. The Questionnaire was be divided into three parts; Section A was used to gather data on demographics, Section B was used to gather data on board composition in terms of size of board, gender diversity, occupational expertise, tenure and proportion of outside directors. Section C was used to gather data on financial data, that is, capital adequacy, asset quality, earnings and liquidity.

The questionnaires were sent to the company secretaries and financial analysts as respondents of the commercial banks to provide information since they are the key custodians of board and financial information. The data collection was carried out over a period of four weeks which allowed the researcher to reflect and make adjustments as necessary.

3.5 Data Analysis

The data obtained was analyzed using descriptive and inferential statistical analysis. The quantitative data was then coded and thereafter analysed using SPSS statistical software to summarize the group of data using a combination of tabulated description, graphical description and statistical commentary.
The study used regression analysis to determine the relationship between the dependent and independent variables of study. Study by Yartey (2008) used regression analysis when researching on relationship between variables. This analysis intended to establish to what extent the dependent variables that is capital adequacy, asset quality, management efficiency, earnings and liquidity are associated to the independent variables that is the size of board, gender diversity, occupational expertise, tenure and proportion of outside directors.

The regression model was of the form;

\[ Y_i = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \varepsilon \]

Where \( Y_i \) = each of the dependent variables (CAR, Asset quality, Management quality, Liquidity, ROE and ROA)

\( X_1 \) = Average tenure

\( X_2 \) = Board Size

\( X_3 \) = Ratio of female directors

\( X_4 \) = Occupational experience
CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

This chapter provides a summary of the data analysis, results of the study and the discussion of the results of the study. The chapter is organized in sections that describes the data presentation, analysis and the results of the study, it also discusses the implication of findings of the study with regard to the central objective of the study which was to determine whether the composition of Board of Directors of Commercial Banks in Kenya influence their financial performance.

4.2 Demographic Information

Data was collected from the 43 commercial banks in Kenya for three years (2010, 2011 and 2012). Data collected relating to the board of directors composition included size of the board, proportion of outside directors, ratio of women to total board members, average age of board members, average board tenure and occupational expertise. Data collected relating financial performance included capital adequacy, asset quality, management efficiency, earnings and liquidity. The researcher was successful in collecting data for 33 banks which was coded and analyzed through descriptive and inferential statistics. The inferential statistics applied included regression and correlation statistics. The presentation was done through tables to represent the analysis from descriptive and inferential analysis.

The data was analyzed descriptively and also using multiple regression analysis and Pearson correlation analysis. The descriptive findings will be presented first, followed by the findings from regression analysis and then Pearson correlation analysis.
4.3 Composition of Board of Directors of Commercial Banks in Kenya

The following is a descriptive analysis of composition of the board of the board of directors for the surveyed banks and results are presented in Tables below.

The average tenure in the surveyed banks was investigated and results are presented in Table 4.3.1 below.

Table 4.3.1: Average Tenure of the Board

<table>
<thead>
<tr>
<th>Average Tenure in Years</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 and Below</td>
<td>19</td>
<td>58</td>
</tr>
<tr>
<td>6 – 10</td>
<td>13</td>
<td>39</td>
</tr>
<tr>
<td>Above 10</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The average tenure of the board was assessed and results presented in Table 4.3.1. The study results indicate that most of the banks (58%) had boards with an average tenure of 5 years and below while those with the highest tenure (above 10 years) were 3%.

The number of directors in the surveyed banks was investigated and results are presented in Table 4.3.2 below.

Table 4.3.2: Total Number of Directors

<table>
<thead>
<tr>
<th>Number of Directors</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 and below</td>
<td>6</td>
<td>18</td>
</tr>
<tr>
<td>6 - 10</td>
<td>17</td>
<td>52</td>
</tr>
<tr>
<td>11 - 15</td>
<td>9</td>
<td>27</td>
</tr>
<tr>
<td>Above 15</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The total number of directors in the surveyed banks was investigated and the analyzed results are presented in Table 4.3.2. The results indicate that the banks with 5 or less
directors were 18%, while those with 6 to 10 directors were the most (52%). Only one bank (3%) had more than 15 directors.

The ratio of female directors to total number of board of directors in the surveyed banks was investigated and results are presented in Table 4.3.3 below.

**Table 4.3.3: Ratio of Female Directors to Total Number of Board of Directors.**

<table>
<thead>
<tr>
<th>Ratio of Female Directors</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 – 5%</td>
<td>13</td>
<td>39</td>
</tr>
<tr>
<td>5% - 10%</td>
<td>6</td>
<td>18</td>
</tr>
<tr>
<td>10% - 15%</td>
<td>6</td>
<td>18</td>
</tr>
<tr>
<td>15% - 20%</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td>Above 20%</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The ratio of female directors in the board was investigated among the surveyed banks and findings are presented in Table 4.3.3. The study results indicate that 39% of the banks had less than 5% female directors while those banks with above 20% female directors were 15%.

The number of non-executive directors in the surveyed banks was investigated and results are presented in Table 4.3.4 below.

**Table 4.3.4: Number of Non-Executive Directors**

<table>
<thead>
<tr>
<th>Number of Non-executive Directors</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>8</td>
<td>24</td>
</tr>
<tr>
<td>2</td>
<td>19</td>
<td>58</td>
</tr>
<tr>
<td>3</td>
<td>4</td>
<td>12</td>
</tr>
<tr>
<td>4</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>11</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
Study results on the number of non-executive directors indicated that 58% of the banks had 2 non-executive directors while one bank (3%) had 11 non-executive directors.

The occupational experience of the bank directors was investigated. This was to establish whether the directors had banking experience only on whether they had mixed experiences. Study results are presented in Table 4.3.5 below.

**Table 4.3.5: Occupational Experience of the Board**

<table>
<thead>
<tr>
<th>Occupational Experience</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking only</td>
<td>19</td>
<td>58</td>
</tr>
<tr>
<td>Mixed</td>
<td>14</td>
<td>42</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Study results indicate that 58% of the boards had banking experience only while 42% had board which had members who had mixed experiences.

**4.4 Financial Performance of Commercial Banks in Kenya**

The following is a descriptive analysis of the financial performance variables for the surveyed banks.

**Table 4.4.1: Capital Adequacy Ratio**

<table>
<thead>
<tr>
<th>CAR</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>15% and below</td>
<td>6</td>
<td>18</td>
</tr>
<tr>
<td>15% - 20%</td>
<td>7</td>
<td>21</td>
</tr>
<tr>
<td>20% - 25%</td>
<td>8</td>
<td>24</td>
</tr>
<tr>
<td>25% - 30%</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>30% - 35%</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>35% - 40%</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td>&gt;40%</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
On capital adequacy, most of the banks have a CAR of below 15% (18%) while those with CAR of above 40% were 9%.

The asset quality of the surveyed banks was investigated and results are presented in Table 4.4.2 below.

**Table 4.4.2: Asset Quality Ratios**

<table>
<thead>
<tr>
<th>Asset Quality</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>5% and below</td>
<td>13</td>
<td>39</td>
</tr>
<tr>
<td>5% - 10%</td>
<td>9</td>
<td>27</td>
</tr>
<tr>
<td>10% - 20%</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td>20% - 30%</td>
<td>4</td>
<td>12</td>
</tr>
<tr>
<td>Above 30%</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Results on asset quality of the surveyed banks indicate that 39% had asset quality ratio of below 5% while those with asset quality ratio of above 20% were 6% of all the banks surveyed.

The number of management quality in the surveyed banks was investigated and results are presented in Table 4.4.3

**Table 4.4.3: Management Quality**

<table>
<thead>
<tr>
<th>Management Quality</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>0% and below</td>
<td>4</td>
<td>12</td>
</tr>
<tr>
<td>0% - 100%</td>
<td>12</td>
<td>36</td>
</tr>
<tr>
<td>100% - 200%</td>
<td>9</td>
<td>27</td>
</tr>
<tr>
<td>200% - 300%</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td>Above 300%</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
Results on management quality indicate that 36% of the banks had management quality between 0 and 100% while 9% of the banks had management quality of between 200% and 300%.

The return on equity in the surveyed banks was investigated and results are presented in Table 4.4.4

Table 4.4.4: Return on Equity

<table>
<thead>
<tr>
<th>ROE</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>10% and below</td>
<td>8</td>
<td>24</td>
</tr>
<tr>
<td>10% - 20%</td>
<td>6</td>
<td>18</td>
</tr>
<tr>
<td>20% - 30%</td>
<td>7</td>
<td>21</td>
</tr>
<tr>
<td>30% - 40%</td>
<td>9</td>
<td>27</td>
</tr>
<tr>
<td>Above 40%</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Study results presented in Table 4.4 indicated that those banks with ROE of below 10% were 24% of the total banks surveyed. Those banks with ROE of above 40% were 9% of the total banks surveyed.

The Return on Assets in the surveyed banks was investigated and results are presented in Table 4.4.5 below

Table 4.4.5: Return on Assets

<table>
<thead>
<tr>
<th>ROA</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>10% and below</td>
<td>19</td>
<td>58</td>
</tr>
<tr>
<td>10% - 20%</td>
<td>11</td>
<td>33</td>
</tr>
<tr>
<td>20% - 30%</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>Above 30%</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
Study results presented in Table 4.5 indicate that those banks with ROA of below 10% were 58% of the total banks surveyed while those banks with ROA of above 30% were 3% of the total banks surveyed.

The Liquidity ratios in the surveyed banks were investigated and results are presented in Table 4.4.6 below.

**Table 4.4.6: Liquidity Ratios**

<table>
<thead>
<tr>
<th>Liquidity Ratios</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>20% - 30%</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td>30% - 40%</td>
<td>10</td>
<td>30</td>
</tr>
<tr>
<td>40% - 50%</td>
<td>13</td>
<td>39</td>
</tr>
<tr>
<td>50% - 60%</td>
<td>4</td>
<td>12</td>
</tr>
<tr>
<td>Above 60%</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Study results on liquidity are presented in Table 4.6 where most banks (39%) surveyed had liquidity ratios between 40% and 50%. Nine percent (9%) of the banks surveyed had liquidity ratios of above 60%.

**4.5 Board of Directors Composition and Financial Performance**

Multiple regression analysis was performed on dependent and the independent variables in order to determine whether the composition of Board of Directors of Commercial Banks in Kenya influence their financial performance. The independent variables used were average tenure of the board, board size, ratio of female directors, occupational experience of the directors and ratio of non-executive directors. Various models were run with the stated independent variables and each of the dependent variables at a time that is Capital Adequacy ratio, Management quality, Asset quality, liquidity, ROE and ROA. Results for the regression analysis are presented in Table
4.5.1. The regression coefficients are presented for each dependent variable while the t-values are indicated in parenthesis.

**Table 4.5.1: Regression statistics of Board of Directors Composition and Financial Performance**

<table>
<thead>
<tr>
<th>Statistic</th>
<th>CAR</th>
<th>Asset Quality</th>
<th>ROE</th>
<th>Mgt Quality</th>
<th>ROA</th>
<th>Liquidity</th>
</tr>
</thead>
<tbody>
<tr>
<td>R²</td>
<td>.322</td>
<td>.284</td>
<td>.416</td>
<td>.296</td>
<td>.432</td>
<td>.297</td>
</tr>
<tr>
<td>F</td>
<td>1.766</td>
<td>1.349</td>
<td>3.202*</td>
<td>1.471</td>
<td>3.519*</td>
<td>1.479</td>
</tr>
<tr>
<td>Intercept</td>
<td>.074</td>
<td>.046</td>
<td>.346</td>
<td>4.194</td>
<td>.295</td>
<td>.176</td>
</tr>
<tr>
<td>Average Tenure</td>
<td>.001</td>
<td>-.002</td>
<td>-.014</td>
<td>-.465</td>
<td>-.013</td>
<td>.010</td>
</tr>
<tr>
<td>Board Size</td>
<td>(.205)</td>
<td>(-.330)</td>
<td>(-1.707)</td>
<td>(-1.337)</td>
<td>(-3.152)*</td>
<td>(1.567)</td>
</tr>
<tr>
<td>Ratio of female directors</td>
<td>-.018</td>
<td>-.006</td>
<td>.023</td>
<td>-.556</td>
<td>.004</td>
<td>-.012</td>
</tr>
<tr>
<td>Occupational experience</td>
<td>(-2.602)*</td>
<td>(-1.092)</td>
<td>(2.582)*</td>
<td>(-1.510)</td>
<td>(1.001)</td>
<td>(-1.744)</td>
</tr>
<tr>
<td>Ratio of non-executive directors</td>
<td>-.105</td>
<td>.080</td>
<td>.271</td>
<td>-5.473</td>
<td>.045</td>
<td>-.067</td>
</tr>
<tr>
<td>Ratio of non-executive directors</td>
<td>(-1.203)</td>
<td>(1.230)</td>
<td>(2.431)*</td>
<td>(-1.172)</td>
<td>(.811)</td>
<td>(-.747)</td>
</tr>
</tbody>
</table>

* Significant at 5%

The regression results in Table 4.5.1 indicate that the independent variables (Average tenure of the board, board size, ratio of female directors, occupational experience of the directors and ratio of non-executive) can significantly predict ROE (F= 3.202) and ROA (F= 3.519). The independent variables also explain 41.6% of ROE and 43.2% of ROA. The $r^2$ for the other dependent variables is small (0.322 for CAR, 0.284 for Asset quality, 0.296 for management quality and 0.297 for liquidity).
Average tenure of the board can significantly predict ROA ($B = -0.013; t = -3.152$). This indicates that as the average tenure of the board increases, ROA decreases and vice versa. Average board tenure did not have a significant predictive value on CAR, management quality, asset quality, ROE and liquidity levels.

Board size is a significant predictor of Capital Adequacy Ratio ($B = -0.018; t = -2.602$), and ROE ($B = 0.023; t = 2.582$). The relationship between board size and CAR is negative indicating that as the size of the board increases, CAR decreases. However, board size has a positive relationship with ROE indicating that increasing the board size will have a positive effect on ROE and vice versa.

Ratio of female directors to the total number of directors in the board was a significant predictor of ROE ($B = 0.271; t = 2.431$) but was insignificant in predicting the other performance measures. The relationship between the ratio of female directors and ROE is positive indicating that increase in the ratio of female directors would have a positive effect on ROE.

Occupational experience of the directors had a significant predictive ability on ROA ($B = -0.068; t = 3.7$). The occupational experience for the directors was rated 1 for directors having banking experience only and 2 for directors with mixed experiences. This negative relationship indicates that directors having only banking experience were related to better ROA than the boards with members with different occupational experiences.

Ratio of non-executive directors was a significant predictor of CAR ($B = 0.296; t = 2.452$) and Liquidity ratio ($B = 0.255; t = 2.057$). The relationship between the ratio of non-executive directors and both CAR and liquidity ratios is positive indicating that having a high ratio of non-executive directors is positively related to higher CAR and
liquidity ratio and vice versa. The ratio of non-executive directors cannot significantly predict ROA, ROE, asset quality and management quality.

A correlation analysis was also performed on the variables under study using the Karl Pearson’s correlation coefficients. Results are presented on Table 4.5.2.

Table 4.5.2: Pearson Correlation Coefficients matrix of Board of Directors Composition and Financial Performance

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Capital Adequacy Ratio</td>
<td></td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Asset Quality</td>
<td>.309*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Mgt Quality</td>
<td>.184</td>
<td>.354*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. ROE</td>
<td>-.487*</td>
<td>-.301*</td>
<td>-.092</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. ROA</td>
<td>-.286*</td>
<td>-.041</td>
<td>.141</td>
<td>.743*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Liquidity</td>
<td>.520*</td>
<td>.075</td>
<td>.162</td>
<td>-.411*</td>
<td>-.381*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Average Tenure</td>
<td>-.049</td>
<td>-.131</td>
<td>-.163</td>
<td>-.118</td>
<td>-.228*</td>
<td>.091</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Board Size</td>
<td>-.124</td>
<td>-.107</td>
<td>-.199*</td>
<td>.242*</td>
<td>.065</td>
<td>-.007</td>
<td>.146</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Female directors</td>
<td>-.140</td>
<td>.121</td>
<td>-.130</td>
<td>.266*</td>
<td>.068</td>
<td>-.097</td>
<td>.208*</td>
<td>.127</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Occupational experience</td>
<td>.032</td>
<td>.116</td>
<td>-.055</td>
<td>-.021</td>
<td>-.272*</td>
<td>.116</td>
<td>-.216*</td>
<td>.302*</td>
<td>.277*</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>11. Non-executive directors</td>
<td>.122</td>
<td>.142</td>
<td>.066</td>
<td>.005</td>
<td>-.095</td>
<td>.152</td>
<td>-.080</td>
<td>.226*</td>
<td>-.132</td>
<td>.110</td>
<td>1</td>
</tr>
</tbody>
</table>

* Correlation is significant at 5%

The correlation coefficients presented in table 4.5.2 indicate the variables that had significant relationships. The matrix confirms the results of the regression analysis and also indicates that relationship between the independent variables themselves. The results indicate a significant positive relationship between asset quality and
capital adequacy ratio (0.309), management quality and asset quality (0.354), ROA and ROE (0.743) and between CAR and liquidity (0.520).

Board size is also positively related to ROE (0.242) though the relationship is not very strong. Board size however, has a significant negative relationship with management quality (-0.199). Ratio of female directors has a significant positive relationship with ROE (0.266). This indicates that increasing the ratio of female directors increases the ROE. Occupational experience of the board has a negative relationship with ROA (-0.272) indicating that having a board with mixed occupational experiences had a negative effect on ROA.

4.6 Discussion of Findings

According to the presentation and analysis of board of directors composition and financial performance variables, this study found a significant negative relationship between board tenure and financial performance, in that as the average tenure of the board increases, ROA decreases and vice versa. However average board tenure did not have a significant predictive value on CAR, management quality, asset quality, ROE and liquidity levels. This study disagrees with the findings from a study by Westphal and Khanna (2003) who observed that longer tenure appears to increase director independence as it offers some insulation against social isolation for objecting to a course of action preferred by management and other directors. The researcher suggests that heterogeneity of board tenure may ensure a greater influx of new ideas for dealing with previously unforeseen threats or new opportunities hence increasing profitability of the Bank.

It showed that the relationship between board size and CAR is negative indicating that as the size of the board increases, CAR decreases. However, board size has a positive
relationship with ROE indicating that increasing the board size will have a positive
effect on ROE and vice versa. The findings from this study is in line with previous
study by Adam Jackling and Johl (2009) who found that board size drives improved
firm performance. However, the study findings disagree with a study by Eklund et al.
(2009) which found a negative relationship between board size and financial
performance. The researcher’s view is that more directors should benefit the
monitoring and advisory functions, improve governance, and raise returns. However,
there is a limit beyond which the coordination, control, and decision-making problems
outweigh the benefits hence board size is a trade-off between advantages and
disadvantages.

The finding on relationship between the ratio of female directors and ROE is positive
indicating that increase in the ratio of female directors would have a positive effect on
ROE. These results concur with findings by Carpenter and Westphal (2001) who
observed that diversity of board involves having a well balanced board membership
that is made of individuals not necessarily from different cultural background but
those from different gender and age group. The study by Carpenter and Westphal
(2001) indicated that having a mixed gender board creates synergy that helps board in
carrying out its statutory responsibilities. The researcher has observed that at meetings
with at least three directors of each gender in attendance, boards were twice as likely
to take actions such as demanding added information or suggesting alternatives to
executives' proposals. Companies with gender-balanced boards are also more likely to
get rid of chief executive officers during periods of poor performance. On the
financial front, they generated significantly higher returns for shareholders.
CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter summarises the findings of the study in relation to its objective. It gives conclusion drawn from the study and highlights the recommendation, limitations of the study and recommendation for further research.

5.2 Summary of Findings

The main objective of this study was to determine whether the composition of Board of Directors of Commercial Banks in Kenya and how they influence their financial performance. To find answers to this objective the main variables of Board of Directors were clearly defined, that is, average tenure of the board, board size, ratio of female directors, occupational experience of the directors and ratio of non-executive directors. Moreover, measure of financial performance had to be chosen, which in this case were Capital Adequacy ratio, Management quality, Asset quality, liquidity, ROE and ROA. To collect these the researcher did send questionnaires to all commercial Banks.

An important observation on average tenure of the board indicates that most of bank directors had an average tenure of five years while those with the highest average tenure were very few. On board size depends on size and age of the bank, one bank had the least number only two directors while another bank had the most number up to eighteen directors. Regarding the ratio of female directors in the board, majority banks had no female directors in their board while those banks with female directors, there representation was a minority. On non-executive directors, most of the banks had a maximum of up to three. Regarding occupational experience of the bank directors, study results indicate that more than half of the boards had banking
experience only while slightly less than half had board which had members who had mixed experiences.

Regression correlation analysis indicate that board size, average tenure, ratio of female directors, occupational experience of the directors and ratio of non-executive could significantly predict only CAR, ROE and ROA. This indicates that as the average tenure of the board increases, ROA decreases and vice versa. Average tenure did not have a significant predictive value on CAR, management quality, asset quality, ROE and liquidity levels. Board size is a significant predictor of CAR and ROE. The relationship between board size and CAR is negative indicating that as the size of the board increases, CAR decreases. However, board size has a positive relationship with ROE indicating that increasing the board size will have a positive effect on ROE and vice versa. Ratio of female directors to the total number of directors in the board was a positive significant predictor of ROE but was insignificant in predicting the other performance measure that is an increase in the ratio of female directors would have a positive effect on ROE. Occupational experience of the directors had a significant predictive ability on ROA.

The occupational experience for the directors was rated one for directors having banking experience only and two for directors with mixed experiences. This negative relationship indicates that directors having only banking experience were related to better ROA than the boards with members with different occupational experiences. This indicates that having a board with mixed occupational experiences has a negative effect on ROA. Ratio of non-executive directors was a significant predictor of CAR and Liquidity ratio. The relationship between the ratio of non-executive directors is a significant predictor of both CAR and liquidity ratios, the relationship is positive.
indicating that having a high ratio of non-executive directors is positively related to higher CAR and better liquidity ratio and vice versa. The ratio of non-executive directors cannot significantly predict ROA, ROE, asset quality and management quality.

Correlation coefficients indicate that board size is also positively related to ROE though the relationship is not very strong. Board size however, has a significant negative relationship with management quality implying that increasing board size will negatively affect management quality and vice versa. Ratio of female directors has a significant positive relationship with ROE. This indicates that increasing the ratio of female directors increases the ROE. Occupational experience of the board has a negative relationship with ROA indicating that having a board with mixed occupational experiences had a negative effect on ROA.

5.3 Conclusion of the Study

From the study findings, the following conclusions are made. First, having boards members serve for a longer duration will negatively affect ROA but will not have any significant relationship on CAR, asset quality, management quality, ROE and liquidity levels. The size of the board has a negative relationship with CAR but has a positive relationship with ROE. This indicates that increasing the board size would affect capital adequacy adversely but will improve ROE. The board size however, does not have a significant relationship and does not affect ROA, management quality, asset quality and liquidity.

Third, ratio of female directors to the total number of directors in the board significantly predicts ROE but it is insignificant in predicting CAR, asset quality, management quality, ROA and liquidity. The occupational experience of the members
of the board can significantly predict ROA. Boards with members who have experience in banking only perform better than the firms with boards who have members mixed occupational experiences. However, occupational experiences of the board cannot predict the CAR, management quality, asset quality, ROE or liquidity.

Lastly, ratio of non-executive directors to the total board size is a significant predictor of CAR and Liquidity ratio. The relationship between the ratio of non-executive directors and both CAR and liquidity ratios is positive indicating that a high ratio of non-executive directors is positively related to higher CAR and liquidity ratio and vice versa. The ratio of non-executive directors cannot significantly predict ROA, ROE, asset quality and management quality.

5.4 Recommendations of the Study

From the study results, it is recommended that banks should first engage in establishing which of the many performance measures to prioritize since board composition have varied significant influence on the different performance measures. Commercial banks that would like to improve their CAR should increase the ratio of non-executive directors in the board. Increasing the ratio of the non-executive board members would also increase the liquidity levels of the bank.

Last but not least, commercial banks who value ROA should have their board members serving for a shorter term and have more board members experienced in banking. Banks focusing on improving ROE should increase the board size and increase the ratio of female members in the board. Therefore code for best practices and corporate governance guidelines should focus critically on these board dynamics as the cornerstone to achieving the much needed board effectiveness in improving financial performance in Banks.
5.5 Limitation of the Study

First it was not possible to obtain 100% of the required data. Most board and financial data for the three years 2010, 2011 and 2013 for some Banks was not available. Some Banks did not provide full data on their financial results and board information with fear that they may release sensitive information to their competitors or they have not complied with CBK guidelines.

Some of the data that was obtained from annual financial reports had conflicting figures with the one received from the respondents that agreed to provide the information. Finally there was a time limit in conducting the research since it was a nationwide survey.

5.6 Suggestions for Further Research

This study was aimed at establishing the influence of board composition on financial performance of commercial banks. The researcher suggest further research on how board composition affects Tobin’s Q which is an inclusive measure of performance used in analyzing commercial bank performance.

Another study on the effect of board composition on other financial institutions and organisations would be very beneficial. This would be able to determine how board composition in other sectors affects performance of firms in those sectors order to prevent dangerous market conditions and provide financial stability.
REFERENCES


Ilhomovich, S.E. (2009) Factors affecting the performance of foreign banks in Malaysia. Malaysia: A thesis submitted to the fulfillment of the requirements for the degree Master of Science (Banking)


APPENDICES

Appendix I: Introduction Letter

2nd August 2013

University of Nairobi
School of Business
Department of Business Administration
Nairobi

Dear Respondent,

REF: Data Collection for Research Project

I am a Post Graduate student at the University of Nairobi pursuing MBA degree. In order to fulfil the degree requirements, I am undertaking a research project titled: The Influence of Board of Directors Composition on Financial Performance of Commercial Banks in Kenya.

Your Bank has been selected as part of this study and this is to kindly request you assist me collect the data by filling in the attached questionnaire. Your feedback will assist the researcher come up with useful information on the study.

Your cooperation will be highly appreciated.

Thanks and Regards,

Percy Chepkosgei

MBA, Student.
Appendix II: Questionnaire

This questionnaire is designed to collect data on board composition and how they influence financial performance of all commercial banks in Kenya. The information will be used strictly for academic purposes and will be treated with utmost confidentiality. Your feedback will assist the researcher come up with useful information on the study.

Section A: General Information

1. Name of your Bank………………………………………………

2. What is your Position in the Bank?…………………………

3. Please indicate your department……………………………

4. How long have you worked with the bank.
   (i) Below 5 Years ( )
   (ii) 5 - 10 Years ( )
   (iii) Over 10 Years ( )

Section B: Board Composition

1. Please indicate the number of directors in the following categories

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of Directors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Executive Directors</td>
<td></td>
</tr>
<tr>
<td>Number of Non-Executive Directors</td>
<td></td>
</tr>
<tr>
<td>Number of Ladies in the Board</td>
<td></td>
</tr>
</tbody>
</table>
2. What is the number of Board of Directors that fall into the age brackets below?

<table>
<thead>
<tr>
<th>Average Age</th>
<th>Number of Directors</th>
</tr>
</thead>
<tbody>
<tr>
<td>20-30</td>
<td></td>
</tr>
<tr>
<td>31-40</td>
<td></td>
</tr>
<tr>
<td>41-50</td>
<td></td>
</tr>
<tr>
<td>51-60</td>
<td></td>
</tr>
<tr>
<td>Above 61</td>
<td></td>
</tr>
</tbody>
</table>

3. Please indicate number of Board of Directors’ average tenure below.

<table>
<thead>
<tr>
<th>Average Tenure</th>
<th>Number of directors</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-5</td>
<td></td>
</tr>
<tr>
<td>6-10</td>
<td></td>
</tr>
<tr>
<td>11-15</td>
<td></td>
</tr>
<tr>
<td>16-20</td>
<td></td>
</tr>
<tr>
<td>Above 20</td>
<td></td>
</tr>
</tbody>
</table>

4. What is the number of Board of Directors in each of the Occupational category below?

<table>
<thead>
<tr>
<th>Occupation</th>
<th>Number of Directors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bankers</td>
<td></td>
</tr>
<tr>
<td>Lawyers</td>
<td></td>
</tr>
<tr>
<td>Business People</td>
<td></td>
</tr>
<tr>
<td>Teachers</td>
<td></td>
</tr>
<tr>
<td>Any other</td>
<td></td>
</tr>
</tbody>
</table>
Section C: Financial Performance

1. Please indicate the capital adequacy ratio for 2010-2012.

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital Adequacy Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Total Capital to Total Assets)</td>
</tr>
<tr>
<td>2010</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td></td>
</tr>
</tbody>
</table>

2. Please indicate the Asset Quality for 2010-2012

<table>
<thead>
<tr>
<th>Year</th>
<th>Asset Quality Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Non-performing loans to Total loans)</td>
</tr>
<tr>
<td>2010</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td></td>
</tr>
</tbody>
</table>

3. Please indicate the Management Efficiency for 2010-2012

<table>
<thead>
<tr>
<th>Year</th>
<th>Management Efficiency Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Total Operating Revenue to Total Profit)</td>
</tr>
<tr>
<td>2010</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td></td>
</tr>
</tbody>
</table>
4. Please indicate the Earnings for 2010-2012

<table>
<thead>
<tr>
<th>Year</th>
<th>Earnings Ability</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Ratio of Income to its total asset</td>
</tr>
<tr>
<td></td>
<td><em>(Return on Asset - ROA)</em></td>
</tr>
<tr>
<td>2010</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td></td>
</tr>
</tbody>
</table>

5. Please indicate the Liquidity for 2010-2012

<table>
<thead>
<tr>
<th>Year</th>
<th>Liquidity ratios</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><em>(Total Loans to Total Customer Deposit)</em></td>
</tr>
<tr>
<td>2010</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td></td>
</tr>
</tbody>
</table>

6. Any other comments on board of director’s composition and their influence on financial performance in your bank.

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Appendix III: List of Commercial Banks in Kenya

1. ABC Bank (Kenya), P.O Box 46452-00100, Nairobi
2. Bank of Africa Kenya, P. O. Box 69562-00100 Nairobi
3. Bank of Baroda (K) Ltd, P. O Box 30033 - 00100 Nairobi
4. Bank of India Kenya, O. Box 30246 - 00100 Nairobi
5. Barclays Bank of Kenya Ltd., P. O. Box 30120 - 00100, Nairobi
6. CFC Stanbic Bank Kenya, P. O. Box 72833 - 00200 Nairobi
7. Chase Bank Kenya, P. O. Box 28987 - 00200 Nairobi.
8. Charterhouse Bank Ltd, P. O. Box 43252 Nairobi (under - statutory management)
9. Citibank N.A Kenya, P. O. Box 30711 - 00100 Nairobi
10. Commercial Bank of Africa Ltd, P. O. Box 30437 - 00100, Nairobi
11. Consolidated Bank of Kenya Ltd, P. O. Box 51133 - 00200, Nairobi
12. Co-operative Bank of Kenya Ltd, P. O. Box 48231 - 00100 Nairobi
13. Credit Bank Ltd, P. O. Box 61064, 00100 Nairobi
14. Development Bank of Kenya Ltd, P. O. Box 30483 - 00100, Nairobi
15. Diamond Trust Bank (K) Ltd, P. O. Box 61711 - 00200, Nairobi
16. Dubai Bank Kenya Ltd, P. O. Box 11129 -00400, Nairobi
17. Ecobank Kenya Ltd, P. O Box 49584- 00100 Nairobi
18. Equatorial Commercial Bank Ltd, P. O. Box 52467 - 00100 Nairobi
19. Equity Bank of Kenya Limited, P. O Box 75104-00200, Nairobi
20. Family Bank Ltd, P. O Box 74145,00100 Nairobi
21. Fidelity Commercial Bank Ltd, P. O. Box 34886 - 00100 Nairobi
22. Fina Bank Ltd, P. O. Box 20613 - 00200, Nairobi
23. First community Bank Limited, P. O. Box 26219-00100, Nairobi
24. Giro Commercial Bank Ltd, P. O. Box 46739 - 00200, Nairobi
25. Guardian Bank Ltd, P. O. Box 67681 - 00200, Nairobi
26. Gulf African Bank Limited, P. O. Box 43683 - 00100, Nairobi
27. Habib Bank Ltd, P. O. Box 43157 - 00100, Nairobi
28. Habib Bank A.G Zurich Postal, P. O. Box 30584 - 00100 Nairobi.
29. I & M Bank Ltd-Kenya, P.O. Box 30238 - 00100, Nairobi
30. Imperial Bank Ltd Postal , P. O. Box 44905 - 00100, Nairobi
31. Jamii Bora Bank Ltd. , P. O. Box 22741 - 00400, Nairobi
32. Kenya Commercial Bank Ltd, P. O. Box 48400 - 00100, Nairobi
33. K-Rep Bank Ltd, P. O. Box 25363 - 00603, Nairobi
34. Middle East Bank (Kenya) Ltd, P. O. Box 47387 - 0100 Nairobi
35. National Bank of Kenya Ltd , P. O. Box 72866 - 00200 Nairobi
36. NIC Bank Ltd , P. O. Box 44599 - 00100 Nairobi
37. Oriental Commercial Bank Ltd , P.O BOX 44080 - 00100, Nairobi
38. Paramount Universal Bank Ltd, P. O. Box 14001 - 00800 Nairobi
39. Prime Bank Ltd, P. O. Box 43825 - 00100, Nairobi
40. Standard Chartered Bank Kenya Ltd Postal , P. O. Box 30003 - 00100 Nairobi
41. Trans-National Bank Ltd, P. O. Box 34353 - 00100 Nairobi
42. UBA Kenya Bank Ltd, P. O. Box 34154 - 00100, Nairobi
43. Victoria Commercial Bank Ltd, P. O. Box 41114 - 00100 Nairobi

**Source:** Central Bank of Kenya Banking Services Delivery Report (2012).