CORPORATE GOVERNANCE PRACTICES BY MAJOR COMMERCIAL BANKS IN KENYA

BY

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DECLARATION

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

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This research project has been submitted with my approval as the university supervisor.

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I thank my family for the patience that they have shown to me in difficult times of this academic journey. Their anticipation to my graduation has always provided me with the driving force that I needed when I felt deflated.

I finally pass my sincere gratitude to my supervisor in this research, Mr Eliud Mududa whose guidance, criticisms and direction had a major impact in the outcome of this document.

DEDICATION

I dedicate this research project to my late father whose echoes of past lectures about the importance of advanced education still ring in my ears.

ABSTRACT

The banking industry in Kenya has not received due attention as regards corporate governance, and how they measure with established standards. This research project sought to fill this void by achieving two objectives; establish the corporate governance practices that are employed by the major commercial banks in Kenya, and to expose differences between these practices and established best practices. This study used both primary and secondary data to achieve these objectives. Primary data was obtained directly from top management in banks through questionnaire administration that had both closed and open ended questions that provided this research with both qualitative and qualitative data. Secondary data was especially used to establish best practices. The respondents were six top managers of the six major commercial banks in the country that comprise tier one status in the market. Findings indicate that Kenya has made great strides in corporate governance practices in the banking industry through benchmarking and to some extent regulation. The study however exposed shortfalls in representation in boards of management and certain aspects of regulation such as remuneration. The study recommends sound regulatory governance as regards representation. The quality of supervision and prudential guidelines need to be carefully crafted.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Although the subject of corporate governance in developing countries has of late received attention and considerable research, information on the corporate governance of banks in these countries has not been abundant. The banking sector is vital in the economy; it dominates the financial sector, in terms of investment banking since the financial markets are largely underdeveloped, thus being typically the most important source of finance for firms; as well as holding public savings. Kenya for instance has pumped funds in banks so as to advance credit to Small and Micro Enterprises (SME's) and the demographic segments of youth and women. It is not clear if these funds are monitored to ensure the success of its intended purposes. This is compounded by the fact that after the structural adjustment programs pioneered by the IMF, the sector became liberalized.

The government also divested from ownership in banks reducing the role of economic regulation. Consequently, managers of banks in these economies have obtained greater freedom in how they run their banks. This study seeks to fill the academic void that exists as regards corporate management in the Kenyan banking sector.

1.1.1Corporate governance

Shleifer and Vishny (1996) define corporate governance as referring to the way in which suppliers of finance assure themselves a return on their investments.
The modern business corporation is one of the world's most powerful means of wealth creation and prosperity. It is indeed at the core of the wealth of nation's theory by Adam Smith. Corporations were invented for the benefit of society, but to fulfill this role, they must

be well governed. They must have responsible internal leadership and operate within competitive markets under sound corporate governance.

From the above, corporate governance structures the relationships among investors, boards of directors, managers, and other stakeholders like regulatory agencies and members of the public. Its goal is to maximize long-term shareholder value by improving corporate decision making and performance. Firms are therefore guided under certain structures and boundaries, legal, economic and institutional, so as to protect private rights as well as public responsibilities.

1.1.2 Corporate Governance best practices

An effective corporate governance system relies on a combination of internal and external discipline to maximize corporate performance, minimize risk, and protect the interests of investors and stakeholders. That firms do not operate in a vacuum sets the context for the operational practices. Certain principles can be derived from a vast field of literature in corporate governance as being generally accepted best practices.

The rights of shareholders and their equitable treatment is a key tenet of corporate governance best practice. This starts from secure ownership. Kenya has seen instances of corrupt dealings at stock brokerage firms, as well as insider dealings that leave the not so well connected vulnerable. This is a clear pointer to failed corporate governance practice. Information must and should be free and available to all. Shareholders should also be allowed to fully participate in the affairs of the firm. This is secured by equal voting rights and full and timely disclosure. Moreover, all shareholders should have an equitable share of profits. This return on investment is what corporate governance seeks to guarantee. This right must extend wholesomely to include minority and even foreign shareholders.

A key practice of corporate governance is the place of the board of directors in the firm. This includes their rights, responsibilities and duties. The board is responsible for strategic guidance of the firm, and encouraging enhanced performance. Management acts as agents for the board and only implement by operationalizing strategic choices of the board. The board must therefore act as a check and oversight to management. The duty of care and duty of loyalty to shareholders must be the guiding principles of the board.

Ethical and responsible decision making is a key principle of corporate governance best practice. There should be an established code of conduct at all levels of the firm, that includes a policy concerning trading in company securities by directors, officers and employees. A company must also recognize and manage risk. This is done by establishing a sound system of risk oversight and management and internal control.

Contemporary strategic standards being imposed on boards include gender, children and special needs rights, as well as that of the host communities. Kenya's publicly owned firms are for instance being required to reserve one third of seats to either gender (read women), and a third of all contractual tenders for youth owned firms.

1.1.3 Banking industry in Kenya

The banking industry in Kenya is governed by the companies Act, the Central Bank of Kenya Act and the various prudential guidelines issues by CBK from time to time. The Central Bank of Kenya was established by an Act of Parliament, the Central Bank of Kenya Act Cap 491. Its principle object has been to formulate and implement monetary policy directed to achieving and maintaining stability in general level of prices in Kenya. The second principle objective is to foster liquidity, solvency and proper functioning of stable market-based financial system. Other objectives include formulating and implementing foreign exchange policy, hold and manage foreign policy reserves, license dealers in the money markets, promoting the smooth operation of payments, clearing and settlement systems, issue legal tender and advice the government and act as its fiscal agent.

The Banking Act Cap 488 Laws of Kenya regulates the business of banking in Kenya. The commercial banks have organized themselves in an association called The Kenya Bankers Association (KBA). Its core function has over time metarmophosized from negotiating on behalf of employers with the union on labor matters to include promoting member banks' interests, by engaging the government and the regulator, the CBK. Some successes have come out of it most notable being the cheque truncation system that has reduced cheque clearing days to T+1. Another of its flagships is the current plan of chipping all debit cards, and doing away with the fraud prone stripped cards.

1.2 Research problem

Corporate governance has become an issue of global significance. The globalization and liberalization of economies has presented both challenges and opportunities for African countries. As expressed by Littlefield (2003), the need to strengthen corporate governance has become critical for promotion of sustainable development and self-dependence in Africa.

In Kenya, there is a need for good governance, especially in the banking sector. Kenya has had a serious crisis in the last two decades in the banking sector, where thirty three banking and non-banking institutions folded their businesses. It is important to determine the main causes of the failure of these banks.

The role that CBK plays to ensure adequate supervision and enforcement of banking laws and prudential regulations needs to be examined. Choudry and Ahmed, (2002) observe that, although the emergence and legitimacy of banks in democratic governance has been well documented, little research has explored appropriate practices of good governance in these banks. In particular, little has been done to examine these topics in the comparative text. The role of banks in the economy should be looked at in relationship to accountability relationships between them and businesses. Especially, one needs to examine the internal and external relationships among the banks management, boards, regulators, and other stakeholders. Although corporate governance might be a conscious practice in the private and public sector, it is not evident as to whether and to what extent it is practiced by the major banking institutions in Kenya.

Previous research on corporate governance in Kenya has focused mainly on compliance with/or the state of the principles of corporate governance and best practices in other industries: Jebet (2001), on the corporate governance structures prevalent in public companies; Kitonga (2002) on the need for corporate governance audit in Kenya; Mwangi (2002) on corporate governance practices in the insurance industry in Kenya; Mucuvi (2002) on corporate governance practices in the motor vehicle sector in Kenya; Wainaina (2002) on corporate governance practices in the micro-financial institutions; Gakuo (2003) on corporate governance practices in non-governmental organizations; Wangómbe (2003) on corporate governance practices in cooperative societies in Nairobi; and Mwangi (2003) on the determinants of corporate board composition. No literature could be accessed as regards corporate governance practices by major commercial banks in Kenya leading to the research question of this project; what practices of corporate governance are employed in the major Kenyan commercial banks vis-a-vis established best practices?

1.3 Research Objectives

The objectives of this research study were:

(i) To establish corporate governance practices by major Kenyan commercial banks.

(ii) To establish the comparability of these practices vis-a-vis established best practices.

1.4 Value of the Study

The Central Bank of Kenya as a regulatory authority to assess the current and future expectations of industry players in banking can use the findings of this study. This will help in examining the role that corporate governance plays in the industry.

The study will aid the commercial banks in Kenya, as they will get an insight as to the role of corporate governance, especially in issues of transparency and accountability, and social responsibility. This will go a long way in boosting confidence in the sector by the general public. Students of corporate governance and banking in general will find information useful in their academic work as well.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The American model of corporate structure and governance is the one that most researchers point to as the dominant paradigm. However, with companies seeking capital from all corners of the globe, one would argue that investors would predictably prefer consistent models that would optimize shareholder value and performance transparency. This argument seems convincing within the scope of international business, driving the urge for establishing if the Kenyan banking sector is headed towards this direction, especially those that have regional footprints like KCB and Equity.

But Davis and Useem note that previously, the German system and the Japanese managerial structures had been favored at the expense of American system. This suggests that a cycle of corporate governance fashion in the western culture is present. These contrasting views mean the studies may not provide insights for our local context. Documentation on trends of corporate governance in the developing countries especially as regards the banking sector is not available. Literature has dwelt largely on the western context, and the financial sector got attention largely after the world economic crisis.

2.2 Corporate Governance

Shleifer and Vishny (1997) define Corporate Governance as referring to the way in which suppliers of finance assure themselves a return on their investment. Because returns to suppliers of finance depend on myriad legal and contractual arrangements, the operation of various markets, and the behavior of different types of players, corporate governance has evolved into various sub-literatures (e.g., Zingales, 1998; Betcht, Bolton, and Roell, 2003; Hermalin, 2009).

This approach to corporate governance views the subject as the mechanism through which shareholders are assured that managers will act in their interests as already discussed above. However, the approach seems narrow in that managers do not always act in the best interests of shareholders. This has been compounded further by separation of ownership and control, creating room for shirking or empire building and, in the extreme, outright expropriation (Jensen and Meckling, 1976).

Macey and O'Hara (2001) on the other hand argue that a broader view of corporate governance should be adopted in the case of banking institutions, arguing that because of the peculiar contractual form of banking, corporate governance mechanisms for banks should encapsulate depositors as well as shareholders. This assertion is more convincing as the sectoral players in the financial field are varied.

Thomsen and Conyon (2012) support Shleifer and Vishny's definition by claiming a difference between corporate governance and corporate management. Although corporate governance is concerned with good management, it is not about management as such. Rather, corporate governance is about the control and direction of managers. Operationally, this insinuates that important business functions like human resources, marketing etc are not normally part of corporate governance. These managers are expected to be controlled by higher level managers. But who will control these 'top' managers? It follows then that some mechanism to control them is devised; corporate governance.

2.3 Theories of Corporate Governance

The market model views the firm as driven by profit maximization. All resource allocation is handled by the price mechanism. Firms maximize profits by choosing what to produce while taking market prices for given and do not have to expend resources on solving information or incentive problems. This assumes that price mechanism leads to a market equilibrium; and is efficient in the sense that it will not be possible to find a universally better resource allocation. Individual agents may also not do better by changing their production or consumption plans.

This seamless working of price system insinuates that there is no need for other institutions e.g. regulators, to intervene. They would only be justifiable when the market fails. And it will only fail when certain assumptions e.g. free flow of information is affected. This has advised the paradigm that advocates for increased transparency in the belief that more transparency will lead to better resource allocation. The EU for instance is trying to harmonize standards in the belief that a common European capital market would benefit the competitiveness of European companies (Thomsen and Conyon, 2012). In this perfect market model, ownership is just a parameter of determining income distribution.

The Agency model theory on the other hand states that a relationship arises between two (or more) parties when one, the agent, acts for, or on behalf of, or as a representative for the other, a principal, in a particular domain of decision problems. This model attempts to create a clear delineation between owners and managers. It is argued by many scholars that this agency relationship lead to costly incentive problems that arise from conflicting interests (selfishness), since principal and agent each have and further their own utility functions rationally. These agency problems manifest in several ways;

First is between the owner and the manager. This arises between shareholders (the principals) and managers as agents. These problems arise when managers/agents do not act in the interests of the principals. Another of the agency problems is between majority shareholders and minority shareholders. A founding family in control of the firm may for instance have different views from those of minority investors. The family in charge effectively acts on behalf of the other investors, so in this case the family is the agent while the minorities are the principals. Type three agency problems are between shareholders and stakeholders. This occur when the former make self interested decisions which influence the welfare of the latter. For example, shareholders may decide to pursue a risky venture, which puts the welfare of creditors at risk. This type of agency problem falls under the broad heading of corporate social responsibility.

Given the above discussed agency problems, the central governance problem is how they are solved. Thomsen and Conyon (2012) describe several mechanisms and practices of governance, all of which attempt to mitigate agency problems; they first mention informal governance systems which include social norms, reputation and trust, and moral codes. Morality is however an imperfect solution to governance problems. Regulation through company law is very important. The law obligates companies to various practices that aim at protecting shareholder and stakeholder value. The law stipulates that directors have a duty of care and loyalty to shareholders. Regulation also manifests through audit and creditor monitoring. The duo finally argues that incentive systems solve agency problems. Incentive systems and compensation can clearly give managers incentive to work in the interest of the shareholders; they can help address governance problems both of the moral hazard and the adverse selection variety. But incentive systems have seen crazy risk taking by managers in order to boost their bonuses.

Ownership through large owners, shareholder activism and takeovers are another means of tackling agency problems. Ownership structures and board compositions have however brought another form of the agency problem as discussed above.

2.4 Corporate Governance Best Practices

Berle and Means (1932) identified what appeared to be a fundamental contradiction in the corporate form of an organization: While dispersed shareholders collectively have incentives to monitor the management of the firms for which they own stock, individually, the free-rider problem can ruin such incentives, leading to a lack of shareholder involvement in firms. Given that the distribution of stock ownership is important because of these free riding considerations, Shleifer and Vishny (1996) pointed out that large percentage block shareholdings are prevalent in the U.S. The same authors have attempted to demonstrate robust empirical relation between these large shareholdings and corporate performance. The underlying reasons, however, for this co-relation between ownership structures in relation to firm performance do not come out clearly in their explanations. This research will study shareholding scenarios locally.

It is also important to understand the extent to which findings are due to particular legal and institutional features of different geographical contexts. As Becht, Franks, Mayer and Rossi (2009) note, legal rules in the U.K. for example, give shareholders much more power than U.S. shareholders. This also introduces the aspect of shareholder activism. The financial crisis intensified the debate about the role that shareholders should play in Corporate Governance.

An alternative to direct activism by shareholders is through governance by the Board of Directors that is elected by shareholders. Berle and Means (1932) posited that directors' interests may not fully overlap with those of shareholders. The complex three way relationship between shareholders, boards and top management has been subject of a large literature. Gordon (2007) has prescribed independent boards. These boards must be structured to add value. These efforts have been adopted elsewhere, e.g. following the Enron scandal in the U.S. in 2002, the exchanges increased independence requirements, and the Sarbanes-Oxley Act of 2002 required the independence of audit committees. The Kenyan situation is however unique. Most board memberships are dominated by certain clique of individuals that cut through various companies. These board members include top management who are large shareholders. How then can this be replicated locally? This research will seek to examine boardroom compositions, gender diversity, cross directorships and even profession diversity and experience, and even succession within the general context of the core question of corporate governance practices.

Executive compensation has also been a subject of much literature. One view sees executive pay arrangements as the product of arms' length contracting between boards and executives, which lead to contracts that provide efficient incentives for reducing agency problems. Others like Bebchuk and Fried (2003, 2004) question whether pay arrangements are the products of arm's length contracting and sees such pay arrangements as part of the agency problem itself.

One angle of the debate concerns compensation levels (Kaplan 2008). Are the levels of executive compensation, which have grown considerably relative to rank and file compensation in recent years a reflection of supply and demand in the labor market for executives? Or do they reflect rent-seeking by powerful managers? In the Kenyan context, financial reporting does not reveal much as regards executive compensation, other than lumped up figures. Even with such disclosures, share option issues have not come into play yet as such the stock exchange disclosure on shares is limited to bonus and rights issues to the general investing public (Muriuki, 2005). In view of this, the relationship between stock performance and CEO compensation may be weak as the stock market performance is not a determinant of the level of executive pay. Pay at all levels should be fair and responsible.

Aduda(2007) found a negative non-significant relationship between executive compensation and performance of commercial banks in Kenya. In the major banks, size is a key criteria in determining executive compensation as it is significantly but negatively related to compensation. This, Aduda explains, can be attributed to the diminishing influence of key owners in the management as the banks grow in size.

There is also research that takes the legal rules as they are and examines how agents make choices given to them. But why would countries that are in a similar stage of their economic development have legal rules that are so different and why do so many countries persist in having systems that seem to provide patently insufficient legal protection to public investors? These cross country differences may relate to cross-cultural differences such as the country's legal origin (Shleifer and Vishny, 1998), its culture and ideology (Bebchuk and Roe, 1999), or the religion of its population (Stulz and Williamson, 2003).

Regulatory decisions have also been put into focus as to how they are arrived at. The theory of regulatory capture (Stigler, 1971) suggests that the decisions by public officials might be influenced and sometimes distorted by the influence activities of rent-seeking interest groups. This is more profound in developing countries like Kenya where political patronage is rife. In the Journal of Economic Literature Survey, Morck, Wolfenzon, and Yeung (2005) admit the need for developing formal political economy models of corporate governance arrangements and view this task as unchartered territory for the academia to exploit. Bebchuk and Neeman (2009) try to develop a formal political economy model of how lobbying by interest groups affects the level of investor protection, through their constant jostling for influence among politicians.

Corporate governance was a major factor of the recent world financial crisis; various flaws associated with the processes and laws governing corporate governance accounted for the global financial crisis, with other factors playing incidental roles (Yeoh, 2010). The financial crisis has focused a great deal of scrutiny on failures in corporate governance, in particular lax board oversight of risk management and executive compensation practices that encouraged excessive risk taking.

In his report on corporate governance and the last financial crisis, Kirkpatrick (2009) confirmed that the crisis was attributed to failures and weaknesses in corporate governance arrangements, which did not serve their purpose to safeguard against excessive risk taking. Similarly, Festisov (2009) cited drastic deterioration in corporate governance quality as a main cause of the financial crisis. Indicating similar failures, Lewis et al. (2010) accused bank managers and fund managers of pocketing enormous bonuses with no thought of long term consequences of their actions. He argues that bankers believed that when things go bad, borrowers, investors, taxpayers, governments, and other stakeholders would bear the lion's shares of the losses.

2.5 Corporate governance and the banking industry in Kenya

According to Central Bank of Kenya (2002), corporate governance in the banking sector largely relates to the responsibility conferred to and discharged by the various entities and persons responsible for and concerned with the prudent management of the financial sector. In January 2002, the Capital Markets Authority while responding to the growing importance of corporate governance issued a Gazette notice spelling out the guidelines, adherence to which is mandatory to all listed public banks. The Central Bank observes that many of the requirements are already taken care of either in the Banking Act or in Prudential regulations.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents a detailed description of the selected research design. It describes the research design and methodology i.e, what was done and how it was done. The chapter comprises the research design, data collection instruments, procedures and data analysis.

3.2 Research Design

The study adopted a cross-sectional descriptive research design that will provide answers to the research questions of establishing what is practiced within the corporate governance context in major commercial banks in Kenya, and what has been the result under the same.

3.3 Population of the study

The target population comprised of the six tier one banks that command 70.3 per cent of market share, on the basis of total industry deposit and net asset value base. A census survey will be conducted of these companies, thus no sampling frame.

3.4 Data collection methods

This study obtained primary data through questionnaire administration to senior banking officers, including the executive and the board; and had both closed and open ended questions.

Secondary data was obtained from policy/ strategic documents of these banks, financial laws and regulatory policy frameworks. Interviews schedules were used primarily to obtain this data.

3.5 Data analysis

This study used inductive analysis, indulging in the details and specifics of the data to discover important patterns, themes, and inter-relationships of various cases.
Item analysis will also be used, involving giving the response rate for each item and deducing frequency and commonality. Regression analysis was used in analyzing the relationship between what is the practice of corporate governance and what has been experienced elsewhere.

Questionnaires have been tabulated and descriptive analysis used for open-ended questions. Statistical techniques used include the mean, percentages and averages of responses to questionnaires.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Descriptive statistics

This chapter gives a summary of the descriptive statistics relating to the surveyed banks. All six banks completed questionnaires dispatched.

4.1.1 Years of operation

Table 4.1.1 below gives a summary of the number of years in which the surveyed banks have been in operation.

Years of Operation	frequency	percentage
1-10	1	17
11-20	0	0
21-50	2	33
50 and above	3	50
Total	6	100

Table 4.1.1: years in operation

The result shows that more than 50 % have been in operations more than 10 years. Only one has been in operations for less than 10 years.

4.1.2 Range of services

Table 4.1.2 below gives a summary of the range of services that the surveyed banks offer.

Services offered	Category label	frequency	Percentage
Deposit	1	6	100

Trade finance	2	5	83
Micro credit	3	3	50
Savings and current account	4	6	100
Mortgage	5	6	100
Insurance premium finance	6	4	67
Custodial	7	4	67

Table 4.1.2: Range of services

The results show that all of the banks provide the most basic services of deposit taking, savings and current accounts and mortgage finance. Micro-finance is only advanced by half the banks.

4.2 Management and the board

This section gives a summary of the responses relating to the banks management and involvement of shareholders in management and guiding strategy, values and performance.

4.2.1 Number of directors

Table 4.2.1 below gives a summary of the number of directors that the surveyed banks have in the structure.

Class interval of the number of directors	frequency	percentage
1-5	1	17
6-10	4	66

10 and above	1	17
Total	6	100

Table 4.2.1: total number of board directors

The results show that most range between six to ten directors

4.2.2 Methods of appointing board

Table 4.2.2 below gives a summary of the methods that the banks surveyed appoint board directors.

Methods of appointing the board	Frequency	percentage
Vote of majority shareholders	1	17
Vote of all shareholders	4	66
Head hunt	1	17
Other	0	0
Total	6	100

Table 4.2.2: methods of appointing board members

Results tabulated above show that most banks (66%) appoint board members through vote of all shareholders.

4.2.3 Board composition by profession

Table 4.2.3 below shows the variety of profession that comprises boards of the surveyed banks

Profession of the board	frequency	percentage
Lawyers	1	17
Banking and finance specialists	2	33
CPA(K)	2	33
Engineers	0	0
Economists	1	17
Total	6	100

Table 4.2.3: composition of boards by profession

The above summary shows banking and finance specialists and certified public accountants provide 66% of board compositions by profession.

4.2.4 Board effectiveness

Respondents were asked to rate the effectiveness of their boards in leadership, integrity, enterprise, judgment and decision. The rating scale had four levels; (1) very effective, (2)not very effective (3)effective, (4)below average.

Figure 1 below shows the various board effectiveness ratings received from respondents as regards their respective banks, based on the 5 parameters.

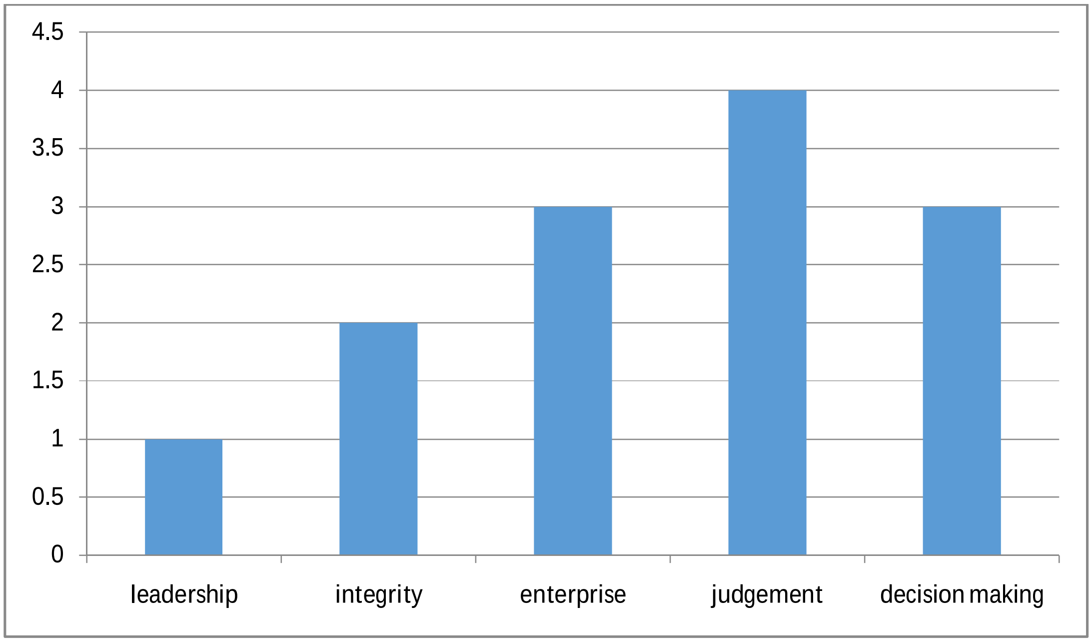

Figure1**:** board effectiveness rating

The results show that judgment ability is the highest rated lever of perceived effectiveness by respondents. Leadership was rated least.

4.2.5 Frequency of board meetings

Respondents were asked how often their boards met, and the results are summarized in table 4.2.5 below.

Frequency of board meetings	frequency	percentage
Monthly	5	83
Bi-weekly	0	0
Quarterly	1	17
Bi-annually	0	0
Total	6	100

Table 4.2.5: frequency of board meetings

The results show that an overwhelming majority (86%) hold monthly meetings.

4.2.6 Methods of communicating deliberations

Table 4.2.6 below summarizes responses about which method was most applied by boards in communicating deliberations.

Methods of communication	frequency	percentage
Newsletters	0	0
Press	3	50
Posted letters	1	16.6
Board meetings	1	16.6
Management memos	1	16.6
Total	6	100

Table 4.2.6: methods of communicating deliberations

Results show that the press is the most preferred mode of communication for these banks.

4.2.7 Board performance effectiveness appraisal

Respondents were asked whether their respective banks carried out performance appraisals. Table 4.2.7 below summarizes the responses.

Performance appraisal of board effectiveness	response	frequency	percentage
Board	Yes	3	50

Induction of board members	Yes	4	67
Chief executive officer	Yes	6	100

Table 4.2.7: board performance effectiveness appraisal

All banks surveyed conduct performance appraisals for chief executive officers. Data show that half of them conduct performance appraisals for board members.

4.2.8 Assessment reports

Respondents were asked the level at which assessment reports were discussed with the below summarized results in table 4.2.8

Level of assessment reports	frequency	percentage
Board meetings	4	67
Annual general meetings	1	16
Special meetings	1	16
Total	6	100

Table 4.2.8: level of discussing assessment reports

The above tabulated results show that board meetings are the most preferred mode of discussing assessment reports.

4.2.9 Management training

The research sought to establish from respondents the level of training top management were exposed to. Table 4.2.9 below shows a summary of the results.

Training program	frequency	percentage
Induction for new board members	4	67
Continuous member skills development	4	67
Management training	6	100

Table 4.2.9: management training

The results above show that management training is somewhat common across the respondents.

4.2.10 Succession planning

The research sought to establish the type of succession plan that the surveyed banks is hinged on. Table 4.2.10 below presents the summary.

Type of succession planning	frequency	percentage
Graduate trainee	1	16.5
Management trainee	4	67
Succession planning	1	16.5
Total	6	100

Table 4.2.10: succession plan

The above results show that in most cases, the succession plan is hinged on the management trainee programme.

4.3 Shareholders and stakeholders

This section summarizes responses on the relationships between the shareholders and the board. The number of individual shareholders range from a minimum of 2 to a maximum of 57,000. Institutional shareholders range from 1-9.

4.3.1 Procedures for ensuring accountability

Respondents were asked which parameter most described the means by which accountability is ensured in their respective banks. Table 4.3.1 below summarizes the findings.

Procedures of ensuring accountability	frequency	Percentage
Monitoring	1	16
Regular reporting	2	33
Internal audit	6	100

Table 4.3.1: accountability procedures

The results show that in all cases, internal audit was employed while in others regular reporting was also employed.

4.3.2 Stakeholders

The research sought to establish the constitution of shareholding of the surveyed banks. Table 4.3.2 below shows the findings.

Internal stakeholders	frequency	percentage
Staff	4	67
Staff and suppliers	1	16.5

Staff, customers and others	0	0
External shareholders		
Community	0	0
Government and community	0	0
Customers and suppliers	1	16.5
Total	6	100

Table 4.3.2: internal and external shareholders

The table shows that staff comprise of the largest chunk of shareholding.

4.4 Strategies, values, performance and compliance

4.4.1 Role of board of directors

Respondents were asked to indicate the level of involvement of the board in determining the purpose of the bank, the strategy to achieve the banks values and the implementation of the banks values. Respondents rated their boards involvement on the following 3 point scale; (1)in all cases, (2)in some cases, (3)never. The results are summarized in figure 2 below.

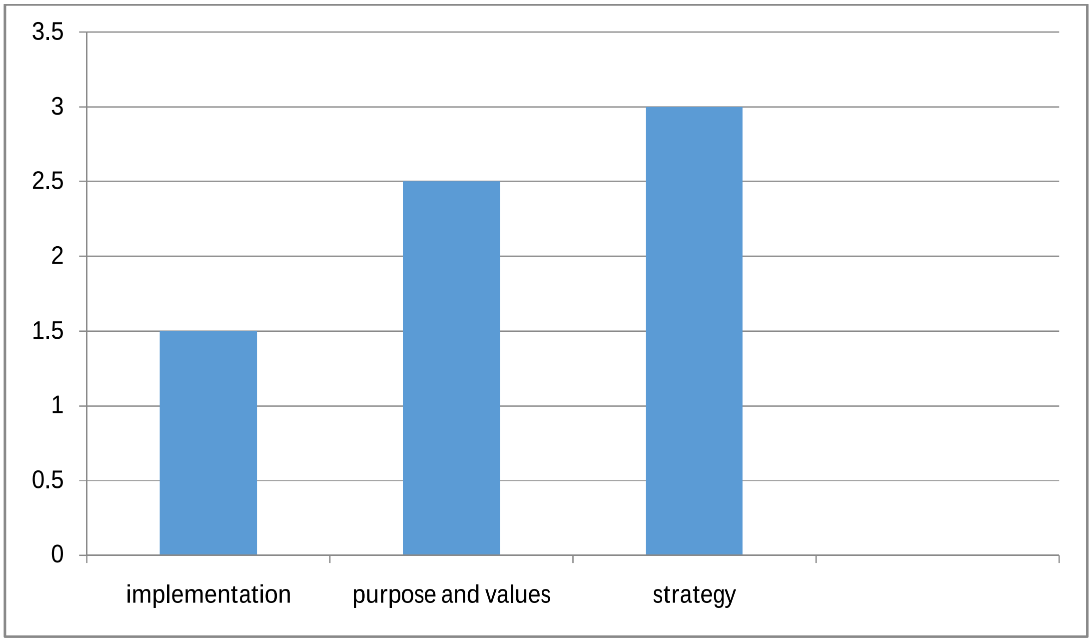

Figure 2**:** Board’s involvement in strategies, values and their implementation.

The above results show that strategy formulation is the most key level of involvement of the board. Implementation is least.

4.4.2 Responsibility for setting up bank procedures and values

Table 4.4.2 below summarizes the responsibility of creating procedures and values, as given by respondents.

Responsibility of creating procedures and values	frequency	percentage
The board	0	0
CEO	1	16.5
Department heads	1	16.5
Management level staff, board and CEO	4	67

Total	6	100

Table 4.4.2: responsibility for setting up procedures

The summarized results show that a big majority of the surveyed banks depend on management level staff; board and CEO are all involved in setting up procedures.

4.4.3 Responsibility for monitoring and evaluation of banks policies, strategies and performance

Respondents were asked whose responsibility it was in monitoring and evaluating the banks policies, strategies and performance. Table 4.4.3 below summarizes the responses.

Responsibility of monitoring of policies and strategy	Frequency	percentage
The board	1	16.5
CEO	1	16.5
Management level staff, board and CEO	4	67
Total	6	100

Table 4.4.3: responsibility for monitoring and evaluation

The tabulated results above show that management level staff, the board and CEO are all involved in monitoring and evaluating policies, strategies and performance.

4.4.4 Responsibility for review of bank viability and financial sustainability

Respondents were asked whose responsibility it was to review the banks viability and financial sustainability. Table 4.4.4 below shows the summarized findings.

Responsibility for review of bank viability and financial sustainability	frequency	percentage
Board	4	67
Shareholders	1	16.5
Management level staff, board and CEO	1	16.5
Total	6	100

Table 4.4.4: responsibility for viability and sustainability

The summary demonstrates that most banks leave the responsibility of review of the bank viability and financial sustainability to the board.

4.4.5 Frequency of viability and sustainability reviews of banks' strategies

Table 4.4.5 below summarizes responses from respondents as to the frequency of viability and sustainability reviews.

Frequency of viability and sustainability reviews	frequency	percentage
Yearly	1	25
Half yearly	2	25
Quarterly	3	50
Total	6	100

Table 4.4.5: frequency of viability and sustainability reviews

In most cases, data reveals that reviews are performed quarterly.

4.4.6 Compliance with laws, regulations and standards by banks

All of these banks have measures to ensure compliance with laws, regulations, governance practices, accounting and auditing standards. Respondents were asked to list at least three such measures. Table 4.4.6 below summarizes the responses.

Measures of compliance with laws	Frequency	percentage
Membership of professional bodies	4	67
Transparency index listings	4	67
Subscribe to certain legislation	6	100
Risk based policies	6	100
Inviting external and CBK auditors	6	100
Internal compliance department	6	100

Table 4.4.6: measures to ensure compliance

4.5 Management of corporate risk and corporate social responsibility

This section gives a summary of the key risk areas that have been identified by the board, key performance indicators and circumstances under which banks have sought the help of consultants.

4.5.1 Risk areas

Respondents were queried on key risk areas that their banks have identified. Table 4.5.1 below summarizes the responses.

Risk areas	frequency	Percentage
Terrorism	1	16
Money laundering	0	0
Lending to certain sectors of the economy	3	50
Operational interest rate risks	6	100

Table 4.5.1: key risk areas identified

The results show that most respondents considered risk as that of lending to certain sectors of the economy. None however viewed money laundering as an internal risk area.

4.5.2 Performance indicators

Respondents in the surveyed banks were asked the key performance indicators in place.

Table 4.5.2 summarizes the responses.

Performance Indicators	frequency	Percentage
Regulatory framework based on money laundering	0	0
Profitability	6	100

Staff performance appraisal results	4	67

Table 4.5.2: key performance indicators

The results show clearly that the key performance indicators of the surveyed banks are profitability (100%)

4.5.3 Circumstances whereby banks used consultants

The research sought to establish the use of external consultants by surveyed banks and on what cases. Results have been summarized below in table 4.5.3.

Areas of use of consultants	frequency	percentage
Network expansion	1	16
Re-branding	2	33
Taxation	4	67
Finding strategic partners	2	33
Employee opinion survey	1	16
Crisis cases in sector in areas of lending interest	1	16

Table 4.5.3: circumstances where banks used consultants

Results summarized above show that taxation is the most case whereby banks consulted.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the findings, conclusions, recommendations and suggestion for further studies. The chapter is guided by the findings of the preceding chapter, objectives of the study and the questions that were answered by the respondents. The study was aimed at finding out the corporate governance practices by the major commercial banks in Kenya, and how they compare with established best practices.

5.2 Summary

This study generally established that corporate governance practices in the major commercial banks in Kenya have a come a long way towards convergence with accepted global standards. Most of these banks (over 50%) have operated for more than 50 years, and offer a wide range of services that include deposit taking, savings and current accounts, mortgage and trade finance. The latter being instrumental in the growth of local businesses in the global markets. Micro finance was however not offered across the board. This may be a worrying statistic bearing in mind the economy of Kenya and to a large extension third world countries are driven by micro enterprises.

Boards are majorly appointed through vote of majority shareholders (66%), and the numbers range between 6-10. Banking and finance specialists were found to dominate numbers in these boards, making a total of 66%. As much as this can be said to be a positive statistic as regards professionalism, the industry may be starved of practices established in other professions that may be replicated in banking. These boards were rated to be mainly effective in judgement and least effective in leadership. Results show that they meet monthly, and communicate strategic deliberations through the press.

Results have established that board's role lay mostly in strategy and least in implementation; a role left to top management. The responsibility of setting up bank procedures and values was mostly left to management level staff and the Chief executive, as well as responsibility for monitoring and evaluation of banks policies, strategies and performance. The boards however dominated review of bank viability and financial sustainability; and this was done quarterly.

Compliance to laws is widespread, with all banks in the study complying and subscribing to laws and regulations and set standards, except on membership of professional bodies and transparency index listings.

5.3 Conclusions

The study's main objectives were to establish the corporate governance practices practiced by the major commercial banks in Kenya and to compare these practices with established benchmarks. To achieve these objectives, a census survey of all banks was carried out. A total of 6 questionnaires were obtained from all of the targeted banks, representing a 100% response rate.

The major findings of this study are that the central system for corporate governance responsibility in banks lies with the board; therefore the manner the manner of appointment and composition plays an important role in the corporate governance of these banks. This compares well with the Basel committee, which recognizes that the primary responsibility for good corporate governance rests with boards and senior management.

This survey found that the boards in Kenyan banks pursue sound corporate governance practices and in this regard have a number of responsibilities; review and guiding of corporate strategy, succession planning, review of remuneration, ensuring integrity of accounting and audit and overseeing disclosure and communication. The boards are involved in determining purpose and values, and strategies of their banks in all cases and are sometimes involved in implementation.

The Basel committee on banking supervision (1999) considers corporate governance in the banking industry perspective to include how banks set their objectives, run day to day operations, consider the interest of recognized stakeholders and align corporate activities and behaviour with the expectations of safe and sound operations as well as protect the interests of depositors. The results of the survey indicate that the boards of directors are involved in setting the values and objectives of the bank, in line with the suggestions of the Basel committee. Given the above results it is concluded that corporate governance in banks involves setting up strategies, values and procedures of a bank and ensuring that there is some form of measures to guide the implementation of such strategies and also to ensure that the bank complies with laws, regulations and generally accepted governance practices.

It is also concluded that there is moderate use of corporate governance practice within the sector. Those most used emanate from the banks own self-regulatory mechanisms, banking act requirements, CBK prudential guidelines, CMA requirements and membership of professional bodies.

It can be concluded that there is general awareness of the importance of corporate governance in banks and that there have been great advances in this financial sector in complying with the basic corporate governance framework. As outlined earlier, the banks present a special problem of corporate governance because of their role in the economy and also the nature and diversity of the stakeholders especially creditors and depositors. While the responsibility of corporate governance rests with the board of management, it is not evident that all the diverse stakeholders are represented in these boards.

5.4 Recommendation

An important policy implication is that to bridge the gap in representation, there is need for sound regulatory governance. The quality of supervision and prudential guidelines needs to be carefully crafted.

5.5 Limitation of Study

During the data collection there was a challenge in getting some information from respondents due to the busy work schedule and the fact that competitors in the industry might use the information to their advantage, however substantial and sufficient information was gathered from the respondents.

5.6 Areas of further research

This research did not examine the relationship between bank performance and corporate governance, an important subject that would put into perspective and isolate benefits of corporate governance. This is an area that can be explored further. Moreover, the role of senior management and its relationship with the board can also be researched. This would test the client-patron hypothesis that is the agency theory and give more insight to corporate management and good governance.

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APPENDIX

QUESTIONNAIRE

A SURVEY OF CORPORATE GOVERNANCE PRACTICES OF MAJOR COMMERCIAL BANKS IN KENYA

Date: ……………..

Name of Bank: …………………………….

A: Introduction

A1. For how long has this bank been in operation in Kenya? (.......years)

A2. Is this bank entirely privately owned or held partly with the government?...........

A3. What is the range of services that this bank offers?....................................

B: Management and the Board

B1. What is the total number of the Board of Directors?.....

B2. On a scale of 1 to 5, where 1 denotes least applied and 5 being most applied indicate in the boxes provided how the following methods of appointing board members characterize your organization.

(1) By vote of the majority shareholders ☐
(2) By vote of all shareholders ☐
(3) By the old board when being replaced ☐
(4) Headhunt ☐
(5) Other process (please describe)……………….

B3. What is the composition (number) of the board in terms of professional qualification?

(1) Lawyers (give number)…..

(2) Banking and finance professionals…….

(3) CPA (K)…..

(4) Engineers…

(5) Economists….

(6) Doctors…..

(7) Other professions (list and give number)……..

B4. How effective do you consider the board to be exercising the following so as to achieve the banks objectives:

(1) Very effective (2) effective (3) least effective

i. Leadership ☐

ii. Integrity ☐

iii. Enterprise ☐

iv. Judgment ☐

v. Decision making ☐

B5. How often does the board meet?..................

B6. How are the deliberations communicated to other shareholders and stakeholders?.............................

B7. Does the board assess the performance and effectiveness of;

1. Itself? (yes or no)…….
2. Individual members?.........
3. The chief executive?.........

B8. How often is the above done for each?

1. Itself………..
2. Individual members………
3. The chief executive………

B9. Are there any induction programs in place for new board members?

(1) Yes

(2) No

B10. Are there continuous skill development programs for the board?

(1) Yes

(2) No

B11. Does the board have a succession plan for itself?

(1) Yes

(2) No

B12. Does the board have a succession plan for top management?

(1) Yes

(2) No

B13. If yes to the above, briefly explain how it works………………………………………

C: Shareholders and Stakeholders

C1. What is the total number of shareholders, both individual and institutional? ....

C2. To what extent do the shareholders exercise the authority to ensure that only competent and loyal persons are appointed to the board?

....

C3. What mechanisms are in place to ensure accountability?

……………………………………………………………………………………………….

C4. Do shareholders have the power to change composition of the board?

(1) Yes

(2) No

C5. How does the bank communicate with its shareholders and stakeholders?

……………………………………………………………………………………………

C6. To what extent is the bank accountable to its shareholders and how?

……………………………………………………………………………………………….

C7. Is there a policy that guides how the bank should relate to external stakeholders?

(1) Yes

(2) No

(3)

D: Strategy, values performance and compliance

D1. Would you say that the boards of directors do determine the following?

(1) In all cases (2) in some cases (3) not at all

i. The purpose and values of the bank ☐

ii. Strategy ☐

iii. Implementation of the banks values ☐

D2. Who ensures that the procedures and values that protect the assets and reputation of the bank are put in place? (Tick accordingly)

(1) The board
(2) The chief executive officer
(3) Shareholders
(4) Departmental heads
(5) All top management
(6) Other (specify)…………………

D3. Who monitors and evaluates the implementation of the banks strategies, policies, plans and management performance? (Tick accordingly)

(1) The board
(2) The chief executive officer
(3) Shareholders
(4) Departmental heads
(5) All top management
(6) Other (specify)…………………

D4. Who reviews the viability and financial sustainability of the bank? (Tick accordingly)

(1) The board
(2) The chief executive officer
(3) Shareholders
(4) Departmental heads
(5) All top management
(6) Other (specify)…………………

D5. How frequently is this done? ....

D6. Is there any measure in place to ensure that the bank complies with all relevant laws, regulations, governance practices, accounting and auditing standards?

(1) Yes

(2) No

D7. If yes, please list at least three such measures

…………………………..

…………………………..

…………………………..

D8. Who enforces these measures?

(1) The board

(2) The chief executive officer

(3) Shareholders

(4) Departmental heads

(5) All top management

(6) Other (specify)…………………

E: Management of Corporate Risk and social responsibility

E1. What are some of the key risk areas that the board has identified?....... …………………

……………………………………………………………………………………………..

E2. What are some of the key performance indicators that the bank has put in place? ………

……………………………………………………………………………………………………

E3. In what circumstances has the bank sought the advice of external consultants? ………….

…………………………………………………………………………………………………..

E4. What are some of the bank's social responsibilities? ……………………………………

…………………………………………………………………………………………………..

F: On a scale of 1 to 5, where 1 denotes least competitive and 5 being most competitive indicate in the boxes provided how you feel your organization rates with the best standards under the issues.

1) Customer service ☐
2) Service / product range ☐
3) Executive compensation ☐
4) Corporate social responsibility ☐
5) Ethics and accounting standards ☐
6) Risk management ☐

G: Is there any other thing that you may wish to add related to the above that you feel was not captured in the questionnaire?

……………………………………………………………………………………………….

Thank you for your time