THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE PRACTICES AND PERFORMANCE OF COMMERCIAL BANKS IN KENYA

BY

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DECLARATION

This Research Project is my original work and has not been submitted for the award of a degree in any other university.

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This Research Project has been submitted for examination with my approval as the university supervisor.

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DEDICATION

To my late father John H. Ochieng Ongolo who continues to inspire me in my work.

To my beloved wife Carolyne Baraza for the continuous encouragement and support that has enabled me achieve my goal.

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ABSTRACT

Effective corporate governance practices are essential to achieving and maintaining public trust and confidence in the banking system and also critical to bank performance. Good corporate governance should facilitate efficient, effective and entrepreneurial management that can deliver shareholder value over the long term. Corporate governance of banks is important since commercial banking operations are not as transparent as other firms. The opaqueness of bank's balance sheets and income statement makes it very costly for depositors to constrain managerial discretion and they cannot know the true value of the bank's loan portfolio as such information is incommunicable and very costly to reveal.

This project looks at how corporate governance affects bank performance, since good corporate governance shall ensure that strategic goals and corporate values are in place and communicated throughout the bank. Sound corporate governance therefore creates an enabling environment that rewards banking efficiency, mitigates financial risks, and increases systematic stability. A good working relationship between the board of directors, management and other stakeholders in any given bank would result in increased efficiency, throughput and profits. Companies with better corporate governance have better operating performance than those companies with poor corporate governance. It is also believed that good corporate governance helps to generate investor goodwill and confidence.

The researcher identified basically two different models of the firm concerning the impact of corporate governance on performance, the shareholder model and the stakeholder model. The shareholder model describes the formal system of accountability of senior management to shareholders while the stakeholder model describing the network of formal and informal relations involve the corporation.

This study was to establish if there was a relationship between corporate governance practices and commercial bank performance in Kenya. The population of the study was

the 45 banks licensed by the Central Bank of Kenya as at the end of 2010. The study adopted a census study approach because of the small population and the banks are easily assessable. Secondary data was collected from the published financial reports. Two methods of data analysis were employed, the descriptive analysis which provides some averages of relevant variables and the regression analysis to establish a relationship between the corporate governance variables (independent variables) and firm performance (the dependent variable) over the period of study.

From the study the researcher concludes that the Board should be involved in the selection and appointment of senior executives, the board should also put systems in place for identifying, monitoring and managing the organization's risk profile. Given the increasing complexity of business today, there is need for the financial reports to include more comprehensive information as investors rely on information they receive from companies in making their investment decisions. Failures in corporate governance practices have aggravated incidences where management manipulates financial reports for different purposes hence making it difficult for the stakeholder to build confidence in them. By examining the existing relationships between the directors, management, shareholders, and the other stakeholders, the study recommends that existing boards setbacks need to be addressed in order to improve the corporate governance in banking institutions in Kenya.

The researcher concludes that corporate governance practices (directors' effectiveness, management effectiveness, shareholder protection, disclosure and transparency) have a positive relationship with bank performance. Amongst other success factors to overall bank performance, this study attributes 20.7% of these to corporate governance practices. Therefore banks should embrace adequate corporate governance practices in order to increase financial performance.

LIST OF ABBREVIATIONS

CAR	Capital Adequacy Ratio
CBK	Central Bank of Kenya
FRC	Financial Reporting Council
GDP	Gross Domestic Product
IMF	International Monetary Fund
KCC	Kenya Cooperative Creameries
OECD	Organization for Economic and Corporation Development

CHAPTER ONE

1.0 INTRODUCTION

1.1. Background of the Study

Recent examples of massive corporate collapses of some outstanding banking institutions around the globe have highlighted the need to improve and reform corporate governance. Effective corporate governance practices are essential to achieving and maintaining public trust and confidence in the banking system and also critical to bank performance.

Bino and Tomar (2009) identifies corporate governance as putting in place the structures, processes and mechanisms that ensure that the firm is being directed and managed in a way that enhances long term shareholder value through accountability of managers and enhancing firm performance. FRC Combined Code (2009) states that good corporate governance should contribute to better company performance by helping a board discharge its duties in the best interests of shareholders. That good corporate governance should facilitate efficient, effective and entrepreneurial management that can deliver shareholder value over the long term. OECD principles of corporate governance (2004) identifies that good governance should facilitate efficient, effective and entrepreneurial management that can deliver shareholder value over the long term.

Kaur and Gill (2007) defines corporate governance as the relationship among various primary participants (shareholders, directors, and managers) in determining the directions and performance of corporations. That corporate governance delineates the rights and responsibilities of each primary stakeholder and the design of institutions and mechanisms that control board directors and management to best serve the economic interests of shareholders (and other stakeholders) of a company.

It can therefore be summarized that corporate governance is about consistent management, cohesive policies and processes intended to improve the company's efficiency, effectiveness and overly improve firm performance. It is concerned with the framework within which management decisions are taken. This is clear from the definition provided by Kaur and Gill (2007) that there is a relationship between corporate governance and firm performance. As explained by Kaur and Gill (2007) the essence of good corporate governance include, managerial discipline, independence , protection of shareholders' rights, board of director's responsibilities, transparency, and accountability. This study shall identify corporate governance through directors' effectiveness, managerial effectiveness, shareholder protection, transparency and accountability (through disclosure) as it improves firm performance.

1.1.1. Corporate Governance in Banking Institutions

The corporate governance of banks is important for several reasons. Firstly, banks have an overwhelmingly dominant position in the economy financial systems and are extremely important engines of economic growth (King and Levine 1993a,b; Levine 1997). Secondly, as financial markets are usually underdeveloped, banks in developing economies are typically the most important source of finance for the majority of firms. Lastly, they provide a generally accepted means of payment, and are usually the main depository for the economy's savings.

Commercial banking operations are not as transparent as other firms. The bank's balance sheets and income statement are generally opaque; a bank cannot show a list of major debtors (borrowers) and creditors (depositors) for the shareholders to use in judging the performance of board and management (Capiro and Levine, 2002). Depositors do not know the true value of the bank's loan portfolio as such information is incommunicable and very costly to reveal implying that a bank's loan portfolio is highly fungible (Bhattacharya et al, 1998). The opaqueness of banks also makes it very costly for depositors to constrain managerial discretion through debt covenants (Capiro and Levine, 2002).

From banking industry perspective corporate governance relates to the manner in which the business of the bank is governed. This includes setting corporate objectives and risk profiles, aligning corporate behavior, running the bank's operations within the established risk profile and in compliance with applicable laws and regulations, and protecting the interests of depositors and other stakeholders (Greuning and Bratanovic, 2009). Macey and O'Hara (2001) argues 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 protects both depositors as well as shareholders. The special nature of banking requires not only a broader view of corporate governance, but also government intervention in order to restrain the behavior of bank management.

Corporate governance affects bank performance by ensuring that strategic goals and corporate values are in place and communicated throughout the bank. These goals must be transparent with the objective of ensuring proper lines of accountable responsibility, appropriate oversight by senior management, segregation of audit and control functions, effective risk management procedures are in place and board members are properly qualified and do not place undue influence upon management.

Effective governance practices are one of the key prerequisites to achieve and maintain public trust and, in a broader sense, provide confidence in the banking system. Poor governance increases the likelihood of bank failures. Sound corporate governance therefore creates an enabling environment that rewards banking efficiency, mitigates financial risks, and increases systematic stability.

1.1.2. Bank Performance

Bank performance in this study referred to the financial soundness of the banking institutions. This was evaluated through ratio analysis from the data extracted from financial statements. Financial ratios are often examined and analysed under groups reflecting different operating characteristics of banks. This study used the CAMEL methodology to evaluate the financial and managerial soundness of the commercial banks. The banks' Financial Statements shall form the basis of the CAMEL's qualitative analysis from which this study reviewed the ratios relating to Capital Adequacy, Asset

Quality, Managerial Efficiency (Management Quality), Earnings (or Profitability), and Liquidity Management.

Capital Adequacy shows the relationship of bank's capital and bank's risk (weighted) assets. This is a ratio of bank's capital to risk. National regulators track a bank's CAR to ensure that it can absorb a reasonable amount of loss and are complying with the statutory capital requirements. This ratio is used to protect depositors and promote the stability and efficiency of financial systems.

Assets Quality assesses institution's policies associated with assessing portfolio risk. It evaluates the productivity of long-term assets as well as an evaluation on policies for investing in fixed assets and also gives an evaluation of whether the available infrastructure meets the needs of both staff and clients.

Management Efficiency looks at how well the bank's board of directors' functions. The study shall review the operating income to operating expenses ratio. The proportion of every shilling of income spent on the average by the bank as a measure of the efficiency of the bank's management. The higher the ratio, the better the management's efficiency.

Earnings/Profitability is a business's ability to generate earnings as compared to its expenses. Banks must be profitable over the long-term in order to be self-sustaining. Profitability allows a bank to continue operating and to grow. Profitability measures the ability of the institution to maintain and increase its net worth through earnings from operations.

Bank's Liquidity Ratios are designed to help bank's anticipate, measure, and monitor liquidity levels. Liquidity refers to the ability to fund obligations on a timely basis as they come due, to accommodate business growth and acquisitions, and to fulfill obligations under stress conditions. Liquidity management can inform choices about the trade-offs between maintaining liquidity levels and the opportunity costs of keeping resources liquid.

1.1.3. Relationship between Corporate Governance and Bank Performance in Kenya

There are many studies on the relationship between corporate governance and firm performance. A good working relationship between the board of directors, management and other stakeholders in a given bank would result in increased efficiency, throughput and profits (Thomson and Jain, 2006). Daily and Dalton (1992) demonstrated that the likelihood of bankruptcy is related to poor corporate governance characteristics. This is particularly true in the case of Kenyan Banking institutions in the 1990s and early 2000s.

Firms were expected to have improved performance by strengthening their governance practices. As pointed out by Bowen et al. (2004), ignoring corporate governance can lead to doubtful inferences on firm performance. Companies with better corporate governance have better operating performance than those companies with poor corporate governance (Black, Jang, and Kim, 2005) which was concurrent with the view that better governed firms might have more efficient operations, resulting in higher expected returns (Jensen and Meckling, 1976). It is also believed that good corporate governance helps to generate investor goodwill and confidence. This affected the Kenyan economy in the 1990s with a string of banks collapsing with depositor's money.

The relationship between corporate governance and bank performance in Kenya can be examined from the experiences of the large number of banking institutions that collapsed in the last two decades. According to Matengo (2008), systematic failures of the banking industry in Kenya and other African countries in the 1990s were attributed to moral hazards. In particular, insider lending and lending at high interest rates to borrowers in the most risky segments of the credit markets. The scale of the collapses across the country in the late 1990's and the ramifications for the rest of the economy was so devastating. Banks that were performing well suddenly announced huge losses due to credit exposures that turned sour, interest rates going up among other macro economic factors. Vibrate financial institutions like the Trust Bank collapsed in 2001 and Euro Bank that collapsed with billions of shillings of depositors' money. Maiko (2003) explained that these banks were known as a conduit for money laundering and had strong political connections which kept the banks open. The banks in Kenya that collapsed had poor corporate governance practices as this was evidenced when political power changed hands and the political protective veil withdrawn. Maiko (2003) states that some previous banking crashes related to the 1992 and 1997 elections sucked in politically connected banks that used to haul money off the CBK through devious schemes. That at least six banks were put in liquidation after the 1992 elections and that a state bank (National Bank of Kenya) had been stripped clean by politicians and shareholders to the brink of collapse after the 1997 elections. Kenya Commercial Bank, had it not been better capitalized, would have been sailing in the same boat (Maiko, 2003).

Mwega (2010) obtained the following results from his research work that was relating improvements in corporate governance in Kenyan banking institutions to better performance. Firstly, from the data obtained the amounts of capital and capital ratios held by banks in Kenya in 2006 to 2008 showed that all banks met the four minimum capital requirements, even though the excess amounts and ratios vary from one bank to another. Secondly, the rate of Return on Assets in Kenya generally declined in the late 1990s but showed a general upward trend from 2000. Thirdly, the non performing loans to Assets Ratio decreased from a high of 23.27% in 2000 to a low of 4.02% in 2008, an indication that the banking system's asset quality had improved. According to Mwega (2010) Kenya's banking sector grew strongly during the past decade, by about 20% points, from around 85% of gross domestic product (GDP) in 2001 to 115% of GDP in 2008 (IMF, 2009b). It improved tremendously in terms of product offerings and service quality, stability and profitability. During this period, only two banks had been put under CBK statutory management (Prudential Bank and Charterhouse Bank), in comparison with the 1980s and early 1990s, when a large number of banks collapsed due o poor governance.

Kilonzo (2008) argued that good corporate governance in Kenyan Financial Institutions is required to restore market confidence, attract foreign direct investment or private capital inflows and investments that will propel the institutional performance. That this could be achieved by increasing, accountability of directors, transparency of corporate structures, and financial transactions.

The United Nations Conference on Trade and Development (2003) also asserted that improving corporate governance was an important aspect for the financial system especially for the problems that had plagued the financial industry in Kenya. CBK demands good corporate governance for financial stability and sustainability from all licensed banks and financial institutions.

1.2. Statement of the Problem

The scale of commercial bank collapses across the country in the late 1990's was so devastating. Banks that were performing well suddenly announced huge losses which was largely attributable to poor corporate governance practices in their operations (Maiko, 2003).

One of the main areas in the banking industry today is on risk management (Greuning and Bratanovic, 2009). FRC (2009) review of the UK's combined code observed that there is need for Boards to take responsibility for assessing major risks facing the institutions, agreeing the institution's risk profile and tolerance risk, and overseeing the risk management systems. Management should also not be consumed in conflating moral hazard and opportunism strategies at the expense of the organizations.

Several studies have been done locally and internationally on the relationship between Corporate Governance practices and performance. However, these studies have given mixed results. Local studies have also been done on the relationship between corporate governance and firm performance: Muriithi (2004), Mutisya (2006), Kerich (2006), Nyaga (2007), Kiamba (2008), Matengo (2008), Ong'wen (2010). The results from these studies drew mixed conclusions with specific corporate governance practices having strong correlations with firm performance than others.

Matengo (2008) examined the relationship between corporate governance practices and performance of banking institutions in Kenya. Matengo's study sort to establish the relationship between three governance tenets of transparency, disclosure and trust in influencing performance of the banking institutions. The study relied on the provisions from Basel II on banking and supervision and questionnaire developed on the basis of the three tenets. The findings were that it was not apparent that some of these factors singularly provide convincing relationship between performance and Corporate Governance. This study thus examined the corporate governance variables that were not reviewed by Matengo (2008) in establishing a relationship with performance of commercial banks. It is expected that board effectiveness, top management and shareholders effectiveness as well as the disclosure and transparency policies and practices shall have a positive relationship with the performance of commercial banks. This is what had not been examined by Matengo (2008).

The researcher was to find an answer to the question: Is there a significant relationship between Corporate Governance Practices and performance of commercial banks? This study predicted a positive relationship between corporate governance practices and the performance of commercial banks.

1.3. Objective of the Study

To establish relationship between corporate governance practices and commercial bank performance in Kenya.

1.4. Importance of the Study

The area of corporate governance has attracted a rapidly growing interest in most economies, given the banking industry's position in the national development. There is continued scrutiny of banks' performance both through regulatory framework and increased responsibilities for Boards of directors and senior managers to act in the most accountable and transparent manner. This study of corporate governance was thus important as it emphasised that resources should be used effectively and efficiently managed to sustain growth in business and the development of all linked sectors of the economy.

Given the increasing complexity of business today, there is need for the financial reports to include more comprehensive information as investors rely on information they receive from companies in making their investment decisions. Failures in corporate governance practices have aggravated incidences where management manipulates financial reports for different purposes hence making it difficult for the stakeholder to build confidence in them.

By examining the existing relationships between the directors, management, shareholders, and the other stakeholders, the study attempted to identify existing gaps that need to be addressed in order to improve the corporate governance in banking institutions in Kenya.

This study offered an opportunity to provide an in-depth understanding of banking failure beyond the regulatory framework and assist bank management and the board of directors in appreciating the importance of corporate governance in enhancing bank performance.

The study also offered a body of knowledge to the academicians for further research on corporate governance and reference to scholars and practicing professionals.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter discussed literature on corporate governance. Section 2.2 examined the theoretical relationship between corporate governance and bank performance, discussing the shareholders model, the stakeholder's model, the agency theory and the stewardship models as they relate to bank performance. Section 2.3 covers the empirical literature on the relationship between corporate governance and bank performance. Section 2.4 was the summary section which is a recap of the issues of this chapter.

2.2 The Theoretical Relationship Between Corporate Governance and Bank Performance

Different governance models have contributed to the development of corporate governance practices. The models in this study provide a good framework with which to understand how corporate governance affects firm performance. It is however difficult in arriving at a general model of corporate governance, given the inherent complexity of the subject. One feature of its complexity is that companies combine economic and social roles. Insights from the social sciences, therefore, have their place alongside those from economics. Another feature of complexity is the diversity of governance systems and processes around the world. Forms of corporate governance are shaped nationally by their economic, political and legal backgrounds, by their sources of finance, and by the history and culture of the countries concerned. Shleifer and Vishny (1997) argue that much of the differences in corporate governance systems around the world stem from varying regulatory and legal environments.

In the economics debate concerning the impact of corporate governance on performance, there are basically two different models of the firm, the shareholder model and the stakeholder model. In its narrowest sense (shareholder model), corporate governance often describes the formal system of accountability of senior management to shareholders. In its widest sense (stakeholder model), corporate governance can be used to describe the network of formal and informal relations involving the corporation. The stakeholder approach emphasizes contributions by stakeholders that can contribute to the long term performance of the firm and shareholder value. On the other hand, the shareholder approach recognizes that business ethics and stakeholder relations can also have an impact on the reputation and long term success of the firm.

2.2.1 The Shareholder Model

According to the shareholder model, the objective of the firm is to maximise shareholder wealth, in other words, a firm's only purpose is to serve the needs and interests of the firms' owners. The criteria by which performance is judged in this model is simply taken as the market value (i.e. shareholder value) of the firm. Brealey and Myres (2002) and Block and Hirt (2000) also agree that shareholder wealth maximization should be the overall goal of every corporate entity. Maximization of shareholder's wealth ensures that shareholders are adequately compensated for risk undertaken (Dufrene and Wong, 1996). Shareholder wealth includes dividends and importantly capital appreciation of the investors' investments. Woods and Randell (1989) generally accept shareholder wealth as the aggregate market value of common shares which in turn is assumed to be the present value of the cash flows which accrues to the shareholders discounted at their required rate of return on equity.

The underlying problem of corporate governance in this model stems from the principal-agent relationship arising from the separation of beneficial ownership and executive decision-making. It is this separation that causes the firm's behaviour to diverge from the profit-maximising ideal. This happens because the interests and objectives of the principal (the investors) and the agent (the managers) differ when there is a separation of ownership and control. Since the managers are not the owners of the firm they do not bear the full costs, or reap the full benefits, of their actions.

Therefore, although investors are interested in maximising shareholder value, managers may have other objectives such as maximising their salaries, growth in market share, or an attachment to particular investment projects, etc. It is from the principal-agent problem that we derive the Agency theory.

According to the shareholder model, therefore, corporate governance is primarily concerned with finding ways to align the interests of managers with those of investors, with ensuring the flow of external funds to firms and that financiers get a return on their investment.

2.2.2 The Stakeholder Model

The stakeholder theory addresses morals and values in managing an organization. In defining Stakeholder Theory, Clarkson (1994) states that the firm is a system of stake holders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm's activities. The purpose of the firm is to create wealth or value for its stakeholders by converting their stakes into goods and services. Blair (1995) stated that the goal of directors and management should be maximizing total wealth creation by the firm. That, the key to achieving this is to enhance the voice of and provide ownership-like incentives to the participants in the firm who contribute or control critical, specialized inputs and to align the interests of these critical stakeholders with the interests of outside, passive shareholders. Porter (1992) also recommended that corporations should seek long-term owners and give them a direct voice in governance and to nominate significant owners, customers, suppliers, employees, and community representatives to the Board of directors.

All these recommendations would help establish the sort of business alliances, trade related networks and strategic associations. In other words, Porter (1992) is suggesting that competitiveness can be improved by using all four institutional modes for governing transactions rather than just markets and hierarchy. It is the moral obligation of the firm's managers to maintain a balance among these interests when directing the activities of the firm. This view holds that corporations should be socially responsible institutions, managed in the public interest. Accordingly, performance is judged by a wider constituency interested in employment, market share, and growth in trading relations with suppliers and purchasers, as well as financial performance (Blair, 1995).

What matters is the impact that the various stakeholders can have on the firm's corporate governance and performance. It is often the case that the competitiveness and ultimate success of the firm will be the result of teamwork that embodies contributions from a range of different resource providers including investors, employees, creditors, and suppliers. Therefore, it is in the interest of the shareholders to take account of other stakeholders, and to promote the development of long term relations, trust, and commitment amongst various stakeholders (Mayer, 1996). Corporate governance in this context becomes a problem of finding mechanisms that elicit firm specific investments on the part of various stakeholders, and that encourage active co-operation amongst stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises (OECD, 1999).

According to the stakeholder model, corporate governance is primarily concerned with how effective different governance systems are in promoting long term investment and commitment amongst the various stakeholders (Williamson, 1985). Kester (1992), for instance, states that the central problem of governance is to devise specialised systems of incentives, safeguards, and dispute resolution processes that will promote the continuity of business relationships that are efficient in the presence of self-interested opportunism. Blair (1995) also defines corporate governance in this broader context and argues that corporate governance should be regarded as the set of institutional arrangements for governing the relationships among all of the stakeholders that contribute firm specific assets.

2.2.3 The Agency Theory

Managers and directors have an implicit obligation to ensure that firms are run in the interests of shareholders. This theory is linked to the Shareholder model and this section shall look at how the theory directly contributes to performance. As explained under the shareholder model the Agency Theory is about the relationship between the owners (principal) and the managers (agents).

The fact that managers have most of the control rights can lead to problems of management entrenchment and rent extraction by managers. Much of corporate governance deals with the limits on managers' discretion and accountability as Demb and Neubauer (1992) states that corporate governance is a question of performance accountability.

Agency problems may affect the value of companies through two distinct channels, the expected cash flows accruing to investors and the cost of capital. First, firms with stronger governance would be more likely to have better management of cash and thereby increasing firm value. Jensen and Meckling (1976) suggest that better-governed firms are more likely to invest in profitable projects, resulting in higher future cash flows. La Porta et al. (2002), Shleifer and Wolfenzon (2002), as well as Durnev and Kim (2005) argue that good governance prevents expropriation by managers or controlling shareholders. Jensen (1986) puts forth the theory that good governance reduces the resources under the control of managers, and thus indirectly reduces the chance of expropriation by managers. Second, good governance decreases the cost of capital either through the reduction of shareholders' monitoring and auditing costs (Lombardo and Pagano, 2000; Garmaise and Liu, 2005) or through the reduction of information asymmetry (Easley and O'Hara, 2002; Leuz and Verrecchia, 2004).

One of the economic consequences of the possibility of expropriation of rents (or opportunistic behavior) by managers is that it reduces the amount of resources that investors are willing to put up to finance the firm (Grossman and Hart, 1986). A major consequence of opportunistic behavior is that it leads to socially inefficient levels of investment that, in turn, can have direct implications for firm performance.

There are broadly three types of mechanisms that can be used to align the interests and objectives of managers with those of shareholders and overcome problems of management entrenchment and monitoring. Firstly, there should be attempts to induce managers to carry out efficient management by directly aligning managers' interests with those of shareholders e.g. executive compensation plans, stock options, direct monitoring by boards, etc. It also involves the strengthening of shareholder's rights so shareholders have both a greater incentive and ability to monitor management. This approach enhances the rights of investors through legal protection from expropriation by managers e.g. protection and enforcement of shareholder rights, prohibitions against insider-dealing, etc. Lastly, the use of indirect means of corporate control such as that provided by capital markets, managerial labour markets, and markets for corporate control e.g. take-overs.

2.2.4 The Stewardship Model

It is a requirement in Kenyan Company Law (Cap 486) that directors show a fiduciary duty towards the shareholders of the company. Inherent in the idea of directors having a fiduciary duty is that they can be trusted and will act as stewards over the resources of the company. Thus directors' duties are based on stewardship theory. This duty is higher than that of an agent as the person must act as if he or she was the principal rather than a representative.

According to Donaldson and Davis (1997), managers are good stewards of the corporations and diligently work to attain high levels of corporate profit and shareholders returns. Those managers are principally motivated by achievement and responsibility needs.

2.3 Empirical Literature on the Relationship Between Corporate Governance and Bank Performance

Numerous studies have looked at the implications of corporate governance structures on firm performance. Although the literature is not unanimous in its conclusions, there is clear evidence supporting the opinion that there is a significant relationship between governance structures and firm performance. Firms which implement sound corporate governance systems provide more useful information to investors and its other stakeholders to reduce information asymmetry as well as to help the company improve its operations (Hsiang-tsai Chiang et al. 2005). According to a survey by McKinsey & Company (2002), in 2002, 78% of professional investors in Asia said that they were willing to pay a premium for a well-governed company. The average premium these investors were willing to pay generally ranged from 20% to 25%. Many scholars have attempted to investigate the relationship between good governance and firm performance in a more rigorous way.

Empirical studies of the effect of board membership and structure on firm value or performance generally show results either mixed or opposite to what would be expected from the agency cost argument. While some studies find better performance for firms with boards of directors dominated by outsiders (Ellingson 1996; Millstein and Mac Avoy 1998; Rosenstein and Wyatt 1990; Weisbach 1988), others find no such relationship in terms of accounting profits or firm value (Bhagat and Black 2002; Hermalin and Weisbach 1991; Klein 1998; Mac Avoy et al 1983; Mehran 1995). Dalton et al (1998) provide an analysis of 54 empirical studies of board composition and 31 empirical studies of board leadership structure and their relationships to firm financial performance. They find little evidence of a relationship between board composition or leadership and firm financial performance.

Unlike for board composition, a fairly clear negative relationship appears to exist between board size and firm value (Eisenberg, Sundgren, and Wells 1998; Yermack 1996). Too big a board is likely to be less effective in substantive discussion of major issues (Jensen 1993; Lipton and Lorsch 1992) and to suffer from free-rider problems among directors in their supervision of management (Hermalin and Weisbach 1991). Gompers, Ishii, and Metrick (2001) find that firms with strong shareholders' rights in relation to provisions for defending against takeovers perform better and have a higher market valuation. Other studies have also suggested for a stronger shareholder rights and legal protection mechanisms lowers investors capital costs (La Porta et al., 2000) or incentive effects associated with takeover vulnerability (Bebchuk et al., 2009).

Evans et al. (2002) noted that in any efficient capital market, investors will discount the price they are willing to pay for a firm's share by the expected level of managerial agency costs. This was further asserted that for a firm's corporate governance practice to have a positive effect on its market value, two conditions must be fulfilled. Firstly, corporate governance must increase the returns to firm's shareholders, and secondly, the stock market must be sufficiently efficient so that the share prices reflect fundamental values. Unfortunately these conditions are more likely to be satisfied in mature markets than in emerging markets.

Kim and Rasiah (2010) in their study concluded that there was a positive and significant association between the corporate governance and bank performance in Malaysia. That during the prior to the Asian financial crisis in 1997, foreign owned banks had a better implementation of good corporate governance and had gained better performance than that of private domestically owned banks in Malaysia. They note that this changed in the post crisis, private domestically owned banks had a better implementation of good corporate governance, and had gained better performance than that of foreign-owned banks due to prudential regulatory and supervisory measures in internal governance and external governance by government and central bank.

Shabirr and Padgett (2005) when investigating whether corporate governance compliance matters for firm performance, including both market-based as well as accounting measures of performance. They found that there was a clear link between compliance and the market driven measures of firm performance. That increasing compliance was leading to increasing total shareholder return from the sampled companies. No evidence of such a relationship was however, found between compliance and the accounting measures of the firm's performance, return on assets (ROA) and return on equity (ROE). The results suggesting that although compliance may not improve firm's operating performance, it does improve investors' perceptions of the governance of companies, with the resultant impact on firm value.

2.3.1 Empirical Literature on Corporate Governance and Firm Performance in Kenya

Langat (2006) studied the relationship between corporate governance structures and performance of quoted companies on Nairobi stock exchange and found that frequency of board meetings, ratio of outside directors to the number of directors, percentage of inside share ownership and executive compensation were all positively related to firm performance.

Muturi (2007) surveyed the degree of compliance with the capital Market Authority guidelines on corporate governance. The study found that the degree of compliance was high among the listed companies.

Murrithi (2008) studied corporate governance and financial performance of state corporations, the case of New KCC and found that the board of New KCC adopted practices of good corporate governance that were reviewed and improved over time and had yielded improved financial performance. Some corporate governance practices identified included the appointment and leadership of the board, corporate communication, and assessment of performance of the board, responsibility of stakeholders, social and environmental responsibility.

Musyoki (2008) analysed board committees in terms of their size, composition, structure and diversity and the effect these has on firm financial performance. The study established that non-executive directors and presence of several board committees has a positive effect on firm's financial performance. That properly constituted board committees with the right mix of non-executive directors tends to contribute more to performance than boards with a predominance of insider directors.

Matengo (2008) examined the relationship between corporate governance practices and performance of banking institutions in Kenya. The results from the study were apparent that singularly none of the corporate governance variables would provide convincing relationship between performance and corporate governance, however there was high preference of compliance to transparency and disclosure. It was uncertain whether this trend was because of the regulatory requirements.

Ong'wen (2010) sought to establish whether listed firms which adopted corporate governance provisions which exceeded the minimum provisions significantly outperformed those which stuck to the minimum. The study concluded that there was a positive relationship between firm performance and corporate governance attributes which exceeded the minimum level prescribed by law and common practices.

The study by Mandu (2010) examined the relationship between measures of board independence and the financial performance of commercial banks in Kenya. The study found that CEO tenure had a significantly positive influence on performance of small firms but larger board composition had significantly negative correlation with performance of smaller firms.

2.4 Conclusion

The presence of an effective corporate governance system, within commercial banks helps to provide a degree of confidence that is necessary for the proper functioning of the entire industry and enhances performance. Corporate governance should ensure the strategic guidance of the banks through effective monitoring of management by the Board, and the Board's accountability to the bank and the shareholders and to ensure positive bank performance.

As pointed out earlier, there is no general model of corporate governance that can best describe the relationship between corporate governance and performance. The empirical studies on the relationship between corporate governance and performance have given mixed results with some studies showing positive correlation while others like Heracleous (2001) arguing that corporate governance best practices are not associated with higher firm performance. Thus it is important to have a broad and deeper understanding of the corporate governance variables which can then individually be related to performance. Most of the literature on corporate governance identifies board characteristics and their impacts on the bank's performance outcomes.

As noted under the agency theory managers are good stewards of the banks and diligently work to attain high levels of corporate profit and minimize costs of capital through the reduction of shareholders' monitoring and auditing costs. The shareholders have a duty to ensure that the bank is managed well and thus leading to improved firm performance. Shareholders exert corporate governance by ensuring only competent and reliable persons who can add value are elected or appointed to the board of directors, and that the board is constantly held accountable and responsible for the efficient and effective governance of the bank. This will reduce operational inefficiencies and will lead to increased profitability.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter discussed the methodology that was adopted by the researcher in carrying out the study. The chapter presented the Research Design, Population studied, the methods used to sample it and the data collection methods used by the researcher and procedures that were used in data analysis.

3.2 Research Design

This study adopted a descriptive research design. A questionnaire (appendix II) was administered to the target through drop and pick later method. The data then was analyzed quantitatively using descriptive and inferential statistics.

3.3 Study Population

The target population comprises of banking firms in Kenya listed in appendix III. The population of the study was the 45 banks licensed by the Central Bank of Kenya as at the end of 2010. The study adopted a census study approach because of the small population and the banks are easily assessable.

3.4 Data Collection

Secondary data was collected from financial reports and journals among other publications of the commercial banks. The secondary data for the period 2006 through to 2010 which was obtained from the Financial Reports of the Banking Institutions while primary data was collected by using a well structured questionnaire (appendix II) to capture all the necessary information required. The questionnaire was explored to the respondents understanding, feelings and perceptions on issues to do with corporate governance and firm performance.

To capture the objectives more effectively the questionnaire was divided into various sections, namely; organization profile, board of directors' effectiveness, management effectiveness, shareholder effectiveness, disclosure, and transparency. For the secondary data, the information was analyzed from financial statements of banks on the basis of CAMEL criterion of assessing bank performance.

3.4.1 Dependant variable description

The dependent variable in the study was firm performance. Firm performance depends on the success as reflected in the financial reports. Financial ratios from the financial reports shall be examined and analyzed under groups reflecting different operating characteristics of banks. This shall be based on the CAMEL framework which includes capital adequacy, asset quality, managerial efficiency, profitability, and liquidity.

Variable	Description/Measure
Capital Adequacy	$\frac{\text{Total Capital}}{\text{Total Loans}}$
Assets Quality	$\frac{\text{Total Loans}}{\text{Total Assets}}$
Managerial Efficiency	$\frac{\text{Operating Income}}{\text{Operating Expenses}}$
Profitability	$\frac{\text{Net Income}}{\text{Total Assets}}$
Liquidity	$\frac{\text{Total Loans}}{\text{Total deposits}}$

3.4.2 Independent variable description

The independent variable investigated by this study was: the Board of Directors effectiveness, effectiveness of Management, Shareholders effectiveness in corporate governance, disclosure and transparency as they affect the firm performance.

Variable	**Description/Measure**
Dir	total mean score for the factors within the Board's effectiveness
Mgt	total mean score for the factors within the Management effectiveness
S-holder	total mean score for the factors within the shareholder effectiveness
Discl	total mean score for the factors within the disclosure
Transp	total mean score for the factors within the transparency attributes
chal	total mean score for the challenges in the organizational corporate governance practices

3.5 Data Analysis

The data collected from the questionnaires was first checked for errors, edited and coded to facilitate the analysis. Two methods of data analysis were employed, that is, the results were divided into two to reflect this categorization. The first type of analysis was descriptive analysis, which provides some averages of relevant variables. The second method of analysis was the regression analysis to establish a relationship between the corporate governance variables (independent variables) and firm performance (the dependent variable) over the period of study.

The questionnaire responses were grouped into various categories for analysis using descriptive analysis. The study applied a quantitative approach through the use of frequency distribution, mean scores and standard deviations in analyzing the data. With the help of Statistical Package for Social Sciences (SPSS) software version 17.0, the findings were presented in form of frequency distribution tables, bar charts and pie charts. The data was then summarized according to the study's specific objectives.

Correlation analysis was carried out to get the effectiveness of the independent variables on the dependent variable. The relationship between corporate governance and bank performance was analysed using Pearson correlation techniques and regression analysis. The chi-square, F-test, and t-tests was applied to examine the strength of the relationship between performance variables and corporate governance measures using SPSS. The statistical level was set at a 0.05 significance level. If the probability was less than or equal to the significance level, then the outcome was statistically significant.

3.5.1 The Conceptual Model

The conceptual model of this study related corporate governance practices to bank performance; corporate governance being a function of bank performance. Corporate governance practices in this study referred to Directors Effectiveness, Management Effectiveness, Shareholders Protection, Transparency and Disclosure. The study was relying on the CAMEL criterion in assessing the bank performance.

Thus,

$$BPF = f(De+Me+ Sp + Tp + Dcl)$$

Where, BPF was the Bank performance, De was the directors effectiveness, Me was the management effectiveness, Sp was the shareholders protection, Tp was Transparency and Dcl was Disclosure.

The independent variables was quantified using a Likert scale score whose means was computed for each factor within the element.

The objective of the model was to provide an assessment of the relationship of corporate governance on bank performance. It was expected that the corporate governance variables (independent) was a positive relationship (correlation) with bank performance.

3.5.2 The Analytical Model

The study was a multiple regression model as the analytical model of this study to investigate the relationship between bank performance as the dependant variable and corporate governance as the independent variables.

The model was taking this form:

$$BPF = \beta_0 + \beta_1(Dir) + \beta_2(Mgt) + \beta_3(S\text{-}holder) + \beta_4(Discl) + \beta_5(Transp) + \epsilon$$

Where, BPF was the bank performance, β_0 was the constant, while β_1, β_2 ,β_3, β_4, and β_5 were the coefficients of the independent variables.

Dir was total mean score for the factors within the Board's effectiveness to firm performance, Mgt was total mean score for the factors within the Management effectiveness to firm performance, S-holder was total mean score for the factors within the shareholder effectiveness that enhances firm performance, Discl was is the total mean score for the factors within the disclosure attributes that enhance firm performance, Transp was the total mean score for the factors within the transparency attributes that enhance firm performance and ϵ the error term for the model.

The data collected in the questionnaire was coded and run in SPSS so as to get the coefficient of the regression model above.

CHAPTER FOUR

4.0 DATA ANALYSIS, PRESENTATION AND INTERPRETITION

4.1 Introduction

This chapter presents analysis and findings of the study as set out in the research methodology. The results were presented on the relationship between corporate governance practices and performance of commercial banks in Kenya with a specific reference to commercial banks in Kenya. The data was gathered exclusively from questionnaire as the research instrument. The questionnaire was designed in line with the objectives of the study. To enhance quality of data obtained, Likert type questions were included whereby respondents indicated the extent to which the variables were practiced in a five point Likerts scale.

4.1.1 Response Rate

The study targeted to sample 45 respondents in collecting data with regard to the relationship between corporate governance practices and performance of commercial banks in Kenya. From the study, 28 out of 45 sampled respondents filled in and returned the questionnaire contributing to 62.2%. This commendable response rate was made a reality after the researcher made personal visits to remind the respondent to fill-in and return the questionnaires.

Table 4:1: Response Rate

Response	Frequency	Percentage
Responded	28	62.2
Not responded	17	37.8
Total	45	100.0

Source: Survey Data, 2011

4.2 Organizational profile

4.2.1 Current number of employees

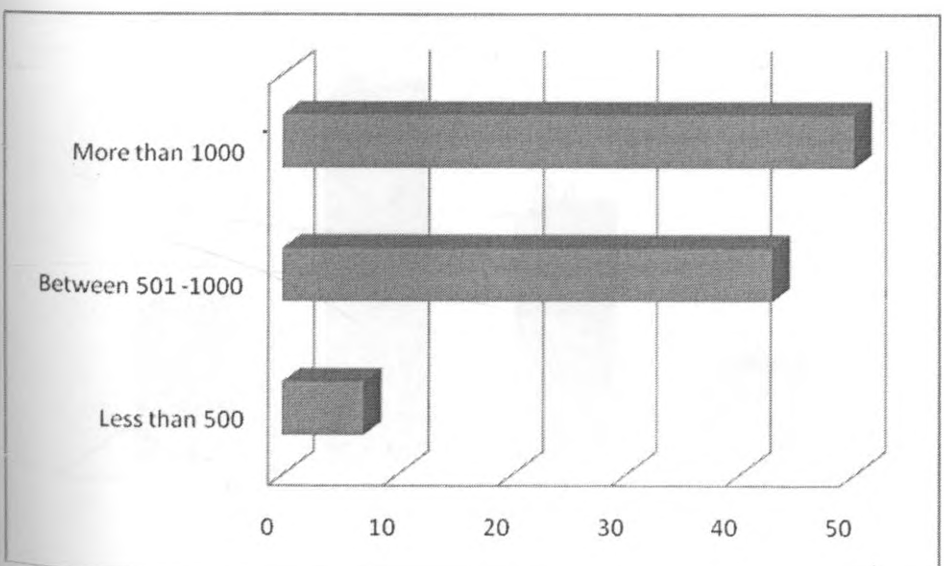
On the current number of employees of the respondents, the study found that banks with more than 1000 employees was represented by 50% which were the majority followed by between 501 - 1000 employees (42.9%) and banks with Less than 500 the study found that they were represented by 7.1%.This is depicted in the table and figure below.

Table 4.2: Current number of employees

Number of employees	Frequency	Percent
Less than 500	2	7.1
Between 501 -1000	12	42.9
More than 1000	14	50
Total	28	100.0

Source: Survey Data, 2011

Figure 4.2: Current number of employees



Source: Survey Data, 2011

4.2.2 Number of times the Board meets in a year

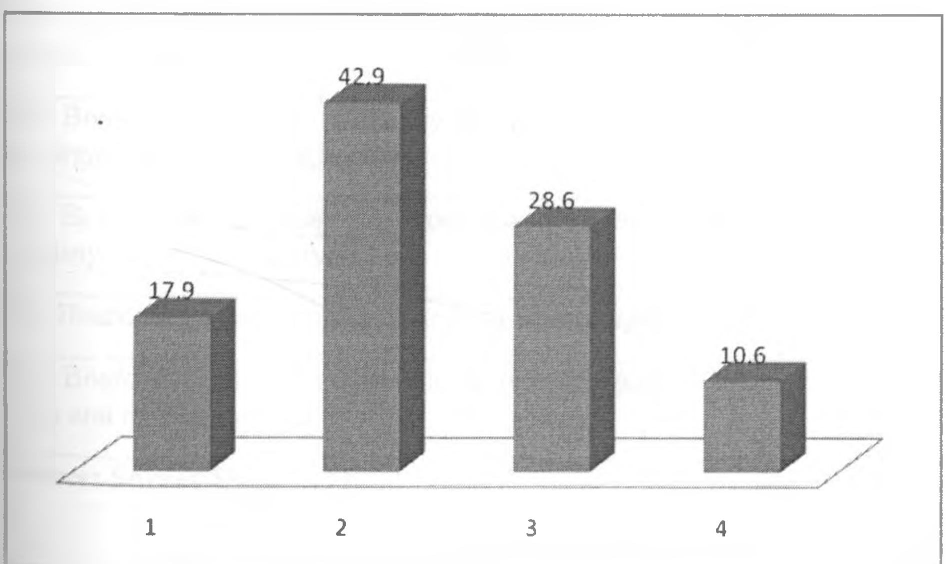
The study also sought to establish number of times the board meets in a year. According to the study majority of the respondents (42.9%) indicated that the board member meet twice a year, followed by once in a quarter (28.6%), as need arises (10.6%) and the least once a year (17.9%) as shown by the table below.

Table 4.1: Number of times the Board meets in a year

Number of employees	Frequency	Percent
Once a year	5	17.9
Twice a year	12	42.9
Once in a quarter	8	28.6
As need arises	3	10.6
Total	28	100.0

Source: Survey Data, 2011

Figure 4.3: Number of times the Board meets in a year



Source: Survey Data, 2011

4.3 Board of Directors Effectiveness

4.3.1 Board of Directors Effectiveness

On the extent to which the Board has got an operating plan that defines its functions, activities and its objectives was to a moderate extent with a mean score of 3.1311, the Board consults technocrats on professional matters with a mean score of 3.0492, the Board is not involved in day to day running of the organization's affairs with a mean score of 2.9672, the Board provides the necessary resources for the achievement of the organization's strategic goals with a mean score of 2.8689, the Board approves proposals from the management after thorough scrutiny, debate and analysis with a mean score of 2.8689, the Board formulates long term strategy of the organization with a mean score of 2.7705, the Board defines and communicate to management their powers, roles and responsibilities with a mean score of 2.5738.

Table 4.4: Board of Directors Effectiveness

	Mean	**Std Dev.**
The Board has got an operating plan that defines its functions, activities and its objectives	3.1311	1.47733
The Board consults technocrats on professional matters	3.0492	1.56446
The Board is not involved in day to day running of the organization's affairs	2.9672	1.77921
The Board provides the necessary resources for the achievement of the organization's strategic goals	2.8689	1.57560
The Board approves proposals from the management after thorough scrutiny, debate and analysis	2.8689	1.56499
The Board formulates long term strategy of the organization	2.7705	1.58528
The Board defines and communicate to management their powers, roles and responsibilities	2.5738	1.45441

Source: Survey Data, 2011

4.3.2 The Boards' first duty

On the extent to which the Boards' first duty on the organization was to a moderate extent shown by a mean score of 2.9180, the members and other stakeholders a mean score of 2.7869, the directors a mean score of 2.6885 and finally to the shareholders a mean score of 2.2951.

Table 4.5: The Boards' first duty

	Mean	Std Dev.
The organization	2.9180	1.40588
The members and other stakeholders	2.7869	1.30531
The directors	2.6885	1.48931
The shareholders	2.2951	1.45309

Source: Survey Data, 2011

4.3.3 The Boards' Meetings and Conducts

The study sought to establish whether The Board meetings are democratic and open for all members and the findings were to a moderate extent with a mean score of 3.3115 and on the Board conducts in its activities whether in a free and democratic atmosphere with a mean score of 2.7049.

Table 4.6: The Boards' meetings and conducts

	Mean	Std Dev.
The Board meetings are democratic and open for all members	3.3115	1.40879
The Board conducts its activities in a free and democratic atmosphere	2.7049	1.38256

Source: Survey Data, 2011

4.3.4 The Boards' Strength in relation to the Organization

The study sought the respondents' level of agreement with various statements that related to the Boards' strength in relation to the organization. A succession plan is in place for the Board's chairperson, Board members, the CEO and the senior management was strong with a mean of 4.0333, board performance is evaluated at least once in a year was on average with a mean of 3.0492, the selection considers present skills and requirements in the Board of directors was on average with a mean of 3.0000, where the conduct of any director becomes questionable, he or she is asked to leave the Board was an average with a mean of 3.0000, interest and conflicts between Board members are declared and resolved amicably was strong with a mean of 2.9344, the Board is composed of members representing diverse interest groups was strong with a mean of 2.9016, absence from the Board meetings is by exception not as a rule was strong with a mean of 2.6885, a new Board member is given clear information on the role of management and that of the Board and the relationship between the two was strong with a mean of 2.5738, minutes of all meetings are securely kept and are available to all members of the Board was strong with a mean of 2.5082, the Board is involved in the selection of the directors was strong with a mean of 2.3934, the members receive advance written agenda and notices of meetings was strong with a mean of 2.3607, all proceedings and resolutions of the Board are accurately recorded on a timely basis was strong with a mean of 2.3607 and every new Board member is inducted well after selection was least strong with a mean of 1.1967.

Table 4.7: The Boards' Strength in relation to the Organization

	Mean	Std Dev.
A succession plan is in place for the Board's chairperson, Board members, the CEO and the senior management.	4.0333	5.61163
Board performance is evaluated at least once in a year	3.0492	1.75524
The selection considers present skills and requirements in the Board of directors	3.0000	1.50555
Where the conduct of any director becomes questionable, he or she is asked to leave the Board.	3.0000	1.44914
Interest and conflicts between Board members are declared and resolved amicably	2.9344	1.54778
The Board is composed of members representing diverse interest	2.9016	1.56743

groups		
Absence from the Board meetings is by exception not as a rule	2.6885	1.80315
A new Board member is given clear information on the role of management and that of the Board and the relationship between the two	2.5738	1.55412
Minutes of all meetings are securely kept and are available to all members of the Board	2.5082	1.73803
The Board is involved in the selection of the directors	2.3934	1.63584
The members receive advance written agenda and notices of meetings	2.3607	1.51694
All proceedings and resolutions of the Board are accurately recorded on a timely basis	2.3607	1.71302
Every new Board member is inducted well after selection.	1.1967	1.44706

Source: Survey Data, 2011

4.3.5 The Structure of the Board in the Organization

On the extent that the chairperson is not the CEO and their roles are clearly defined and separate was to a moderate extent with a mean score of 2.3934, the Board has formally constituted and recorded committees with clearly defined terms of reference, composition and reporting mandates shown by a mean score of 2.0328 and the Board consists of the executive and non executive members on a fairly balanced proportion with a mean score of 2.0164.

Table 4.8: The structure of the Board in the organization

	Mean	Std dev
The chairperson is not the CEO and their roles are clearly defined and separate	2.3934	1.54141
The Board has formally constituted and recorded committees with clearly defined terms of reference, composition and reporting mandates	2.0328	1.39005
The Board consists of the executive and non executive members on a fairly balanced proportion	2.0164	1.20405

Source: Survey Data, 2011

4.3.6 The Committee's Appointment

On the extent of agreement with statements related to the need to increase the Board's effectiveness utilizing the specialized skills of the Board a mean of 2.4262 was captured, the need to provide support and guidance to the management a mean score of 2.4262 and the need for effective and independent audit and finance reports with a mean score 2.0656.

Table 4.2: The committee's appointment

	Mean	**Std Dev.**
The need to increase the Board's effectiveness utilizing the specialized skills of the Board	2.4262	1.64782
The need to provide support and guidance to the management	2.4262	1.64782
The need for effective and independent audit and finance reports	2.0656	1.50409

Source: Survey Data, 2011

4.3.7 Sub Committees on Board with Clearly Defined Terms of References

On the extent of agreement with statements related to the different sub committees if are on Board and have clearly defined terms of references. Audit committee captured a mean score of 3.3115, the executive committee a mean score of 2.7049 and the Board appointment and remuneration committee a mean score of 2.0820.

Table 4.10: Sub Committees on Board with Clearly Defined Terms of References

	Mean	**Std Dev.**
Audit committee	3.3115	1.40879
Executive committee	2.7049	1.38256
Board appointment and remuneration committee	2.0820	1.58425

Source: Survey Data, 2011

4.4 Management Effectiveness

4.4.1 Corporate Governance Practices

The study sought to investigate the extent to which the respondent attribute corporate governance practices in their organization the findings were the organization's strategic direction with a mean score of 3.0656, organization culture with a mean score 2.3934, the existing Board structure with a mean score 2.3934, the efficiency and effectiveness of service delivery with a mean score 2.2951, the policies of the organization with a mean score 2.0164 and the share holders interest with a mean score of 1.5410. on whether the Board is involved in the selection and appointment of senior executives a mean score of 2.5738 was recorded, are there systems in place for identifying, monitoring and managing the organization's risk profit a mean score of 2.3279, management provides directors with information they need to meet their responsibilities a mean score of 2.1639 and if there are adequate policies that increase accountability of the managers recorded a mean of 1.8033.

Table 4.11: Corporate Governance Practices

	Mean	**Std dev**
Organization's strategic direction	3.0656	1.40082
Organization culture	2.3934	1.54141
The existing Board structure	2.3934	1.32008
The efficiency and effectiveness of service delivery	2.2951	1.53128
The policies of the organization	2.0164	1.24488
The share holders interest	1.5410	2.77833
	Mean	**Std dev**
The Board is involved in the selection and appointment of senior executives	2.5738	1.55412
Are there systems in place for identifying, monitoring and managing the organization's risk profile.	2.3279	2.82088
Management provides directors with information they need to meet	2.1639	1.21354

their responsibilities.		
Are there adequate policies that increase accountability of the managers.	1.8033	1.09270

Source: Survey Data, 2011

4.5 Shareholders Protection

The respondents were requested to indicate the extent to attribute corporate governance practices in their organization to the shareholders have the right to participate in and to be sufficiently informed on, decisions concerning fundamental corporate changes a mean score of 3.7705, shareholders of the same class are treated equally a mean score of 2.7541, ensures shareholders have a freehand in the election, appointment and removable of directors a mean score of 2.6393, there is a policy in the organization that ensures members of the Board and key executives disclose to the Board whether they directly or indirectly have a material interest in any transaction or mater directly affecting the organization a mean score of 2.5902 and protects and facilitates the exercise of shareholder's rights a mean score of 1.6066.

Table 4.12: corporate governance practices in the organization

	Mean	Std dev
Shareholders have the right to participate in and to be sufficiently informed on, decisions concerning fundamental corporate changes	3.7705	5.60177
Shareholders of the same class are treated equally	2.7541	1.51279
Ensures shareholders have a freehand in the election, appointment and removable of directors	2.6393	1.43797
There is a policy in the organization that ensures members of the Board and key executives disclose to the Board whether they directly or indirectly have a material interest in any transaction or mater directly affecting the organization	2.5902	1.41865
Protects and facilitates the exercise of shareholder's rights	1.6066	1.00463

Source: Survey Data, 2011

4.6 Disclosure

4.6.1 Information Flow and Communication within the Board and the Management

The respondents were also requested to indicate the extent to which Information flow and communication within the Board and the management in their organization among the responses given the majority 86.9% indicated that the Board's information requirements are communicated to the management on a regular basis while majority of respondents (65.6%) indicated no on that the Board receives sufficient and timely information from senior management in an agreed upon format. The responses are as shown in the table below.

Table 4.13: Information and Communication Flow

	Yes		No	
	F	%	F	%
Every Board member is given the organization's legal documents; mission and vision, strategy documents on first appointment	30	49.2	31	50.8
Every Board member receives a copy of the Board manual at the time of his or her appointment	42	68.9	19	31.1
Every Board member has access to organization's policy documents on personnel, finance as reviewed from time to time	19	31	42	69
The Board receives sufficient and timely information from senior management in an agreed upon format	21	34.4	40	65.6
The Board's information requirements are communicated to the management on a regular basis	53	86.9	8	13.1
Information is prepared and disclosed at all times in accordance with the governing laws and regulations.	27	44.3	34	55.7
The Board's responsibilities regarding financial communication is properly disclosed	35	57.4	26	42.6
The ownership structure is fully disclosed o all interested parties. Changes in the shareholdings of substantial investors is disclosed as soon as the bank becomes aware of them.	44	72.1	17	27.9

Source: Survey Data, 2011

4.6.2 Timely and Accurate Disclosure on all Material Matters

On the extent the respondents can you attribute the timely and accurate disclosure is made on all material matters in their organization the study found out that Organizational objectives was shown by a mean score of 2.7049, financial and operating results with a mean score of 2.3607, remuneration policy for members of the Board and key executives with a mean score of 2.2787 and major share ownership and voting rights with a mean score of 2.1803.

Table 4.14: timely and accurate disclosure on all material matters

	Mean	**Std dev**
Organizational objectives	2.7049	1.28250
Financial and operating results	2.3607	1.27845
Remuneration policy for members of the Board and key executives	2.2787	1.57195
Major share ownership and voting rights	2.1803	1.58649

Source: Survey Data, 2011

4.7 Transparency

The study sought to investigate the extent to which the organization boards transparency in effectively represents the management to the Board with a mean score of 2.7213 which was poor, promotes effective participation of all Board members in Board meetings with a mean score of 2.6393, clearly articulates the division of responsibilities among different supervisory, regulatory and enforcement authorities with a mean score of 2.1148, channels for disseminating information provide for equal, timely and cost effective access to all relevant information by users with a mean score of 1.7869, external auditors are independent, competent and qualified and are accountable to the shareholders with a mean score of 1.7541, monitors and evaluates in consultation with other Board members, the CEO' s performance and that of the senior management with a mean score of 1.7377, ensures succession plans are in place for both the senior management and the directors with a mean score of 1.5410 and Is effective in maintaining transparency and accountability with a mean score of 1.4754 which indicate it was very poor.

Table 4.15: Board Transparency

	Mean	Std dev
Effectively represents the management to the Board	2.7213	1.61381
Promotes effective participation of all Board members in Board meetings	2.6393	1.48361
Clearly articulates the division of responsibilities among different supervisory, regulatory and enforcement authorities	2.1148	1.48434
Channels for disseminating information provide for equal, timely and cost effective access to all relevant information by users	1.7869	.96807
External auditors are independent, competent and qualified and are accountable to the shareholders	1.7541	1.13513
Monitors and evaluates in consultation with other Board members, the CEO' s performance and that of the senior management	1.7377	.98152
Ensures succession plans are in place for both the senior management and the directors	1.5410	.97594
Is effective in maintaining transparency and accountability	1.4754	1.02643

Source: Survey Data, 2011

4.8 Relationship Between Financial Performance and Corporate Governance

Table 4.16: Model Summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.455[a]	.207	-.001	.177408697

a. Predictors: (Constant), DE, Me, SP, Dcl, Tp

The coefficient of determination (R square) measures the proportion of variability in a data set that is accounted for by a statistical model. In this case it was found that there is relatively strong relationship between financial performance and corporate governance. It was found that corporate governance determines 20.7% of firm's financial performance of banks.

Table 4.17: ANOVA

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.556	5	.031	.994	.448[a]
	Residual	.198	19	.031		
	Total	.754	24			

a. Predictors: (Constant), Dcl, DE, SP, Me, Tp

b. Dependent Variable: firms financial performance

In this case we found that the regression model is higher than the residual model that is 0.556 and 0.198 hence giving us the confidence that our model accounts for most of the variation on the dependent model, F statistic measures if the regression model fits well.

Nevertheless pegging the significance level at 0.5 we found that the variables are significant as they have a significance level of 0.448.

Table 4.18: Coefficients

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	.320	.314		1.018	.321
	DE	.064	.067	.200	.959	.350
	Me	.069	.063	.220	1.016	.322
	SP	.027	.054	.106	.492	.628
	Tp	.043	.066	.282	0.258	.224
	Dcl	.058	.066	.192	.879	.390

a. Dependent Variable: firms financial performance

The t-test determines the strength of the relationship between business financial performance and corporate governance. We found that financial performance is. relates highly with, management efficiency (Me), board of directors effectiveness (De) and lowly with transparence and disclosure.

The unstandardized coefficients are the coefficients of the estimated regression model. With this information, we can be able to write the following equation:

Bpf = 0.320+0.64De+0.69Me+0.27SP+0.043TP+0.058Dcl

CHAPTER FIVE

5.0 SUMMARY OF FINDINGS CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the summary of the findings from chapter four, and also it gives the conclusions and recommendations of the study based on the objective of the study. The objective of this study was to establish relationship between corporate governance practices and commercial bank performance in Kenya.

5.2 Summary of the Findings

From the study, 28 out of 45 sampled respondents filled in and returned the questionnaire contributing to 62.2%. This was a good response rate which was above average. The study found that majority of the banks had more than 1000 employees which were represented by 50%. According to the study majority of the respondents (42.9%) indicated that the board member meet twice a year.

The study found out that the Board has got an operating plan that defines its functions, activities and its objectives was to a moderate extent in that , the Board consults technocrats on professional matters, the Board is not involved in day to day running of the organization's affairs, the Board provides the necessary resources for the achievement of the organization's strategic goals, the Board approves proposals from the management after thorough scrutiny, debate and analysis, the Board formulates long term strategy of the organization, the Board defines and communicate to management their powers, roles and responsibilities. The study further found out that the Board is involved in the selection of the directors was strong, the members receive advance written agenda and notices of meetings was strong, all proceedings and resolutions of the Board are accurately recorded on a timely basis was strong and every new Board member is inducted well after selection was least strong according to the respondents.

The study also found the respondent attribute corporate governance practices in their organization the findings were the organization's strategic direction was moderate, organization culture, the existing Board structure with a mean score, the efficiency and effectiveness of service delivery was all moderate and the share holder's interest was least to least extent. Also the study found out that the Board is involved in the selection and appointment of senior executives was moderate, there systems in place for identifying, monitoring and managing the organization's risk profit, management provides directors with information they need to meet their responsibilities were also moderate and if there are adequate policies that increase accountability of the managers was least existence.

On management effectiveness the study found that the organization's strategic direction with a moderate extent, still on the organization culture, the existing Board structure, the efficiency and effectiveness of service delivery, the policies of the organization were to an extent and the share holders interest was to a least extent on whether the Board is involved in the selection and appointment of senior executives was recorded to an extent , on systems in place for identifying, monitoring and managing the organization's risk profit and on management provides directors with information they need to meet their responsibilities was also to an extent but on if there are adequate policies that increase accountability of the managers the study found to be on least extent.

The study findings on disclosure were that the Information flow and communication within the Board and the management in their organization among the responses were positive but on the Board's information requirements are communicated to the management on a regular basis while majority of respondents indicated that this was not in order in the organization. On Transparency the study found that the organization boards transparency in effectively represents the management to the Board was poor, promotes effective participation of all Board members in Board meetings was poor, clearly articulates the division of responsibilities among different supervisory, regulatory and enforcement authorities was also poor. Channels for disseminating information provide for equal, timely and cost effective access to all relevant information by users with a mean score of was very poor, external auditors are independent, competent and qualified and are accountable to the shareholders was very poor, monitors and evaluates in consultation with other Board members, transparency and accountability was indicate to be very poor.

5.3 Conclusions

From the study the researcher concludes that the Board should be involved in the selection and appointment of senior executives, the board should also put systems in place for identifying, monitoring and managing the organization's risk profile. Management should provide directors with information they need to meet their responsibilities this will result to adequate policies that increase accountability of the managers.

The study also concludes that shareholders have the right to participate in and to be sufficiently informed on, decisions concerning fundamental corporate changes and make sure that shareholders of the same class are treated equally and this can be achieved by ensuring that shareholders have a freehand in the election, appointment and removable of directors. It is also concluded that there is a policy in the organization that ensures members of the Board and key executives disclose to the Board whether they directly or indirectly have a material interest in any transaction or mater directly affecting the organization but its also important for every Board member is given the organization's legal documents; mission and vision, strategy documents on first appointment this will further cascade to ensures succession plans are in place for both the senior management and the directors.

It was found that corporate governance practices (directors' effectiveness, management effectiveness, shareholder protection, disclosure and transparency) have a positive relationship with bank performance. Amongst other success factors to overall bank performance, this study attributes 20.7% of these to corporate governance practices. Therefore banks should embrace adequate corporate governance practices in order to increase financial performance.

5.4 Recommendations

Given the increasing complexity of business today, there is need for the financial reports to include more comprehensive information as investors rely on information they receive from companies in making their investment decisions. Failures in corporate governance practices have aggravated incidences where management manipulates financial reports for different purposes hence making it difficult for the stakeholder to build confidence in them. By examining the existing relationships between the directors, management, shareholders, and the other stakeholders, the study recommends that existing boards setbacks need to be addressed in order to improve the corporate governance in banking institutions in Kenya.

5.5 Suggestions for Further Research

The study has explored on the relationship between corporate governance practices and performance of commercial banks in Kenya. The study therefore recommends another study be done with an aim to investigate the factors influencing corporate governance practices and performance of commercial banks in Kenya. Further a study should also be carried out to investigate the factors influencing corporate governance practices and performance of commercial banks in Africa.

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APPENDIX I: LETTER OF INTRODUCTION

UNIVERSITY OF NAIROBI

SCHOOL OF BUSINESS

To: All Respondents,

Dear Sir/Madam,

RE: THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE PRACTICES AND PERFORMANCE OF COMMERCIAL BANKS IN KENYA

I am a postgraduate student at the University of Nairobi, pursuing Master of Business Administration Degree in Finance. I am carrying out a survey for a study as referenced above in partial fulfillment of the requirements for the award of the degree.

You have been selected to provide information on the performance in relation to the implementation of corporate governance practices in your bank. The information provided for this study will be treated with the confidentiality it deserves and used purely and exclusively for academic purposes.

Thank you in advance for your cooperation and participation towards making this academic work a success.

Simplicious O. Ochieng

Reg. No. D61/70097/2007

MBA Student

APPENDIX II: RESEARCH QUESTIONAIRE

Section A: Organization profile

1. Name of your Organization ______________________________
2. Current number of employees (tick as appropriate)

    Less than 500 [ ]
    Between 501 -1000 [ ]
    More than 1000 [ ]

3. The number of members serving in the Board of Directors ___________
4. The number of times the Board meets in a year (tick as appropriate)

    Once a year [ ]
    Twice a year [ ]
    Once in a quarter [ ]
    Once a month [ ]
    As need arises [ ]

Section B: Board of Directors Effectiveness

1. Use the scale provided for part a) and b) where **1**= Not at all, **2** = To a little extent, **3** = To a moderate extent, **4** = To a great extent, **5** =To a very great extent.

a) To what extent can you say the following apply to the Board?

I. The Board formulates long term strategy of the organization

[1] [2] [3] [4] [5]

II. The Board is not involved in day to day running of the organization's affairs

[1] [2] [3] [4] [5]

III. The Board provides the necessary resources for the achievement of the organization's strategic g

[1] [2] [3] [4] [5]

IV. The Board defines and communicate to management their powers, roles and responsibilities

[1] [2] [3] [4] [5]

V. The Board approves proposals from the management after thorough scrutiny, debate and analysi

[1] [2] [3] [4] [5]

VI. The Board consults technocrats on professional matters

[1] [2] [3] [4] [5]

VII. The Board has got an operating plan that defines its functions, activities and its objectives

[1] [2] [3] [4] [5]

VIII. The Boards' first duty is to;

I. The organization [1] [2] [3] [4] [5]
ii. The shareholders [1] [2] [3] [4] [5]
iii. The directors [1] [2] [3] [4] [5]
iv. The members and other stakeholders [1] [2] [3] [4] [5]

IX. The Board conducts its activities in a free and democratic atmosphere

[1] [2] [3] [4] [5]

X. The Board meetings are democratic and open for all members

[1] [2] [3] [4] [5]

2. State whether the following applies to the Board by ticking indicating to what strength it relates to y organization.

1 Least Strong, 2 Strong, 3 Average, 4 Strong, 5 Very Strong

	1	2	3	4	5
Minutes of all meetings are securely kept and are available to all members of the Board					
The members receive advance written agenda and notices of meetings					
Absence from the Board meetings is by exception not as a rule					
All proceedings and resolutions of the Board are accurately recorded on a timely basis					
The Board is involved in the selection of the directors					
The selection considers present skills and requirements in the Board of directors					
The Board is composed of members representing diverse interest groups					
Every new Board member is inducted well after selection.					
A new Board member is given clear information on the role of management and that of the Board and the relationship between the two					
Board performance is evaluated at least once in a year					
A succession plan is in place for the Board's chairperson, Board members, the CEO and the senior management.					
Where the conduct of any director becomes questionable, he or she is asked to leave the Board.					
Interest and conflicts between Board members are declared and resolved amicably					

3. This is a question on the structure of the Board. Please tick to what extent it applies to your organizati

1Least extent, 2Extent, moderate, 4 great extent, 5very great extent

	1	2	3	4	5
The Board consists of the executive and non executive members on a fairly balanced proportion					
The chairperson is not the CEO and their roles are clearly defined and separate					
The Board has formally constituted and recorded committees with clearly defined terms of reference, composition and reporting mandates					
The committees have been established and appointed based on i. The need to increase the Board's effectiveness utilizing the specialized skills of the Board ii. The need to provide support and guidance to the management					

iii. The need for effective and independent audit and finance reports					
The different sub committees are on Board and have clearly defined terms of references. i. Executive committee ii. Audit committee iii. Board appointment and remuneration committee					

Section C: Management Effectiveness

1. To what extent can you attribute corporate governance practices in your organization to the given factors?
   i. Organization culture
      [1] [2] [3] [4] [5]
   ii. Organization's strategic direction
      [1] [2] [3] [4] [5]
   iii. The policies of the organization
      [1] [2] [3] [4] [5]
   iv. The share holders interest
      [1] [2] [3] [4] [5]
   v. The existing Board structure
      [1] [2] [3] [4] [5]
   x. The efficiency and effectiveness of service delivery
      [1] [2] [3] [4] [5]
2. The Board is involved in the selection and appointment of senior executives.
   [1] [2] [3] [4] [5]
3. Management provides directors with information they need to meet their responsibilities.
   [1] [2] [3] [4] [5]
4. Are there systems in place for identifying, monitoring and managing the organization's risk profile.
   [1] [2] [3] [4] [5]
5. Are there adequate policies that increase accountability of the managers.
   [1] [2] [3] [4] [5]

Section D: Shareholders Protection

1. To what extent can you attribute corporate governance practices in your organization to the given factors?
   i. Protects and facilitates the exercise of shareholder's rights
      [1] [2] [3] [4] [5]
   ii. Ensures shareholders have a freehand in the election, appointment and removable of directors

[1] [2] [3] [4] [5]

iii. Shareholders have the right to participate in and to be sufficiently informed on, decisions concerning fundamental corporate changes.

[1] [2] [3] [4] [5]

iv. Shareholders of the same class are treated equally

[1] [2] [3] [4] [5]

v. There is a policy in the organization that ensures members of the Board and key executives disclose to the Board whether they directly or indirectly have a material interest in any transaction or mater directly affecting the organization.

[1] [2] [3] [4] [5]

Section E: Disclosure

1. Information flow and communication within the Board and the management

Tick either **YES or No** as applicable in your organization

	Yes	No
Every Board member is given the organization's legal documents; mission and vision, strategy documents on first appointment		
Every Board member receives a copy of the Board manual at the time of his or her appointment		
Every Board member has access to organization's policy documents on personnel, finance as reviewed from time to time		
The Board receives sufficient and timely information from senior management in an agreed upon format		
The Board's information requirements are communicated to the management on a regular basis		
Information is prepared and disclosed at all times in accordance with the governing laws and regulations.		
The Board's responsibilities regarding financial communication is properly disclosed		
The ownership structure is fully disclosed o all interested parties. Changes in the shareholdings of substantial investors is disclosed as soon as the bank becomes aware of them.		

2. To what extent can you attribute the timely and accurate disclosure is made on all material matters in your organization that relate to the given factors?

i. Financial and operating results

[1] [2] [3] [4] [5]

ii. Organizational objectives

[1] [2] [3] [4] [5]

iii. Major share ownership and voting rights

[1] [2] [3] [4] [5]

iv. Remuneration policy for members of the Board and key executives

[1] [2] [3] [4] [5]

Section F: Transparency

1. Use the provided scale where 1= [very poor], 2= [poor], 3= [fair], 4= [good], 5= [good] to evaluate the effectiveness of the organization.

i. Promotes effective participation of all Board members in Board meetings

[1] [2] [3] [4] [5]

ii. Effectively represents the management to the Board

[1] [2] [3] [4] [5]

iii. Is effective in maintaining transparency and accountability

[1] [2] [3] [4] [5]

iv. Ensures succession plans are in place for both the senior management and the directors

[1] [2] [3] [4] [5]

v. Monitors and evaluates in consultation with other Board members, the CEO' s performance and that of the senior management

[1] [2] [3] [4] [5]

vi. Clearly articulates the division of responsibilities among different supervisory, regulatory and enforcement authorities.

[1] [2] [3] [4] [5]

vii. Channels for disseminating information provide for equal, timely and cost effective access to all relevant information by users.

[1] [2] [3] [4] [5]

viii. External auditors are independent, competent and qualified and are accountable to the shareholders.

[1] [2] [3] [4] [5]

THANK YOU FOR YOUR RESPONSE

APPENDIX III: BANKING FIRMS IN KENYA

1. African Banking Corporation Ltd.
2. Bank of Africa Kenya Ltd.
3. Bank of Baroda (K) Ltd.
4. Bank of India
5. Barclays Bank of Kenya Ltd.
6. CFC Stanbic Bank Ltd.
7. Charterhouse Bank Ltd. (Under Statutory Management)
8. Chase Bank (K) Ltd.
9. Citibank N.A Kenya
10. Commercial Bank of Africa Ltd.
11. Consolidated Bank of Kenya Ltd.
12. Co-operative Bank of Kenya Ltd.
13. Credit Bank Ltd.
14. Development Bank of Kenya Ltd.
15. Diamond Trust Bank Kenya Ltd.
16. Dubai Bank Kenya Ltd.
17. Ecobank Kenya Ltd.
18. Equatorial Commercial Bank Ltd.
19. Equity Bank Ltd.

20. Family Bank Limited
21. Fidelity Commercial Bank Ltd.
22. Fina Bank Ltd.
23. First community Bank Limited
24. Giro Commercial Bank Ltd.
25. Guardian Bank Ltd.
26. Gulf African Bank Limited
27. Habib Bank A.G Zurich
28. Habib Bank Ltd.
29. Imperial Bank Ltd.
30. I & M Bank Ltd.
31. Jamii Bora Bank Limited
32. Kenya Commercial Bank Ltd.
33. K-Rep Bank Ltd.
34. Middle East Bank (K) Ltd.
35. National Bank of Kenya Ltd.
36. NIC Bank Ltd.
37. Oriental Commercial Bank Ltd.
38. Paramount Universal Bank Ltd.
39. Prime Bank Ltd.

40. Southern Credit Banking Corporation Bank Ltd

41. Standard Chartered Bank Kenya Ltd.

42. Trans-National Bank Ltd.

43. UBA Kenya Bank Limited

44. Victoria Commercial Bank Ltd.

45. Housing Finance Ltd.

Source: 1. Commercial Banks & Mortgage Finance Companies
(http://www.centralbank.go.ke/financialSystem/banks/Register.aspx)

2. Kenya Banker's Association (KBA) Branch Listing as at 4th March 2011

APPENDIX IV: COMMERCIAL BANK PERFORMANCE RATIOS

	Banks	Capital Adequacy	Assets Quality	Managerial Efficiency	Profitability	Liquidity
1	Barclays Bank	0.3611	0.5054	1.8524	0.0909	0.7038
2	CFC Stanbic Bank	0.1334	0.5370	1.3615	0.0426	0.8778
3	Co-operative Bank	0.2332	0.5625	1.7028	0.0616	0.6985
4	Equity Bank	0.3883	0.5445	2.1659	0.0826	0.7657
5	Kenya Commercial Bank	0.2976	0.6158	1.8476	0.0829	0.8416
6	Standard Chartered Bank	0.3179	0.4454	2.3610	0.0569	0.6326
7	Bank of Baroda	0.3531	0.4155	3.9995	0.0001	0.5248
8	Chase Bank	0.1541	0.5092	1.4835	0.0502	0.6594
9	Diamond Trust Bank	0.2183	0.6299	2.1130	0.0833	0.8221
10	Family Bank	0.3063	0.5056	1.1912	0.0827	0.6489
11	Imperial Bank	0.2748	0.5806	1.8440	0.1084	0.8234
12	I & M Bank	0.3640	0.5701	2.5353	0.0506	0.7753
13	National Bank of Kenya	0.4764	0.3473	1.7576	0.0228	0.0435
14	NIC Bank	0.2059	0.7000	1.9990	0.0621	0.8460
15	Prime Bank	0.2627	0.4573	1.7423	0.0347	0.5816
16	ABC Bank	3.0842	0.5136	1.7929	0.0673	0.6331
17	Consolidated Bank	0.2442	0.5771	1.4296	0.0592	0.7551
18	Development Bank	0.3123	0.5861	1.9121	0.0356	1.1617
19	Equatorial Commercial Bank	0.3295	0.6157	1.3162	0.0640	0.7806
20	Fidelity Commercial Bank	0.1791	0.5449	2.1638	0.0274	0.6208
21	Fina Bank	0.1989	0.4761	1.4147	0.0816	0.5796
22	First Community Bank	0.1895	0.4676	0.6333	0.0546	0.5317
23	Gulf African Bank	0.2473	0.6388	0.7791	0.0567	0.6064
24	K-Rep Bank	0.2205	0.6848	1.0968	0.1140	0.9630
25	Middle East Bank	0.4640	0.5508	1.9069	0.0397	0.8758
26	Oriental Commercial Bank	0.4644	0.5376	1.7766	0.0322	0.7503
27	Trans-National Bank	0.7953	0.4069	1.5025	0.0730	0.6436
28	HFCK Bank	0.2326	0.7349	1.4040	0.0416	0.9908

Source: Researcher's computations from the Banks' Published Financial Statements