

**THE EFFECT OF CORPORATE GOVERNANCE ON THE FINANCIAL  
PERFORMANCE OF COMMERCIAL BANKS IN RWANDA**

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**DECLARATION**

This is to declare that this research project is my original work that has not been presented to any other University or Institution of Higher Learning for examination.

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## LIST OF ABBREVIATIONS

BCR	BanqueCommerciale du Rwanda
BK	Bank of Kigali
BNR	National Bank of Rwanda
BPR	BanquePopulaire du Rwanda
CIR	Cost-to-Income Ratio
CSR	Corporate Social Responsibility
EAC	East African Community
GDP	Gross Domestic Product
ICT	Information and Communication Technology
MFI	Micro-Finance Institution
NIM	Net Interest Margin
NSE	Nairobi Stock Exchange
OECD	Organization for Economic Co-operation and Development
PSF	Private Sector Federation
ROA	Return on Assets
ROE	Return on Equity
SPSS	Statistical Package for Social Sciences
SSA	Sub-Saharan Africa

## ABSTRACT

This study sought to investigate the effect of corporate governance on the financial performance of commercial banks in Rwanda. This study examined the board size, board composition, board sub-committees and board meetings and how they affect the financial performance of commercial banks in Rwanda. The firm performance was measured using the Return on Assets. This study adopted a descriptive research design to investigate the relationship between corporate governance and financial performance of commercial banks in Rwanda. The population of study was eleven commercial banks regulated by the central bank of Rwanda. The response rate was 73% of the total population which makes eight commercial banks. The secondary data were collected from the annual reports of the eight commercial banks. The data were analyzed using SPSS 20.

The study found that all measures of corporate governance are not significant predictors of financial performance of commercial banks in Rwanda. The board size, board composition, the sub-committees and board meetings were found to be insignificant in explaining the profitability of commercial banks in Rwanda. Based on the findings, another study should be conducted to determine the other corporate governance variables that affect the financial performance of commercial banks in Rwanda.

Financial institutions are the key engines of growth in many developing economies. The study recommends the Government of Rwanda to ensure that financial entities are operated in the interest of the depositors, the shareholders and the wider economy. Financial institutions also must conduct their activities in such a manner so as not to compromise the financial wellbeing of all its stakeholders.

## CHAPTER ONE

### INTRODUCTION

#### 1.1 Background of the Study

Corporate Governance has become an important topic in developing economies in recent years. Directors, owners & corporate managers have started to realize that there are benefits that can accrue from having a good corporate governance structure (McGee, 2008). Countries with strong corporate practices attract capital. Countries that guarantee investor rights and have good corporate governance practices like adequate corporate disclosure, sound board practices, are more likely to attract both domestic and international investors than those which do not. Corporate governance is about the way in which boards oversee the running of a company by its managers, and how board members are in turn accountable to shareholders and the company. This has implications for company behavior towards employees, shareholders, customers and banks (OECD, 2004).

The Rwandan banking sector remains liquid and very well capitalized. The National Bank of Rwanda (BNR) continues to strike an appropriate balance in its supervision and regulation between protecting consumers and financial stability, and encouraging innovation. The sector has been growing rapidly, with consumers benefitting from the very large increase in outreach—over 100 new physical service locations over the last five years, as well as automated teller machines (ATMs) and card products and the newly introduced agency banking model (Andrews et al., 2012). During an interview with the New Times in 2012, Sanjev Anand, the Managing Director of Rwanda Commercial Bank (BCR) said that “The banking sector has been very stable for the past three years. It has enjoyed capitalization and profitability.” Anand noted that investors are always attracted by stability, profitability and potential, where Rwanda scores highly. Rwanda has recently attracted a number of banks mainly from Kenya including I&Mbank (formerly known as BCR), Guaranty trust bank (formerly known as Fina bank), Kenya Commercial Bank and Equity Bank.

Corporate governance plays an important role in the financial performance of Commercial banks. Banks seem to be more important than other industries because the banking sector plays a crucial financial intermediary role in any economy, particularly in developing countries. Poor corporate governance of the banks can drive the market to lose confidence in the ability of a bank to properly manage its assets and liabilities, including deposits, which could in turn trigger a liquidity crisis and then it might lead to economic crisis in a country and pose a systemic risk to the society at large(Cebenoyan & Strahan, 2001).

### **1.1.1 Corporate Governance**

Corporate governance is the relationship among shareholders, management, members of board of directors, employees, customers, suppliers and other interest groups in determining the direction and performance of corporations (Monks & Minow, 2004). Corporate governance refers to that blend of law, regulation and appropriate voluntary private sector practices which enable the corporation to attract financial and human capital, perform efficiently, and thereby perpetuate itself by generating long-term economic value for its shareholders, while respecting the interests of stakeholders and society as a whole(Hart & Milstein, 2003).

The principal characteristics of effective corporate governance are transparency (disclosure of relevant financial and operational information and internal processes of management oversight and control. Protection and enforceability of the rights and prerogatives of all shareholders; and directors capable of independently approving the corporation's strategy and major business plans & decisions, and of independently hiring management, monitoring management's performance and integrity, and replacing management when necessary (World Bank, 1999). Effective corporate governance structures encourage companies to create value (through entrepreneurship, innovation, development and exploration) and provide accountability and control systems commensurate with the risks involved(ASX Corporate Governance Council, 2003).

Good corporate governance practices convert principles into objective recommendations, aligning interests with the purpose of preserving and enhancing the organization's value, facilitating its access to capital and contributing to its longevity(IBGC, 2010).

### **1.1.2 Financial Performance**

The financial performance of a corporation is of vital interest to many different groups and individuals. Lenders such as commercial banks are concerned with the corporation's ability to repay loans as well as whether it is abiding by loan contracts. Purchasing agents for other companies are concerned with its viability as a supplier of goods or services for its products. Potential investors are interested in determining the financial strength of a company as an element in assessing the company's value. The primary sources of information the analysts use to evaluate a firm's performance are its financial statements(Scott, 2007).

The most common method of analyzing financial statements is the use of ratios. To measure the profitability of commercial banks there are variety of ratios used of which Return on Asset(ROA), Return on Equity (ROE) and Net Interest Margin(NIM) are the major ones (Murthy & Sree, 2003).The importance of bank profitability can be appraised at the micro and macro levels of the economy. At the micro level, profit is the essential prerequisite of a competitive banking institution and the cheapest source of funds. It is not merely a result, but also as a necessity for successful banking in a period of growing competition in financial markets. Hence, the basic aim of a bank's management is to achieve a profit as the essential requirement for conducting any business (Bobakova, 2003).

### **1.1.3 The Effect of Corporate Governance on Financial Performance**

The concept of corporate governance is a key issue for the improvement of economic growth and efficiency. Top level management considered the corporate governance as a tool to reduce the mismanagement or misconduct in organizational processes, and for the enforcement of regulation and management policies and decisions for protection of the rights of stockholders & stakeholders in banking industry (Gompers et al. 2003).Good corporate practices lead to reduced agency costs in firms, and there is a reduction in inefficiencies caused by conflict of interest between managers, owners and stakeholders, firms have improved competitive advantage over other firms, and there is fulfillment of their social responsibilities towards the communities that they operate in (OECD, 2004).Shleifer&Vishny (1997) note that having a good corporate governance system ensures firms have access to capital and increased returns. Investors are

willing to pay large premiums for companies with effective corporate governance (Coombes & Watson, 2000). Commercial banks lend money that is in effect borrowed from depositors, and the failure of banks could result in a monetary loss for the depositors. The interests of depositors should be protected, and for this reason, amongst others; the importance of corporate governance of banks differs from that of other companies and needs special attention. The Board & Management of banks have to take into account the interests of these non-shareholders i.e. depositors. To be competitive in a changing world, banks as well as banking supervisors must continue to innovate and adapt their corporate governance practices and frameworks; so that they can meet new demands and grasp new opportunities (OECD, 2006).

Financial efficiency is the main issue for banking sector, if bank performs well than it has financial resources to obtain the corporate goal and to alive the hope of survival in the competitive market. Several studies have been done on the relationship between corporate governance and firm performance. Yermack (1996), Claessens et al. (2000), Kappler and Love (2003), Gompers et al. (2003), Black et al. (2003), Sanda et al. (2003), Weir & Laing (1999) and Baghat & Bolton (2008) found that Corporate Governance leads to high firm Performance and protect stakeholder's interests.

#### **1.1.4 Commercial Banks in Rwanda**

The Rwanda's banking sector is composed of eleven commercial banks and five specialized institutions (that include three microfinance banks, one development bank and one co-operative bank). Banking service operations date back in early 1960, originating from the oldest banks of BCR (Currently I&M Bank Rwanda) and Bank of Kigali (BK) respectively (Ecobank, 2013).

Recently, most commercial banks have centered their operations on trade finance as opposed to long-term debt financing. This has triggered off to lack of productive investment activity, thus there is urgent need to focus attention on the reform and strengthening of the financial sector. This appeal for introduction of more banks, financial products and capital market.

However, banking sector penetration still remains low, with the ratio of total banking sector assets to GDP standing at 28% in local currency terms, and representing a massive growth

opportunity. The Bank of Kigali (BK) continued its dominance as the country's largest bank, with total assets worth USD 496mn at the close of 2012. From a profitability perspective, the Rwandan banking sector's 13% return on equity (ROE) places it at the bottom of the profitability rankings of the EAC region. However, on a micro-level, Banque Commerciale du Rwanda (Currently known as I&M bank Rwanda) is the country's most profitable bank. With regard to efficiency, the country's banking sector ranked as least efficient compared to its major EAC peers, with a consolidated cost-to-income ratio (CIR) of 71%. However, on a micro-level, BK is the most efficient bank while Equity Bank ranked at the bottom as the least efficient one. Overall capital adequacy levels remained strong and the sector still ranks as the most capitalized one in the EAC region, with industry total qualifying capital to total risk assets standing at 25%, well above the regulatory threshold of 15% (Ecobank, 2013).

Commercial banks are among the main institutions that play a key role in maintaining good corporate governance in Rwanda. These commercial banks have stringent rules for borrowers including audited financial reports, corporate structure, list of directors, and subjecting borrowers to greater scrutiny (Mwika, 2012). Commercial banks in Rwanda play an important role in the economic development of the country. One way to attain efficiency and effectiveness in the banking sector in Rwanda is through good corporate governance practices. Sound corporate governance practices will also bolster confidence in the capital market and the confidence of the Rwandan society in general, in the way in which business functions (PSF Rwanda, 2009).

## **1.2 Research Problem**

The profitability of the banking sector is inevitable in order to encourage economic activities. The issue of Corporate Governance is of much concern for the banking sector as these financial institutions are a key element in the payment system and play a major role in the functioning of economic systems both in developing as well as developed nations. They are also highly leveraged firms, due mainly to the deposits taken from customers. The unique character of the institutions and the complexity of the governance problems provides to the issue of corporate governance special emphasis. The poor governance of these institutions leads to the involvement of large amount of systematic as well as social cost (De Andreas & Vallelado, 2008).



In Rwanda, the issues and need for corporate governance have been propelled by the corporate scandals in neighboring countries in the East African Community particularly in Kenya and Uganda, as well as globally. The biggest culprit of these failures was weak corporate governance. In order for Rwanda to have an efficient capital market, improve economic growth and efficiency, have attractive markets, enhance investor confidence and maintain financial stability, it is very critical to have a good corporate governance regime. Rwanda has a lot of work to do in regards to corporate governance; it needs to rely not only on the legal and regulatory framework to enhance good governance. Borrowing from the experiences of other countries where stringent regulations have not curbed bad governance it is important to advocate and promote the improvement of internal control mechanisms, ethics of company management and staff, and promoting ethical behavior from top to bottom (Namara, 2012).

Brown & Caylor (2004) provide insights to relationships between good corporate governance and corporate performance. Research indicates that companies with better corporate governance guarantee the payback to the shareholder and limit the risk of the investment. McAvoy & Millstein (2003) found that board composition does not have any effect on Financial Performance. Oluyemi (2005) considers corporate governance to be of special importance in ensuring stability of the economy and successful achievement of banks' strategy. In achieving this; strict compliance to standards of lending high risky loan should be adequately secured. Murithii (2004) did a paper on the relationship between corporate governance mechanisms & performance of firms quoted on the NSE. In this study, the researcher found out that there was no significant relationship, in case of non-executive Board of directors.

Most academic papers on corporate governance exclude financial firms from their data and focus on non-financial firms. However this research is important, we will be able to know how Corporate Governance affects the Financial Performance of banks. There is limited literature and empirical studies that look at the phenomenon and state of corporate governance in Rwanda. Most of the available literature on corporate governance mainly focuses on developed countries and African countries such as South Africa, Nigeria and Kenya. From the above research gap, this study aims to address the following research question: "What is the effect of corporate governance on the performance of commercial banks in Rwanda?"

### **1.3 Research Objective**

To establish the effect of corporate governance on the financial performance of commercial banks in Rwanda.

### **1.4 Value of the Study**

This study is of immense value to bank regulators, investors and other relevant stakeholders in Rwanda. This study provides a picture of where banks stand in relation to the codes and principles on corporate governance so that to find out remedial actions to improve the existing corporate governance practices. The boards of directors will find this information of value in benchmarking the performance of their banks, against that of their peers.

This study will contribute to the existing corporate governance literature in emerging markets. There are very few empirical studies that exist on corporate governance and financial performance in Rwanda. In addition, the scopes of these studies are too narrow. The result of this study will also serve as a data base for further researchers in this field of research. The lessons learned from this study can be used by other regulatory agencies to build a culture of good corporate governance in firms under their jurisdiction.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The chapter presents theoretical background, corporate governance models, the empirical review, conceptualization, operationalization and the research gap.

#### **2.2 Theoretical Review**

The main purpose of this literature review is to identify and examine what has been done by other scholars and researchers in relation to the effect of corporate governance on the financial performance of banks. The theoretical review will provide detailed knowledge of what has been done and form a framework within which the research findings are to be interpreted and also to overcome the limitations of previous studies.

The following section will describe and discuss different theories such as Agency Theory, Stewardship Theory, Resource Dependency Theory and Stakeholder Theory.

##### **2.2.1 Agency Theory**

Agency theory having its roots in economic theory was expounded by Alchian & Demsetz (1972) further developed by Jensen & Meckling (1976). Agency theory is defined as “the relationship between the principals, such as shareholders and agents such as the company executives and managers”. In this theory, shareholders who are the owners or principals of the company, hire the agents to perform work. Principals delegate the running of business to the directors or managers, who are the agents to the shareholder Clarke (2004). Daily et al. (2003) argued that two factors can influence the prominence of agency theory. First, the theory is a simple theory that reduces the corporation to two participants of managers and shareholders. Second, agency theory suggests that employees or managers in organizations can be self-interested.

The agency theory shareholders expect the agents to act and make decisions in the principal's interest. On the contrary, the agent may not necessarily make decisions in the best interests of the principals (Padilla, 2000). Such a problem was first highlighted by Adam Smith in the 18<sup>th</sup> century and subsequently explored by Ross (1973) and the first detailed description of agency theory was presented by Jensen and Meckling (1976). Indeed, the notion of problems arising from the separation of ownership and control in agency theory has been confirmed by Schoorman & Donaldson (1997). In agency theory, the agent may be succumbed to self-interest, opportunistic behavior and falling short of congruence between the aspirations of the principal and the agent's pursuits.

Although with such setbacks, agency theory was introduced basically as a separation of ownership and control (Bhimani, 2008). Holmstrom & Milgrom (1994) argued that instead of providing fluctuating incentive payments, the agents will only focus on projects that have a high return and have a fixed wage without any incentive component. Although this will provide a fair assessment, but it does not eradicate or even minimize corporate misconduct. Here, the positivist approach is used where the agents are controlled by principal-made rules, with the aim of maximizing shareholders value. Hence, a more individualistic view is applied in this theory (Clarke, 2004). Indeed, agency theory can be employed to explore the relationship between the ownership and management structure. However, where there is a separation, the agency model can be applied to align the goals of the management with that of the owners. Due to the fact that in a family firm, the management comprises of family members, hence the agency cost would be minimal as any firm's performance does not really affect the firm performance (Eisenhardt, 1989).

The model of an employee portrayed in the agency theory is more of a self-interested, individualistic and are bounded rationality where rewards and punishments seem to take priority (Jensen & Meckling, 1976). According to this model, people or employees are held accountable in their tasks and responsibilities. Employees must constitute a good governance structure rather than just providing the need of shareholders, which maybe challenging the governance structure.

### **2.2.2 Stewardship Theory**

Stewardship theory is defined by Schoorman & Donaldson (1997) as “a steward protects and maximizes shareholders wealth through firm performance, because by so doing, the steward’s utility functions are maximized”. A steward is a person who essentially wants to do a good job, to be a good steward of the corporate assets (Donaldson & Davis, 1991). This theory assumes that managers are basically trustworthy and attach significant value to their own personal reputation (Fernando, 2009).

In contrast to agency theory, stewardship theory suggests that executives tend to be more motivated to act in the best interest of the corporation than in their own self-interest. Whereas agency theory focuses on extrinsic rewards that serve such lower-level needs as pay and security, stewardship theory focuses on the higher-order needs, such as achievement and self-actualization. Stewardship theory argues that, over time, senior executives tend to view the corporation as an extension of themselves. Rather than the use of firm for their own ends, the executives are more interested in guaranteeing the continued life and success of the corporation. The relationship between the board and top management is thus one of principle and steward, not principle and agent (“hired hand”). Stewardship theory notes that in a widely held corporation, the shareholder is free to sell his/her stock at any time. A diversified investor may care little about risk at the company level, preferring that management assume extraordinary risk so long as the return is adequate. Because executives in a firm cannot easily leave their jobs when in difficulty, they are more interested in a merely satisfactory return and put heavy emphasis on the firm’s continued survival. Thus, stewardship theory would argue that in many instances, top management may care more about a company’s long-term success than do more short-term oriented shareholders (Monks & Minow, 2004).

On the other end, Agyris (1973) argues agency theory looks at an employee or people as an economic being, which suppresses an individual’s own aspirations. However, stewardship theory recognizes the importance of structures that empower the steward and offers maximum autonomy built on trust (Donaldson and Davis, 1991). It stresses on the position of employees or executives to act more autonomously so that the shareholders’ returns are maximized. Indeed,

this can minimize the costs aimed at monitoring and controlling behaviors (Schoorman& Donaldson, 1997).

Moreover, stewardship theory suggests unifying the role of the CEO and the chairman so as to reduce agency costs and to have greater role as stewards in the organization. It was evident that there would be better safeguarding of the interest of the shareholders. It was empirically found that the returns have improved by having both these theories combined rather than separated (Donaldson and Davis, 1991).

### **2.2.3 Resource Dependency Theory**

There is an additional theory used in corporate governance research, namely, resource dependency theory. According to this theory, organizations attempt to exert control over their environment by co-opting the resources needed to survive. The concept of co-optation has important implications for the role of the board and its structure. Boards are important boundary spanners. Boards can be used as a mechanism to form links with the external environment. Inter-organizational linkages, such as the appointment of outside directors and board interlocks, can be used to manage environmental contingencies. Directors who are prestigious in their professions and communities can be a source of timely information for executives (Pfeffer and Salancik, 1978).

According to Pfeffer and Salancik (1978), when an organization appoints an individual to a board, it expects that the individual will come to support the organization, will concern himself with its problems, will favorably present it to others, and will try to aid it. This assistance is believed to raise organizational performance, and increase returns to shareholders. Pfeffer (1972) has made the case that the board's co-optation role, in which he includes establishing contacts and raising funds, best explains board composition. His evidence shows that board size and type of outside director are related to an organization's needs for capital and the degree of regulation in its environment.

#### **2.2.4 The Stakeholder Theory**

Stakeholder theory was embedded in the management discipline in 1970 and gradually developed by Freeman (1984) incorporating corporate accountability to a broad range of stakeholders. In essence, stakeholder theory considers the firm as an input-output model by explicitly adding all interest groups: Employees, customers, dealers, government and the society at large- to the component mix. Stakeholder theory can be defined as “any group or individual who can affect or is affected by the achievement of the organization’s objectives” (Fernando, 2009).

Unlike agency theory in which the managers are working and serving for the stakeholders, stakeholder theorists suggest that managers in organizations have a network of relationships to serve – this include the suppliers, employees and business partners. And it was argued that this group of network is important other than owner-manager employee relationship as in agency theory (Freeman, 1999). On the other end, Sundaram&Inkpen (2004) contend that stakeholder theory attempts to address the group of stakeholder deserving and requiring management’s attention. Whilst, Donaldson & Preston (1995) claimed that all groups participate in a business to obtain benefits. Nevertheless, Clarkson (1995) suggested that the firm is a system, where there are stakeholders and the purpose of the organization is to create wealth for its stakeholders. Freeman (1984) contends that the network of relationships with many groups can affect decision making processes as stakeholder theory is concerned with the nature of these relationships in terms of both processes and outcomes for the firm and its stakeholders.

#### **2.3 Determinants of Financial Performance**

The determinants of bank performance can be classified into internal and external factors. These are stochastic variables that determine the output. Internal factors are individual bank characteristics which affect the banks’ performance. These factors are basically influenced by internal decisions of management and the board. The external factors are: The macroeconomic policy stability, Gross Domestic Product, Inflation, Interest Rate and Political instability (Athanasoglou et al., 2005).

### **2.3.1 Corporate Governance**

It is essential for economies to develop efficient and stable banking sectors and this need is particularly acute in developing countries. Having recognized the need, many developing countries have initiated financial reform measures in order to improve the efficiency of banking firms. Corporate Governance is considered to be one of the institutional means that aims to align decision making in financial institutions with that of the best interest of their stakeholders (Arun & Turner, 2009).

In a study conducted in Bangladesh, Arun & Turner (2009) concluded that the entry of foreign banks in the banking industry enhances not only the competitive pressure but also introduces the relatively better functioning and more prudent governance mechanisms of western economies into developing economies. Therefore, policies regarding the financial sector and corporate governance reform must ensure the participation of foreign banks as well as investors in the banking sectors.

### **2.3.2 Capital**

According to Athanasoglou et al. (2005), Capital should be an important variable in determining bank profitability, although in the presence of capital requirements, it may proxy risk and also regulatory costs. Capital is the amount of own funds available to support the bank's business and act as a buffer in case of adverse situations. In imperfect capital markets, well-capitalized banks need to borrow less in order to support a given level of assets, and tend to face a lower cost of funding due to lower prospective bankruptcy costs. Also, in the presence of asymmetric information, a well-capitalized bank could provide a signal to the market that a better-than-average performance should be expected.

Athanasoglou et al. (2005) find a positive and significant effect of capital on bank profitability, reflecting the sound financial condition of Greek banks. Likewise, Berger et al. (1987) find positive causation in both directions between capital and profitability.



### **2.3.3 Size**

Size of the Bank is another specific variable that affects the profitability of a bank. The results obtained by the literature for the relationship between size and profits are diverse.

Using market data (stock prices) instead of accounting measures of profitability, Boyd & Runkle (1993) find a significant inverse relationship between size and rate of return on assets in U.S. banks from 1971 to 1990, and a positive relationship between financial leverage and size. Goddard et al. (2004) use panel and cross-sectional regressions to estimate growth and profit equations for a sample of banks for five European countries over the 1990s. The growth regressions suggest that, as banks become larger in relative terms; their growth performance tends to increase further, with little or no sign of mean reversion in growth.

### **2.3.4 Market Power**

According to Flamini et al. (2009), Market Power is expected to be a major determinant of profits. This is because banks in more concentrated markets should be capable of adjusting spreads in response to unfavorable changes in the macroeconomic environment to leave returns unaffected. We test for the existence of market power in different ways: (i) market concentration, measured by the ratio of each bank's total outstanding loans to the net domestic credit of the country; (ii) the impact of managerial inefficiency (proxied by the log of overheads costs).

Heggestad (1977) studies the interaction of market structure, profitability and risk, and argues that banks with monopoly power systematically reduce the risk they take at the expense of greater profitability. Given the importance of bank credit as a factor of production for almost all firms, this effect may plausibly affect market concentration in other sectors of the economy by making the expansion of smaller firms more difficult. Bourke (1989) and Molyneux & Thornton (1992) find a positive relationship between better quality management and profitability in European banks.

### **2.3.5 Macro-Economic Variables**

The impact of macroeconomic variables on bank risk has recently been highlighted in the literature. We use GDP growth as a control for cyclical output effects, which we expect to have a positive influence on bank profitability. As GDP growth slows down, and, in particular, during recessions, credit quality deteriorates, and defaults increase, thus reducing bank returns (Flamini et al., 2009).

By employing a direct measure of business cycle, Athanasoglou et al. (2005) find a positive, albeit asymmetric, effect on bank profitability in the Greek banking industry, with the cyclical output being significant only in the upper phase of the cycle. The macroeconomic environment has only limited effect on net interest margins in SSA countries according to Al-Hashimi (2007). Athanasoglou et al. (2005) in relation to the Greek situation state that the relationship between inflation level and banks profitability is remained to be debatable.

## **2.4 Empirical Review**

Various researchers have investigated the relationship between corporate governance and the performance of firms in various dimensions.

### **2.4.1 International Evidence**

Yermack (1996) in a study done in the US tested the effect of board size on the performance and management efficiency. He estimated a regression relationship using the ratio of (market value of assets over the replacement cost of assets) as the dependent variable and board size as the most important of the explanatory variables. Other measures of firm value and profitability used by Yermack (1996) include the return on assets and return on sales ratios. All three dependent variables have negative and significant associations with the board size, and the main result is that there is an inverse relationship between board size and firm value. Companies with large boards appear to use assets less efficiently and earn less profit. He also did a study of 452 US firms and found that market would be gaining value to firms where CEO duality did not exist.

Klapper and Love (2002), in a study conducted in the US, use the CLSA governance index to examine corporate governance and performance in a sample of 374 firms in 14 countries, most of which are developing economies. They find that better corporate governance is associated with better performance in the form of Tobin's q and Returns on Asset (ROA) and that firm-level corporate governance matters more in countries with weak shareholder protection and poor judicial efficiency. They also found that firm-level governance is correlated with variables related to the extent of the asymmetric information and contracting imperfections that the firm faces, which they proxied with firm size, sales growth (proxy for the growth opportunities) and intangibility of assets.

Drobetz et al. (2003) in a study done in Germany further developed the one-country approach which links the relationship between strong shareholder rights and the long-run performance of a cross-section of German firms. They classify corporate governance rules into five categories to construct a governance index, which is related cross-sectionally to leading measures, including dividend yields, price to earnings ratios and book-to-market ratios. Using price to earnings ratios, dividend yields and historical returns to proxy the rate of return on capital, Drobetz et al (2003) provide evidence that for the sample period from January 1998 to March 2002, the price-earnings ratios and market-to-book ratios are positive, which implies, in turn, that better protection of shareholders leads to higher firm valuations.

Murithii (2004) conducted a study in Nairobi on 44 Firms listed at the NSE between 1999 and 2003, used a number of governance variables which included, block ownership, family ownership, foreign ownership, Board size and Board composition. Board composition variable under consideration in his study was the proportion of non-executive directors. In this study, the researcher found out that there was no significant relationship, in case of non-executive Board of directors. Murithii (2004) went further to conclude that, "No measure of Firm performance has a significant relationship with the percentage of non-executive Board members. Though the importance of independent directors should not be put to doubt, the outcomes of this study conflict with the conventional wisdom that suggests that a Board's principle task is to monitor management and only independent directors' can be effective monitors." The study by

Murithii(2004) is largely skewed to the position of Agency Theory on the monitoring role of the Board which roots for outside director representation.

Sanda et al (2005), Conducted a study in Nigeria. Using pooled ordinary least squares regression analysis for a sample of 93 firms quoted on the Nigerian Stock Exchange for the period 1996-1999, while making a case for boardsizeoftenandforconcentratedasopposedtodiffusedequityownership, the results argue for the separation of the posts of Chief Executive Officer (CEO) and Chair. They found that firms run by expatriate CEOs tend to achieve higher levels of performance than those run by indigenous CEO. Their results show no significant evidence to support the idea that outside directors help promote firm performance. They also found that leverage has significant positive influence on firm performance, indicating the tendency for firms with higher levels of debt as a proportion of equity to perform better.

Beltratti and Stulz (2012) investigate the relation between corporate governance and bank performance during the credit crisis (July 2007 – December 2008) in an international sample of 164 large (i.e. more than \$50 billion of assets) banks. They use data on board attributes collected by Institutional Shareholder Services (ISS), such as size, independence, composition of committees, and transparency, to construct an index for shareholder-friendly boards in 2006. Beltratti and Stulz found that banks with better governance (in terms of more shareholder-friendly board structures) performed significantly worse during the crisis than other banks and had higher overall stability risk than before the escalation of the crisis. Specifically, they find that banks with higher controlling shareholder ownership are riskier. This evidence is consistent with the view that banks that grew more in sectors that turned out to perform poorly during the crisis were pursuing policies favored by shareholders before the crisis as their boards were more shareholder-friendly but suffered more during the crisis when these risks led to unexpectedly large losses.

Shehzad et al. (2010) conducted a study in the Netherlands and Germany. They examined the impact of bank ownership concentration on two indicators of bank riskiness, namely banks' non-

performing loans and capital adequacy. Using balance sheet information for around 500 commercial banks from more than 50 countries averaged over 2005–2007, they found that concentrated ownership (proxied by different levels of shareholding) significantly reduces a bank's non-performing loans ratio, conditional on supervisory control and shareholders protection rights. They concluded that ownership concentration affects the capital adequacy ratio positively conditional on shareholder protection. At low levels of shareholder protection rights and supervisory control, ownership concentration reduces bank riskiness.

Ujunwa (2012) in Nigeria employed the random-effects and fixed-effects generalized least squares (GLS) regression to test the six hypotheses formulated for the study, while controlling for firm size and firm age. Using panel data from 122 quoted firms in Nigeria between 1991 and 2008, He found that board size, CEO duality and gender diversity were negatively linked with firm performance, whereas board nationality, board ethnicity and the number of board members with a PhD qualification were found to impact positively on firm performance. The result of the robustness test using the same board characteristics for 160 small firms showed that board duality was positively linked to firm performance, while a PhD qualification was negatively linked to firm performance in Nigeria.

#### **2.4.2 Local Evidence**

Mwika (2012) did a study in Rwanda on the Rwanda Capital Market. Using qualitative research, she found that Rwanda's amended Company law is strong on investor protection, but there is a non-existent corporate governance code which leaves room for managers to exploit minority shareholders and stakeholders. Mwika (2012) concluded that proper governance practices and principles not only improve financial performance of an organization but also promote a better public image (through CSR) and to be recognized by the society in which it operates as a socially receptive organization, and this will support its operations and survival.

Kimanzi&Baig (2012) conducted a study on the commercial banks in Rwanda. They employed a regression analysis to establish the relationship between corporate governance and profitability of commercial banks in Rwanda. Using, the data from BCR (BanqueCommerciale du Rwanda), they found a positive relationship between corporate governance and the profitability of

commercial banks in Rwanda; particularly BCR. They also found that several factors such as lack of separation of roles, weak boards, and failure to recognize other stakeholders, lack of accounting and auditing standards and political interference hinder the effectiveness of the subject matter.

## **2.5 Summary of Literature Review**

The theories discussed in this chapter explained how Corporate Governance mechanisms such as Board composition, CEO duality and Executive compensation affects Shareholders' wealth maximization through firm performance. However, the theories have not indicated the effect of corporate governance on the financial performance of commercial banks.

According to the different studies, Corporate Governance is vital to the performance of banks. There is no research that has been conducted to provide empirical evidence particularly on the impact of corporate governance mechanisms on financial performance of commercial banks in Rwanda. And most of the literature related to corporate governance and firm performance is taking ownership structures and boards into consideration as governance dimensions. It was found that banking sector was of lesser concern for researchers. Taking into account these gaps in the literature, the aim of the paper is to find out the relationship between corporate governance of banks and their performance in Rwanda.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter provides information on the type of research design, the population and sample that will be selected for the study. In this section, we will also discuss the data collection, data analysis and presentation techniques that will be used in this study.

#### **3.2 Research Design**

According to Green & Tull (1978), “A research design is the specification of methods and procedures for acquiring the information needed”. It is the over-all operational pattern or framework of the project that stipulates what information is to be collected from which source by what procedures. Research Design constitutes the blueprint for the collection, measurement and analysis of data (Kothari, 2004).

For this study; the researcher adopted a descriptive research design. According to Burns & Grove (2003), descriptive research “is designed to provide a picture of a situation as it naturally happens. It may be used to justify current practice and make judgment and also to develop theories”. The choice of the descriptive research design was based on the fact that the researcher was interested in carrying out an in-depth study on corporate governance and its effect on the Financial Performance of commercial banks in Rwanda. The researcher used only quantitative approaches in this study.

#### **3.3 Population**

A population refers to an entire group of individuals, events or objects having common observable characteristics (Mugenda & Mugenda, 2003). The target population for this study was 11 commercial banks in Rwanda as at 31 December 2013 regulated by the Central Bank known

as the National Bank of Rwanda(Appendix I). The researcher used a census of the population and managed to collect data from eight commercial banks in Rwanda.

### **3.4 Data Collection**

Yin (2003), points to six possible sources of data for case studies; documents, archived records, interviews, direct observations, participant-observation and physical artifacts. The study used secondary data source in gathering data for analysis. The researcher consulted the annual financial reports of commercial banks in Rwanda over a period of five years (2009-2013).

### **3.5 Data Analysis**

Data Analysis is the process of systematically applying statistical and/or logical techniques to describe and illustrate, condense and recap, and evaluate data. Data analysis is developed to deal with manipulation of the information that has been gathered so as to present the evidence (Shamoo & Resnik, 2003).

The study used Statistical Package for Social Science (SPSS20) to analyze the quantitative data. A linear regression model of financial performance versus corporate governance has been applied to examine the relationship between the variables. The model treated financial performance of commercial banks as dependent variable while independent variables are board size, board composition, board sub-committees and board meetings. The significance of each independent variable has been tested. Fischer distribution test called F- test has been used to test the significance of the overall model at a 95% confidence level.

In this study four measures of corporate governance were used. The first one was the board size. The second was the board composition. The third the board sub-committees and the last one was the board meetings.

#### **3.5.1 Analytical Model**

The researcher used a multiple regression analysis to establish the relationship between corporate governance and financial performance of commercial banks in Rwanda. The Dependent variable is Financial Performance of commercial banks while the independent variable is Corporate



Governance. This model was based on the study done by Simon Ndungu (2013) where he was investigating the effect of corporate governance on the financial performance of insurance companies in Kenya. The analytical model used in analyzing the relationship between the dependent and independent variables is:

$$Fp = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + e$$

Where;

Fp= Financial performance of commercial banks measured by ROA

$\alpha$  = Constant Term (Total Assets)

$\beta_i$  = Beta Coefficient of variable i which measures the responsiveness of Y to change in i

$X_1$  = Board size

$X_2$  = Board sub-committees

$X_3$  = the number of board meetings

$X_4$  = Board composition

e=Error term

In this study, four measures of corporate governance were used. The board size measured by the number of directors. Board sub-committees measured by the number of sub-committees. The number of board meetings measured by the number of meetings held per year and the board composition measured by dividing the number of non-executive directors by the total number of board of directors. Financial performance as dependent variable was measured in terms of the return on assets (ROA) which is the ratio of annual net income to average total assets.

### **3.5.2 Test of Significance**

To test the significance of the analytical model, the researcher used the Analysis of Variance (ANOVA). According to Larson (2008), Analysis of variance (ANOVA) is a statistical technique to analyze variation in a response variable (continuous random variable) measured under conditions defined by discrete factors (classification variables, often with nominal levels). Frequently, we use ANOVA to test equality among several means by comparing variance among groups relative to variance within groups (random error).

## **CHAPTER FOUR**

### **DATA ANALYSIS, RESULTS AND DISCUSSION**

#### **4.1 Introduction**

The raw data and data analysis are presented in this chapter. This study was quantitative in nature and used the analysis of secondary data gathered exclusively from the annual reports to arrive at various conclusions in order to address the research objective.

#### **4.2 Response Rate**

The target population of the study was eleven commercial banks which are registered by the central bank of Rwanda. This study managed to get data for eight commercial banks which represent 73% of all the commercial banks. Two commercial banks were microfinance up to 2011 and got a license to operate as a commercial bank in 2012. The other commercial bank (Crane bank Rwanda) was licensed by the National Bank of Rwanda in June 2014. That's the reason why we didn't include them into our analysis. The data was gathered from the annual reports of those commercial banks. These commercial banks that responded are also the largest in terms of asset size and they constituted more than 98% of the total assets of the eleven commercial banks.

#### **4.3 Data Presentation**

The data that was collected was for five years for the period 2009 to 2013. Raw data is presented first then followed with correlation and regression analysis.

**Table 1 Descriptive statistics**

<b>Name of the Bank</b>	<b>ROA (%)</b>	<b>Board Size (Frequency)</b>	<b>Board Composition (Ratio)</b>	<b>Board Sub- Committees (Frequency)</b>	<b>Board Meetings (Frequency)</b>
KCB	5.522	9	0.74	7	5
Bank of Kigali	3.79	8	1	4	5
BanquePopulaire du Rwanda	10.89	9	1	5	6
COGEBANQUE	6.65	8	1	5	6
Ecobank	7.8	6	0.8	5	4
Guaranty Trust Bank	6.6	9	0.7	5	5
I&M Bank (Rwanda)	7	9	0.87	4	5
Access Bank Rwanda	4.8	5	0.4	5	4
<b>Average</b>	<b>6.6315</b>	<b>7.875</b>	<b>0.81375</b>	<b>5</b>	<b>5</b>
<b>Max</b>	<b>10.89</b>	<b>9</b>	<b>1</b>	<b>7</b>	<b>6</b>
<b>Min</b>	<b>3.79</b>	<b>5</b>	<b>0.4</b>	<b>4</b>	<b>4</b>

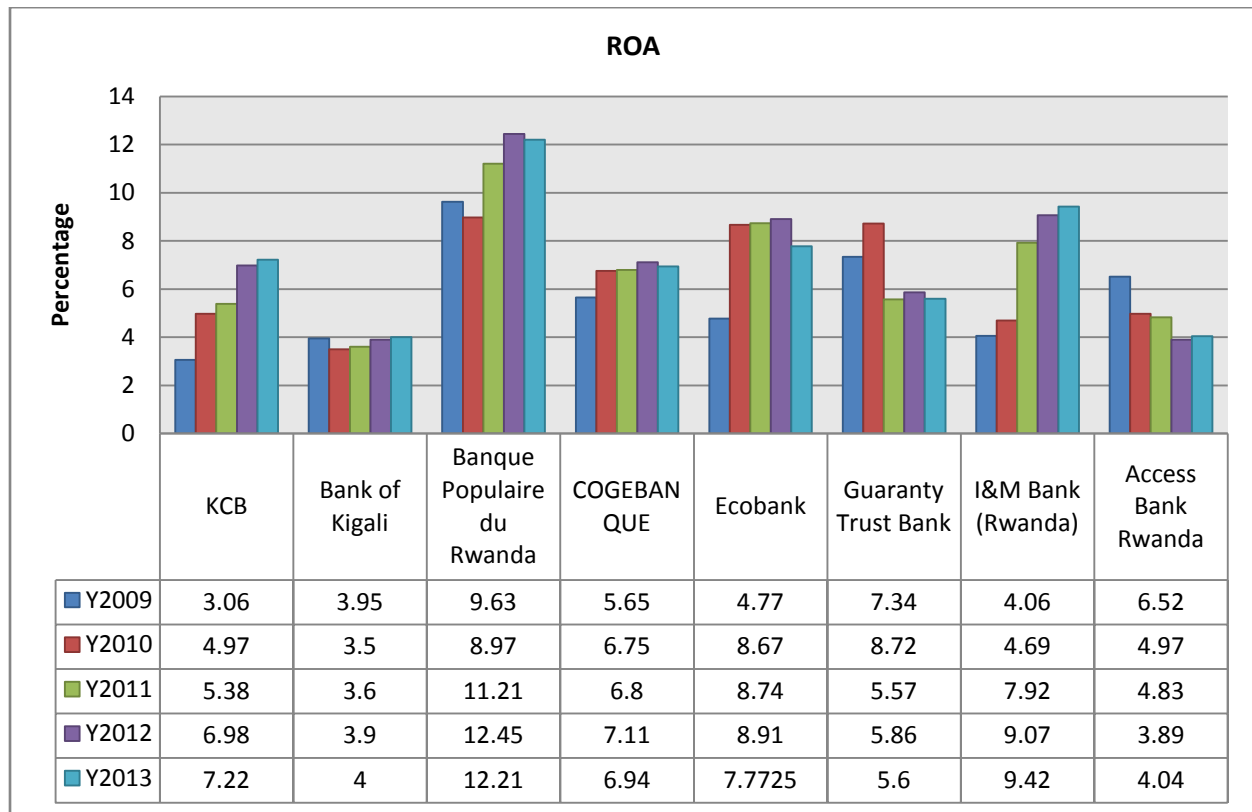
**Source: Research Findings**

The table 1 indicates that the eight commercial banks generated a Return on assets of 6.6315% on average. The maximum being 10.89% and the minimum being 3.79% suggesting that there was an average profit for the period.

The average board size is approximately 8 suggesting that banks in Rwanda have a moderate board size. This is good in respect with the size of these companies. On board composition, the study shows that the averages of 80% of all board members are outsiders which suggest that these boards are relatively independent. The average number of board sub-committees is 5 in the eight banks. The table indicates an average of 5 meetings held per year for the eight commercial banks implying that most of these commercial banks met at least 5 times per year over the five years (2009-2013).

The following section presents and discusses the raw data for the variables for each of the eight commercial banks

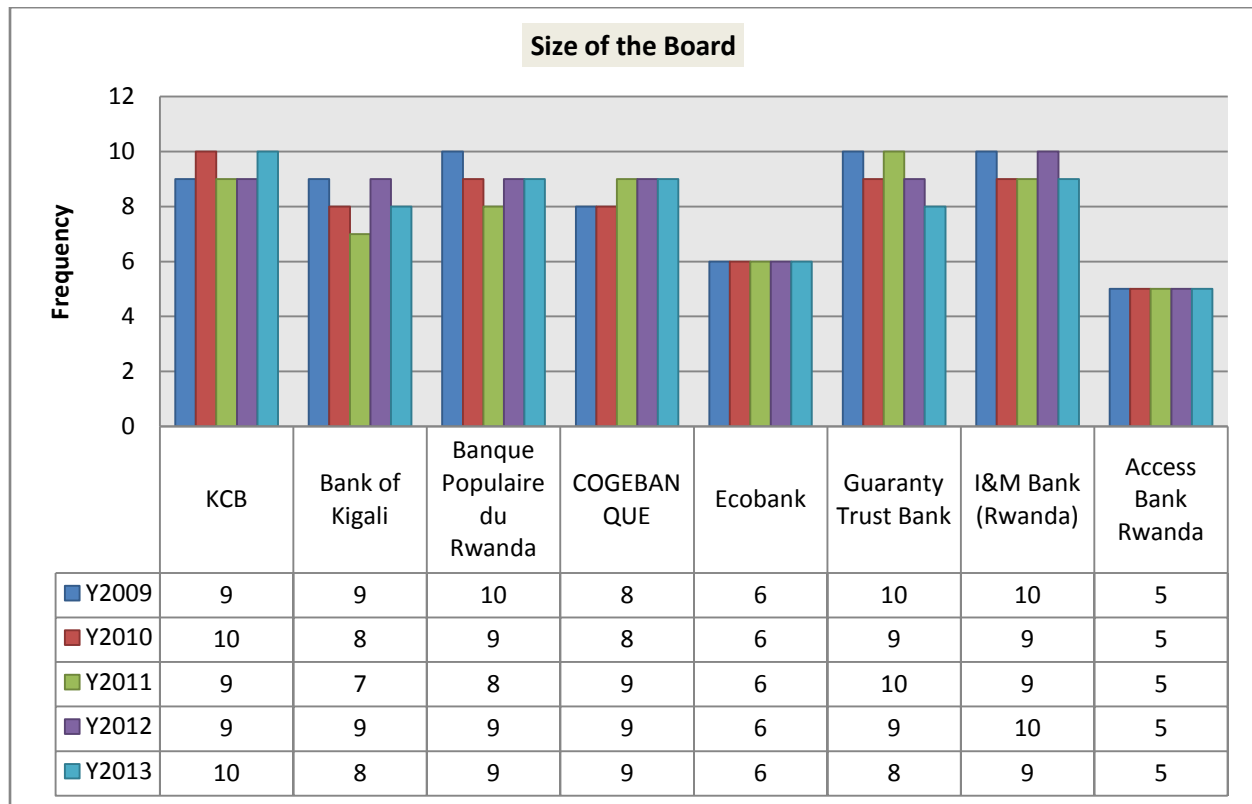
**Figure 1 Trends of Return on Assets**



**Source: Research Findings**

The figure 1 shows the trend on Return on Assets. Banks like BPR, KCB, ECOBANK, and COGEBANQUE have the best trend on Return on Assets and also these banks showed a steady improvement over the five years. BK, Access Bank Rwanda and Guaranty Trust bank had a declining trend over the five years.

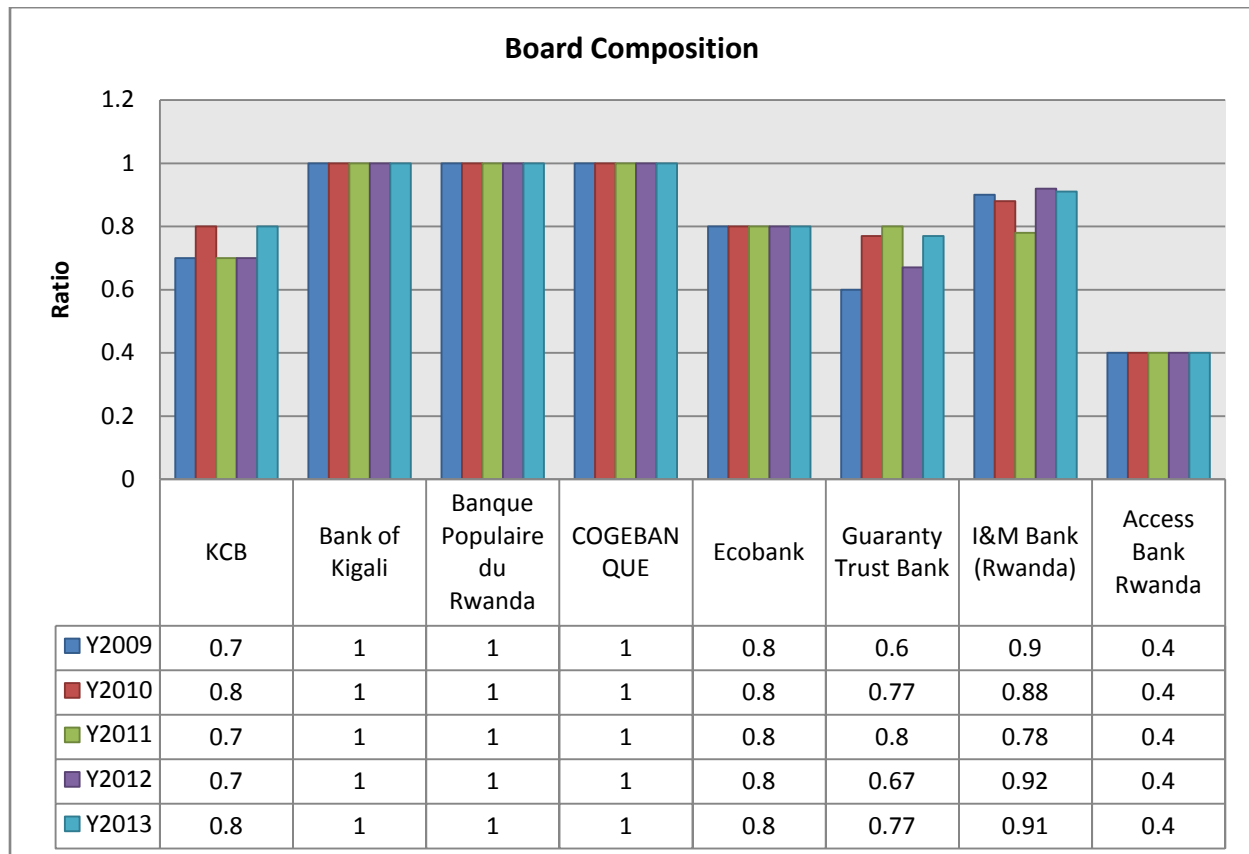
**Figure 2 Board Size**



**Source: Research Findings**

The figure 2 shows the number of people composing the Board of directors in each bank. KCB, BPR, Guaranty Trust Bank and I&M bank Rwanda have the highest number of people in the Board of directors compared to other banks. Access Bank Rwanda has the lowest number of people in the Board of directors.

**Figure 3 Board Composition**

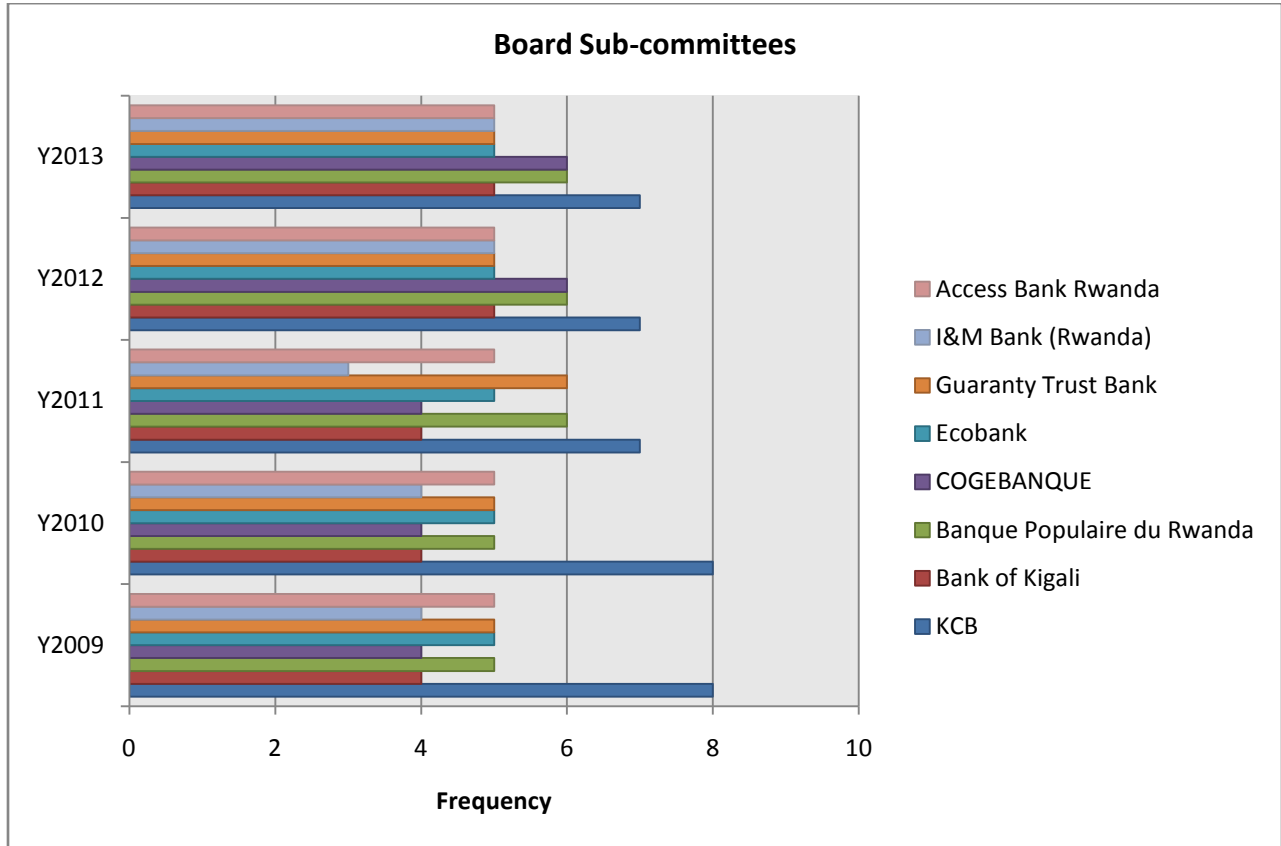


**Source: Research Findings**

According to the figure 3, Bank of Kigali, Banque Populaire du Rwanda and COGEBANQUE have the highest number of non-executive directors in the Board of Directors. In these three banks, the board is composed only by non-executive directors. While Access Bank Rwanda, has the lowest number of non-executive directors in the board; it is mainly composed by Executive directors.



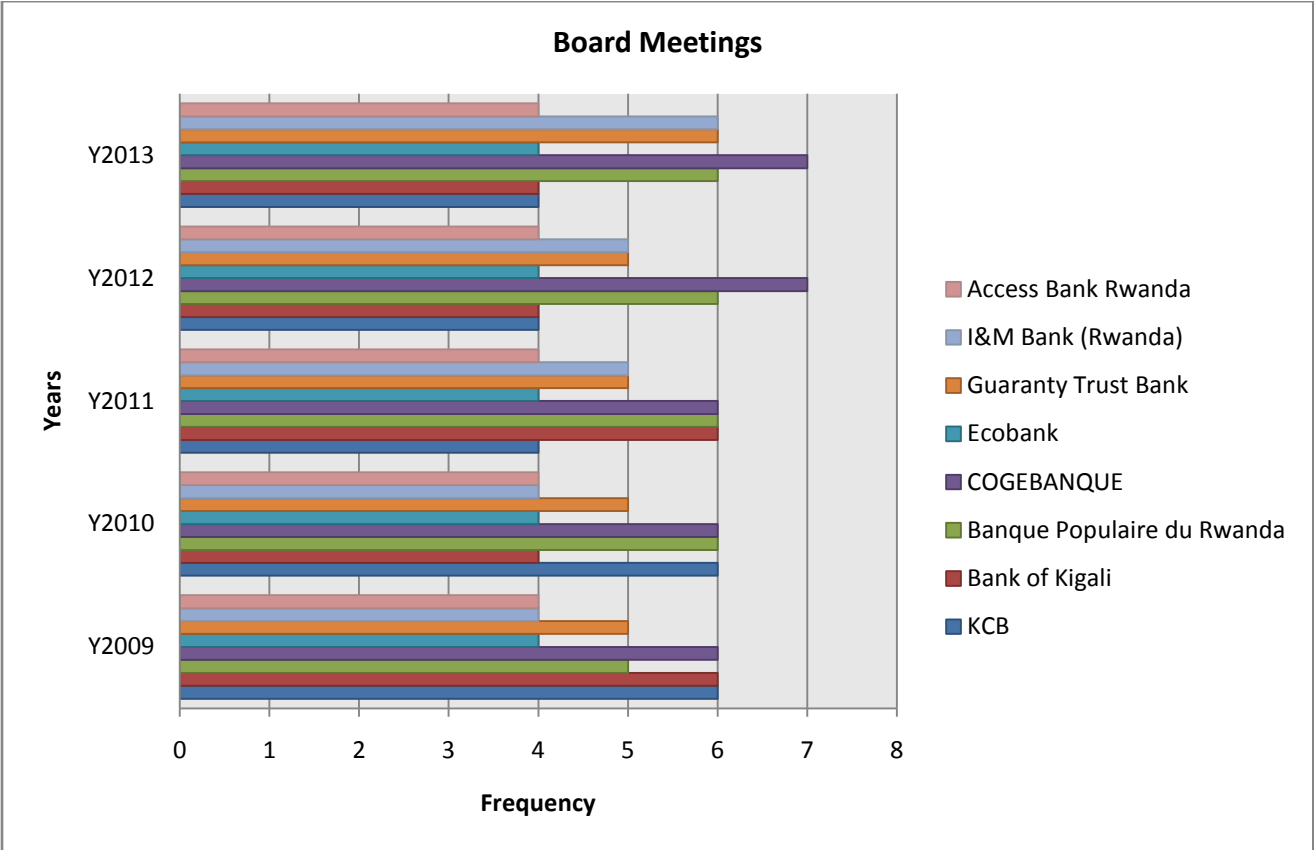
**Figure 4 Board Sub-Committees**



**Source: Research Findings**

Figure 4 indicates the number of sub-committees in each commercial bank in Rwanda. KCB scores highly with a number of 7 sub-committees. Bank of Kigali and I&M Bank Rwanda have the lowest number of sub-committees. KCB experienced a declining trend over the five years while COGEBANQUE, BPR and BK indicated an increase in the number of sub-committees over the five years.

**Figure 5 Number of Board Meetings**



**Source: Research Findings**

Figure 5 shows the number of board meetings held over the five years. COGEBANQUE has the highest number of meetings held with a steady improvement while Ecobank and Access Bank have the lowest number of meetings held. COGEBANQUE and I&M bank increased the number of meetings held per year from 2009 to 2013 while KCB and BK indicated a declining trend over the five years.

#### 4.4 Correlation Analysis

Correlation analysis attempts to determine the degree of relation between the variables. Correlation is a statistical device which helps in the analysis of co-variation of two (or) more variables. In this study, the dependent variable is Return on Assets and the independent variables are board size, board composition, board sub-committees and board meetings.

**Table 2 Pearson Correlation Coefficients**

		ROA (%)	Board Size	Board Composition	Board Sub-Committees	Board Meetings
ROA (%)	Pearson Correlation	1	.185	.295	.104	.279
	Sig. (2-tailed)		.254	.065	.524	.081
	N	40	40	40	40	40
Board Size	Pearson Correlation	.185	1	.580	.227	.445
	Sig. (2-tailed)	.254		.000	.159	.004
	N	40	40	40	40	40
Board Composition	Pearson Correlation	.295	.580	1	-.141	.522
	Sig. (2-tailed)	.065	.000		.387	.001
	N	40	40	40	40	40
Board Sub-Committees	Pearson Correlation	.104	.227	-.141	1	.122
	Sig. (2-tailed)	.524	.159	.387		.452
	N	40	40	40	40	40
Board Meetings	Pearson Correlation	.279	.445	.522	.122	1
	Sig. (2-tailed)	.081	.004	.001	.452	
	N	40	40	40	40	40

**Source: Research Findings**

Table 2 illustrates the Pearson correlation coefficients between the variables. There is a weak positive relationship between the Return on Assets (0.185) and the board size. The return on assets has a positive relationship with the board composition (0.295). The Return on Assets and

the number of sub-committees shows a very weak linear correlation (0.104). Then there is a moderate positive relationship between the Return on Assets and board meetings (0.279) which means that the increase in one variable is associated with an increase in the other variable.

#### 4.5 Significance of Corporate Governance on Financial Performance

The study sought to establish the relationship between Corporate Governance and Financial Performance of Commercial Banks Rwanda.

This was done by the use of linear regression analysis with ROA (%) as dependent variables and corporate governance for the derived four factors representing the independent variables (Board Size, Board Composition, Board Sub-Committees and Board Meetings). The outputs of analysis are presented in Table 4.3, Table 4.4 and Table 4.5. They are aimed at testing if there is a significant relationship between Corporate Governance and Performance of the Banks.

**Table 3 Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.354 <sup>a</sup>	.125	.025	2.4085853	.125	1.251	4	35	.308

a. Predictors: (Constant), Board Meetings, Board Sub-Committees, Board Size, Board Composition

#### Source: Research Findings

Regression analysis revealed a positive relationship ( $R = 0.354$ ). The R coefficient of 0.354 indicates that the predictors of the model which are board size, board composition, board sub-committees and board meetings have a correlation of 35.4% with the dependent variable (return on assets)

The study also revealed that a combination of Board Meetings, Board Sub-Committees, Board Size and Board Composition together contributed to 12.5% ( $R^2 = 0.125$ ) of the Financial Performance (ROA). The F value (1.251) changes are not significant which implies that

the model is not fit or robust at 95% level of confidence since the P-value is greater than 0.05 (p-value = 0.308).

**Table 4 Regression Coefficients**

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	1.239	2.789		.444	.660
1 Board Size	-.113	.308	-.077	-.366	.717
Board Composition	3.481	2.777	.282	1.253	.218
Board Sub-Committees	.319	.392	.143	.814	.421
Board Meetings	.364	.469	.149	.775	.443

a. Dependent Variable: ROA (%)

**Source: Research Findings**

The regression output is laid on Table 4. Standardized coefficients (Beta) were used to determine the relative importance of the significant predictors of financial performance. The larger the absolute standardized coefficient, the larger the contribution of that predictor to financial performance as indicated by the T-statistics. The Board Composition has a larger contribution ( $\beta=0.282$ ) to the financial performance, followed by Board meeting ( $\beta=0.149$ ), and Board Sub-Committees ( $\beta=0.143$ ) while the least contributor to financial performance in commercial banks is Board size with Beta value of  $-0.077$ .

The results indicate that a unit change (1%) in the board size causes a decline of  $-0.077$  ( $-7.7\%$ ) change in the return on assets of the eight commercial banks. This indicates that board size does not have an influence on the financial performance (return on assets) of the eight Commercial banks which means that the board size is not a predictor of financial performance of eight commercial banks in Rwanda. A unit change (1%) in board composition leads to an increase of  $0.282$  ( $28.2\%$ ) change in profitability (ROA) of the eight commercial. This indicates that the board composition has a contribution to the financial performance (ROA) of the eight commercial banks in Rwanda. A unit change in board sub-committees leads to a positive change of  $0.143$  ( $14.3\%$ ) change in the financial performance (return on assets) of the eight commercial

banks. This also indicates that the board sub-committees have an influence on the financial performance of commercial banks in Rwanda. A unit change (1%) in the board meetings leads to a significant increase of 0.149 (14.9%) change in the profitability of the eight commercial banks in Rwanda.

A t-test statistics has been used to generate a p-value or coefficient of significance. A smaller p-value indicates higher significant influence of the predictor to financial performance. A scan of the p-values of all the four predictors shows that none of the p-values is less than 0.05. This means that board size (p-value of  $0.717 > 0.05$ ), board composition (p-value of  $0.218 > 0.05$ ), board sub-committees (p-value of  $0.421 > 0.05$ ) and board meetings (p-value of  $0.443 > 0.05$ ) are not significant in explaining the financial performance of the eight commercial banks in Rwanda.

**Table 5 Analysis of Variance-ANOVA**

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	29.025	4	7.256	1.251	.308 <sup>b</sup>
Residual	203.045	35	5.801		
Total	232.070	39			

a. Dependent Variable: ROA (%)

**Source: Research Findings**

Table 5 shows that variations in the performance (return on assets) can be explained by the model to the extent of 29.025 out of 232.070 or 12.5% while other variables not captured by this model can explain 87.5% (203.045 out of 232.070) of the variations in return on assets.

F value of the model produces a p-value of 0.308 which is significantly different from zero. A p-value of 0.308 is greater than the set level of significance of 0.05 ( $0.308 > 0.05$ ) for a normally distributed data. This means that the model is not significant in explaining performance of the eight commercial banks in Rwanda. However, the model can be considered fit at 69.2% level of significant. This calls for further studies which can include other corporate governance determinants of performance. From the Tables, it can be concluded that the corporate governance variables have no significant effect on financial performance (p-values  $> 0.05$ ).

#### **4.6 Interpretation of the Findings**

The Pearson correlation coefficients between the variables revealed that Returns on Assets had a positive weak correlation with the board size. It has been revealed again that Return on assets and board composition had a positive relationship. The Return on Assets and the number of sub-committees revealed a very weak linear correlation. Finally, the Return on Assets and board meetings had a moderate positive relationship.

The model summary revealed that the independent variables: board size, board composition, board sub-committees and board meeting have a correlation of 35.4% with the dependent variable which implies that they are not significant predictors of financial performance of the eight commercial banks in Rwanda. The model is not fit or robust at 95% level of confidence since the P-value  $>0.05$ .

A regression analysis was also used in this study. The results indicate that a unit change (1%) in the board size causes a decline of -0.077 (-7.7%). A unit change (1%) in board composition leads to an increase of 0.282 (28.2%) change in profitability (ROA) of the eight commercial. A unit change in board sub-committees leads to a positive change of 0.143 (14.3%) change in the financial performance (return on assets) of the eight commercial banks. This also indicates that the board sub-committees have an influence on the financial performance of commercial banks in Rwanda. A unit change (1%) in the board meetings leads to a significant increase of 0.149 (14.9%) change in the profitability of the eight commercial banks in Rwanda.

ANOVA showed that variations in the performance (return on assets) could be explained by the model to the extent of 12.5% while other variables not captured by this model could be explained to the extent of 87.5% of the variations in return on assets. In terms of significance of each of the predictors, a t-test statistics has been used to generate a p-value or coefficient of significance. Then the result has shown that board size, board composition, board sub-committees and board meetings are not significant in explaining the financial performance of the eight commercial banks in Rwanda.

## CHAPTER FIVE

### SUMMARY, CONCLUSION AND RECOMMENDATIONS

#### 5.1 Introduction

This chapter provides the summary of the findings from chapter four, and it also gives the conclusions and recommendations of the study based on the objective of the study. The objective of this study was to establish the effect of corporate governance on the financial performance of commercial banks in Rwanda.

#### 5.2 Summary

The aim of this study was to establish the effect of corporate governance on the financial performance of commercial banks in Rwanda. In this study, the researcher adopted a descriptive research design which assisted to investigate the relationship between corporate governance and the financial performance of commercial banks in Rwanda. The researcher used a census of the population. The population of the study was 11 commercial banks. The response rate was 73% of all the commercial banks in Rwanda. The data was gathered exclusively by analyzing the annual reports of commercial banks from 2009 to 2013 and the data was analyzed using SPSS 20.

The descriptive statistics revealed that the average ROA for the eight commercial banks for the five years is 6.6315% suggesting that there was an average profit. The Pearson correlation analysis revealed a weak positive linear correlation between the Return on Assets and the independent variables: Board size, board composition, sub-committees and board meetings ( $r < 0.3$ ). The board size, board composition, board sub-committees and board meetings are not significantly related to the financial performance of the eight commercial banks.

A t-test statistics has been used to generate a p-value or coefficient of significance. It was concluded that the board size, board composition, board sub-committees and board meetings are not significant in explaining the financial performance of the eight commercial banks in Rwanda. The study recommends further studies to be carried out to find the other corporate governance determinants of financial performance in the context of commercial banks in Rwanda.



### **5.3 Conclusion**

From the findings, the study concludes that the model is not significant in explaining the financial performance of the eight Commercial banks in Rwanda. Board size, board composition, board sub-committees and board meetings are not significant predictors of financial performance.

The board size does not explain the financial performance of the eight commercial banks since the p-value is 0.717 ( $p\text{-value} > 0.05$ ). This implies that whether the board is large or small; it does not affect the financial performance of the eight commercial banks in Rwanda. The board composition is not a significant predictor of financial performance with a p-value of 0.218 ( $p\text{-value} > 0.05$ ). As seen earlier, the board in these eight banks is mainly composed by outside directors. The fact that the board is mainly composed by outside directors does not affect the financial performance of the banks.

The sub-committees are also not significant in explaining the financial performance ( $p\text{-value}$  of 0.421  $> 0.05$ ). This suggests that whether the bank has a large number of sub-committees or not; this does not affect the financial performance of the bank. The board meetings is not a significant predictor as shown by the analysis ( $p\text{-value}$  of 0.443  $> 0.05$ ). The number of meetings held per year does not affect the financial performance of the eight commercial banks in Rwanda.

### **5.4 Policy Recommendation**

Financial institutions are the key engines of growth in many developing economies. Failures of financial institutions would thus impede the economic growth and would cause serious damage to the system. One way to maintain financial stability in a country like Rwanda is through good corporate governance. The quality of corporate governance can also influence the ability of Rwanda to attract investment, which is particularly important for small economies that depend on attracting substantial funds, in terms of local and foreign investment, to facilitate economic activity.

Since corporate governance impacts so directly on macroeconomic development, it should be accorded the highest possible priority by the State. The Government of Rwanda has a

responsibility, as a regulator, to ensure that financial entities are operated in the interest of the depositors, the shareholders and the wider economy. Financial institutions must conduct their activities in such a manner so as not to compromise the financial wellbeing of all its stakeholders. Regulators, however, must not be a substitute for directors and management of financial institutions, as they cannot guarantee that institutions will not fail. The board of directors must take responsibility for the strategic direction of their institutions and for satisfying themselves that management has put systems in place to mitigate risks.

### **5.5 Limitations of the study**

During this study, the researcher faced some challenges and limitations.

During data collection, some banks provided data which was in Ksh and some were in Rwf so this caused a problem of having different currencies. This was resolved by converting all the figures into the same currency which is the Rwf. This happened with banks like Guaranty trust bank (former Fina bank) and Kenya commercial bank (KCB). The study was limited by constraints of resources, access, and time. The researcher had scheduled time and budget that enable the study to be completed using the budget drawn and within the required time of the study.

Some commercial banks in Rwanda don't disclose the full information in their annual reports especially data related to corporate governance. This was very challenging to the researcher. In some financial institutions, it was difficult to get the data on time due to the fact that they have many work responsibilities. This has really delayed the whole work process.

### **5.6 Suggestions for Further Research**

This study is not comprehensive in explaining the corporate governance determinants of financial performance. Further studies therefore, will be of great use in determining the other corporate governance variables that determine the financial performance of commercial banks in Rwanda. Other studies can be conducted in Rwanda by including other corporate governance variables such as board characteristics, transparency, disclosure and Executive compensation.

The study recommends that a further study should be carried out on the effect of corporate governance on the financial performance of private companies in Rwanda. This study would be of greater significance since the private Sector is a crucial source of attraction of foreign investment, generation of productive employment and income for the government of Rwanda. Another study also should be carried out on how corporate social responsibility affects the financial performance of commercial banks in Rwanda.

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**APPENDIX I: List of Commercial Banks in Rwanda as at 31st December 2013**

1	Access Bank Rwanda
2	Bank of Kigali
3	Banque Populaire du Rwanda SA (BPR)
4	Compagnie Générale de Banque (COGEBANQUE)
5	Crane Bank (Rwanda)
6	EcobankRwanda Ltd ( ex. BCDI)
7	Equity Bank (Rwanda)
8	Guaranty Trust Bank (Rwanda)
9	I&M Bank (Rwanda) - Formerly Commercial Bank of Rwanda (BCR)
10	Kenya Commercial Bank
11	Urwego Opportunity Bank

*Source: Central Bank of Rwanda 2013*

**APPENDIX II: Return on Assets**

<b>Name of the Bank</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
<b>KCB</b>	3.06	4.97	5.38	6.98	7.22
<b>BK</b>	3.95	3.5	3.6	3.9	4
<b>BPR</b>	9.63	8.97	11.21	12.45	12.21
<b>COGEBANQUE</b>	5.65	6.75	6.8	7.11	6.94
<b>ECOBANK</b>	4.77	8.67	8.74	8.91	7.7725
<b>GUARANTY TRUST BANK</b>	7.34	8.72	5.57	5.86	5.6
<b>I&amp;M BANK (Rwanda)</b>	4.06	4.69	7.92	9.07	9.42
<b>ACCESS BANK RWANDA</b>	6.52	4.97	4.83	3.89	4.04

**Source: Research Findings**

**APPENDIX III: To whom it may concern**



**UNIVERSITY OF NAIROBI  
SCHOOL OF BUSINESS  
MBA PROGRAMME**

Telephone: 020-2059162  
Telegrams: "Varsity", Nairobi  
Telex: 22095 Varsity

P.O. Box 30197  
Nairobi, Kenya

DATE: 7<sup>th</sup> August 2014

**TO WHOM IT MAY CONCERN**

The bearer of this letter ..... KAJIYESI RAISSA .....


Registration No. .... NA/61165/213 .....

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

  
**PATRICK NYABUTO  
MBA ADMINISTRATOR  
SCHOOL OF BUSINESS**

