THE EFFECT OF CORPORATE GOVERNANCE ON
FINANCIAL PERFORMANCE OF COMMERCIAL BANKS
LISTED AT THE NAIROBI SECURITIES EXCHANGE

BY
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DECLARATION

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

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

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DEDICATION

To my mother Esther Vuyanzi Otieno for teaching me the value of hard work and trusting in God in whatever I do. To my beloved wife Beatrice Kisare for continuous encouragement and support that has enabled me to achieve my goal.
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<table>
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<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AIMS</td>
<td>Alternative Investment Market Segment</td>
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<td>BCCI</td>
<td>Bank of Credit and Commerce International</td>
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<td>CAMEL</td>
<td>Capital adequacy, Asset quality, Managerial efficiency, Earnings and Liquidity Management</td>
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<td>CBK</td>
<td>Central Bank of Kenya</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
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<td>CMA</td>
<td>Capital Market Authority</td>
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<td>GEMS</td>
<td>Growth and Enterprise Market Segment</td>
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<td>MIMS</td>
<td>Main Investment Market Segment</td>
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<td>NSE</td>
<td>Nairobi Securities Exchange</td>
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<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<td>REITs</td>
<td>Real Estate Investment Trusts</td>
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<td>ROA</td>
<td>Return on Asset</td>
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<td>ROE</td>
<td>Return on Equity</td>
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<tr>
<td>UK</td>
<td>United Kingdom</td>
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<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
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ABSTRACT

Good corporate governance practices enable banks to build public trust and confidence which in turn influences their performance. Good corporate governance influences shareholder value over the long term. Corporate governance of banks is important since commercial banking operations are not as transparent as other firms. The bank’s balance sheets and income statement do disclose information in a way that do not clearly reveal some details. Therefore, the depositors cannot constrain managerial decisions since they lack the necessary information to do so. Such information is very costly to reveal.

The study examined the Corporate Governance factors namely; Shareholders rights, transparency and disclosure and Board operation on financial performance of commercial banks quoted at Nairobi Securities Exchange (NSE) in Kenya. The aim of the study was to establish the effects of corporate governance elements on financial performance of commercial banks quoted at Nairobi Securities Exchange (NSE).

A descriptive design was used in this study. The population involved in this study was all the 10 commercial banks quoted at Nairobi Securities Exchange (NSE) in Kenya for the period 2011 to 2015. Primary data were obtained by administering questionnaires to CEOs of the banks. Secondary sources were also used to obtain information; data from the published annual reports and company sources spanning five years. The content validity of the two instruments of data collection was assured by ensuring that each of the items in the questionnaire addressed specific contents and objectives of the study. Multiple Regression Analysis was used to establish whether a relationship exist between corporate governance and financial performance. Spearman Correlation Coefficient was used to determine the magnitude of the relationship between corporate governance and financial performance.

The findings of the study shows that corporate governance practices have significant effect on financial performance of banks. From the findings, corporate governance factors; shareholders rights, transparency and disclosure and board operation accounts for 52.1% of the financial performance of commercial banks, derived from adjusted R square value of the regression test.
CHAPTER ONE
INTRODUCTION

1.1 Background to the Study

In recent past a number of banks in Kenya and other parts of the world have collapsed highlighting the need to embrace corporate governance. Since 2007 to date, about six banks namely Euro Bank, Trade Bank, Charter House, Imperial Bank, Dubai Bank and most recently the Chase Bank have collapsed. In the global scene we have Bank of Credit and Commerce International (BCCI) and Baring Bank in UK. The public will have confidence on banking institutions if they uphold sound corporate governance practices.

According to OECD (2015) Report on Principles of Corporate Governance, “good corporate governance is not an end in itself but it is a means to create market confidence and business integrity, which in turn is essential for companies that need access to equity capital for long term investment. Access to equity capital is particularly important for future oriented growth companies and to balance any increase in leveraging.” Corporate governance has become an important aspect for investors, private sector, state owned enterprises and the government since it helps an organization to create a competitive advantage. Corporate governance is now recognized as a critical business practice in promoting the investor’s confidence and the general economic growth. A company’s corporate governance structure influences the setting and implementation of its objectives, monitoring and assessment of risks and the performance optimization.
1.1.1 Corporate Governance

According to Capital Market Authority of Kenya (2015) code of corporate governance practices for issuers of securities to the public, corporate governance is described as, “the process and structure used to direct and manage the business and affairs of a company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking account of the interests of other stakeholders.”

OECD (2015) Report on Principles of Corporate Governance describes corporate governance as, “a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined”. Adams and Mehran (2003) explain corporate governance as "the mechanism through which stakeholders (shareholders, creditors, employees, clients, suppliers, the government and the society, in general) monitor the management and insiders to safeguard their own interests." Morin and Jarrel (2001) describe it as "a framework through which monitors and safeguards the concerned actors in the market (managers, staff, clients, shareholders, suppliers and the board of administration."

1.1.2 Corporate Governance in Banking Institutions

The corporate governance practices in banks are essential for prosperity and growth of any economy since banks play a critical position in the financial systems of any economy. Banks in less developed countries are usually the major avenues of finance for most firms and individuals. They also provide variety of means of payment to enable firms and individuals to settle their transactions. A large percentage of an
economy’s savings is constituted by deposits in financial institutions which is dominated by commercial banks.

Capiro and Levine (2002) states that “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. The opaqueness of banks also makes it difficult for depositors to constrain managerial decisions through debt covenants.” Therefore as stated by Bhattacharya et al (1998), “it is not easy to communicate the true value of the bank’s loan portfolio as such information is very costly to disclose implying that a bank’s loan portfolio is highly fungible.”

1.1.3 Bank Performance

Bank performance as related to this study refers to the financial soundness of the banking institutions. Commercial banks have several goals which include to make profits, social goals and economical goals. However, making profits is the major goal and therefore most of the plans and activities of an organization aim at realizing this key objective. Different ratios are normally used to measure profitability of firms. These ratios include Return on Asset (ROA) and Return on Equity (ROE).

Khrawish (2011) states that, “Return on Equity (ROE) is a financial ratio that refers to how much profit a company earned compared to the total amount of shareholder equity invested or found on the balance sheet. ROE is what the shareholders look in return for their investment. A business that has a high return on equity is more likely to be one that is capable of generating cash internally. Thus, the higher the ROE the
better the company is in terms of profit generation. Return on Asset (ROA) is also another major ratio that indicates the profitability of a bank. It is a ratio of Income to its total asset. It measures the ability of the bank management to generate income by utilizing company assets at their disposal. In other words, it shows how efficiently the resources of the company are used to generate the income.”

1.1.4 Relationship between Corporate Governance and Bank Performance in Kenya

Thomson and Jain (2006) observed that “a cordial working relationship between the board of directors and management and also between the management and other stakeholders in a bank would result in increased efficiency, productivity and profitability.” Daily and Dalton (1992) concluded from their study that “the likelihood of bankruptcy can be attributed to poor corporate governance practices.” This was witnessed in the Kenyan banking sector in the 1990s and early 2000s when a number of banks collapsed.

Firms can tremendously improve their performance by strengthening their governance practices. Jensen and Meckling (1976) concluded that “companies with better corporate governance have better operating performance than those companies with poor corporate governance. This is in line with the view that better governed firms might have better operations, resulting in higher profits. It is a common belief that good corporate governance helps to generate investor trust and confidence.”

1.1.5 Commercial Banks in Kenya

The two major players in the banking industry in Kenya consist of the Central Bank of Kenya (CBK) and the commercial banks. Other players include non-bank financial institutions, forex bureaus and microfinance institutions. According to Central Bank
of Kenya (2016), “there are 42 commercial banks in Kenya and 1 mortgage finance company. Commercial Banks and Mortgage Finance Institutions are licensed and regulated pursuant to the provisions of the Banking Act and the Regulations and Prudential Guidelines issued thereunder.” Commercial banks are the dominant players in the Kenyan Banking system and therefore are supervised closely by the Central Bank of Kenya.

According to CBK (2016) “there are 42 licensed commercial banks and 1 mortgage finance company. Out of the 43 institutions, 39 commercial banks and the mortgage finance institution are privately owned while the Kenya Government holds controlling stakes in the remaining 3 commercial banks. This include Development Bank of Kenya Ltd., Consolidated Bank of Kenya Ltd. and National Bank of Kenya Ltd. 25 of the 39 privately owned banks and the 1 mortgage finance institution are locally owned (i.e. their controlling shareholders are domiciled in Kenya) while 14 are foreign owned.”

The Kenya’s banking sector has experienced a number of banks collapsing. According to Infohub Kenya (2016) “before the passing of 1989 Banking Act between 1984 and 1989, the following banks which included mainly family/community owned banks collapsed: Union Bank, Jimba Credit Cooperation, Estate Finance, Estate Building Society, Business Finance, Nationwide Finance, Kenya Saving and Mortgages, Home Saving and Mortgages, Citizen Building Society. During the period between 1993 and 1995, 19 banks collapsed, several of which had been wrapped up in the Goldenberg Scandal. From 1998 to 2006 the following banks collapsed: Bullion Bank, Fortune Finance, Trust Bank, City Finance Bank, Reliance Bank, Prudential Bank. From 2007 to 2015, under former Central Bank of Kenya (CBK) Governor Prof Njuguna Ndungu the following banks
collapsed: Kenya Finance Corporation, Trade Bank, Euro Bank, Charter House. On August 14, 2015 Dubai Bank was placed under statutory management by the Central Bank of Kenya for a period of one year with Kenya Deposit Insurance Corporation (KDIC) as the receiver manager. On 13th October 2015, Imperial Bank was placed by the Central Bank of Kenya under management and control of the state's Kenya Deposit Insurance Corporation. The latest bank to be placed under receivership in the year 2016 is Chase Bank.”

1.1.6 Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE) is the main bourse in Kenya offering online platform for listing and transacting in a variety of securities. It trade in both equities and bonds. It was registered in 1954 as “a voluntary association of stockbrokers and its main function was to develop the securities market and regulate trading activities” (NSE, 2016). Two indices are commonly used to measure performance. According to NSE (2016), they include “the NSE 20-Share which measures the performance of 20 best performing companies and Nairobi Stock Exchange All Share Index (NASI) which was introduced as alternative index.”

According to NSE (2016), “equities are listed on four segments, namely Main Investment Market Segment (MIMS), Alternative Investment Market Segment (AIMS), Growth and Enterprise Market Segment (GEMS) and Real Estate Investment Trusts (REITS). In MIMS segment deals with companies with fully paid up share capital of Kshs. 50 million and net assets of Kshs.100 million. (AIMS) segment is designed to assist medium-sized companies that require access to capital and a public platform to continue growth. The company must have minimum authorised, issued and fully paid up shares of Kshs. 20 million and net assets of Kshs. 20 million before
listing. GEMS segment was launched in 2013. GEMS provide an opportunity for small and medium-sized companies to list within a regulatory environment designed specifically to meet their needs. They need to have a minimum fully paid up share capital of Kshs. 10 million with no minimum assets required. Income REITS provide retail investors with exposure to Kenya’s booming property market while Development REITs are restricted to professional investors with minimum parcel sizes of Kshs 5 million.”

1.2 Statement of the Problem

Greuning and Bratanours (2009) states that “corporate governance relates to the way in which the business of the a firm is managed. This includes setting corporate objectives and risk profiles, setting standards on corporate behaviour, running the firms’s operations within the established risk profile and complying with stipulated laws and regulations and protecting the interests of depositors and other stakeholders.” Corporate governance affects bank performance by ensuring that strategic goals and corporate values are set up and communicated to all the parties of the bank. According to Thomson and Jain (2006) “cordial working relationship between the board of directors, management and other stakeholders in a bank would result in increased efficiency, productivity and profits.”

The topic concerning corporate governance in Kenya’s banking sector has drawn attention for a number of years. Centre for Corporate Governance of Kenya (CCG, 2004) observed that “focus on corporate governance is important mostly because the banking industry is highly exposed to the public scrutiny. Failing in governance leads to risks such as adverse publicity.” The scale of commercial bank collapses across the country in the late 1990’s and 2000’s was a pointer about something not going right in
the banking sector in Kenya. Banks that were performing well suddenly announced huge losses which were largely attributable to poor corporate governance practices in their operations.

Several studies have been done locally and internationally on the relationship between Corporate Governance practices and financial performance of different institutions. However, these studies have given mixed results. Local studies have also been done on the relationship between corporate governance and firm financial performance of different institutions: Muriithi (2008), Mutisya (2006), Kerich (2006), Nyaga (2007), Matengo (2008), Ong’wen (2010). The results from these studies demonstrated different conclusions. The correlations between different corporate governance elements with firm financial performance were varied.

Linyiru (2006) study main objectives was “to assess the nature of and characteristics of corporate governance systems of commercial banks in Kenya and to assess the prevalence and extent of use of selected corporate governance practices in the banks.” The study did not attempt to show the effect of corporate governance practices to financial performance of commercial banks in Kenya. A recent study by Ogega (2014) and Rotich (2015) “on the effect of ownership structure on financial performance of commercial banks in Kenya” concentrated only on one element of corporate governance i.e. ownership structure. The various form of ownership structure was investigated. They include government ownership, domestic ownership, corporate ownership and individual ownership.

Kalungu (2012) study on “the impact of corporate governance on financial performance of commercial banks of Kenya” narrowed down on a few variables of corporate governance practices. It concentrated on the elements of the board i.e.
board size, board composition and board monitoring. They are many other elements of corporate governance that were not considered. On the basis of these gaps, the researcher intends to conduct the study to investigate the effects of various elements of corporate governance on financial performance of commercial banks quoted in NSE. The study will therefore, attempt to answer the following research question; Does board operations, disclosure and transparency policies and respect of shareholders rights affect the financial performance of commercial banks quoted in NSE.

1.3 The Objective of the Study

The aim of the research is to find out whether corporate governance practices affect financial performance of commercial banks in Kenya.

1.4 The Value of the Study

The research will provide a valuable tool to policy makers to modify their policies to fit into good corporate governance practices. This will support economic efficiency and financial stability in the economy. Capital Markets Authority (CMA), the Kenya Revenue Authority (KRA) and Central Bank of Kenya (CBK) can use the study findings to improve on the structure and processes for regulation as well as develop incentive programs that will motive firms to adopt and uphold good corporate governance practices.

The study findings will assist the management and staff of commercial banks to embrace good corporate governance practices since the study supports the idea that good corporate governance practices boost the financial performance of a firm. Banks that will embrace good corporate governance practices are likely to have a better
competitive advantage. Most importantly, this study will add value to the literature on corporate governance of commercial banks in less developed countries like Kenya. The findings will also be useful to the academicians, who may use the research gaps in the study to conduct more research.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The chapter is concerned with the theories connected to corporate governance and some of the empirical studies that has been done in the field of corporate governance.

2.2 Theoretical Framework

They are several theories that attempt to explain the concepts and practices of corporate governance practices. They are expounded in the subsequent chapters.

2.2.1 Agency Theory

Berle and Means (1932) are credited as carrying out the early work in agency theory. They supported the view that corporate governance focuses upon the division of ownership and management. The early work of Alchian and Demstez (1972), define the firm “as a nexus of contracts among individual factors of production resulting in the emergence of the agency theory. The firm is not an individual but a legal fiction.” The basis of the agency theory, as described by Jensen and Meckling (1976), “is a contractual relationship between one party (principal) engaging another party (agent) to perform a service(s) on behalf of the principal, which involves some decision-making authority being yielded to the agent.”

This study intends to establish whether shareholders rights, disclosure and transparency and board operations has an impact on the financial performance of commercial banks. The shareholders are the principal while the board and the CEO are the agents. The shareholders have yielded decision making authority to the board and CEO. The shareholders have rights which the board and the CEO should respect.
and uphold. The board is also under the obligation to disclosure some information to shareholders and to be transparent in their operations. Since the study focuses on shareholders as principal and board and CEO as the agents, it justify the use of the theory.

As noted by Hogan (1997), “Agency theorists portray people as opportunistic players who rationally maximise their own utility and are focused on extrinsic rewards, even to the detriment of others.” According to Donaldson and Davis (1994) “the agent and principal both seek personal benefits with little regard to the other party. The principal normally incurs agency costs when the interests of the principal and the agent vary. The principal who usually loses out on the optimality stakes, as the theory restrictively attributes opportunism to the agent”. Darus (2011) agrees saying that “corporate governance problems arise due to the misalignment of interests between managers and investors because of the separation As of ownership and control in a company”.

2.2.2 Stewardship Theory

Donaldson and Davis (1991) states that “stewardship theory presents a different model of management, where managers are considered good stewards who will act in the best interest of the owners.” Agency theorists differ from stewardship theorists since the latter focus on “non-economic” elements that influences managerial activity (Mason et al., 2007). Donaldson and Davis (1994) states that “a manager as stewards of the corporation diligently work to attain high levels of corporate profit and shareholder returns. Thus, organizational financial performance and shareholder wealth will be maximized by empowering managers to exercise unencumbered authority and responsibility.” According to Turnbull (1997) “directors have a
fiduciary duty [and] that they can be trusted and will act as stewards over the resources of the company”. The stewardship theorist assumes “those managers are seeking to maximize organizational performance” (Fox and Hamilton, 1994).

This study seeks to establish whether among other variables the operations of the board affects the financial performance of commercial banks. The board and the CEO act as the stewards whose focus may not be to advance their interest but to promote the interest of the principals by pursuing both the objectives of their principals and their own objectives or interest at the same time (Davis et al., 1997). Various elements of the board will be studied to establish whether they are acting as good stewards. This include the extent the board supervises the implementation of major plans of action, whether the board carries out performance review of individual board members and whether the internal auditor has authority to contact the board. Therefore, this justifies the use of the theory in the study.

2.2.3 Stakeholder Theory

Stakeholder theory is rooted on the fact that there are several parties interested in the activities and decisions of companies. Edward Freeman (1998) describes stakeholders as “groups and individuals who benefit from or are harmed by, and whose rights are violated or respected by, corporate actions. In addition to shareholders, stakeholders include creditors, employees, customers, suppliers, and the communities at large.” Stakeholder theory proposes that companies have a social duty to ensure that interest of all parties affected by their activities is taken into consideration. According to Werhane and Freeman (1999) “the goal of any company is or should be the flourishing of the company and all its principal stakeholders. It is
important to emphasize that shareholders are just one among the many stakeholders affected by the actions of a company.”

This study seeks to establish whether among other variables disclosure and transparency impact on the performance of commercial banks in Kenya. According to Hung (1998) “corporate governance involves the adoption of pluralist approach to management.” Stakeholders including employees, customers, suppliers and creditors interests should not be ignored. The study seek to find out whether the board disclose material risks to stakeholders, whether information on employee share ownership plan is disclosed and whether financial statements, annual reports and other important information about the company are posted in company’s website for all stakeholders to be made aware. Therefore, this justifies the use of the theory in the study.

2.3 Determinants of Financial Performance of Commercial Banks

According to Al-Tamimi (2010) “the determinants of bank performances can be classified into bank specific (internal) and macroeconomic (external) factors.” Ongore and Kusa (2013) states that “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 sector-wide or country-wide factors which are beyond the control of the company and affect the profitability of banks.”

CAMEL framework is commonly used to study bank internal factors. Dang (2011) states that “CAMEL stands for Capital Adequacy, Asset Quality, Management Efficiency, Earnings Ability and Liquidity.” Athanasoglou et al. (2005) define “capital as the amount of own fund available to support the bank's business and act as a buffer in case of adverse situation.” The interest charged by banks on loans
constitutes the largest share of banks revenue. Therefore, loan is the major asset of the banks. The management of bank loans greatly affect the profitability of the bank. According to Dang (2011) “the highest risk facing a bank is the losses derived from delinquent loans.” Management Efficiency also contributes to the bank profitability. According to Ongore and Kusa (2013) “the performance of management is often expressed qualitatively through subjective evaluation of management systems, organizational discipline, control systems, quality of staff, and others.” Liquidity also affects banks profitability. According to Dang (2011) “liquidity refers to the ability of the bank to fulfill its obligations, mainly of depositors. Adequate level of liquidity is positively related with bank profitability.”

Macroeconomic variables that impact on the performance of banks include legislative laws, inflation rate, interest rate, economic growth level measured using Gross Domestic Product (GDP). Athanasoglou et al., (2005) states that “the trend of GDP affects the demand for banks asset. During the declining GDP growth the demand for credit falls which in turn negatively affect the profitability of banks. On the contrary, in a growing economy as expressed by positive GDP growth, the demand for credit is high due to the nature of business cycle. During boom the demand for credit is high compared to recession.”

2.4 Corporate Governance Theoretical Framework

Corporate governance framework or system involves many aspects that include the following: the rights of shareholders, shareholders rights, board operations and disclosure and transparency.
2.4.1 The Rights of Shareholders

The corporate governance structure should provide cover to shareholders to enable them to exercise their rights in a conducive environment. Minority shareholders and foreign shareholders should be treated fairly. Mechanisms should be put in place to enable shareholders obtain justice when their rights are abused. Organization for Economic Cooperation and Development (OECD), states in their Report on Principles of Corporate Governance (2015) that “Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.”

2.4.2 Disclosure and Transparency

The corporate governance structure should be designed such that all essential matters are disclosed accurately and in good time. Organization for Economic Cooperation and Development (OECD), states in their Report on Principles of Corporate Governance (2015) that “Disclosure should include, but not be limited to, material information on: 1. the financial and operating results of the company. 2. Company objectives and non-financial information 3. Major share ownership, including beneficial owners, and voting rights 4. Remuneration of members of the board and key executives 5. Information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board. 6. Related party transactions 7. Foreseeable risk factors. 8. Issues regarding employees and other stakeholders 9. Governance structures and policies, including the content of any corporate governance code or policy.”
2.4.3 Board Operations and Control

The Board exercises a critical function in corporate governance framework of any organization. A board composed of qualified, competent and people of high integrity who are capable of exercising objective and independent decisions will be effective on guiding strategy development and monitoring management. Organization for Economic Cooperation and Development (OECD), states in their Report on Principles of Corporate Governance (2015) that “A proper understanding of the role and responsibilities of the Board must be shared not only by members of the Board, but also by company executives and external stakeholders, to ensure that the Board has appropriate autonomy, authority, and accountability in exercising its functions and that it can be held accountable by stakeholders. The board should fulfill certain key functions, including, reviewing and guiding corporate strategy, major plans of action, risk management policies and procedures, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.”

2.5 Empirical Studies on Effects of Corporate Governance on Bank Performance

In a study on “the effect of foreign management and board membership on the performance of foreign acquired Turkish banks” by Polovina and Peasnell (2015) they found out that “the presence of the foreign chairman has a positive effect on the profitability of the foreign acquired bank and on the improvement of the income generated from interest activities, indicating that foreign chairman improves the monitoring of board of directors and brings new skills and experiences. Furthermore, foreign acquired banks are associated with an increase in the income generated from
non-interest activities in the fifth year following their acquisitions, showing the introduction of new strategies.”

A study on “the ownership structure, corporate governance and bank efficiency from banking industry in Ghana during the period 1999-2007” by Bokpin (2013) discovered that “foreign banks are more cost-efficient than domestic banks, but not necessarily more profit-efficient. Nevertheless, foreign banks are more profitable than domestic banks and enjoy better quality loans. Managerial ownership leads to the cost inefficiency of banks. Banks with inside ownership are unprofitable overall but maintain a high loan quality. Governance (a larger board size) strongly improves profit efficiency but slightly worsens banks’ cost efficiency.”

According to a study by Hugh et al., (2011) “to find out the effect of corporate governance practices on commercial banks performances in the USA” they found out “that CEO duality is negatively associated with financial performance. The extent of executive incentive pay is positively associated with financial performance but exhibits a negative association. They also found concave relationship between financial performance and both board size and average director age. They discovered a weak evidence of an association of anti-takeover devices, board meeting frequency, and affiliated nature of committees with financial performance.”

Utama and Musa (2011) research on “the causality between corporate governance practice and bank performance in Indonesia.” The result showed that “corporate governance practice, bank size and capital adequacy ratio have positive influences on bank performance in Indonesia. However, bank performance does not influence corporate governance practice. This study also found that regional banks have better performance than private banks. The results of the study support the Central Bank’s
efforts to enhance CG practices in the banking sector, to strengthen banks’ capital base and its policy to encourage banks to merge to become larger.”

According to Muranda (2006) while studying “financial distress and corporate governance in Zimbabwean banks” found out that “in all cases of pronounced financial distress, either the chairman of the board or the chief executive wields disproportionate power in the board. The disproportionate power emanates from major shareholding. The overbearing executive overshadows other directors, executive and non-executive, thus creating power imbalance in the board. The study shows that financial institutions in Zimbabwe underestimated the competitive forces that resulted from first, economic deregulation and later economic decline coupled with political meltdown.”

Wairumu (2014) researched on “the effect of corporate governance practices on the financial performance of commercial banks in Kenya.” The corporate governance practices investigated included the number of “non-executive directors”, board size and board diversity-gender. The study sought to draw a relationship between these factors and financial performance. From the research, “it was discovered that board size was seen to have a negative correlation which implied that as board size increased, the financial performance of banks reduced. The study found that there was no significant relationship between financial performance of commercial banks and gender diversity of the board.”

Nyamongo and Kebede (2013) did a study on “the effect of governance on performance of commercial banks in Kenya over the period 2005-2009.” The study found that “a large board size tends to impact performance negatively; the existence of independent board directors tends to enhance the performance of the banks; and
there is no evidence that CEO duality or otherwise has impact on the performance of commercial banks in Kenya. Practical implications – The study therefore recommends that for commercial banks in Kenya to register high performance they need to check the size of their board of directors and also increase the number of independent directors.”

Kalungu (2012) researched on “the impact of corporate governance practice on the financial performance of banking industry in Kenya” for the period 2006-2010. From the data analysis show she concluded that “there is a positive relationship between corporate governance and financial performance in banking industry in Kenya. The results from regression analysis show that both board size and board composition are predictors of financial performance.”

Miseda (2012) did an investigation to find out “the effect of corporate governance practices on financial performance of banks in a Kenya.” The research aimed at “establishing the effects of corporate governance practices and policies on financial performance of commercial banks in Kenya.” The study found out that “corporate governance play an important role on bank stability, performance and bank’s ability to provide liquidity in difficult market conditions. The study concluded that corporate governance factors i.e., corporate governance practices, corporate governance policies, disclosure policies and practices account for 22.4% of the financial performance of commercial banks. He recommended that commercial banks should uphold good corporate governance practices and policies and respect shareholders right if they expect to do well financially.”

Ong’wen (2010) did a study to “establish whether listed firms which adopted corporate governance provisions minimum provisions significantly outperformed
those which stuck to the minimum.” The study showed that “there was a positive relationship between corporate governance attributes which exceeded the minimum level prescribed by law and common practice and firm performance. The relationship was found to be significant at the 95% level. It was concluded that it is beneficial for a firm to institute corporate governance practices that exceed the minimum levels.”

2.6 Conceptual Framework

The following is the conceptual framework that was used in the study:

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Dependent Variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholders’ Rights</td>
<td>Financial Performance (ROA)</td>
</tr>
<tr>
<td>Transparency and Disclosure</td>
<td></td>
</tr>
<tr>
<td>Board Operations</td>
<td></td>
</tr>
</tbody>
</table>

Source: Author (2016)

Figure 2.1: Conceptual Framework

The independent variables in the conceptual framework include shareholders’ rights, transparency and disclosure and board operations. These factors influence the level of financial performance of commercial banks. Financial performance is the dependent
variable. It will be measured using Return on Asset (ROA). The level of financial performance is determined by the independent variables.

2.7 Summary of Literature Review

When corporate governance system within commercial banks is efficient it helps to provide assurance that is necessary for proper operation of entire industry which significantly influences the economic growth of a country. Corporate governance aims at providing strategic direction to the banks through effective supervision of management by board. The board must account regularly to the shareholders and to ensure positive bank performance. They are several elements that constitute good corporate governance practices. They can be categorized into the following major groups: shareholder’s rights and responsibilities, board operation and control and transparency and disclosure.

A general model of corporate governance that can best describe the link between corporate governance and financial performance do not exist. Most of the research that have been carried out to “establish the relationship between corporate governance and financial performance of commercial banks” tend to point on the operations of the board and board effectiveness. The board plays a major role in advocating for good corporate governance practices. However, they are other elements of corporate governance practices that deserve equal attention and which also contribute to improved financial performance of commercial banks. The above studies with exemption of studies by Miseda (2012) focused mainly on operations of the board. Very little attention is given to shareholder’s rights, transparency and disclosure which are also key contributors to good corporate governance.
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction
The chapter is concerned with the research design, data collection, the analytical model and the test of significance employed in the study.

3.2 Research Design
The research design used in this research is descriptive design. The descriptive design leads to the discovery of assumptions among the different variables. The design was appropriate for carrying out a holistic, in depth and comprehensive investigation. From the design descriptive statistics are derived which will help in explaining the relationships that exists between the dependent variable and the independent variables.

3.3 Target Population
The population used was all the commercial banks that have been listed at NSE for the period 2011-2015; the period of the study. The rationale for selecting only the listed commercial banks and not the unlisted commercial banks is that there is a direct distinction between ownership and management in listed commercial banks unlike in most unlisted commercial banks where the owners form the largest part of management/control. Since all the commercial banks listed at NSE were used there was no need for sampling.

3.4 Data Collection
Data from source was obtained using a questionnaire where CEO’s of the banks were the respondents. The researcher opted for the method mainly because; it is
cheaper to administer compared to other methods, it does not require training to use and it eliminate interaction between data collector and respondents which reduces biasness. The secondary data was obtained from income statements of banks for the period 2011 to 2015.

3.5 Data Analysis

The study employed linear regression and Pearson correlation analysis. The bank performance was the dependent variable while corporate governance elements were the independent variables. Bank performance was measured using Return on Assets. The objective of the study was to investigate whether a relationship exist between corporate governance variables and bank performance. Correlation analysis was used to determine the strength of the link between the corporate governance elements and bank performance.

The study employed the following regression model as the analytical model:

\[ BPF = \beta_0 + \beta_1SR + \beta_2TD + \beta_3BO + \epsilon \]

Where BPF is Bank Performance measured using ROA

\[ \beta_1, \beta_2 \text{ and } \beta_3 \text{: coefficients of independent variables} \]

\[ \beta_0 \text{: constant} \]

SR: Shareholders’ Rights

TD: Transparency and Disclosure

BO: Board Operation

\[ \epsilon \text{ : Error factor} \]
3.6 Test of Significance

The test of significance used was analysis of variance (ANOVA). The means, variances and standard deviation of the variables used in the study was calculated and compared and interpretation drawn using Statistical Package of Social Sciences (SPSS) computer package.
CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION

4.1 Introduction

This chapter presents the data analysis, presentation and interpretation of the findings of the study. Descriptive and inferential statistics have been used to analyze the findings of the study.

4.2 Response Rate

Figure 4.1: Response rate

Source: Field data (2016)

The study aimed at a sample size of 10 respondents from commercial banks listed at NSE. Seven filled in and returned the questionnaires. The response rate was therefore 70%. This response rate was adequate to draw conclusions for the study.
Weisberg, Krosnick and Bowen (1996) recommended a response rate of 70%. According to Mugenda and Mugenda (2003), “a response rate of 50 percent is adequate for analysis and reporting; a rate of 60 percent is good and a response rate of 70 percent and over is excellent.”

### 4.3: Validity and Reliability Analysis

Reliability of the questionnaire was scrutinized using Cronbach’s Alpha. Cronbach’s Alpha is used to measures the internal consistency. Cronbach’s alpha was calculated by using of SPSS version 22 for reliability analysis. The value of the alpha coefficient normally varies from 0-1 and may be used to explain the reliability of factors extracted at 0.5 significance level.

According to Cooper and Schindler (2008), “A higher value shows a more reliable generated scale. A value above 0.7 is normally an acceptable reliability coefficient.” Table 4.1 shows that Shareholders’ rights had the highest reliability ($\alpha=0.954$) followed by Transparency and Disclosure ($\alpha=0.895$), and Board Operation ($\alpha=0.814$). This illustrates that all the five scales were reliable as their reliability values exceeded “the prescribed threshold of 0.7” (Mugenda & Mugenda, 2008).

### Table 4.1: Reliability Coefficients

<table>
<thead>
<tr>
<th>Scale</th>
<th>Cronbach's Alpha</th>
<th>Number of items</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholders’ Rights</td>
<td>0.954</td>
<td>7</td>
</tr>
<tr>
<td>Transparency and Disclosure</td>
<td>0.895</td>
<td>7</td>
</tr>
<tr>
<td>Board Operation</td>
<td>0.814</td>
<td>7</td>
</tr>
</tbody>
</table>

*Source: Field data (2016)*
4.4 Determinants of corporate governance on financial performance of commercial banks listed in NSE at Nairobi

The aim of the study was to establish the impact of corporate governance on financial performance of commercial banks quoted in NSE at Nairobi. The respondents were asked to rate to what extent did they attribute different determinants related to corporate governance on financial performance of commercial banks quoted in NSE in “a five point Likert scale.” The range was from ‘to the very great extent (5)’ to ‘not at all’(1); The score of 1 stand for “not at all” 2 stand for “to a little extent”, 3 stand for “to moderate extent”, 4 stand for “to great extent” and 5 stand for “to a very great extent”

4.4.1 Effects of shareholders’ Rights.

The findings on the presence of shareholders rights are illustrated in the table 4.2 below.

Table 4.2: Effects of Shareholders’ Rights

<table>
<thead>
<tr>
<th>Shareholders’ Rights</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ensure shareholders have a freehand in the election, appointment and removal of directors</td>
<td>4.32</td>
<td>0.845</td>
</tr>
<tr>
<td>Shareholders are adequately informed and are allowed to be involved in decisions concerning major corporate changes</td>
<td>5.00</td>
<td>0.998</td>
</tr>
<tr>
<td>All Shareholders, irrespective of their status are treated equally</td>
<td>4.93</td>
<td>0.958</td>
</tr>
<tr>
<td>Shareholders participate in the election of external auditors</td>
<td>4.90</td>
<td>0.925</td>
</tr>
</tbody>
</table>
### Shareholders' Rights

<table>
<thead>
<tr>
<th>Description</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholders authorizes addition of share capital</td>
<td>4.65</td>
<td>0.884</td>
</tr>
<tr>
<td>Shareholders authorizes extraordinary transactions such as transfer of substantial assets</td>
<td>4.91</td>
<td>0.994</td>
</tr>
<tr>
<td>Shareholders are involved in deciding the pay package of board members and top executives</td>
<td>4.54</td>
<td>0.881</td>
</tr>
<tr>
<td>Shareholders are allowed to vote by proxy</td>
<td>5.00</td>
<td>0.999</td>
</tr>
<tr>
<td>Minority shareholders’ rights are protected from violation</td>
<td>4.76</td>
<td>0.667</td>
</tr>
</tbody>
</table>

**Source:** Field data (2016)

From the findings in the SPSS analysis, the statement ‘Shareholders are adequately informed and are allowed to be involved in decisions concerning major corporate changes and shareholders are allowed to vote by proxy’ had the highest mean (5.00) indicating that most of the respondents were in agreement to very great extent with the statement. This is supported by standard deviation of 0.999. Also noted was that a great number of the respondents attributed to a very great extent that shareholders of the same class are treated equally. This was supported by the mean value of 4.93 and a standard deviation of 0.958. A good number of the respondents agreed to a great extent to the statement that shareholders are involved in deciding the pay package of board members and top executives; this was inferred from the mean value calculated in the analysis of 4.54 and supported by a standard deviation of 0.881. Generally, it was clear that Minority shareholders’ rights are protected from violation.

#### 4.4.2 Effects of Disclosure and Transparency

The findings from the field on the presence of disclosure and transparency are illustrated in the table 4.3 below.
Table 4.3: Effects of Disclosure and Transparency

<table>
<thead>
<tr>
<th>Observation</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members of the board make known if they have any interest in any matter affecting the company</td>
<td>4.96</td>
<td>0.98</td>
</tr>
<tr>
<td>Financial statements of the company are audited by competent auditors</td>
<td>4.83</td>
<td>0.94</td>
</tr>
<tr>
<td>Information about ownership structure is available to all shareholders and other stakeholders</td>
<td>4.98</td>
<td>0.99</td>
</tr>
<tr>
<td>Information about pay package of the board and executive is available to all shareholders and other stakeholders</td>
<td>4.79</td>
<td>0.87</td>
</tr>
<tr>
<td>Information about board members qualifications is available</td>
<td>4.98</td>
<td>0.99</td>
</tr>
<tr>
<td>Foreseeable material risks are disclosed to all stakeholders</td>
<td>4.74</td>
<td>0.89</td>
</tr>
<tr>
<td>Information on employees share ownership plan is disclosed</td>
<td>4.61</td>
<td>0.85</td>
</tr>
<tr>
<td>Information on retention rates of employees is disclosed</td>
<td>4.54</td>
<td>0.74</td>
</tr>
<tr>
<td>Article of association, board charters, committee structures and characters are disclosed</td>
<td>4.67</td>
<td>0.79</td>
</tr>
<tr>
<td>Financial statements, annual reports and other important information about the company are posted in company’s website</td>
<td>4.78</td>
<td>0.81</td>
</tr>
</tbody>
</table>

Source: Field data (2016)
Looking at the table above there is strong presence of the following: Members of the board make known if they have any interest in any matter affecting the company, information about ownership structure is available to all shareholders and other stakeholders, and information about board members qualification was available. This is supported by a mean of 4.96 and above. Financial statement for the company is audited by competent auditors as indicated by a mean of 4.83. Information about pay package of the board and executive is available to all shareholders and other stakeholders as supported by a mean of 4.79. The following aspects of disclosure and transparency: foreseeable material risk, information on employee share ownership, information on retention rates of employees, articles of association, board charters, committee structures, and charters were disclosed and financial statements, annual reports and other important information about the companies were posted in companies websites. This is supported by a mean ranging from 4.5 to 4.8. It should be noted that the standard deviation is low indicating small variance.

4.4.3: Effects of Board Operation

The findings on the presence of effective board operations are illustrated in the table 4.4 below.

Table 4.4: Effects of Effects of Board Operation

<table>
<thead>
<tr>
<th>Effects of Board Operation</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Observation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board members makes informed decisions and exercising a lot of care</td>
<td>4.95</td>
<td>0.96</td>
</tr>
</tbody>
</table>
The board treats all shareholders fairly  
4.94 0.89  
The board applies high ethical standards  
4.80 0.78  
The board considers the interests of all stakeholders in their decisions  
4.96 0.38  
The board monitors implementation of major plans of action and corporate performance  
4.77 0.89  

Source: Field data (2016)

From the table above, the statements; Board members makes informed decisions and exercising a lot of care, the board treats all categories of shareholders fairly, the board uphold high ethical values and the board considers the interests of all stakeholders in their decisions have registered a high mean of above 4.80. This indicates that the board operations on these areas are effective. The statement that he board monitors implementation of major plans of action and corporate performance has a mean of 4.77 which is equally high but not as high as the others. The high means indicate a strong presence of efficient board operations among most respondents.

Table 4.5: Effects of Board Operation

<table>
<thead>
<tr>
<th>Effects of Board Operation</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>The board oversees major capital expenditures, acquisitions and divestitures.</td>
<td>4.99</td>
<td>0.99</td>
</tr>
<tr>
<td>The company carries out performance review of individual boards members</td>
<td>4.94</td>
<td>0.89</td>
</tr>
<tr>
<td>The board oversees the succession to the board</td>
<td>4.82</td>
<td>0.78</td>
</tr>
<tr>
<td>The internal auditor has authority to access to the board</td>
<td>4.96</td>
<td>0.38</td>
</tr>
<tr>
<td>Members of the board undergo training regularly every year</td>
<td>4.75</td>
<td>0.38</td>
</tr>
</tbody>
</table>

**Source: Field data (2016)**

From the table above, the statements; The board oversees major capital expenditures, and selling off of major investments; the company carries out performance review of individual boards members; the board oversees the succession to the board; the internal auditor has authority to access to the board registered a high mean of above 4.80 which indicate that most of the respondent agreed with the statements. This is supported by standard deviation of less than one implying low variance among the respondents’ views. The statement that the board undergoes training regularly every year had a mean of 4.75 which is also high but not as high as the others. Therefore, there is a strong presence of efficient board operation.

### 4.5 Inferential Analysis

The objective of the study was to investigate whether corporate governance practices affects the financial performance of commercial banks quoted in NSE. Pearson Correlation analysis was used at 99% and 95% confidence levels. Table 4.6 shows a strong positive linear relationships between financial performance and shareholder rights given a coefficient of 0.958. The relationship between financial performance and board operations is equally strong and positive indicated by coefficient value of 0.984. The relationship between financial performance and transparency and
disclosure is moderate i.e. not high but not low as indicated by the coefficient of 0.672.

**Table 4.6: Correlation Analysis**

<table>
<thead>
<tr>
<th></th>
<th>Financial performance</th>
<th>Shareholder rights</th>
<th>Transparency and disclosure</th>
<th>Board Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial performance</td>
<td>Pearson Correlation</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholder rights</td>
<td>Pearson Correlation</td>
<td>.958*</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transparency and Disclosure</td>
<td>Pearson Correlation</td>
<td>.672*</td>
<td>.975</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.009</td>
<td>.091</td>
<td></td>
</tr>
<tr>
<td>Board operations</td>
<td>Pearson Correlation</td>
<td>.984**</td>
<td>.008</td>
<td>.049</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.003</td>
<td>.004</td>
<td>.720</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>7</td>
<td>7</td>
<td>7</td>
</tr>
</tbody>
</table>

*. Correlation is significant at the 0.05 level (2-tailed); **. Correlation is significant at the 0.01 level (2-tailed).

**Source: Field data (2016)**

Multiple regression analysis was used to measure the relationship between corporate governance (shareholder’s rights, transparency and disclosure, board operations) and financial performance. The analysis helps to determine correlation coefficient and determination coefficient. Table 4.3 presents a correlation coefficient of 0.721 and
The determination coefficients of 0.521. This implies a strong relationship between financial performance and the corporate governance variables. Thus, the shareholder’s rights, transparency and disclosure and board operations account for 52.1% of the variations in financial performance.

Durbin Watson (DW) test check for autocorrelation. If the value fall in the range 1.9 to 2.1 then there is no autocorrelation. The value in the table below of 2.029 falls within the range and therefore we conclude that there was no autocorrelation.

Table 4.7: Model Summary

<table>
<thead>
<tr>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
<th>Durbin-Watson</th>
</tr>
</thead>
<tbody>
<tr>
<td>.721*</td>
<td>.521</td>
<td>.512</td>
<td>.0073998</td>
<td>2.029</td>
</tr>
</tbody>
</table>

Source: Field data (2016)

Table 4.8 indicates the regression coefficients of independent variables.

Table 4.8: Regression Coefficients

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>2.029</td>
<td>.061</td>
<td>.635</td>
<td>.528</td>
</tr>
<tr>
<td>Shareholder’s Rights</td>
<td>2.311</td>
<td>.000</td>
<td>.020</td>
<td>2.797</td>
</tr>
<tr>
<td>Transparency and</td>
<td>.242</td>
<td>.005</td>
<td>.044</td>
<td>3.425</td>
</tr>
<tr>
<td>disclosure</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board operations</td>
<td>.432</td>
<td>.001</td>
<td>.984</td>
<td>42.865</td>
</tr>
</tbody>
</table>

Source: Field data (2016)

a. Dependent Variable: Financial performance

The following regression model was established:
Financial performance = 2.029 + 2.311*Shareholder’s rights + 0.242*transparency and disclosure + 0.432*Board operations

From the equation, the study found that holding shareholder’s rights, transparency and disclosure, board operations at zero, financial performance becomes 2.029. Additionally, when transparency and disclosure, board operations are held constant and one unit of shareholder’s rights is increased then this will cause financial performance to increase by 2.311 times. When shareholder’s rights and board operations are constant, a unit increase in transparency and disclosure would result into 0.242 increase in financial performance. When shareholders’ rights and transparency and disclosure are held constant, one unit increase in board operations cause financial performance to increase by 0.432 times.
CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of findings, conclusions from the findings and recommendations. It also contains suggestions for further research.

5.2 Summary of the findings

The researcher find that there is a significant connection between shareholders’ rights, transparency disclosure board operations and financial performance of commercial banks. This can be attributed to the fact that the bank’s business relies heavily on trust that clients have in the management of the bank and the more transparent they are and the more the disclosures the more trust they earn from their clients who translates into growth and better financial performance.

The study findings on disclosure were that the members of the board make known if they have any interest in any matter concerning the company and financial statements of the company are audited by competent auditors among the responses were positive. Further the study found that the information about board and top management pay package is available to all shareholders and other stakeholders. Information about board members’ qualification and the retention rates of the employees is made available for organization boards’ members. Articles of association, board charters, committee structures and charters are all disclosed to board members as many respondents indicated which also promotes organization transparency in all dimensions.
On the Board’s operation, board members makes informed decisions and exercise a lot of care since majority of respondents strongly agreed to this. All shareholders are treated fairly by applying high ethical standards. The board takes into consideration the interests of all shareholders. The board monitors implementation of major plans of action and corporate performance. It was also found that, it is the board’s mandate to oversee major capital expenditures, acquisitions and divestiture and the company carries out performance review of individual boards members. Internal auditor has authority to contact to the board directly as the board oversees the succession plan. Training of the board members was done at least once every year which also is a key to enhance the company’s board operations.

5.3 Conclusion

Corporate governance improves a firm’s corporate competitiveness and positively impacts its profitability level. The study scrutinized the effect of corporate governance on the performance of commercial banks quoted at NSE in Kenya. It is evident that corporate governance performs a major function in the overall growth and success of banks. The results from the investigation indicate that the rights of shareholders, transparency and disclosure and board operation enhance performance and eventually improve shareholders’ value.

The results of the research gives a strong support to the idea that good governance framework is crucial in the financial sector as it has it positively influences a firms performance. The conclusion of the study will not only aid in advocating and supporting good corporate governance practices in commercial banks, but also to ensure commercial banks collapsing as a result of poor governance is prevented. This
will have an overall effect of promoting economic growth and development of a country since the financial sector of which commercial banks is a major player play a key role.

The study also concludes that shareholders should be adequately informed and allowed to be involved in decisions concerning major corporate changes, all shareholders irrespective of their same status should be treated fairly 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 top management make known to the board if they have interest in anything affecting the organization but it’s also important that 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.

5.4 Recommendations

Banks should embrace best practices of corporate governance. This will in turn improve their financial performance leading to boosting of the shareholders value and wealth. Embracing good corporate governance will also ensure adequate risk management measures are put in place and that standards are not only in writing but that they are practiced as a daily routine. The board should establish proper structures to compel banks’ management to implement good corporate governance by installing strong control mechanisms.
The study informs government take keen interest in good corporate governance practices in banks since they are different from other sectors. The central bank of Kenya has enacted rules and regulations to ensure that banks uphold good corporate governance practices. As a regulator the CBK can introduce stringent penalties for not complying with the regulations. Advocating for strong corporate governance framework will ensure that banks maintain a reasonable and prudent level of risk so as to protect depositors savings and the banks’ investments.

The Kenya Bankers’ Association should come up with awards for banks that practice best practices of good corporate governance to encourage banks enhance their corporate governance. Shareholder’s rights affect the quality of corporate governance pointedly which in turn affect financial performance of Commercial banks. All shareholders, including minority should be treated fairly. Mechanisms should be put in place to ensure all shareholders to obtain justice for when their rights are abused. All categories of shareholders should be adequately informed of their role of holding the directors accountable.

It was noted that commercial banks listed in NSE have no history of collapsing. This could be attributed to among other factors the presence of the strong corporate governance practices. The researcher recommends that CBK should enforce a law that compels all commercial banks to list their companies with NSE within a stipulated a time after incorporation. Listed commercial banks tend to have more checks and balances since they are not only supervised by CBK but also monitored by CMA and shareholders of respective banks.
5.5 Limitation of the study

This research work like any other do not lack limitations and shortcomings. Only seven banks responded out of the targeted ten. The three that did not respond were unwilling to give out information concerning their firms even after expounding on the purpose of the study. Though the response rate was 70% it does not represent adequately the majority of the financial institutions.

In addition, since the assessment of the pretest of questionnaires was conducted by the researcher himself, a certain level of subjectivity can be found. This would be eliminated if an examiner was involved in the process.

5.6 Suggestions for Further Research

The debate on corporate governance continues both in academic circles and popular press, and both in Kenya and international levels shows that this field is very important and needs urgent attention. The current literature addresses a number of issues relating to corporate governance practices and firm performance, although this study adds value to corporate governance literature on various aspects, the results are not conclusive. A period of five years is not enough to draw conclusive results. The research, therefore, recommend a similar study covering a longer period, say ten years. The study was conducted in one country i.e. Kenya and therefore the results may not be generally applicable to all developing countries. The researcher, therefore, recommend a similar study covering many countries.

The study focused on commercial banks listed in NSE. Given that these banks listed in NSE represent only ten banks out of the forty three licensed by the CBK. The
researcher therefore suggests a study that includes all the commercial banks or that include only unlisted commercial banks in Kenya.
REFERENCES


APPENDICES

Appendix I: List of commercial banks listed in Nairobi Securities Exchange

1. Barclays Bank Ltd
2. CFC Stanbic Holdings Ltd
3. I&M Holdings Ltd
4. Diamond Trust Bank Kenya Ltd
5. KCB Group Ltd
7. NIC Bank Ltd
8. Standard Chartered Bank Ltd
9. Equity Group Holdings
10. The Co-operative Bank of Kenya Ltd

Source: NSE Website (www.nse.ac.ke)
Appendix II: Questionnaire

A. SHAREHOLDERS RIGHTS

Use the following scale 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

To what extent can you attribute the following to your company. Tick the appropriate box.

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<tr>
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<th>1</th>
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<th>3</th>
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<tbody>
<tr>
<td>i.</td>
<td>Ensures shareholders have a freehand in the election, appointment and removal of directors</td>
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<td>ii.</td>
<td>Shareholders have the right to participate in and to be adequately informed on decisions concerning major corporate changes</td>
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<td>iii.</td>
<td>Shareholders of the same class are treated equally</td>
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<td>iv.</td>
<td>Shareholders participate in the election of external auditors</td>
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<td>v.</td>
<td>Shareholders share in the profits of the corporation</td>
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<td>vi.</td>
<td>Shareholders authorizes addition of share capital</td>
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<td>vii.</td>
<td>Shareholders authorizes extraordinary transactions such as transfer of substantial assets.</td>
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<td>viii.</td>
<td>Shareholders participate in deciding the remuneration of board members and key executives.</td>
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<td>ix.</td>
<td>Shareholders are allowed to vote by proxy.</td>
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<td>x.</td>
<td>Minority shareholders are protected from abusive action by, or in the interest of controlling shareholders</td>
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</table>
B. DISCLOSURE AND TRANSPARENCY
Tick either Yes of No as applicable in your company.

<table>
<thead>
<tr>
<th></th>
<th>YES</th>
<th>NO</th>
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<tbody>
<tr>
<td>i. Members of the board disclose whether they directly or indirectly have material interest in any transaction or matter affecting the bank.</td>
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<td>ii. Financial statements of the company are audited by competent auditors.</td>
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<td>iii. Information about ownership structure is available to all shareholders and other stakeholders.</td>
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<td>iv. Information about board and executive remuneration is available to all shareholders and other stakeholders.</td>
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<td>v. Information about board members including their qualification is available</td>
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<td>vi. Foreseeable material risks are disclosed to all stakeholders.</td>
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<td>vii. Information on employee share ownership plan is disclosed</td>
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<td>viii. Information on retention rates of employees is disclosed</td>
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<td>ix. Articles of association, board charters, committee structures and charters are disclosed.</td>
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<tr>
<td>x. Financial statements, annual reports and other important information about the company are posted in company’s website.</td>
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</table>

C. BOARD OPERATION
1. Indicate your level of agreement with the following statements by ticking at the appropriate box. Use the ratings criteria given below.
   Strongly Disagree (SD), Disagree (D), Uncertain (U), Agree (A), Strongly Agree (SA)

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<thead>
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<th></th>
<th>SD</th>
<th>D</th>
<th>U</th>
<th>A</th>
<th>SA</th>
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<tbody>
<tr>
<td>i. Board members act on a fully informed basis, in good faith, with due diligence and care.</td>
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<td>ii. The board treat all shareholders fairly</td>
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<td>iii. The board applies high ethical standards.</td>
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<td>iv. The board takes into account the interests of all stakeholders</td>
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<td>v. The board monitors implementation of major plans of action and corporate performance.</td>
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</tbody>
</table>

2. Tick either Yes or No as applicable in your company.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th>YES</th>
<th>NO</th>
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<tbody>
<tr>
<td>i.</td>
<td>The board oversees major capital expenditures, acquisitions and divestiture.</td>
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<td>ii.</td>
<td>The company carries out performance review of individual boards members.</td>
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<td>iii.</td>
<td>The board oversees the succession plan</td>
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<td>iv.</td>
<td>The internal auditor has a direct access to the board.</td>
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<td>v.</td>
<td>Members of the board are trained at least once every year.</td>
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3. Specify the board committees that exist and are fully operational in your company.

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