

**THE EFFECT OF BOARD COMPOSITION ON FINANCIAL
PERFORMANCE OF COMMERCIAL BANKS IN KENYA**

BY:

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DECLARATION

This Research Project is my original work and to the best of my knowledge it has not been presented for award of a degree at any other university.

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DEDICATION

This Research Project is dedicated to my husband David and my lovely boys Christian, Ryan and Randall. Because of your love, support and understanding, I have been able to complete this research project. To my dear mother, Herrine Ouma, thank you for your continuous prayers, Mum! Indeed God has been faithful.

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ABBREVIATIONS

CBK : Central Bank of Kenya

NIM : Net Interest Margin

ROA : Return on Assets

ROE : Return on Equity

ABSTRACT

This research study was undertaken with the objective to establish the effect of board composition on financial performance of commercial banks in Kenya. The study covered the period 2013 to 2015. Board composition was measured by board size, gender diversity and board independence; while financial performance was measured by the return to assets ratio. The study used a descriptive research design. The population of the study comprised all the forty two commercial banks in Kenya over the period of study. The study was therefore a census study. The research study collected secondary data from the annual reports published by the said firms as well as their financial statements. The study achieved a response rate of 59.52% as only twenty five banks had complete data set sought. Data was obtained and organized and presented in form of tables. Data analysis was then undertaken using descriptive statistics, correlation and regression analyses, and conclusions drawn. The researcher finds that overall board composition has a positive effect on financial performance of commercial banks in Kenya. Board size and board independence have positive effect on return on assets (the proxy for financial performance), while gender diversity has a negative effect. The researcher concludes therefore that banks management and owners should properly constitute their boards, as this affects financial performance. The researcher recommends further research on the gender diversity variable.

CHAPTER ONE: INTRODUCTION

1.1 Background to the Study

Corporate governance has in the past few months attracted more attention from academics and regulators around the world, especially with the recent corporate scandals; firms have had to redesign and implement effective corporate governance systems, including board compositions (Al-Shammari & Al-Saidi, 2013). With appropriate board reorganizations in place, focus shifts to their effectiveness in positively driving firm performance (Samad & Zulkafli, 2009).

Agency theory (Jensen & Meckling, 1976) supposes that agents (managers) are engaged by principals to run firms on behalf of the owners, known as principals and in the owners'/principals' best interests. In practice the interests of these two groups might diverge thus the need for apt corporate governance mechanisms. Board composition is one of the corporate governance mechanisms put in place to safeguard and to assist maximize shareholder wealth. The banking sector is a vital sector built on stakeholder confidence and trust; corporate governance practices in the banking industry are of paramount importance (Al-Shammari & Al-Saidi, 2013).

1.1.1 Board Composition

Board composition is a subset of the corporate governance mechanisms put in place by a firm; it relates to the manner in which a bank's affairs are and or shall be directed and controlled (Bender & Ward, 2009). Board composition refers to the board size, the combination of executive and non-executive directors, and other characteristics, which

includes gender diversity (Ongore, et al., 2015). Al-Shammari & Al-Saidi (2013) identify board composition as being characterized by presence of nonexecutive directors in the board, family directors, role duality and board size.

According to prudential guidelines, banks in Kenya should have at least five directors in their individual boards of directors. However, the exact number of directors varies with different banks according to size, scope and complexity of operations and ownership structure (CBK, 2016). The onus lies with a bank's owners and management to determine the effective composition of its board of directors; this composition is reflected in terms of board size, diversity (age, professional and educational backgrounds, nationality and so on), and demographics. There should also be at least three fifths nonexecutive directors and at least one third independent directors represented in the boards. However, a strict observance to the need for independence could result a board comprising persons with no interaction with a firm and who understand very little of it (Bender & Ward, 2009).

A properly constituted board is thus of importance as a bank's goals and objectives shall not only be achieved effectively and efficiently but also the bank's image shall be enhanced thus attracting stakeholder confidence and goodwill, a key operational factor in the banking industry (Al-Shammari & Al-Saidi, 2013). Besides, poor corporate governance structures (of which board composition is a part) affects a bank's reputational risk adversely.

1.1.2 Financial Performance

Financial performance makes reference to the extent of achievement of a firm's goals, objectives and targets over a given time period expressed in monetary terms. Return on

assets as well as return on equity ratios can assist gauge financial performance. Through the income statement, a firm's financial performance over a given period of time can be ascertained through calculation and interpretation of the said ratios (Ross, Westerfield & Jordan, 2013). Financial performance of a bank shows how well a bank is doing with respect to various ratios (Mishkin, 2004).

Mishkin (2004) identifies that there are three good measures of bank financial performance: (ROA) return on assets, (ROE) return on equity, and (NIM) net interest margin. Return on assets is a ratio of a bank's net income to total assets; this ratio adjusts for total assets. Return on equity is of key importance to funds owners and is a ratio of net income to total shareholders' funds (capital). Net interest margin is a ratio between the difference between total interest income and interest expense, and assets. Enhanced and improving financial performance is important to firms, banks included, (Pandey, 2009). It assists a firm to compete in the market easily, maintain and even grow market share, as well as provide consistent returns in terms of regular dividends and capital gains to the investors.

1.1.3 Relationship between Board Composition and Financial Performance

Board composition is a subset of corporate governance in firms, banks included; where corporate governance in a particular firm improves then firm performance will also increase (Khan & Awan, 2012). One characteristic of board composition is the board size; theoretically, large boards are expected to depict an inverse relationship with financial performance. Problems of poor communication and hampered decision-making weaken the effectiveness and efficiency of larger boards relative to smaller ones (Guest, 2009).

According to agency theory (Jensen & Meckling, 1976), boards of directors should be structured to safeguard the principals (owners') best interests by limiting agency problems (where firm managers might pursue self-advancing goals through board resolutions). Thus board composition influences financial performance positively; only positive net present value projects are vouched for in board decisions. However the stakeholder theory (Freeman, 1984) posits that boards are often composed of stakeholders; each stakeholder has some interest to safeguard through the board of directors, where these interests are not aligned the effect on financial performance could be negative.

1.1.4 Commercial Banks in Kenya

Commercial banks are the main players in the Kenyan financial system. According to the CBK (2016), the banking sector consists 42 commercial banks, one mortgage finance company, and 12 microfinance banks, among other institutions. Of the commercial banks two have been placed under receivership while one is under statutory management. Kenyan Commercial Banks are licensed and are regulated by the Central bank of Kenya under the provisions of the Banking Act Cap No. 488 as well as issued prudential guidelines.

Commercial banks in Kenya have registered continued financial growth over the past decade with total assets accumulating to Kenya shillings 3.6 trillion, gross loans to shillings 2.4 trillion, a deposit base of 2.6 trillion and profit before tax at shillings 38.4 billion as at 31st March 2016. There are also 37.5 million and 7.2 million deposit and loan accounts respectively (CBK, 2016). The banking Act specifies the minimum board composition

thresholds with respect to various aspects such as size, independent board members number, education and experience, and so on.

1.2 Research Problem

According to the agency theory (Jensen & Meckling, 1976), there is present ownership dispersion especially in large organizations, commercial banks included. The owners then have to appoint managers (agents) to run and manage organizations as per the owners' outlined goals and expectations. However in practice, the agents may opt overtly or inadvertently not to pursue the owners' best interests. The owners therefore constitute the boards accordingly and with a view to attain organizational goals effectively and efficiently. Attainment of these goals is reflected by financial performance. Stakeholder theory (Freeman, 1984) advances that the composed boards are representations of various stakes in the firm by different interested parties; boards should thus be composed to reflect and safeguard these parties interests.

In Kenya, commercial banks are closely regulated and supervised by the central bank of Kenya (CBK, 2016); corporate governance issues related to board composition are clearly spelt out under the banking Act and prudential guidelines but the onus of determining the appropriate board composition is on individual banks. Two banks (Imperial bank and Chase bank) have experienced financial difficulties in the recent past; their failures have been traced to weak corporate governance mechanisms (CBK, 2016).

The effect of board composition has been studied in the past by local and foreign scholars. A study by Khan & Awan (2012) found that firms with independent board members show

greater financial performance. The effect of size of the board on firm performance is negative but not significant; increase in board size in turn causes a decrease in firm performance which is measured by return on assets (Al-Matari, et al., 2012). Larger boards inversely affect economic performance of firms but have a positive effect on market reach and output, while female board members do not improve economic performance but positively affects market reach (Gohar & Batool, 2015).

Board members who are independent do not have any significant effect on financial performance. However, gender diversity has significant positive effect on financial performance (Ongore, et al., 2015). There's a weak positive relationship between board diversity and financial performance (Aosa, Machuki, & Letting, 2012). Ngugi (2012) also concluded that there is very minimal relationship between board diversity and financial performance. Board size has an inverse relationship with financial performance, while presence of outside directors do not affect positively firm performance (Ongore, et al., 2015). There's negative relationship between gender diversity and a firm's financial performance (Muriuki, 2012).

The empirical studies indicates lack of unanimity as to the effects of a board's composition on a firm's financial performance. Khan & Awan (2012) find that firms with independent board members show greater financial performance; while Ongore et al., (2015) find independent board members have insignificant effect. Gender diversity has positive effect on the financial performance (Ongore et al., 2015); there is a negative relationship between gender diversity and firm's financial performance (Muriuki, 2012; Gohar & Batool, 2015). Therefore, there is need for further research on the research study area. The research study

attempted to answer the question: What's the effect of composition of board of directors on the financial performance of commercial banks in Kenya?

1.3 Research Objective

The research objective was to establish the effect of composition of board of directors on financial performance of commercial banks in Kenya.

1.4 Value of the Study

The researcher believes that the research study is of benefit to a number of persons in the Kenyan economy and similar emerging economies. Potential and existing directors in commercial banks in Kenya shall find the research study useful and informative; they might become better decision makers, especially those serving in board nominating committees. The research study would also be useful to existing and potential investors in the banking sector; they would be in a better position to appraise investment targets and or approving board composition resolutions appropriately.

The study shall also be of value to other researchers and scholars; they might find the research study an invaluable reference input and source of knowledge. Policy makers such as the market regulators and the legislature could obtain input to their policy drafts from the research study findings thus enacting and amending banking laws aptly. The research study adds to the existing knowledge on corporate governance in general and board composition specifically.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This particular chapter discusses the literature that underpins the research study. It discusses theories relevant to the research study, other determinants of financial performance by commercial banks as well as the empirical review.

2.2 Theoretical Review

This section covers the relevant theories to this research study. These main theories are: Agency theory, Stewardship theory and Stakeholder theory.

2.2.1 Agency Theory

Agency theory (Jensen and Meckling, 1976) seeks to explain the relationship that subsists between the principals and agents. In the context of commercial banks, principals are the owners and bank managers the agents. Agency theory explains that principals recruit or engage the agents to run the affairs of their firms in the best interests of the former. The agents are thus tasked solely to pursue the owners' interest, and they are compensated for this role via salary and wages and other forms of compensation. However in practice the agents might purpose to achieve other goals at contrary to the principals. Thus conflicts might arise; principals often put in place control mechanisms to monitor the agents' behavior.

Boards of directors often have the chief executive officer simultaneously undertaking the role of board chair. From the perspective of agency theory, where such is the case interests

of the principals are best assured by aligning the interests of the chief executive officer and the principals interests via say, having long term stock options schemes in addition to the regular compensation (Davis and Donaldson, 1991). The agency theory however advocates for the role separation (chief executive officer non-duality). The board also ought to be structured with the aim to safeguard the interests of the shareholders. Shareholders often nominate and elect their board representatives during annual general meetings.

2.2.2 Stewardship Theory

Davis and Donaldson (1991) postulate the stewardship theory. The theory is contrary to the agency theory. It posits that a firms managers view their roles as akin to those of stewards; the managers shall thus strive to deliver a good job, by always protecting the corporation resources. As stewards, the theory assumes, the managers have no problem of motivation to do good. They therefore need facilitated in execution of their roles in terms of apt structures and clearly defined roles and roles expectations.

From the stewardship theory perspective, boards of directors should just establish a clear organizational structure and the various role positions as well as the responsibilities of the incumbents. The officeholders should also be fully empowered to deliver their respective goals and targets; sufficient resources should be availed, the stewards shall optimally deploy the same and obtain maximum results (Davis and Donaldson, 1991). Board of directors could thus have shared chairman and chief executive officer roles held by one person. Kenyan banking laws require separation of the said roles (CBK, 2016).

2.2.3 Stakeholder Theory

The stakeholder as postulated by Freeman (1984) holds that firms, commercial banks included, are composed of cumulative interests (stakes) by various representatives (stakeholders). The stakeholders are varied depending on firm size and business type, among other factors. The said stakeholders purpose to protect and safeguard their interests in the firm. These stakes should be congruent where the objectives and goals of the firms are to be effectively and efficiently realized.

Boards should thus be composed with the perspective of the various stakeholders represented taken into consideration to avoid conflicts and unaligned interests. Firms often allocate board seats according to the ownership stakes held; thus stakeholders affect and influence board composition as well as decisions and strategies therefrom (Freeman, 1984). Various stakeholders provide the firms with various resources and anticipate commensurate returns on the same.

2.3 Determinants of Financial Performance of Banks

Board composition influences financial performance by commercial banks. However there are other factors that are theoretically expected to influence financial performance of banks. These factors are, grouped as internal and external factors, presented and discussed as below:

2.3.1 Internal Factors

Internal factors are firm specific variables which influence the profitability and financial performance of a specific organization. They are the factors that are within the scope of a

given firm to manipulate them and they differ from firm to firm. Internal factors thus consist of the organizational resources available to accomplish its goals and objectives (Wheelen and Hunger, 2012). Internal factors include but are not limited to human, technological, financial and physical resources. The onus is on a firm's management to procure the internal factors efficiently and effectively and utilize them efficiently and effectively within the firm.

Human resources refers to the number and quality of a firm's workforce; these should be of enough quantity and capacity to be able to participate in the competitive business environment efficiently and effectively (Wheelen and Hunger, 2012). Technological resources are the computing facilities at a firm's disposal; these are often rendered obsolete by fast changes in the external environment, but have an impact on a firm's competitiveness and ability to drive low cost competitive innovations (Laudon & Laudon, 2014). Financial resources are indicated by the cash and capital reserves at the management's disposal; they facilitate easy and competitive procurement of the other resources, sound working capital management policies are thus essential (Pandey, 2009). Physical resources are the tangible assets such as land and buildings; they should be deployed efficiently to ensure optimum utilization.

2.3.2 External Factors

The other factors that also affect banks performance are factors termed external factors. External factors comprise industry as well as economy-wide variables that affect a firm's operations one way or the other. These factors are outside of an individual firm's influence and include: technological advancements, ecological changes, political-legal changes and

socio-cultural changes (Wheelen and Hunger, 2012). A firm can only adapt to the changes that emanate from the external factors by proactively anticipating the changes early enough and or reacting fast enough to the same.

According to Wheelen & Hunger (2012) external factors are the general forces that indirectly affects a firm's short run activities but does influence the firm's decisions in the long run. Technological changes give rise to problem-solving inventions; as political-legal changes allocate power accordingly and provide constraining and protecting laws and regulations; socio cultural changes influence the values, mores, and customs of the society. Macroeconomic variables also form part of these external factors.

2.4 Empirical Review

This sections presents past empirical studies reviewed and those relevant to the research study. The foreign studies are reviewed first, then the local studies.

Danoshana and Ravivathani (2013) also undertook a research study investigating the impact of corporate governance on the performance of listed financial institutions in the country of Sri Lanka. Corporate governance variables studied are: the board size, the meeting frequency and the audit committee. Population of the study consisted 33 firms; cluster sampling assisted obtain a study sample of 25 firms. Secondary data covering the period 2008-2012 were obtained and analysed using regression analysis and descriptive statistics. The study finds the corporate governance variables significantly impact the performance of the firm; the board size and audit committee size have positive impact on

firm's financial performance, meeting frequency has negative impact on the firm's performance.

Al-Matari et al. (2012) undertook a research study to investigate the relationship between board characteristics and company performance of non-financial listed firms in Kuwait using a correlation research design. Board characteristics studied were chief executive officer duality, tenure of the chief executive, audit size of the committee, board size and the board composition. Population comprised 136 nonfinancial listed firms of the census. The study used secondary data and undertook analysis using regression analysis. The study found that chief executive officer duality and audit committee size have significant positive relationship with performance; chief executive officer tenure has a rather significant negative relationship with the firm's performance, while the size of the board and composition have insignificant negative relationship with company performance.

Khan and Awan (2012) also undertook a research study investigating the effect of board composition on a firms' performance in Pakistan. Population of the study comprised 100 firms that form the stock exchange index and a sample of 91 firms obtained. Secondary data was used in the study and regression analysis undertaken. Levene's test and t tests were undertaken to test the significance of the model and relationships identified. The study findings indicate that the firms with independent board members have greater financial performance. This study supports the agency theory which calls for board independence. However, it narrowly focusses on only one parameter of board composition.

Belkhir (2009) undertook a study to investigate the relationship between board size and firm's performance in the United States. A convenient sample of 192 firms is obtained but a sample of 174 banks, with complete data set, is eventually studied. Secondary data is used in the study, covering the period 1995-2002. Data analysis was done via descriptive statistics, correlation and regression analyses. The researcher found out that increasing the number of directors in banking firms does not weaken the bank's performance; there's a positive association between board size and board performance. This study conclusion is contrary to majority findings on this parameter of corporate governance.

Abdullah (2004) undertook a study to investigate the roles of independence of the board and CEO duality on a firm's performance. Population of the study comprised all 369 firms listed at the Kuala Lumpur stock exchange main board. Secondary data was obtained from firms' annual reports and used in the study; the study period covered 1994-1996. He analyzed the data using descriptive statistics and correlation analysis. Regression analysis and t test were also used in data analysis. The findings indicate neither board independence nor CEO duality impact firm performance, and that Malaysian boards are dominated by non-executive directors and the majority of the companies in the studied practice non-dual leadership structure.

Ongore et al. (2015) in a research study to investigate the effect of a board's composition on financial performance of firms that are listed in Kenya, used a descriptive design and primary data collected via administering of questionnaire. The questionnaire was pretested to ensure data validity and reliability. Population of the study comprised 51 firms listed at

the bourse then (2011); 46 firms were eventual studied. The study used regression analysis in data analysis and found that board members who are independent did not have a significant effect on the financial performance and gender diversity had a significant positive effect on the firm's financial performance, while board size had an inverse relationship with financial performance.

Adhiambo (2014) undertook a research study with objective to determine the relationship between selected aspects of corporate governance and financial performance of commercial banks in Kenya. The Corporate governance aspects studied were: size of the board, composition, education level, and board compensation. The study used a cross-sectional research design and a population of 43 commercial banks, and covered period 2009-2013, and used secondary data sourced from annual reports. Data analysis was done using regression analysis. The study found that a larger board size negatively impacts on performance while the board's composition, board's compensation and board's educational level affects financial performance positively.

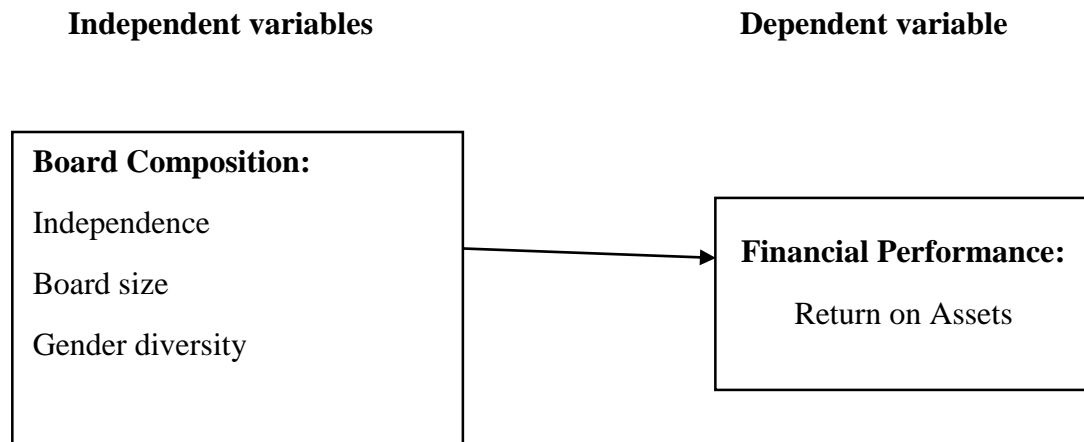
Kitui (2013) also undertook a study with objective to establish the effect of board composition on financial performance of companies listed in Nairobi Securities Exchange. The census study also used a descriptive research design and collected secondary data from annual reports for the period 2008 to 2012 on all the listed firms from the Nairobi securities exchange. Board composition variables studied were age, gender, independence and ethnic background. For analysis of data, regression analysis method was used. The study conclusively finds these variables are significantly associated with financial performance. This study findings thus supports the stewardship theory.

Ngugi (2012) undertook a research study to examine the relationship between board diversity and the financial performance of the Kenyan Commercial banks using a descriptive research design. The study population consisted 44 banks. Secondary data was used in the census study obtained from the (NSE) Nairobi securities exchange and Central Bank of Kenya. Data analysis was done via regression analysis; the variables of board diversity studied were age, experience and exposure, as well as gender ratio of the board of directors. The study finds board gender and experience to have no significant effect on the performance of banks while professional attributes or profession has a relationship with banks performance.

Maina (2005) also undertook a research study that examined the effect of board composition on the firm's financial performance. The study population comprised all the listed firms in Kenya and covered period 1994-2003. The study primarily used primary data sourced using a questionnaire; secondary data was also used by the study. Data collected was analyzed using regression analysis. Board composition variables studied were: board independence, audit committee independence, chief executive officer duality and directors from financial institutions and control variables included firm's size, financial leverage and board size. The research found no significant relationship between firms' performance and board composition variables; therefore the board composition variables are not performance enhancing.

2.5 Conceptual Framework

Figure 2.1: Conceptual Framework



Source: (researcher, 2016).

2.6 Summary of Literature Review

The literature review has been made under this chapter. Theoretical review has been made; three theories relevant to the research study have been discussed: agency theory, stewardship theory, and stakeholder theory. Other determinants of financial performance by banks have also been discussed. Empirical review has also been made in this chapter and a conceptual framework presented. The chapter ends with this summary section.

The empirical studies indicate that there lacks unanimity as to the effect of board composition on the financial performance of firms. Khan & Awan (2012) find that firms with independent board members show greater financial performance; while Ongore et al., (2015) find independent board members have insignificant effect. Gender diversity has positive effect on financial performance (Ongore et al., 2015); there is a positive relationship between board size and firm financial performance (Belkhir, 2009); this is in

contrast with other studies which found that board size has a negative effect on the performance (Adhiambo 2014; Al-Matari et al., 2012). Therefore there is need for further research on this research study area.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the research study research methodology. It covers the study research design, population and sampling, data collection, as well as data analysis.

3.2 Research Design

A research design is an overall plan of approach to a research study. Different types of objectives lead to different kinds of research designs (Zikmund et al., 2010). This research study tried to investigate the effect of board composition on the commercial bank's financial performance using a descriptive research design approach. Descriptive research studies seek to describe the way items, or objects are (Kothari, 2004).

3.3 Population of the Study

Population of a study could be termed as the universe (Kothari, 2004). A population consists of all the items under study, from which samples could be drawn. They comprise the elements whose characteristics are to be studied. The study's population comprised all the 42 commercial banks in Kenya (see appendix I). There are 42 commercial banks in Kenya (CBK, 2016).

3.4 Data Collection

The research study utilized secondary data. These data were obtained from audited annual and financial reports of the commercial banks for period 2013-2015, from the central bank

of Kenya and the respective commercial banks using a data collection form (see appendix II).

3.5 Data Validity and Reliability

The data collection instrument should meet the measures of validity and reliability (Kothari, 2004). The data collection instrument was pretested by the researcher prior to actual data collection; this assisted ensure its reliability and validity. Reliability represents the consistency and repeatability of a measure, while validity refers to the degree to which the instrument measures the concept the researcher wants to measure (Zikmund et al., 2010). The data collection was handled by the researcher solely, thus ensuring consistent treatment of data. The research study also relied on secondary data; thus ensuring reliability.

3.6 Data Analysis

This section details the data analysis processes that were used following data collection. After data was collected, the same was edited and checked for errors, organized and presented in form of tables. Descriptive statistics were used to summarize and present the data. To establish the effect of board composition on financial performance, correlation and regression analyses were undertaken. The specific regression model is presented below:

3.6.1 Analytical Model

$$Y = \beta_0 + \beta_1 \text{Independence} + \varepsilon$$

Where:

Y = financial performance, measured by return on assets (net income/total assets);

B₁ = beta coefficient for the independent variable; indicating the unit

change in financial performance due to a unit change in board

independence;

ε = error term;

Independence = was measured by the ratio of the independent directors to the total

number of directors in a board;

$$Y = \beta_0 + \beta_1 \text{Board Size} + \varepsilon$$

Where:

Y = financial performance, measured by return on assets (net income/total assets);

B₁ = beta coefficient for the independent variable; indicating the unit

change in financial performance due to a unit change in board size;

ε = error term;

Board Size = was measured by the total number of the directors in a board;

$$Y = \beta_0 + \beta_1 \text{Gender Diversity} + \varepsilon$$

Where:

Y = financial performance, measured by return on assets (net income/total assets);

B₁ = beta coefficients for the independent variable; indicating the unit

change in financial performance due to a unit change in the gender diversity

variable;

ε = error term;

Gender Diversity = was measured by the ratio of female directors in the board.

$$Y = \beta_0 + \beta_1 \text{Independence} + \beta_2 \text{Board Size} + \beta_3 \text{Gender Diversity} + \varepsilon$$

Where:

Y = financial performance, measured by return on assets (net income/total assets);

β_i = beta coefficients for the respective independent variables; indicating the unit

change in financial performance due to a unit change in the respective

independent variables;

ε = error term;

Independence = was measured by the ratio of independent directors to total

number of directors in the board;

Board Size = was measured by the total number of directors in a board;

Gender Diversity = was measured by the ratio of female directors in the board.

3.6.2 Tests of Significance

T tests were undertaken at 95% significance level to test the level of statistical significance of the study variables. F test was undertaken to test the significance of the model. A significance level is a critical likelihood linked with a statistical hypothesis test that shows how likely it is that an inference supporting a difference between an observed value and some statistical expectation is true (Zikmund et al., 2010).

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter discusses data analysis, the results and discussion. The response rate, data validity, descriptive statistics, correlation and regression analyses, and findings discussion are made.

4.2 Response Rate

This section explains the response rate. The research study sought to study the effect of board composition on financial performance of Kenya's forty two commercial banks. However only twenty banks had the complete set of the sought data. This gives a response rate of 59.52%. This response rate is adequate for data analysis. According to Kothari (2004), a response rate above fifty percent is sufficient for data analysis.

4.3 Data Validity

As had been detailed out under section 3.5 above, the data collection instrument was pretested by the researcher prior to actual data collection; this assisted ensure its reliability and validity. The data collection was also handled by the researcher solely, thus ensuring consistent treatment of data. The research study also relied on secondary data; thus ensuring reliability.

4.4 Descriptive Statistics

This section discusses the descriptive statistics for each study variable; mean, standard deviation, coefficient of variation, kurtosis and skewness are covered. The table 4.1 below indicates the summary of these statistics.

Table 4.1: Descriptive Statistics

	N Statistic	Mini mum Statistic	Maxi mum Statistic	Mean Statistic	Std. Deviat ion Statistic	Skew ness Statistic	Skew ness Std. Error	Kurto sis Statistic	Std. Error
Board size	75	6	14	9	2.221	0.354	0.279	-1.041	0.552
Retur n on Assets ratio_f	75	-2.9%	5.2%	2.1%	1.7%	-0.827	0.279	0.519	0.552
emale direct ors board _inde pende nce	75	0.0%	50%	16%	12%	0.29	0.279	-0.645	0.552
Valid N (listwi se)	75								

Source: research findings

From the table above, board size has a minimum statistic of 6 and a maximum of 14; the smallest board size among commercial banks in Kenya thus is composed of six members and the largest of fourteen members, given an average board size of nine members with a standard deviation of two. Return on assets (the proxy for bank performance) has the lowest figure of -2.9% and the best return of 5.2%, an average of 2.1%. Board diversity (as measured by the ratio of female members in the boards) indicates that on average 16% of board members are female, some banks have no female board members while others have as high as 50%. Board independence variable has a minimum statistic of 33% and a

maximum of 86%. On average bank boards have 60% independent members, with a standard deviation of 12%. This statistics is slightly skewed to the right and the low kurtosis indicates presence of few outliers.

4.5 Correlation Analysis

This section explains the correlation analysis. The table 4.2 below provides a summary of the correlation between the dependent and each independent variable.

Table 4.2: Correlation Analysis

		Board size	Return on Assets	ratio_female directors	board_independence
Board size	Pearson Correlation	1	0.21	.383**	0.17
	Sig. (2-tailed)		0.07	0.00	0.15
	N	75	75	75	75
Return on Assets	Pearson Correlation	0.21	1.00	-0.18	0.11
	Sig. (2-tailed)	0.07		0.12	0.35
	N	75	75	75	75
ratio_female directors	Pearson Correlation	.383**	-0.18	1.00	0.14
	Sig. (2-tailed)	0.00	0.12		0.23
	N	75	75	75	75
board_independence	Pearson Correlation	0.17	0.11	0.14	1.00
	Sig. (2-tailed)	0.15	0.35	0.23	
	N	75	75	75	75

Source: research findings

From the table above, financial performance (measured by return on assets) has a weak positive correlation with board size and board independence with correlation coefficient of

0.21 and 0.11 respectively. Return on assets however has a weak negative correlation with board diversity (measured by ratio female directors in bank boards). Amongst the independent variables, board size has a 0.383 correlation coefficient with board diversity and board diversity has a 0.14 correlation coefficient with board independence; indicating weak positive correlation between these independent variables. The independent variables are obviously not highly correlated; thus the absence of the problem of multicollinearity.

4.6 Regression Analysis and Hypothesis Testing

This section discusses the regression analyses. It is organized into subsections.

4.6.1 Board Size and Financial Performance

This section discusses the relationship between board size and financial performance.

4.6.1.1 Model Summary

The table 4.3 below provides the model summary.

Table 4.3: Model Summary (Board Size and Return on Assets)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.213 ^a	0.046	0.032	1.65%

a. Predictors: (Constant), Board size

Source: research findings

The table above indicates that R statistic is 0.213 and R square of 0.046. The R statistic indicates that the correlation coefficient is 0.213; thus board size and financial

performance have a weak positive relationship. The model also explains 4.6% of the variations of the dependent variable (return on assets) about the mean.

4.6.1.2 Analysis of Variance

This section discusses the analysis of variance (ANOVA); the variables being return on assets and board size.

Table 4.4: Analysis of Variance^a (Board Size and Return on Assets)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	9.32	1	9.32	3.44	.068 ^b
	Residual	195.293	72	2.71		
Total		204.613	75			

a. Dependent Variable: Return on Assets

b. Predictors: (Constant), Board size

Source: research findings

The analysis of variance above indicates an f statistic of 3.44 and significance statistic of 0.068. The analysis was done at 95% confidence level; the 0.068 significance is slightly above the critical level of 0.025. Thus the model is insignificant in trying to explain the relationship between the size of the board and return on assets.

4.6.1.3 Model Coefficients

The table below details the model coefficients.

Table 4.5: Model Coefficients^a (Board Size and Return on Assets)

Model	Unstandardized Coefficients		Standardized Coefficients		t	Sig.
	B	Std. Error	Beta			
1 (Constant)	0.585	0.821			0.71	0.48
Board size	0.161	0.087	0.21		1.85	0.07

a. Dependent Variable: Return on Assets

From the table above, the below analytical model was obtained.

$$Y=0.585 + 0.161 \text{ Board Size}$$

At the level where the board size variable is zero, financial performance (Y) shall be 0.585. A unit change in the board size leads to an equal change of 0.161. Board size therefore positively affects financial performance of commercial banks in Kenya.

4.6.2 Board Gender Diversity and Financial Performance

This section discusses the effect of gender diversity on financial performance.

4.6.2.1 Model Summary

The table below presents the model summary.

Table 4.6: Model Summary (Gender Diversity and Return on Assets)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.182 ^a	0.033	0.02	1.66%

a. Predictors (constant), gender diversity

Source: research findings

The R statistic of 0.182 indicates that gender diversity and financial performance are weakly positively correlated when these two are correlated alone. This position however contradicts the negative correlation sighted under section 4.5 above. R statistic is the correlation coefficient.

4.6.2.2 Analysis of Variance

The table below presents analysis of variance summary. The dependent variable being return on assets and the independent being gender diversity.

Table: 4.7: Analysis of Variance^a (Gender Diversity and Return on Assets)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	6.768	3.00	6.77	2.46	.121 ^b
	Residual	197.844	72.00	2.75		
	Total	204.613	75			

a. Dependent Variable: Return on Assets

b. Predictors: (Constant), ratio_female directors

Source: research findings

The f statistic is 2.46 and significance 0.121. This significance is outside the critical level of 0.025 as the analysis was undertaken at 95% confidence level.

4.6.2.3 Model Coefficients

The table below presents the model coefficients for the two variables.

Table 4.8: Model Coefficients^a (Gender Diversity and Return on Assets)

Model		Unstandar		Standardi	t	Sig.
		dized		zed		
		Coefficien		Coefficien		
		ts		ts		
		B	Std. Error	Beta		
1	(Constant)	2.45	0.31		7.87	0.00
	ratio_fem					
	ale					
	directors	-0.025	0.016	-18.20%	-1.6	0.12

a. Dependent Variable: Return on Assets

Source: research findings

The above model coefficients result in the analytical model below:

$$Y = 2.45 - 0.025 \text{ Gender Diversity}$$

The model indicates that at the absence of gender diversity in banks board financial performance (measured by return on assets) shall be 2.45. Also a unit change in the gender diversity variable leads to a corresponding negative 0.025 change in financial performance.

4.6.3 Board Independence and Financial Performance

This section details the effect of board independence and financial performance.

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4.6.3.1 Model Summary

The table below provides a model summary.

Table 4.9: Model Summary (Independence and Return on Assets)

Model	R	R Square	Adjusted Square	R	Std. Error of the Estimate
1	.111 ^a	0.012	-0.001		0.02

a. Predictors: (Constant), board_independence

Source: research findings

The correlation coefficient above is 0.111; thus independence of board of directors in banks is positively correlated with financial performance. The model also explains 1.2% variations in the dependent variable return on assets.

4.6.3.2 Analysis of Variance

This section discusses the analysis of variance. The table 4.10 below provides a summary of the analysis of variance between the dependent variable return on assets and the independent variable board independence. Return on assets is the proxy for bank financial performance.

Table 4.10: Analysis of Variance^a (Board Independence and Return on Assets)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.503	1	2.50	0.89	.348 ^b
	Residual	202.11	74	2.81		
	Total	204.613	75			

a. Dependent Variable: Return on Assets

b. Predictors: (Constant), board_independence

Source : research findings

The f statistic above is 0.89 and significance of 0.348. This significance level is outside the critical level of 0.025 (as the data was analysed at 95% confidence level.

4.6.3.3 Model Coefficients

The table below provides the model coefficients summary.

Table 4.11: Model Coefficients (Independence and Return on Assets)

Model		Unstanda rdized Coefficie nts	Std. Error	Standardi zed Coefficie nts	t	Sig.	95.0% Confiden ce Interval for B	
							B	
1	(Const ant)	1.154	1		1.17	0.25	-0.81	3.118
	board_ indepe ndence	0.015	0	0.11	0.94	0.35	-0.017	0.047

a. Dependent Variable: Return on Assets

Source: research findings

From the table above the below analytical model was obtained:

$$Y = 1.154 + 0.015 \text{ Independence}$$

The financial performance by banks in Kenya therefore shall be 1.154 in the absence of board independence. Besides, a unit change in board independence results in similar change in the financial performance by 0.015.

4.6.4 Overall Regression Analysis

This section discusses the effect of the independent variable board composition (measured by board independence, gender diversity and board size) on the financial performance of Kenya's Commercial banks. The return on assets ratio being used as the proxy for financial performance.

4.6.4.1 Model Summary

The table below indicates the model summary.

Table 4.12: Model Summary

Model	R	R Square	Adjusted Square	R	Std. Error of the Estimate
1	.370 ^a	0.137	0.1		1.59%

a. Predictors: (Constant), ratio_female directors, board_independence, Board size

source: research findings

From the table above, the correlation coefficient is 0.370. Therefore bank financial performance as measured using return on assets ratio, is positively correlated with board composition (measured by board size, board independence, and gender diversity variables). The R square statistic is at 0.137. According to Kothari (2004) R square is also known as the coefficient of determination and it explains the model's best fit for explaining the variations in the study variables. The model thus explains 13.7% of the variations in the study variables.

4.6.4.2 Analysis of Variance

This section explains the analysis of variance made.

Table 4.13: Analysis of Variance^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	27.985	3	9.328	3.70	.016 ^b
	Residual	176.627	72	2.523		
	Total	204.613	75			

a. Dependent Variable: Return on Assets

b. Predictors: (Constant), ratio_female directors, board_independence, Board size

From the table 4.13 above, the f statistic is 3.70 and significance of 0.016. The analysis was undertaken at 95% confidence level. The research concludes therefore that the 0.016 significance is within the critical level of 0.025. The model therefore explains significantly the effect of composition of the board on banks' performance financially.

4.6.4.3 Model Coefficients

This section discusses the model coefficients. The table below provides the model coefficients.

Table 4.14: Model Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta	t		Lower Bound	Upper Bound
1	(Constant)	-0.30	1.13		-0.27	0.79	-2.56	1.95
	board_independence	0.01	0.02	0.10	0.90	0.37	-0.02	0.05
	Board size	0.24	0.09	0.32	2.62	0.01	0.06	0.42
	ratio_female directors	-0.04	0.02	-0.32	-2.63	0.01	-0.08	-0.01

a. Dependent Variable: Return on Assets

Source: research findings

From the above table, the researcher obtained the below analytical model:

$$Y = -0.30 + 0.01 \text{ Independence} + 0.24 \text{ Board Size} - 0.04 \text{ Gender Diversity.}$$

Financial performance (Y) of commercial banks in Kenya as measured using return on assets ratio indicates a beta coefficient of negative 0.30. Therefore absence of board composition variables leads to a negative financial performance position. Board independence and board size have positive coefficients of 0.01 and 0.24 respectively; increases in these two variables therefore positively affect financial performance. However gender diversity is found to have a negative 0.04 beta coefficient; increases in gender diversity affect performance negatively.

4.7 Discussion of Research Findings

The research study sought to establish the effect of board composition on financial performance of commercial banks in Kenya. Board composition was measured using three study variables. These are: board size, board independence, and board gender diversity. Financial performance was measured using the return on assets ratio. The research study finds that financial performance is positively correlated with board composition, with a positive 0.370 correlation coefficient. Return on assets also has positive correlation with board size and board independence with coefficients of correlation of 0.21 and 0.11 respectively. Gender diversity variable is found to have a negative correlation relationship with financial performance. Overall therefore the researcher finds that board composition positively affects financial performance of the commercial banks in Kenya.

The above research findings therefore support the position postulated by the Agency theory (Jensen and Meckling, 1976) that boards should be aptly constituted so as to protect the owners' best interests. Stewardship theory (Davis and Donaldson, 1991) also foresees boards that are properly constituted to positively impact firm performance. The research findings support this perspective in that boards' composition has been shown to positively correlate with banks financial performance. Interestingly the research findings indicate a negative correlation on the gender diversity variable and financial performance. Ongore et al. (2015) found gender diversity to have a significant positive relationship with financial performance.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the research study summary, conclusion and recommendation. The limitations encountered by the researcher are also highlighted and suggestion for further research made.

5.2 Summary of Findings

The research study sought to establish the effect of board composition variables (board size, board independence, and gender diversity) on financial performance of the commercial banks in Kenya. This study utilized secondary data covering the period 2013 to 2015. These data was analysed using descriptive statistics as well as correlation and regression analyses undertaken.

The researcher found that on average commercial banks in Kenya have nine members in their boards (the least membership being six and the largest has fourteen members). Gender diversity measured using the ratio of female directors in the boards to total board directors had a minimum score of 0% and a high of 50%, giving an average of 16%. Board independence measured using the ratio of independent board members had a low of 33% and a high of 86%, and mean of 60%.

Financial performance was found to correlate positively with board size and board independence, with correlation coefficients 0.21 and 0.11 respectively. However gender diversity was found to have a negative 0.18 correlation coefficient. Board gender diversity

and board size have a correlation coefficient of 0.383, while gender diversity and board independence have a correlation coefficient of 0.14. In the regression analytical model, board size and board independence have positive coefficients (0.24 and 0.01 respectively), while gender diversity has a negative 0.04 beta coefficient.

5.3 Conclusion

The researcher concludes that board composition has a positive effect on financial performance of commercial banks in Kenya, based on the findings summary as under section 5.2. This is indicated by the positive correlation coefficient between the two variables. This conclusion contradicts the research conclusion by Maina (2005) that board composition variables have no effect on firm performance. However the finding supports Stewardship theory (Davis and Donaldson, 1991) proposition that boards act as stewards, thereby positively drive firm performance.

Board independence variable was found to have a positive correlation coefficient of 0.11 with return on assets. This implies that the two are positively correlated, but in a weak sense. Board independence also has a positive 0.01 coefficient in the regression analytical model; this indicates that increases in this variable have positive impacts on commercial banks financial performance. Khan and Awan (2012) also found that board independence has a positive effect on firm performance. Banks also have a minimum of a third and a high of 86% independent board members; this shows their compliance with the regulator's prudential guidelines calling for presence of these independent board members.

Board size correlates positively also with banks financial performance. The correlation coefficient being 0.21. This variable's beta coefficient in the regression model is also positive. Increases in board sizes therefore are seen to positively contribute to bank financial performance. Board size positively correlates also with the other independent variables studied (board gender diversity and independence). Smaller boards thus would have fewer female representatives relative to larger boards, therefore. Belkhir (2009) as well as Danoshana and Ravivathani (2013) also in a similar study found that board size positively affects firm performance.

Board gender diversity variable was measured using the ratio of female directors to the total number of directors. This variable however has a negative correlation with the dependent variable return on assets. The gender diversity also has a negative beta coefficient in the regression analytical model. This serves to indicate that increasing this variable leads to decline in performance by the commercial banks in Kenya. The minimum number of female in bank boards is 0; this is prevalent among small board sizes. On average females form 16% of the bank boards of directors in Kenyan commercial banks.

5.4 Recommendations

Based on the research findings and conclusions made above, the researcher recommends that banks in Kenya should carefully consider their board compositions in terms of independence, gender diversity and board size. These variables have an overall positive effect on bank financial performance(s). From the regression analytical model, an absence of board composition (at the point where board size, gender diversity and independence are all at zero), bank financial performance registers a negative 0.30 performance. This

shows that board compositions is a key element in realizing positive financial performance by commercial banks in Kenya.

Board size has the largest positive beta coefficient in the regression model. This indicates that this variable leads to the largest variation in the performance, financial by Kenya's commercial banks. Banks should therefore carefully consider increasing their board sizes until they achieve the optimal level of financial performance. Increased board size is seen to enhance the board's competence as more skills and experience are able to be brought in, this therefore translates to positive impact on financial performance.

Board independence also has a positive correlation with firm performance; banks are thus recommended to strike a balance concerning this variable. They should consider increasing their independent members, but with a careful balance with other competing business objectives. Bender and Ward (2009) observe that a strict observance of the need for board independence could result in a board consisting of individuals with little or no interaction with an organization and with little knowledge of the respective firms. This puts achievement of organizational goals in jeopardy.

5.5 Limitations of the Study

The researcher faced and or encountered a number of challenges while undertaking the research study. First among the limitations being financial constraints. The researcher facilitated the research study out of limited personal financial resources. This limitation however did not affect the results of the study in any significant manner. More financial

support would have allowed the researcher explore more methodologies in undertaking the study.

Time was another limitation faced by the researcher. The research study was undertaken with the aim to meet academic requirements. These academic requirements had specified strict timelines within which the study was to be undertaken. More time would have allowed the researcher to enhance the response rate by obtaining the missing data sets from the related banks.

5.6 Suggestion for Further Research

The research study focused on all commercial banks in Kenya. The researcher feels that a study with narrower focus on say Islamic lenders only would assist to better understand the effect of composition of the board on the Kenyan banks' financial performance. Thus building on the existing knowledge base on the study area. The researcher also recommends that the study be replicated in another developing economy set up. This shall assist identify the result from such other similar set up, and a comparison made. The study also surprisingly found that gender diversity has a negative correlation with firm performance. Further research especially focused on this variable would be invaluablely insightful.

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APPENDICES

APPENDIX I: LIST OF BANKS IN KENYA

1	Kenya Commercial Bank Limited	24	NIC Bank Limited
2	Barclays Bank of Kenya Limited	25	Giro Commercial Bank Limited
3	Bank of India	26	ECO Bank Limited
4	Bank of Baroda (Kenya Limited)	27	Equatorial Commercial Bank Limited
5	Commercial Bank of Africa Limited	28	Paramount Universal Bank Limited
6	Habib Bank Limited	29	Jamii Bora Bank
7	Central Bank of Kenya	30	Guaranty Trust Bank (Kenya) Ltd.
8	Prime Bank Limited	31	Victoria Commercial Bank Limited
9	Co-operative Bank of Kenya Limited	32	Guardian Bank Limited
10	National Bank of Kenya Limited	33	I&M Bank Limited
11	Oriental Commercial Bank Limited	34	Development Bank of Kenya Limited
12	Citibank N A	35	Fidelity Commercial Bank Limited
13	Habib Bank A G Zurich	36	Housing Finance Bank
14	Middle East Bank Kenya Limited	37	Diamond Trust Bank Limited
15	Bank of Africa Kenya Limited	38	K-Rep Bank Limited
16	Dubai Bank Kenya Limited	39	Equity Bank Limited
17	Consolidated Bank of Kenya Limited	40	Family Bank Ltd
18	Credit Bank Limited	41	Gulf African Bank Ltd
19	Trans-National Bank Limited	42	First Community Bank
20	Chase Bank Limited	43	UBA Kenya Bank Ltd
21	CFC Stanbic Bank Kenya Limited		
22	African Banking Corp. Bank Ltd		
23	Imperial Bank Limited		

APPENDIX II: DATA COLLECTION FORM

BANK/SERIAL NO. /

YEAR	2013	2014	2015
Board Independence			
Board Size			
Gender Diversity			