

**THE RELATIONSHIP BETWEEN THE LEVEL OF CORPORATE
GOVERNANCE AND FINANCIAL PERFORMANCE OF
GOVERNMENT OWNED COMMERCIAL BANKS IN KENYA**

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DECLARATION

This research project is my original work and has not been submitted to any other college, institution or university

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DEDICATION

To the members of the family

TABLE OF CONTENTS

DECLARATION.....	ii
ACKNOWLEDGEMENT.....	iii
DEDICATION.....	iv
LIST OF TABLES.....	viii
LIST OF FIGURES.....	ix
ABBREVIATIONS AND ACRONYMS.....	x
ABSTRACT.....	xi
CHAPTER ONE: INTRODUCTION.....	1
1.1 Background of the Study	1
1.1.1 Levels of Corporate Governance	2
1.1.2 Financial Performance	4
1.1.3 Levels of Corporate Governance and Financial Performance	5
1.1.4 Commercial Banks in Kenya	6
1.1.5 State Owned Commercial Banks in Kenya.....	6
1.2 Research Problem	7
1.3 Research Objectives.....	9
1.4 Value of the Study	9
CHAPTER TWO: LITERATURE REVIEW.....	10
2.1 Introduction.....	10
2.2 Theoretical Review	10
2.2.1 Agency Theory.....	10
2.2.2 Stewardship Theory	11
2.2.3 Resource-Based Theory or View	12
2.3 Determinants of Financial Performance of State Owned Commercial Banks.....	12

2.3.1 Corporate Governance	13
2.3.2 Size of the Bank	13
2.3.3 Capital Adequacy	14
2.3.4 Non Performing Loans.....	14
2.4 Empirical Literature Review.....	15
2.5 Conceptual Framework.....	17
CHAPTER THREE: RESEARCH METHODOLOGY	18
3.1 Introduction.....	18
3.2 Research Design.....	18
3.3 Target Population.....	18
3.4 Data Collection	18
3.5 Data Analysis	19
3.5.1 Model Specification.....	19
3.5.2 Diagnostic Tests.....	19
CHAPTER FOUR: RESEARCH FINDINGS AND DISCUSSION	21
4.1 Introduction.....	21
4.2 Descriptive Statistics.....	21
4.3 Trend Analysis	22
4.3.1 Trend Analysis on Dependent Variable Financial Performance.....	22
4.3.2 Trend Analysis on Independent Level of Corporate Governance	24
4.3.3 Trend Analysis on Control Variables of the Study	24
4.4 Diagnostic Tests.....	25
4.4.1 Tests for Multicollinearity	25
4.4.2 Normality Test	26
4.4.3 Heteroskedasticity Test.....	27

4.5 Relationship between Levels of Corporate Governance and Financial Performance	28
4.6 Effect of Levels of Corporate Governance on Financial Performance	29
4.6.1 Model Summary	29
4.6.2 Analysis of Variance	30
4.6.3 Coefficients and Significance	30
4.7 Interpretation and Discussion of the Findings	32
CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS ..	34
5.1 Introduction	34
5.2 Summary	34
5.3 Conclusion	36
5.4 Recommendations for Policy	37
5.5 Limitations of the Study	38
5.6 Areas for Further Research	39
REFERENCES.....	40
APPENDICES	46
APPENDIX I: COMMERCIAL BANKS WITH GOVERNMENT PARTICIPATION IN KENYA	46
APPENDIX II: DATA COLLECTION SHEET	47
APPENDIX II: RAW DATA.....	48

LIST OF TABLES

Table 4.1: Descriptive Statistics.....	21
Table 4.2: Tests for Multicollinearity	26
Table 4.3: Skewness and Kurtosis	26
Table 4.4: Correlation Results	28
Table 4.5: Model Summary	30
Table 4.6: ANOVA Results	30
Table 4.7: Coefficients and Significance	31

LIST OF FIGURES

Figure 2.1: Conceptual Framework	17
Figure 4.1: Trend Analysis on ROA.....	23
Figure 4.2: Independent Level of Corporate Governance	24
Figure 4.3: Trend Analysis on Control Variables of the Study	25
Figure 4.4: Normal PP Plot.....	27
Figure 4.5: Scatter Plot	27

ABBREVIATIONS AND ACRONYMS

CBK: Central Bank of Kenya

CBKL: Consolidated Bank

CG: Corporate Governance

CMA: Capital Market Authority

DBK: Development Bank of Kenya

FP: Financial Performance

NIM: Net Operating Margin

ROA: Return on Assets

ROE: Return on Equity

ABSTRACT

Presently, most of the state owned commercial banks in Kenya are having issues with their financial performance with majority of them posting negative cash flows and losses. The study therefore sought to determine relationship with corporate governance and financial performance of state owned commercial banks in Kenya. The adopted design was descriptive. A total of 6 banking entities were targeted and census was used. Information was gathered from auxiliary sources covering a period of eight years (2011-2018). The analysis was done descriptively and inferentially. It was shown that board independent, board gender diversity and audit committee all have positive and significant effect and relationship with financial performance. The study concludes that levels of corporate governance have positive and significant relationship and effect on financial performance. The study recommends that for any firm that seeks to maximize the wealth of shareholders, corporate governance is a critical factor to focus on. It is important that the audit committees are made to be as independent as possible so that they are able to dispense their role and responsibilities effectively as outlined in corporate governance statements and policies in most organizations.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Currently, corporate governance is the heart of success and thus performance of the organizations (Jacoby, 2018). Presently, most organizations are under pressure from lobby groups and shareholders to behave ethically and create value which can best be achieved through sound corporate governance. In an organizational context, corporate governance arises because of existence of agency problems, the conflict of interest and the transaction costs. Theoretically, it is expected that having in place corporate governance mechanisms in an organizations would result into reduction in agency cost and conflict of interest and this would lead to maximizations of the wealth of shareholders and thus performance of an organization (Du-Plessis, Hargovan & Harris, 2018).

The resource based, agency as well as stewardship theories helped in underpinning the study. The agency theory argues that in a firm, the management team is considered as the agent while shareholders are the principal (Manyuanda, 2013). Thus, the management is expected to make decisions that maximize the wealth of shareholders hence financial performance. This however is not always the case as there exists conflicts of interest which are reduced by the board of directors. The stewardship theory view the managers are stewards and thus will be motivated to attain the goals of the principal of maximization of shareholders wealth (Mitai, 2017). Thus, it is assumed that managers of the firm will have no other objective apart from maximization of shareholder's wealth.

On the other hand, the resource based view theory indicates that firms leverage on resources so as perform better.

The operations of the banking industry in the Kenyan context are governed and regulated by the CBK. It is the responsibility of CBK to ensure that sound regulations and prudential guidelines have been passed as far as sustainability of banking entities is concerned (Wanjiru, 2013). There are currently 6 commercial banks in Kenya where the government has participation in terms of ownership of shares (National Treasury, 2019). However, majority of these entities are not performing well which have largely been attributed to poor corporate governance mechanisms. For instance, National Bank of Kenya is currently planning to merge the operations with Kenya Commercial Bank (KCB) due to consistent loss records. Other commercial banks like Consolidated Bank (CBKL) and the Development Bank of Kenya (DBK) have been stuck in negative liquidity positions (Muhindi & Ngaba, 2018).

1.1.1 Levels of Corporate Governance

Corporate governance indicates the interaction between the management team, the board of directors and shareholders of a business entity (Namutebi, 2019). It constitutes of the power and mode of structure determining responsibilities and rights of various people charged with the responsibility of running and maintaining the affairs of the business including the management team, the directors as well as the owners of the entity. It is a system that dictates how the company is to be managed and controlled with the aim of reducing the conflicting interests between the management and shareholders of the company (Allen, 2017). Corporate governance simply describes the structures and

processes needed to control and direct the interaction between shareholders, the management as well as the board directors of the firm (Ndikwe & Owino, 2016).

The shareholders avail the required sources of capital to be used in funding investment projects that earn revenues to the firm. The management team is responsible daily activities and operations of the entity. The directors play an oversight role to ensure that the management of an organization undertake actions aimed at maximization of the wealth of shareholders (Zagorchev & Gao, 2015). Corporate governance does not merely focus on how a given firm is governed but its meaning is broader than that.

Shahwan (2015) indicates that many people have used corporate governance in different contexts and up to now, the term lacks universally accepted meaning. McCahery, Sautner and Starks (2016) perceive corporate governance as mechanisms involving separation of ownership from control. However, separating ownership from control results into the agency relationship and challenges. In a hypothetical or ideal world, it is assumed that the management of the firm would commit and devote all their skills, abilities and competences in generating maximum returns as much as possible hence maximizing the wealth of shareholders. This however is not the case in the real world characterized by increased conflicting interests between firm's managers and the owners. Mollah and Zaman (2015) defines corporate governance as the mechanisms that safeguard the outside shareholders from expropriation of insiders of the firm. According to Hussain et al. (2018), CG is the process of supervising and controlling the operations of the firm so as to improve on performance.

1.1.2 Financial Performance

Performance according to McCahery, Sautner and Starks (2016) is a measure of how the management of an organization has utilized the resources at their disposal within a given time period to create value for the shareholders. It is the valued total output realized from a system in the form of goods and services (Lebans & Euske, 2006). It is normal practice that at the beginning of any financial period, plans are developed in the form of strategies with clearly outlines outcomes. Performance is an underlying measure of why an organization exists.

According To Hussain, Rigoni and Orij (2018), performance is the end outcome of all the activities and work processes in the firm. Performance concerns how the inputs are effectively and efficiently transformed into outputs. Organizational performance covers three key areas of the organization; financial, product/market as well as returns of the shareholders. According to Buallay, Hamdan and Zureigat (2017), there exists no consensus on measures of performance, the dimensions as well as its exact meaning. This has resulted into debate on what constitutes organizational performance and how best organizations can determine their performance. According to Arora and Sharma (2016), assessment of performance of the organization can be structured around these seven key areas; financial viability, innovation, efficiency, customer satisfaction, quality, productivity as well as effectiveness.

Performance can be determined based on either financial or non-financial measures as well as the market based indicators. One example of market based measure of financial performance is Tobin Q. Information on financial performance of an organization is extracted from relevant published statements and reports. The key financial measures of

performance in an organization include ROA, ROE and ROI. Most measures of financial performance are expressed in ratio that facilitates comparison between firms in a similar industry (Turban, King, Lee, Liang & Turban, 2015).

1.1.3 Levels of Corporate Governance and Financial Performance

In an organizational context, CG arises because of existence of agency problems, conflict of interest and transaction costs. Theoretically, it is expected that having in place good corporate governance mechanisms in an organization would result into reduction in agency cost and conflict of interest and this would lead to maximization of the wealth of shareholders and thus financial performance of an organization (Du-Plessis, Hargovan & Harris, 2018). Quttainah, Cocco and Al-Zufairi (2017) looked the determinants of the effectiveness of CG. The study revealed that regulations are the most significant determinants of corporate governance among Islamic banks.

Existence of weak corporate governance in an organization increase incidences of collusion and embezzlement of funds that adversely affects financial performance of a business corporation (Opanga, 2013). Strong corporate governance is characterized by effective boards that monitor all actions and decisions undertaken by the management teams and thus reducing the conflict of interest hence improved financial performance. Despite this fact, the world has witnessed collapse of major companies including the Enron Corporation as a result of the weaknesses in CG. This raises one question on whether companies have realized the value in corporate governance and how it influences their financial performance (Allen, 2017).

1.1.4 Commercial Banks in Kenya

Commercial banks are institutions with specialization in offering wider services to clients including acceptance of deposits, lending, and investment advisory and insurance services. These institutions mobilize savings and investment from customers. By ensuring availability and access to credit facilities in an economy, commercial banks help in boosting investments undertaken that positively influence the growth of an economy (Shaikh & Karjaluo, 2015).

The operations of commercial banks in Kenya are closely monitored and controlled by the CBK. There are several bases used in classification of banks in Kenya including ownership and the tier system (assets). As of the end of 2017, there were 42 commercial banks in Kenya.

1.1.5 State Owned Commercial Banks in Kenya

State owned banks are financial institutions where the government has a controlling percentage of shares. According to CBK report (2017), government participates in 6 banking entities in Kenyan context. However, in the recent past, most of these state owned commercial banks have consistently posted poor records of financial performance. For instance, as of the December 2017, Development Bank of Kenya posted a negative liquidity position at 21.6% against the required legal threshold of 20%. For National Bank of Kenya, the close of 2017 saw the total deposit liability standing at negative 5.5% while core capital to total assets averaged at negative 7.9%. As of 2018, NBK registered a drop in profit by 84 per cent to stand at Kshs 21.97 billion (Pradhan & Shrestha, 2017).

Based on the above mentioned trend, it is evident that urgent measures should be instituted to enhance financial performance. This poor performance of the state owned commercial banks has also been blamed on lack of sufficient board of directors to act as an oversight body against the decisions by the management. More often than, government interference has shaped this state owned commercial banks are managed (Puwanenthiren, Hettihewa & Wright, 2016). Most appointments of the senior executives and the board members of these commercial banks is usually shaped by politics rather than on merit..

1.2 Research Problem

Existence of sound CG mechanisms calls for strengthening the oversight role of directors to minimize the conflicts of interests in the firm (Rico & Rohman, 2018). Strong corporate governance mechanisms means that the management is motivated to make decisions that are geared towards maximization of the wealth of shareholders and thus financial performance. Hence, firms that are striving to improve on their financial performance must first of all start by strengthening the corporate governance systems in place (Rossi, Nerino & Capasso, 2015). However, more often than not, the management team of most firms is tempted to pursue goals and make decisions that satisfy their personal interest hence conflicts of interest hence adversely affecting firm's performance financially.

State owned banking entities operate under strict regulations and guidelines formulated by CBK. Presently, most of the state owned banking entities in Kenya are having issues with their financial performance with majority of them posting negative cash flows and losses (Saidat, Silva & Seaman, 2019). Given the fact that the politics shape the selection

of the boards and the senior managers in most of these entities, it can be inferred that there are challenges with corporate governance. Embezzlement of funds and conflicting interests have been key in explaining their poor performance. Thus, urgent efforts are required to address this state of poor performance of these commercial banks lest so many customers will stand to lose their deposits (Towett, 2018).

On a global scale, Yilmaz (2018) used a case of companies in Oman to establish the interaction between CG and firm's ability to perform financially. It was shown that CG predicts firm's ability to perform financially. Using a case of Italian firms, Rossi, Nerino and Capasso (2015) looked at CG and its interaction with firm's ability to perform financially and noted a direct interaction. Among insurance firms in Bangladesh, Datta (2018) looked at CG and how impacts on FP where a positive relationship was identified.

Locally in Kenya, Wanjiru (2013) relied on evidence from listed firms at the NSE to establish how CG predicts their ability to perform and a direct link was identified. Opanga (2013) relied on Kenyan insurance firm to relate CG and its link with FP where a positive link was noted.. Nganga (2017) focused on the banking entities in Kenyan context to predict how their corporate governance mechanisms enhance their financial performance and noted a significant relationship.

Therefore, from the aforementioned studies, it is clear that some of them were carried out in advanced countries away from Kenya hence while other studies were carried out in different sectors and industries way from the banking sector hence contextual gap. Other studies relied on primary means of data collection and not secondary data which results into methodological gap. To fill these gaps, the current study sought to answer the

following research question: what is interaction between CG and FP of banking entities where the government participates in with Kenyan case?

1.3 Research Objectives

Relationship between the level of CG and FP of state owned commercial banks in Kenya

1.4 Value of the Study

The study would add knowledge to the existing one as it regards the CG and FP. Scholars would rely on the study to conduct literature review. The study would recommend areas that require further studies which shall be important as far as advancement of the theories on corporate governance is concerned.

Policy makers like the Capital Market Authority (CMA) and CBK would borrow the evidence to come up with progressive policies. This would boost growth of the entire Kenyan banking sector. The shareholders, directors and corporate managers are responsible for drafting strategies of firms to remain competitive and improve on their financial performance. Through this study, the various practitioners in the field of CG would be better placed to have an understanding of the interaction with FP.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The information relevant on CG and firm's ability to perform in financial terms shall be reviewed in this chapter.

2.2 Theoretical Review

The agency theory, the stewardship theory as well as the resource based view theory anchored the study.

2.2.1 Agency Theory

This theory was formulated by Michael Jensen and William Meckling (1976) to describe the relationship occurring between the principal and an agent. In this relationship, actions of the agents are governed by the principal. However, some agents may be motivated to undertake other activities that are not in line with the interests of the principal. This brings in the conflict of interest which is the hurt of this agency theory.

Having invested finances and other resources in the company, shareholders of the company become the principals while the management team is the agent (Arora & Sharma, 2016). Thus, the management as agent are required to undertake all activities that are in line with the aim of maximizing the wealth of shareholders and thus organizational performance of an organization. However, conflict of interest usually arises when the management undertakes activities and decisions that are for their personal gain (Hussain, Rigoni & Orij, 2018).

In order to check and control activities of the management, shareholders usually appoint the directors in the annual general meeting who constitute the board. The directors provide a check and balance on managerial actions of the entity that carry out daily operations and decisions of the firm (Abdallah & Ismail, 2017). Apart from the board of directors, external auditors also come in to play the monitoring role on how the management operates.

2.2.2 Stewardship Theory

This theory was advanced by Donaldson and Davis (1991) so as to offer an explanation of the interaction between the management and the ownership of the firm. The theory operates on an assumption that managers of the business are stewards with the aim of attaining the objectives of the principal. The theory proposed a different motivational form (non-financial) to managers that would help to driver performance of the business.

The theory further argues that firms need to have structures that help in bringing harmony hence efficiency of managers. The theory is statistics thus evaluates managerial relationship one at a time. The theory further makes an assumption that there exists no conflicting views between owners and firm managers. The theory hence argues that governance needs to come up with the best way of (structures and mechanisms) that effectively coordinates activities and operations of the firm. The theory further indicates that the management needs to be held accountable and answerable for their decisions and actions (Pfeffer, 1992). This theory is relevant because it links ethical practices as key issues in corporate governance and performance.

2.2.3 Resource-Based Theory or View

Barney (1991) advanced this theory and it argues that a firm can realize improved performance when internally as opposed to externally generated resources is used in carrying out the operations. Unlike external resources, a firm has full control on its internal resources hence effective use of these internal resources is key in influencing competitive advantage and thus performance of the firm. The RBV theory indicates that firm should strive to ensuring efficiency and effectiveness of the internal operations and processes through use of resources in place. Although it is hard to substitute resources, their effective use results into value creation to the firm.

The theory also explains why the companies should exploit their resources to foster their financial performance. Organizations utilize the resources when they possess competitive advantage over the rivals (Colbert, 2004). It is only when firms are competitive that they are able to improve on their performance. Thus, the theory implies that resources are key determinants of competitive positioning and thus performance of the firm. In summary, in as much a firm may have well outlined ideas of how to increase efficiency; these can only be actualized by having resources in place (Barney, 2001).

2.3 Determinants of Financial Performance of State Owned Commercial Banks

This section will review the determinants of financial performance of state oned commercial banks.

2.3.1 Corporate Governance

Di-Berardino (2016) noted a significant interaction between CG and the ability of the firm to perform. De-Haes et al. (2017) established that effectiveness and performance of boards are largely influenced by corporate governance mechanisms. Isaac (2014) established that CG predicts firm's valuation, risk taking behavior and the cost of capital which are key measures of organizational performance. Another analysis was by Hove-Sibanda et al (2017) noted that implementation of corporate governance mechanisms is associated with prospects of improvement in firm performance. Luyima (2015) established that corporate governance structures, pillars and principles all have an influence on firm performance.

Grace, Vincent and Evans (2018) noted that CG significantly predicts performance of an organization. Wathanga (2017) showed that CG influences the ability of the firms to perform. Kalyanaraman and Altuwaijri (2016) sought to relate board independence and capital structure using a case of firms in Saudi Arabia. It was established that board independence significantly predicts firm performance. Ferreira (2008) looked at the composition of audit committee and how this influences performance. The study noted significant effect.

2.3.2 Size of the Bank

Kioko (2013) looked an entity's size and its link with performance. To measure the size of the firm, the following constructs were used, the number of employees in place, the total asset base, total value of loans and deposits. It was shown that firm size significantly determines financial performance of the firm. Muhindi Ngaba (2018) was interested in

determining the interaction between an entity's size and its ability to perform in financial terms. The following were measures of size; loans and advances, customer deposits, capital base as well as the branch network and a significant relationship was established. Kiragu, Riro and Maina (2019) noted a positive interaction between firm size and performance outcomes in financial terms.

2.3.3 Capital Adequacy

Nzioki (2011) established a positive interaction between CA and firm ability to perform in financial terms. Amahalu et al. (2017) also noted a positive link. Umoru and Osemwegie (2016) looked at CA and its influence on financial performance focusing on Nigerian commercial banks. It was established that capital adequacy and financial performance are positively correlated. Barus et al. (2017) indicated that CA predict firm performance in significant terms. Pradhan and Shrestha (2017) also noted a positive interaction. Amahalu et al. (2017) established positive relationship.

2.3.4 Non Performing Loans

Mitai (2017) indicated an inverse interaction between NPLs and firm ability to perform in financial terms. Towett (2018) also noted an inverse interaction between NPLs and firm ability to financially perform. Namutebi (2019) focused on determining how NPLs influence financial performance. It was shown that increase in NPLs was linked to decrease on performance of the firm in financial terms. Manyuanda (2013) established that NPLs has strongly impacts on financial performance.

Gabriel, Victor and Innocent (2019) studied the influence of NPLs and financial performance of Kenyan banks. NPLs were measured by NPLs to total loan portfolio. It

was shown that high level of NPLs would result into a reduction on financial performance. Chege, Olweny and Opuodho (2018) used a case of Kenyan commercial banks where it was shown that NPLs have negative link with financial performance. Jolevski (2017) looked at NPLs and how they impact on financial performance of the bank. It was established that NPLs and financial performance are negatively connected.

2.4 Empirical Literature Review

Yılmaz (2018) noted a significant interaction between CG and firm ability to perform financially. Datta (2018) noted that CG and entities ability to perform financially are directly interlinked. Rico and Rohman (2018) were interested in establishing how CG influence entities ability to perform financially using a case of firms listed in Indonesia. The time horizon that the study considered was 2010 all through to 2014. It was shown that CG significantly influences financial performance. Wanjiru (2013) studied corporate governance and how impacts on financial performance with focus on listed firms in Kenyan context. Positive link was established between CG and firm ability to perform in financial terms. Opanga (2013) noted that CG has significant prediction of how an entity performs in financial terms.

Nganga (2017) focused on Kenyan commercial banks to predict the interaction between CG and firm ability to perform. CG was seen to predict firm ability to perform. Ndikwe and Owino (2016) were interested in establishing how corporate governance influence financial performance while focusing on schools in Kenyan context. The following were identified measures of corporate governance: composition of the boards, skills of the board and separation of duties. Sampling was carried out using stratified techniques

where a total of 153 respondents were sampled out. A link was noted between CG and firm ability to perform financially.

Ann (2018) used a case of tertiary institutions in Kenyan context to determine how CG predict firm ability to perform. A positive link was identified. Kamau, Benard and Matu (2019) focused on state funded entities in Kenyan context to link corporate governance with financial performance. The design used was cross sectional in nature and state corporations were basically targeted. Information was gathered using primary means. CG was seen to predict firm performance.

Mactolo and Irungu (2014) focused on Kenyan state corporate to relate with firm's ability to perform financially. The design used in the study was quantitative and a positive interaction was noted. Olweny and Wanyama (2013) studied the influence of CG on firm's ability to perform using case of listed insurance firm in Kenyan context. Data was collected from 2007 all through to 2011. A mixed link was noted between CG and firm ability to perform.

Mutuku (2016) looked at corporate governance and how determines and predict ability of SACCOs to perform financially. The design used in the study was descriptive. A positive relationship was established. Kariuki (2017) analyzed the link between CG and ability of the firm top performs using a case of Kenyan listed firms. The design used was descriptive and a total of 6 insurance firms listed were targeted. Data was collected from 2008 all through to 2014. Most of the corporate governance constructs posted a positive interaction with firm ability to perform.

2.5 Conceptual Framework

Figure 2.1 is the conceptual framework of the study.

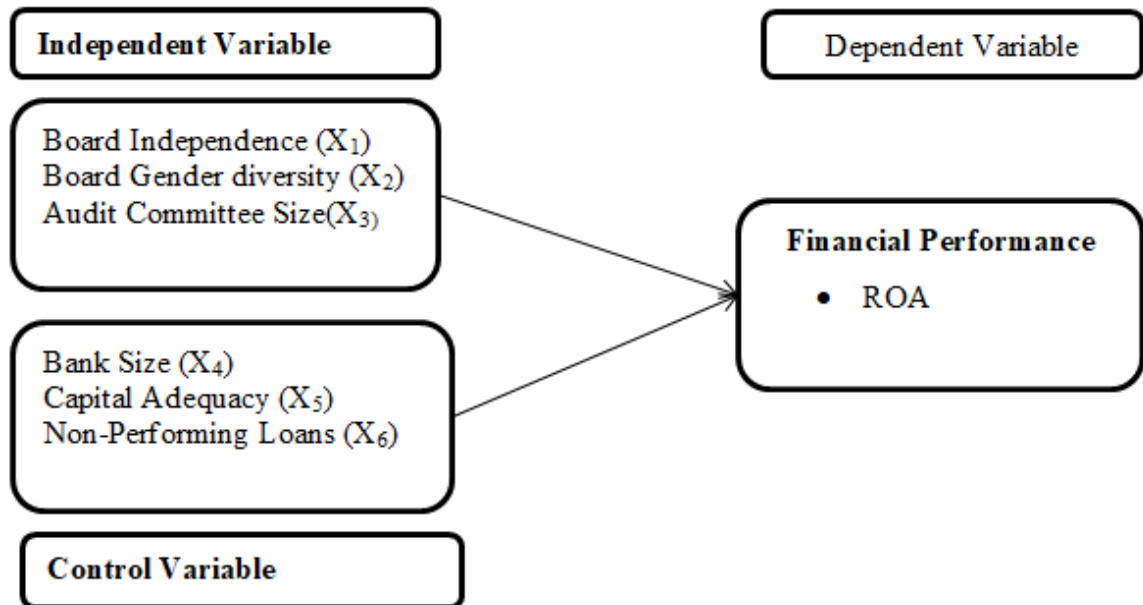


Figure 2.1: Conceptual Framework

Source; Researcher (2019)

Board Independence (X_1)

Board Gender diversity (X_2)

Audit Committee Size (X_3)

Bank Size (X_4)

Capital Adequacy (X_5)

Non-Performing Loans (X_6)

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The chapter details the type of design adopted, the targeted respondents, how the views and information was obtained and how this was processed in statistical terms.

3.2 Research Design

Research design is a detailed arrangement and analysis of data to concur with the study object (Sekaran & Bougie, 2016). Bell, Bryman and Harley (2018) noted that the research design helps in organizing ideas of the project and how the key activities would be realized. The adopted design was descriptive. . The used design was descriptive in nature. It entails estimation of the study population as well as identifying the pattern and interrelationship between the variables.

3.3 Target Population

The list of items or individual that have same features can be viewed as population. A total of 6 banking entities were government takes part were targeted (appendix i). Census was used as informed by a small population.

3.4 Data Collection

Data was gathered from auxiliary sources over eight year period (2011-2018). The period was selected because it was most current for the study to get ideal data. Information from auxiliary sources was readily available. Relevant sources helped in gathering of information.

3.5 Data Analysis

Once data has been sought from the field, cleaning was done to edit inconsistencies and incomplete responses of the quantitative nature of views gathered. Coding process was done where responses were entered into SPSS. The analysis on the findings was carried out with aid of means, standard deviations and regression.

3.5.1 Model Specification

The model is as specified below;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon$$

Where:

Y = Financial Performance (ROA=Net Income/Total Assets)

X_1 = Number of Independent Directors/Total Number of directors

X_2 = Female directors/Total number of directors

X_3 =No. of Audit Committee Members/Total Board Members

X_4 = Natural Logarithm of assets

X_5 = Capital/Total Assets

X_6 =NPLs/Total Loan Portfolio

β = constant,

$\beta_1, \beta_2,$ and β_3 and β_4 = Regression Coefficients

ε = Error Term

3.5.2 Diagnostic Tests

The study carried out normality tests, test for presence of multicollinearity as well as heteroskedasticity tests. The Variance of Inflation Factor was used helped in testing for

multicollinearity. For normality testing, the study used the values of Skewness and Kurtosis while Scatter Plots were used for testing heteroskedasticity.

CHAPTER FOUR: RESEARCH FINDINGS AND DISCUSSION

4.1 Introduction

The essence of this chapter is to present the results of the analysis from the gathered secondary data. Information was obtained from auxiliary sources. The study targeted 6 banking entities that have government participation. From these entities, complete data was obtained from 4 institutions. The study considered an eight year time horizon (2011-2018) and thus a total of 32 data points were used in analysis. The data points were considered as sufficient for performing regression analysis as detailed in this chapter.

4.2 Descriptive Statistics

Consider Table 4.1.

Table 4.1: Descriptive Statistics

	N	Min	Max	Mean	Std. Dev
Return on Assets (%)	32	-.01	.04	.0196	.01185
Board Independence (%)	32	.18	.40	.2858	.05716
Board Gender Diversity (%)	32	.00	.36	.2182	.09956
Audit Committee (%)	32	.00	.55	.3620	.10651
Bank Size (Billions)	32	4.00	5.85	5.1251	.46816
Capital Adequacy (%)	32	.01	.98	.2227	.26843
Non-Performing Loans (%)	32	.00	.66	.0689	.14194

On average, majority of the government owned commercial banks in Kenya generate 1.96% of their profits by leveraging on their assets in place. The independence of the boards among most government owned commercial banks is at 28.58% with 21.82% being represented by female directors. It was further established that 36.2% of the board members are members of the audit committees in their respective institutions.

On control variables, the study established that most of the government owned banking entities are relatively large in size with asset base of Kshs. 5.1251 billion with capital

adequacy standing at 22.27% and non-performing loans at 6.89%. The values of standard deviation were used to express the variation within the period of consideration. From the results, it is clear no significant variation or spread was observed among the variables over the period of study as supported by low values of standard deviation all below 1.

It was established that on average, the studied banking entities had potential to generate a profit of 4% by use of their assets, enhance their level of independence in their boards to 40%, increase the number of female directors to their board by 36% and increase the number of members in the audit committees by 55%. In terms of control variables, the studied banks on average cannot increase their assets beyond Kshs. 5.85 billions, enhance their capital adequacy by 98% and reduce their non-performing loans beyond 66%.

The interpretation of minimum values is that some of the government owned banking entities are generating losses as supported by negative ROA while other institutions neither had audit committees nor female directors on their boards. Other banks had insignificant level of nonperforming loans probably because of the aggressive policies and mechanisms put in place to enhance on their credit risks including adoption of credit referencing bureaus and effective credit appraisal mechanisms.

4.3 Trend Analysis

The study used graphs to depict the movement of the variables across the eight year time period that was considered. Consider subsequent sections.

4.3.1 Trend Analysis on Dependent Variable Financial Performance

ROA helped in determination on financial performance. To determine ROA, obtained the values of net incomes were obtained which were divided by the values of the asset base

of the respective banking entities. The findings of trend analysis are presented in Figure 4.1.

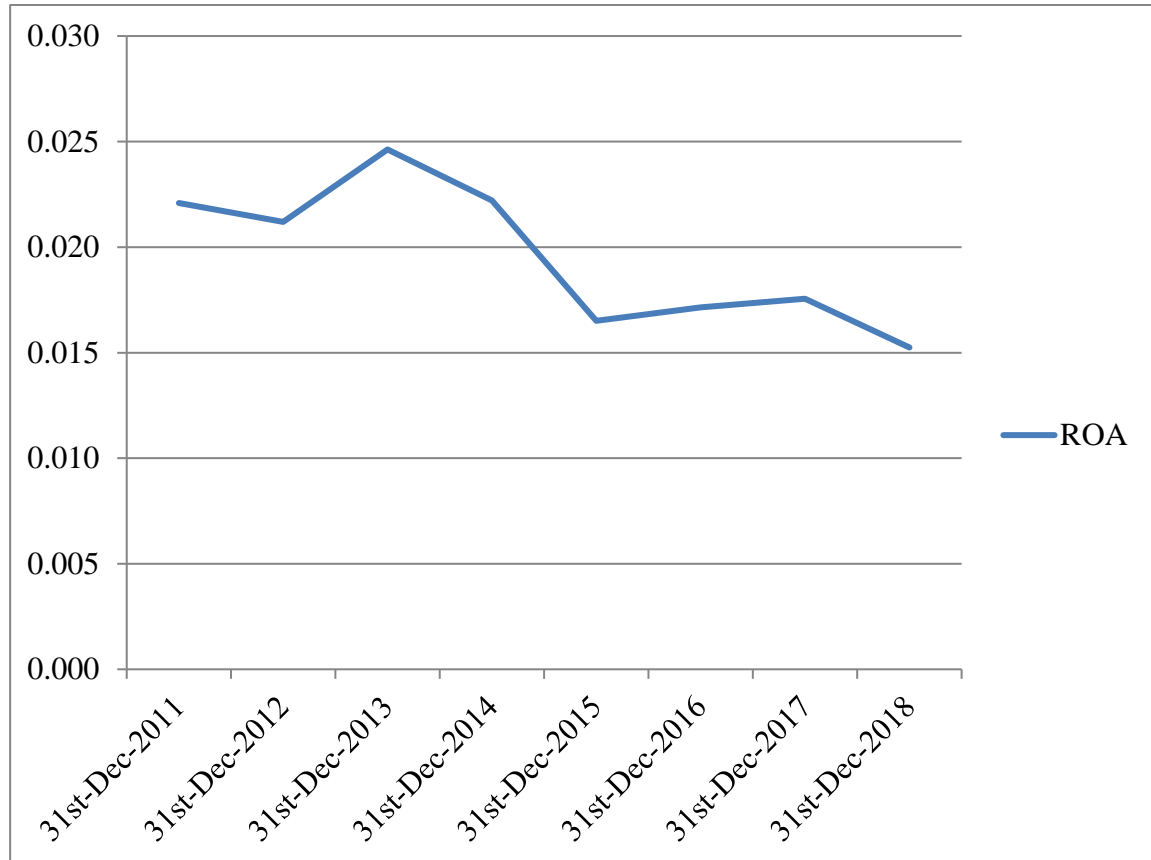


Figure 4.1: Trend Analysis on ROA

From Table 4.1, there has been instability in financial performance of the government owned banking entities in Kenyan context. The assertion is supported by a decreasing value of ROA over the period of consideration. This trend could be explained in terms of their corporate governance mechanisms that were of key focus in this study.

4.3.2 Trend Analysis on Independent Level of Corporate Governance

Figure 4.2 is the summary of trend analysis on level of corporate governance.

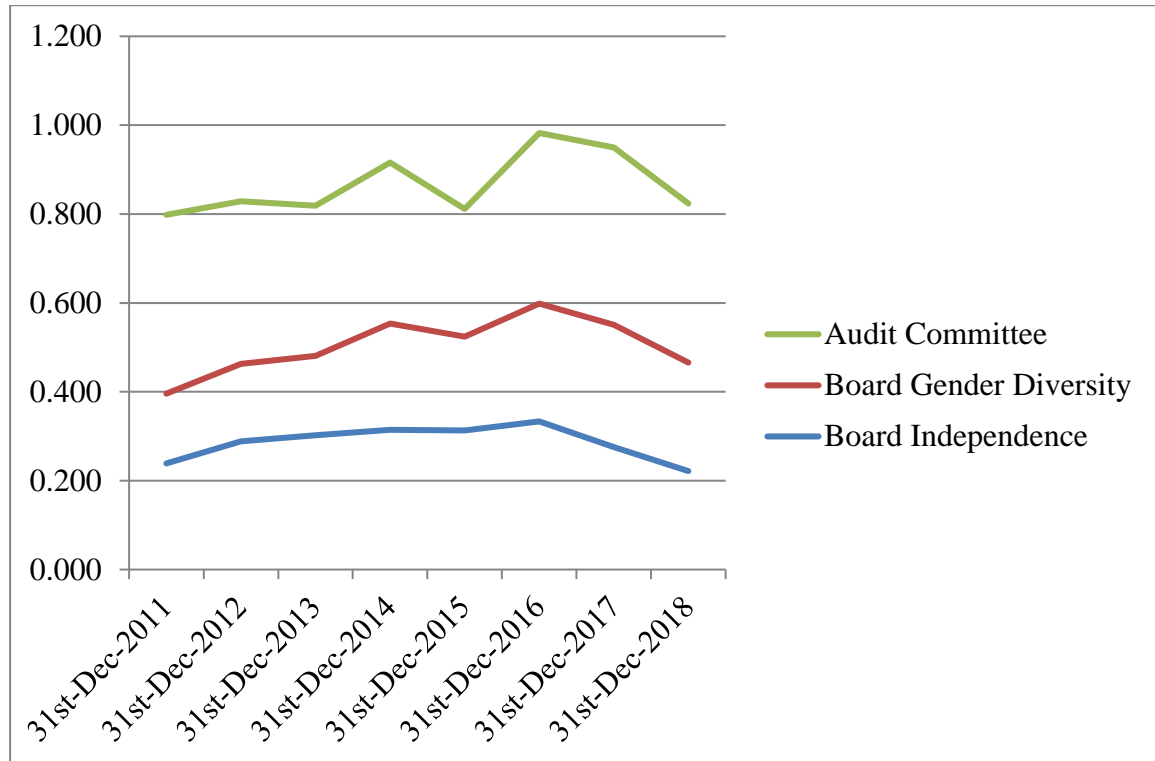


Figure 4.2: Independent Level of Corporate Governance

From the results in Figure 4.2, audit committee is the highly valued and practiced aspect of corporate governance among government owned commercial banks while board independence is relatively low. Board gender as represented by female and male directors in the boards is average among these institutions.

4.3.3 Trend Analysis on Control Variables of the Study

The study used bank size, CA and NPLs as control variables and the findings on trend analysis on these variables are indicated in Figure 4.3.



Figure 4.3: Trend Analysis on Control Variables of the Study

From Figure 4.3, most government owned banking institutions have a relatively higher level of NPLs relative to their sizes. The level of capital adequacy is average among the studied government owned commercial banks.

4.4 Diagnostic Tests

The specific tests that were conducted are presented in subsequent sections.

4.4.1 Tests for Multicollinearity

Consider Table 4.2 for VIF results on multicollinearity testing conducted

Table 4.2: Tests for Multicollinearity

	Collinearity Statistics	
	Tolerance	VIF
Board Independence	.841	1.189
Board Gender Diversity	.666	1.502
Audit Committee	.604	1.656
Bank Size	.407	2.458
Capital Adequacy	.430	2.323
Non-Performing Loans	.629	1.590

a. dependent variable: return on assets

From results, all the variables had VIF values less than 3. This is consistent with Yu, Jiang and Land (2015) who argued that VIF values less than 5 show absence of multicollinearity. It can therefore be inferred that the data was suitable for use in regression detailed in subsequent sections.

4.4.2 Normality Test

The values of skewness and kurtosis were used to test for normality in the data set and the results are shown in Table 4.3.

Table 4.3: Skewness and Kurtosis

	N	Skewness		Kurtosis	
		Statistic	Std. Error	Statistic	Std. Error
Return on Assets	32	-.456	.414	-.370	.809
Board Independence	32	.145	.414	-.176	.809
Board Gender Diversity	32	-.674	.414	.338	.809
Audit Committee	32	-1.053	.414	1.078	.809
Bank Size	32	-.570	.414	.368	.809
Capital Adequacy	32	2.331	.414	1.948	.809
Non-Performing Loans	32	1.587	.414	1.654	.809

From Table 4.3, all the values of Skewness and Kurtosis are within the range of +3 or -3. The findings are consistent with Soberón and Stute. (2017) who gave a threshold of + or 3 as the rule of thumb in determining normality using Skewness and Kurtosis. Thus, it

can be inferred that the data was normally distributed and thus suitable for use. The above results are further represented by the Normal PP plots in Figure 4.4.

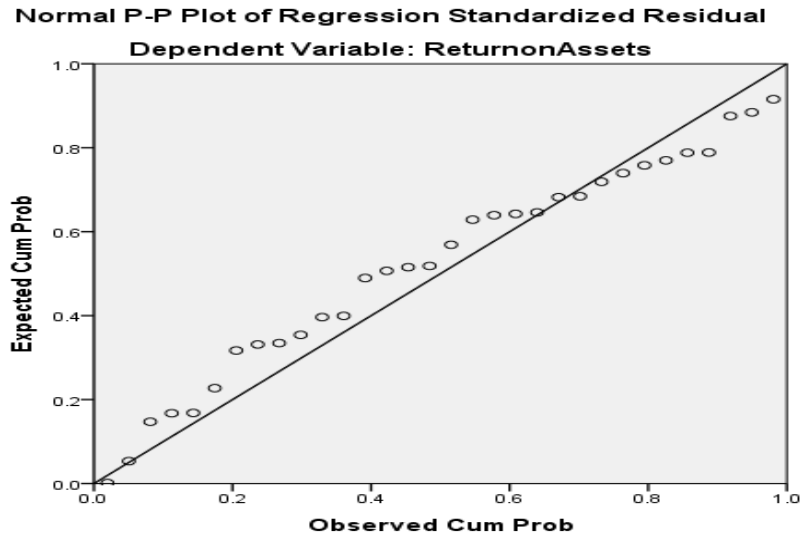


Figure 4.4: Normal PP Plot

From Figure 4.4, it can be shown that the data points fall closely along the normal PP line. This could be an indicator that the study data was normally distributed.

4.4.3 Heteroskedasticity Test

Scatter plots were to test for heteroskedasticity as shown in Figure 4.5.

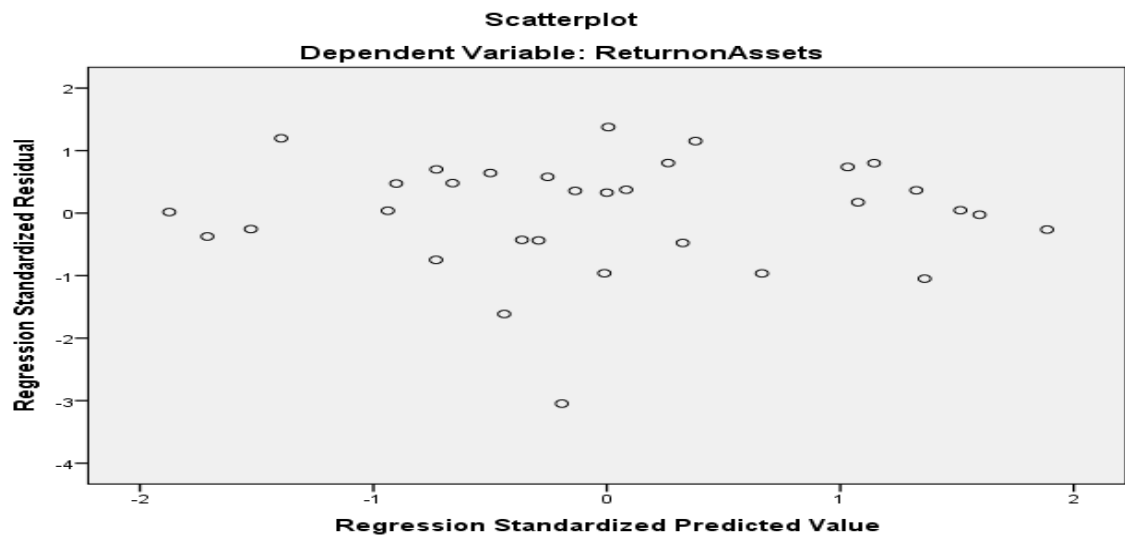


Figure 4.5: Scatter Plot

From Figure 4.5, the data points are far spread with no clearly established pattern. This means that there was heteroskedasticity in the data that was used in the study hence suitable for use.

4.5 Relationship between Levels of Corporate Governance and Financial Performance

Correlation analysis was conducted and the results are documented in Table 4.4.

Table 4.4: Correlation Results

		ROA	X ₁	X ₂	X ₃	X ₄	X ₅	X ₆
ROA	Pearson Correlation	1						
	Sig. (2-tailed)							
	N	32						
X ₁	Pearson Correlation	.108	1					
	Sig. (2-tailed)	.000						
	N	32	32					
X ₂	Pearson Correlation	.107	.016	1				
	Sig. (2-tailed)	.000	.932					
	N	32	32	32				
X ₃	Pearson Correlation	.395*	.015	-.048	1			
	Sig. (2-tailed)	.025	.933	.796				
	N	32	32	32	32			
X ₄	Pearson Correlation	.573**	.092	.255	-.222	1		
	Sig. (2-tailed)	.001	.618	.159	.223			
	N	32	32	32	32	32		
X ₅	Pearson Correlation	-.155	-.084	.213	-.186	-.572**	1	
	Sig. (2-tailed)	.000	.647	.243	.309	.001		
	N	32	32	32	32	32	32	
X ₆	Pearson Correlation	-.305	-.313	-.224	.442*	-.003	-.240	1
	Sig. (2-tailed)	.001	.081	.217	.011	.987	.186	
	N	32	32	32	32	32	32	32

Where;

Board Independence (X_1)

Board Gender diversity (X_2)

Audit Committee Size(X_3)

Bank Size (X_4)

Capital Adequacy (X_5)

Non-Performing Loans (X_6)

Therefore, it was established that the level of independence in boards ($r=-.108$) negatively relates with firm's ability to perform financially. Diversity in gender terms in boards ($r=.107$) positively interacts with firm's ability to perform financially. Audit committee ($r=.395$) positively interacts with firm ability to perform financially. It can therefore be inferred that the level of corporate governance positively interacts with firm's ability to perform. Additionally, while the size of banking entities as well as capital adequacy had positive interaction with firm ability to perform financially, NPLs had negative interaction.

4.6 Effect of Levels of Corporate Governance on Financial Performance

Consider the subsequent section for regression results

4.6.1 Model Summary

Consider Table 4.5 for model summary results

Table 4.5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.720 ^a	.519	.431	.00804

a. Predictors: (Constant), Non-Performing Loans, Bank Size, Board Gender Diversity, Board Independence, Audit Committee, Capital Adequacy

Table 4.5 indicates that R square is 0.519; inferring that the study model was fairly fit for use. The adjusted R square was 0.431; implying that 43.1% change in ability of the government owned commercial banks to perform in financial terms is explained by their levels of corporate governance.

4.6.2 Analysis of Variance

The study conducted ANOVA at 5% and the results are shown in Table 4.6.

Table 4.6: ANOVA Results

	Sum of Squares	df	Mean Square	F	Sig.
Regression	.002	6	.000333	5.495	.000 ^b
Residual	.002	33	.0000606		
Total	.004	39			

a. Dependent Variable: Return on Assets

b. Predictors: (Constant), Non-Performing Loans, Bank Size, Board Gender Diversity, Board Independence, Audit Committee, Capital Adequacy

From Table 4.6, the value of F calculated is 5.495 which are large enough compared to F critical of 2.389. The inference drawn from this finding is that study model was okay.

4.6.3 Coefficients and Significance

Consider Table 4.7 that summarizes these findings.

Table 4.7: Coefficients and Significance

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.052	.027		1.926	.067
Board Independence	.057	.026	.287	2.192	.038
Board Gender Diversity	.055	.018	.210	3.056	.018
Audit Committee	.043	.017	.028	2.529	.019
Bank Size	.018	.005	.727	3.600	.000
Capital Adequacy	.027	.008	.166	3.375	.003
Non-Performing Loans	-.032	.012	-.389	-2.667	.015

a. Dependent Variable: Return on Assets

The predicted equation becomes:

$$Y = .052 + .057X_1 + .055X_2 + .043X_3 + .018X_4 + .027X_5 - .032X_6$$

Where:

Y = Financial Performance (ROA=Net Income/Total Assets)

X₁ = Board Independence

X₂ = Board gender diversity

X₃=Audit Committee

X₄ = Bank Size

X₅= Capital Adequacy

X₆=NPLs

At 5%, the study established that board independence, diversities in gender terms on boards and audit committee all significantly predicts firm's ability to perform ion

financial terms ($p < 0.05$). It was further established that bank size, capital adequacy and NPLs all significantly predict firm's ability to perform financially.

4.7 Interpretation and Discussion of the Findings

Corporate governance has been proved significantly predict the ability of the firm to perform in financial terms. In particular, the level of independence in the board has been identified as factor that positively influences financial performance of the firm. Kalyanaraman and Altuwaijri (2016) sought to relate board independence and capital structure using a case of firms in Saudi Arabia and established that board independence significantly predicts firm performance.

The study has shown that board gender diversity in an important factor influencing ability of an entity to perform in financial terms. The study has further noted that audit committee is a key predictor of the firm's ability to perform financially. This finding is consistent with Ferreira (2008) who looked at the composition of audit committee and how this influences performance and noted significant effect. Broadly, the study has established that corporate governance has positive relationship and effect with financial performance. These finding is empirically supported by Rossi et al. (2015), Datta (2018), Wanjiru (2013), Opanga (2013), Nganga (2017) Ndikwe and Owino (2016) who established that corporate governance significantly predict financial performance.

It has been shown that bank size has significant effect on financial performance. The finding is supported by Kioko (2013) who established that firm size significantly determines firm's ability to perform in financial terms. Kiragu et al. (2019) established that the size of the bank and financial performance are positively correlated. Capital

adequacy (CA) was found to have an influence on firm's ability to perform in financial terms. The findings are empirically consistent with Nzioki (2011) who established a positive interaction between CA and firm's ability to perform financially. Amahalu et al. (2017) established a positive link between CA and firm's ability to perform in financial terms. Umoru and Osemwegie (2016) established that capital adequacy and financial performance are positively correlated. Barus et al. (2017) noted that CA significantly influenced financial performance of the firm. Pradhan and Shrestha (2017) showed that a positive link between CA and firm's ability to perform financially. Udom and Eze (2018) noted that CA has a significant influence on firm's ability to perform financially. .

It was shown that NPLs have significant effect and interaction with firm's ability to perform financially. The finding is consistent with Towett (2018) noted an inverse interaction between NPLs and firm's ability to perform in financial terms. Gabriel et al. (2019) noted that high level of NPLs would result into a reduction on financial performance. Chege, Olweny and Opuodho (2018) noted that NPLs have negative link with financial performance. Jolevski (2017) established that NPLs and financial performance are negatively connected.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter shall summarize the analyzed findings based on the objectives that guided the study. The chapter concludes while at the same time making recommendations as informed by the study findings are also suggested. The inherent factors that limited the study as well as areas that future studies should focus on are also discussed.

5.2 Summary

The study largely focused on determining the interaction between the levels of corporate governance and ability of the banking entities to perform in financial terms. It was carried out in the context of banking entities that have government participation in Kenya. A total of 6 institutions were targeted by information was available from 4 entities. The study considered a time horizon of 8 years (2011-2018) resulting into 32 data points that were deemed to be sufficient for inferential analysis.

The results from descriptive statistics indicated that some of the government owned banking entities are generating losses as supported by negative ROA, while other institutions neither had audit committees nor female directors on their boards. Other banks had insignificant level of nonperforming loans probably because of the aggressive policies and mechanisms put in place to enhance on their credit risks including adoption of credit referencing bureaus and effective credit appraisal mechanisms.

From trend analysis, the study established that there has been instability in financial performance of the government owned banking entities in Kenya. Audit committee is the highly valued and practiced aspect of corporate governance among government owned commercial banks while board independence is relatively low. Board gender as represented by female and male directors in the boards is average among these institutions. Most government owned banking institutions have a relatively higher level of NPLs relative to their sizes. The level of capital adequacy is average among the studied government owned commercial banks.

It was critical; to perform diagnostic tests for aligning the study with regression assumptions. From the results, all the tests gave results that were within established thresholds. This opened an opportunity for conducting inferential statistics including correlation and regression analysis. From correlation results, it was shown that independence in board has a negative relationship with firm's ability to perform in financial terms. Diversities in gender on the boards have a positive relationship with ability of the firm to perform in financial terms. Audit committee has a positive relationship with financial performance. It can therefore be inferred that the level of corporate governance has positive relationship with financial performance. At the same time, the size of the respective banking entities as well as capital adequacy was found to positively determine ability of the firm to perform in financial terms. For NPLs, the interaction with ability of the firm to perform in financial terms was however negative.

The study regressed levels of corporate governance against firm's ability to perform in financial terms. The value of adjusted R square was 0.431; implying that 43.1% change in financial performance of government owned banks is explained by their levels of corporate governance. The ANOVA results gave a $p < 0.05$, inferring that corporate governance significantly predicts firm's performance in financial terms. At 5%, it was shown that board independence, diversity in gender terms in boards and audit committee all significantly predict firm's ability to perform in financial terms. It was further established that bank size, capital adequacy and NPLs all have significant controlling influence on firm's ability to perform in financial terms.

5.3 Conclusion

The key focus of the study was on determining the interaction between levels of corporate governance and bank's ability to perform in financial terms. Correlation results showed that the studied variables all had positive relationship with financial performance. Hence, it was inferred that corporate governance has positive relationship with financial performance. This conclusion is justified and informed by the agency theory of corporate governance.

It was shown that the degree of independence in the board has a larger effect on firm's ability to perform in financial terms followed by board gender independence and lastly audit committee. It was further established that board independence, board gender independence and audit committee all have significant effect on financial performance. Hence, corporate governance was seen to significantly predict the ability of the firm to perform in financial terms. This conclusion is informed by the stewardship theory as detailed in this study.

From trend analysis, the study concludes that audit committee is the highly valued and practiced aspect of corporate governance among government owned commercial banks while board independence is relatively low. Board gender as represented by female and male directors in the boards is average among government owned commercial banks. Based on descriptive statistics, the study concludes that some of the government owned banking entities are generating losses while others neither have audit committees nor female directors on their boards. Other banks have insignificant levels of nonperforming loans.

As informed by the findings of control variables, the study concludes that while bank size, capital adequacy have positive relationship with financial performance, NPLs however have a negative relationship. Viewing these variables in terms of the resources of respective banking entities, it can be inferred that this conclusion is grounded on the resource based view theory that calls for firms including banking entities to leverage on their resources for gaining of competitive advantage and thus improving on their financial performance. It is further concludes that bank size, capital adequacy and NPLs all significantly predict the ability of banking entities to perform in financial terms. Most government owned banking institutions have a relatively higher level of NPLs relative to their sizes. The level of capital adequacy is average among most of the studied firms.

5.4 Recommendations for Policy

It has been shown that corporate governance is an important factor influencing financial performance of any firm. Hence, for any firm that seeks to ensure that shareholder's wealth is maximized, corporate governance is a critical factor to focus on. Care should be exercised in formulation of the boards in place.

The role played by audit committees as corporate governance mechanisms in enhancing financial performance of any entity cannot be overlooked. It is therefore important that the audit committees are made to be as independent as possible so that they are able to dispense their role and responsibilities effectively as outlined in corporate governance statements and policies in most organizations.

Apart from corporate governance, this study recommends that there are other factors that commercial banks should focus on in enhancing their financial performance. First, efforts should be put in place to reduce the level of nonperforming loans among these lending institutions. Secondly, banks should actively seek to grow their sizes by opening up more branches and increasing the assets in place. Lastly, banking institutions should maintain sufficient capitals to safeguard and protect themselves against shocks and other unforeseen risks that are inherent and inevitable in any industry of operation.

5.5 Limitations of the Study

The study covered three controlling variables: bank size, capital adequacy and NPLs. The agency theory, the stewardship theory as well as the resource based view theory provided anchorage to these variables of the study. The stewardship and agency theories were used to anchor corporate governance while resource based view was used to provide underpinning on the control variables of the study.

Contextually, the study focused on commercial banks operating in Kenya. The specific reference of these institutions was mainly on commercial banks with government participation in Kenya. In total, 6 entities were covered as indicated in appendix I. This

would mean that other studies conducted using other banking entities would give non consistent results. s

Methodologically, the study used a descriptive design and information was gathered from secondary sources. The study gathered this information with the aid of data collection sheets. The study considered a time frame from 2011 all through to 2018 representing 8 years. A total of 32 data points were covered and used in the analysis of the findings in this study.

5.6 Areas for Further Research

The present study was conducted among 6 state owned commercial banks in Kenya. Future studies are therefore recommended among other institutions including foreign owned banks and the Savings and Credit Cooperatives and well as the Microfinance Institutions. Future studies should also be carried out on other aspects like competitive advantage and operational performance apart from financial performance. The study recommends future studies to be conducted with adoption of complex analytical methods including panel data methodologies.

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APPENDICES

APPENDIX I: COMMERCIAL BANKS WITH GOVERNMENT PARTICIPATION IN KENYA

1. Consolidated Bank of Kenya Ltd.
2. Development Bank of Kenya Ltd.
3. Housing Finance Ltd.
4. KCB Group
5. National Bank of Kenya Ltd.
6. Stanbic Bank Kenya Limited.

Source; CBK (2019)

APPENDIX II: DATA COLLECTION SHEET

Year	Net Income	Total assets	NPLs	Loan portfolio	Independent directors	Female directors	Audit committee members	Total number of directors	Total capital
2011									
2012									
2013									
2014									
2015									
2016									
2017									
2018									

APPENDIX II: RAW DATA

Bank	Year	ROA	Board Independe nce	Board Gender Diversity	Audit Commi tee	Bank Size	Capital Adequac y	Non- Performing Loans
National Bank of Kenya	31st- Dec- 2011	0.023	0.250	0.083	0.417	4.837	0.152	0.038
Stanbic Bank Kenya Limited	31st- Dec- 2011	0.013	0.273	0.364	0.455	5.146	0.067	0.013
KCB Group	31st- Dec- 2011	0.033	0.182	0.182	0.364	5.519	0.134	0.062
Housing Finance Ltd.	31st- Dec- 2011	0.020	0.250	0.000	0.375	4.503	0.148	0.105
National Bank of Kenya	31st- Dec- 2012	0.011	0.231	0.154	0.308	4.827	0.156	0.024
Stanbic Bank Kenya Limited	31st- Dec- 2012	0.023	0.273	0.364	0.455	5.125	0.130	0.008
KCB Group	31st- Dec- 2012	0.033	0.364	0.182	0.273	5.565	0.008	0.070

Housing Finance Ltd.	31st-Dec-2012	0.018	0.286	0.000	0.429	4.612	0.125	0.077
National Bank of Kenya	31st-Dec-2013	0.012	0.400	0.200	0.400	4.966	0.128	0.007
Stanbic Bank Kenya Limited	31st-Dec-2013	0.029	0.250	0.333	0.250	5.232	0.131	0.017
KCB Group	31st-Dec-2013	0.037	0.273	0.182	0.273	5.592	0.162	0.084
Housing Finance Ltd.	31st-Dec-2013	0.021	0.286	0.000	0.429	4.676	0.124	0.071
National Bank of Kenya	31st-Dec-2014	0.007	0.400	0.200	0.500	5.089	0.099	0.008
Stanbic Bank Kenya Limited	31st-Dec-2014	0.032	0.308	0.308	0.231	5.234	0.155	0.015
KCB Group	31st-Dec-2014	0.034	0.250	0.250	0.417	5.690	0.154	0.065

Housing Finance Ltd.	31st-Dec-2014	0.016	0.300	0.200	0.300	4.785	0.108	0.069
National Bank of Kenya	31st-Dec-2015	-0.009	0.300	0.200	0.400	5.098	0.087	0.051
Stanbic Bank Kenya Limited	31st-Dec-2015	0.024	0.333	0.250	0.417	5.298	0.142	0.012
KCB Group	31st-Dec-2015	0.035	0.333	0.250	0.333	5.747	0.146	0.036
Housing Finance Ltd.	31st-Dec-2015	0.017	0.286	0.143	0.000	4.855	0.852	0.000
National Bank of Kenya	31st-Dec-2016	0.001	0.364	0.182	0.364	5.059	0.097	0.001
Stanbic Bank Kenya Limited	31st-Dec-2016	0.022	0.364	0.273	0.364	5.312	0.148	0.014
KCB Group	31st-Dec-2016	0.033	0.273	0.273	0.364	5.775	0.162	0.012

Housing Finance Ltd.	31st- Dec- 2016	0.013	0.333	0.333	0.444	4.857	0.843	0.001
National Bank of Kenya	31st- Dec- 2017	0.003	0.273	0.182	0.545	5.041	0.066	0.528
Stanbic Bank Kenya Limited	31st- Dec- 2017	0.018	0.273	0.364	0.273	5.379	0.138	0.025
KCB Group	31st- Dec- 2017	0.030	0.333	0.222	0.333	5.811	0.164	0.091
Housing Finance Ltd.	31st- Dec- 2017	0.018	0.222	0.333	0.444	4.002	0.984	0.000
National Bank of Kenya	31st- Dec- 2018	0.001	0.182	0.182	0.545	5.060	0.061	0.658
Stanbic Bank Kenya Limited	31st- Dec- 2018	0.022	0.182	0.273	0.273	5.449	0.123	0.014
KCB Group	31st- Dec- 2018	0.034	0.250	0.250	0.250	5.854	0.159	0.028

Housing Finance Ltd.	31st- Dec- 2018	0.004	0.273	0.273	0.364	4.006	0.972	0.001
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Source; Annual Reports of Respective Commercial Banks