

**A COMPARATIVE STUDY ON CORPORATE GOVERNANCE
PRACTICES OF SHARIAH COMPLIANT BANKS AND
CONVENTIONAL BANKS IN KENYA**

SAYYIDA NISHAT JAWEED

**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF
THE REQUIREMENT OF MASTER IN BUSINESS ADMINISTRATION
AT THE UNIVERSITY OF NAIROBI**

NOVEMBER 2011

DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university for academic credit.

Signed _____ **Date** _____

Sayyida Nishat Jaweed

D61/75168/2009

This project report has been submitted for examination with my approval as the appointed supervisor: Herick Ondigo.

Signed _____ **Date** _____

DEDICATION

I dedicate this work to my loving family: parents Sikander Jaweed, Khairunissa Begum and my four siblings.

ACKNOWLEDGEMENTS

Foremost, I would like to express my sincere gratitude to my supervisor Mr Herick Ondigo for the continuous support of my MBA study and research, for his patience, motivation, enthusiasm, and immense knowledge. His guidance helped me the whole time of research and writing of this study and I could not have imagined having a better advisor and mentor for my MBA study.

I would like to thank the research proposal defense committee: Mr Herick Ondigo, Mr Ng'ang'a and Mr Odipo for their encouragement, insightful comments, and the hard questions. In particular, I am grateful to Mr. XN Iraki for the enlightening first experience of research. Thank you Sabra of the finance department at the Gulf African Bank, and her colleagues who agreed to provide and expedite the crucial information sought by this study.

My sincere thanks also goes to my fellow classmates in the MBA program 2009 to 2011: Edward Kinyanjui, Ruwaida Saanun, Hannah Njau, and Lawrence Kirui for the stimulating discussions, for the sleepless nights we were working together before deadlines, and for all the fun we have had in the last two years.

Last but not the least; I would like to thank my family: my loving parents, Sikander Jaweed and Khairunissa, for giving birth to me in the first place and supporting me spiritually throughout my life, and am grateful to my four ever-kind siblings.

God bless all of you.

ABSTRACT

This study made a comparison of the corporate governance practices between Shariah Complaint Banks (SCB) and conventional banks in Kenya. Islamic banking was introduced in Kenya in early 2008, and hence only two SCB exist. Islamic banking is facing some great challenges worldwide as the financial system favors conventional banking practices more. SCB deal in Islamic principles and practices as Shariah law prohibits interest dealing activities. Therefore, they engage in profit and loss element. To date, no study has attempted to investigate corporate governance practices in SCB in Kenya, as this is a relatively new type of financial institution worldwide.

Objectives of the study were to carry out a comparative study on the corporate governance structure in SCB and conventional banks and to highlight basic principles involved in SCB transactions. To accomplish this, primary and secondary data were collected from the population of 43 banks, 2 SCB, and 41 conventional banks. Questionnaires were sent to 43 banks in Nairobi to collect primary information; and a 75% respondency rate was achieved, as some did not manage to complete the questionnaires.

The questionnaires were then coded in the Statistical Package for Social Sciences (SPSS) computer software for analysis of the responses and later a narrative report was written. Quantitative data for the study for the study was extracted from the following annual financial reports: profit and loss accounts, balance sheets and cash flow statements, and a period of 4 years was considered (2008 to 2011). Chi-square and anova tests were used to analyse the data, and a number of findings were noted and recorded. The study concluded that corporate governance practices carried out by SCB versus conventional banks were not much different, as anticipated earlier and further research may have to be carried out in the future to state another opinion.

TABLE OF CONTENTS

DECLARATION	ii
DEDICATION.....	iii
ACKNOWLEDGEMENTS.....	iv
ABSTRACT.....	v
TABLE OF CONTENTS.....	vi
CHAPTER ONE	1
INTRODUCTION	1
1.1 Background of the Study	1
1.2 Research Problem	6
1.3 Objectives	8
1.4 Value of the study	9
1.4.1 The banks' management.....	9
1.4.2 The banks' regulators and the Shari'ah Supervisory Board.....	9
1.4.3 Academicians, researchers and practitioners	10
CHAPTER TWO	11
LITERATURE REVIEW	11
2.1 Introduction.....	11
2.2 Theoretical Literature Review	11
2.2.1 Theory of Financial Intermediation.....	13
2.2.2 Agency Theory.....	14
2.2.3 Savings/Lending: Irving Fisher Theory	15
2.2.4 Market Theory: Loanable Funds.....	16
2.2.5 Other Theories and CMA Guidelines	17
2.2.5.1 The Stakeholder Theory	17
2.2.5.2 Resource Dependency Theory.....	18
2.2.5.3 Capital Markets Authority guidelines on Corporate Governance	19
2.2.5.4 Corporate Governance, and Banking Models.....	20
2.2.5.4.1 The Western Concept of Corporate Governance.....	20
2.2.5.4.2 The Anglo-Saxon Model	20
2.2.5.4.3 The European Model	21

2.2.5.4.4	Islamic Corporate Governance Model.....	21
2.2.5.4.5	The Conventional Banking Model	22
2.2.5.4.6	The Shari’ah economy and Islamic banking	22
2.3	Empirical Literature Review.....	24
2.4	Conceptual Issues.....	28
2.4.1	Some Conceptual Shortcomings	29
2.4.1.1	Lack of Standardization.....	29
2.4.1.2	Accounting Practices	30
2.4.1.3	Competition from Conventional Banks.....	31
2.5	Islamic Banking in the Kenyan Context	31
2.6	Summary of Literature Review.....	33
CHAPTER THREE.....		35
RESEARCH METHODOLOGY.....		35
3.1	Introduction.....	35
3.2	Research Design.....	35
3.3	Population and sample	35
3.4	Data Collection	36
3.5	Data Analysis	36
3.6	Data Validity and Reliability	36
 CHAPTER FOUR.....		 37
DATA ANALYSIS, RESULTS AND DISCUSSION		37
4.1	Introduction.....	37
4.2	Descriptive Analysis	37
4.3	Quantitative Analysis.....	39
4.3.1	Return on Assets (ROA)	40
4.3.2	Return on Funds Employed (ROFE).....	41
4.3.3	Profit Expense Ratio (PER).....	42
4.4	Liquidity Ratios	44
4.4.1	Loan to Deposit Ratio (LDR).....	44
4.4.2	Loan to Asset Ratio (LAR)	45

4.4.3	Efficiency Ratio.....	46
4.5	Interest Yield.....	47
4.6	Liquidity.....	48
4.7	Discussion of Findings.....	49
CHAPTER FIVE		51
SUMMARY, CONCLUSION AND RECOMMENDATIONS.....		51
5.1	Introduction.....	51
5.2	Summary	51
5.3	Conclusion and Recommendations.....	52
5.4	Limitations of the Study.....	54
5.5	Suggestions for Further Research	54
References		56
Appendix 1: Questionnaire		66
Appendix 2: List of Shariah Compliant and Conventional Banks in Kenya		76
Appendix 3: Checklist of Corporate Governance Principles in Islamic Countries & the Western Countries		78
Appendix 4: Sample Frame Summary.....		86

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. In contemporary business corporations, the main external stakeholder groups are shareholders, debt holders, trade creditors, suppliers, customers and communities affected by the corporations activities. Internal stakeholders are the board of directors, executives, and other employees.

Recent financial scandals have raised the issue of whether profit oriented public companies are being run in the best interests of shareholders. The question that has been attracting the attention of scholars, public, investors, management and governments alike is whether the management of these firms may be wielding too much power and not enough supervision or accountability, particularly in companies with widely dispersed ownership(Banker and Datar, 1989).

The agency conflict that has been advocated all along arise from the separation of ownership and control, and may therefore not be effectively resolved through corporate governance systems. The board composition as an internal mechanism has been on focus as a tool of governance and success of an organization. Therefore the constitution of an effective board will be an important step towards the achievement of the organizational goal and more so the maximization of shareholder wealth.

Corporate governance systems are defined in a variety of contexts. (Farinha, 2003) reviews definitions of corporate governance dating back to (Berle and Means, 1932) through current researchers and conclude that although the definitions of governance differ, they share some common elements. All of them refer to conflicts of interest between insiders and outsiders over the generation of value by a firm that cannot be effectively resolved by contracting. A corporate governance system then is the system of monitoring devices, internal and external, specific to each organization, that defines how these mechanisms are set up and how each will fulfill its monitoring role. It is important to understand that the governance system is specific to each company, that different ownership structures may result in different structures, cultures, and outcomes based on their unique governance objectives.

The overriding goal is the protection of outsider stakeholder interests. Stakeholder interests are protected in a variety of ways, i.e., by ensuring compliance with laws, regulations, and technical standards, by ensuring equitable allocation of economic rents, by monitoring management decision-making to ensure that decisions will create long-term value for the entity, and/or by ensuring that information prepared and provided by management is relevant and objective (Dunn,2004).

The contemporary business environment, both internal and external, is turbulent. In such a dynamic environment, boards become very important for the smooth running and functioning of the organization. The board of a firm is expected to perform certain functions, which include but not limited to, monitoring of management (Shleifer and Vishny, 1997), hiring and firing of management (Hermalin and Weisbach, 1998), provision and access of resources (Hendry and Kiel, 2004), grooming the CEO (Vancil,1987) and providing strategic direction for the firm (Tricker,1984). Further, (Jiang, et al., 2008) pointed out that the function of the board will

include among others: reviewing and guiding corporate strategy; monitoring the effectiveness of the company's governance practices; selecting, compensating, monitoring and, when necessary, replacing key executives; aligning executive and board remuneration with the long-term interests of the company and its shareholders; ensuring a formal and transparent board nomination and election process; monitoring and managing potential conflicts of interest in the company; ensuring the integrity of corporate financial reporting systems; and overseeing the process of disclosure and communication.

Therefore, board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interests of the company and the shareholders. The board should also apply high ethical standards and take into account the interests of all stakeholders. With such a role, it becomes imperative that the composition of an effective board should be given all the attention that it deserves by the owners of a firm.

It is widely acclaimed that good corporate governance enhances a firm's performance (Brickley, et al., 1994) and (Lee, et al., 1992). However, despite the generally accepted notion that effective corporate governance enhances firm performance, other studies have reported negative relationship between corporate governance and firm performance (Hutchinson,2002) or have not found any relationship (Park and Shin,2003); (Young,2003). Several explanations have been given to account for these apparent inconsistencies. Some have argued that the problem lies in the use of either publicly available data or survey data as these sources are generally restricted in scope.

It has also been pointed out that the nature of performance measures (i.e. restrictive use of accounting based measures such as return on assets (ROA), return on equity (ROE), return on

capital employed (ROCE), or restrictive use of market based measures (such as market value of equities) could also contribute to this inconsistency (Gani and Jermias, 2006). Furthermore, it has been argued by different scholars that the “theoretical and empirical literature in corporate governance considers the relationship between corporate performance and ownership or structure of boards of directors mostly using only two of these variables at a time” (Krivogorsky, 2006).

Over the past three decades, Islamic banking has emerged as one of the fastest growing industries. It has spread to all corners of the globe and received wide acceptance by both Muslims and non-Muslims alike (Iqbal and Molyneux, 2005). Islamic law forbids earning interest on debt but allows investors to earn a return for taking on risk in their investments (Chiu, et al., 2005). SCB perform the same essential functions as banks do in the conventional system, except that the need for them to carry out their transactions in accordance with the rules and principles of Islam (Henry and Wilson, 2004). As one of the most important players in service industry today, SCB is no longer regarded as a business entity striving only to fulfill the religious obligations of the Muslim community, but more significantly, as a business that is in need for winning over customers whilst retaining the old ones (Peterson, et al., 1992). This necessitates Islamic banks to really understand the perceptions of their customers towards them in terms of service quality and other patronage factors to secure customers' allegiance.

Role of Islamic Banks: The role of Islamic banks becomes difficult compared to their conventional counterparts because of the basic principle that money is not supposed to earn interest. This eliminates a major role of the financial institution. So, what do they do? They invest in viable projects, with reliable borrowers. If the project succeeds, the banker shares in the profit, and if it fails, he suffers the losses. Islamic vision of socio-economic justice is based

on abolishing interest and all other exploitative elements from the economic sphere. SCB has the same purpose as conventional banking except that it claims to operate in accordance with the rules of Shari'ah, known as Fiqh al-Muamalat (Islamic rules on transactions). The basic principle of Islamic banking is the sharing of PLS and the prohibition of ribá (interest). Amongst the common Islamic operations used in SCB are profit sharing (Mudharabah), joint venture (Musharakah), cost plus (Murabahah) and leasing (Ijarah).

According to (Khan, et al., 2008), the Islamic financial system facilitates lending, borrowing and investment functions on a risk-sharing basis. This allows market forces to determine the productivity of capital rather than fixing it in priori as an “interest rate” to sabotage the free market mechanism and encourage speculative use and hoarding of capital. The Islamic financial system ensures the optimal rate of capital formulation and its efficient utilization leading to a sustainable economic growth and fair opportunities for all. It is a value-based system that primarily aims at ensuring moral and material wellbeing of the individual and society as a whole (Siddiqi, 2000).

The mainstream commercial banks' approaches to corporate governance are substantively altered in the Islamic case. According to (Choudury and Hoque, 2006), the rationality episteme is opposed and is replaced by the episteme of Unity of Divine Knowledge understood now in terms of its functional perspective working through the Shari'ah-determined instruments. This premise is used to develop guiding rules of participation and sharing in the cost, profit and risk of joint ventures. Participation across inter-systems and intra-system being the ultimate structure of the Mudarabah-Musharakah (profit and equity participation) and similar co-operative ventures, the shareholders become active participants in the decision-making process as stakeholders.

The Shari'ah Board and the constituent Shuras of groups of participants is to simulate the social well-being function for common wellbeing rather than to only maximize shareholders' wealth. In this way, much of the institutional transaction costs caused by lack of transparency, moral hazard and excludability are reduced in the presence of active and responsible participation at large (Choudury and Hoque,2006).

1.2 Research Problem

The interest in corporate governance has been fuelled by the recent international crisis, whose effects the world economy is still reeling from, and it was evident that the macro-economic difficulties could be exacerbated by a systematic failure of corporate governance. These institutional failures are a manifestation of a number of structural reasons why corporate governance has become more important for economic development and more importantly for policy issues.

(John and Senbet, 1998) argue that boards are more independent as the proportion of their outside directors increases. A number of studies from an agency theory perspective on outside directors support the beneficial monitoring and advisory function to firm shareholders. There is a significant body of theoretical and empirical literature in corporate finance that considers the inter-relationships among corporate governance, management turnover, corporate performance, corporate capital structure, and corporate ownership structure. Many of these studies find that certain governance structures are associated with better performance and higher firm value. However, it is sometimes hard to interpret the results in these studies since governance structure is a variable chosen by firms, in part because of their monitoring needs.

Previous local studies, mostly the unpublished MBA projects which investigated the link of corporate governance and various variables of a firm such as capital structure, liquidity, performance and dividend policy have been undertaken. (Jebet, 2001) set out to determine the existing corporate governance structures in publicly quoted companies in Kenya. Other studies include (Mwangi, 2003) investigated the determinants of corporate governance practices. Also (Mululu, 2005), who undertook a research on the relationship between the board activity and firm performance. There is (Muriithi, 2004), who in a study of 44 firms listed at the NSE between 1999 and 2003, used a number of governance variables which included, block ownership, family ownership, foreign ownership, board size and board composition. He concluded in the study that 'No measure of firm's performance has a significant relationship with the percentage of non-executive board members'.

Conventional banking services do not meet the needs of the minority Muslim population in Kenya. The reason for this is that conventional financial institutions charge interest on their loans/services provided to the small and medium sized enterprises. A vast majority refrain from availing conventional bank loans and services due to the element of interest that is considered repugnant to Shariah. SCB by its economic principles can develop an available human capital base by satisfying the financial needs of the Muslim community and positively contribute towards the economic growth in the country.

There is currently a lot of expectation from both Muslims and non-Muslims for this alternative form of banking that will bring in a new form of partnership and interest free banking. The public has suffered for too long from high interest rates and volatile fluctuation of interest rates by conventional banks. The success of the Islamic system can be gauged by the rush among the

conventional banks to open their own 'Islamic windows' not just in countries dominated by Muslims but also in the rest of the world.

Many other researchers have examined the relationship between a variety of governance mechanisms and firm performance. However, the results are mixed as some examine only the effect of one governance mechanism on performance, while others examine the influence of several mechanisms together on performance. A yawning gap exists since none of them covers the effects of corporate governance practices in SCB in Kenya, and this is a relatively new type of financial institution in Kenya. It is against this background that it was found necessary to carry out a study on corporate governance in the SCB versus the conventional banks in the Kenyan banking sector to bridge the gap that exists. In summary therefore, this study attempts to answer the following questions:

How does corporate governance practice and implementation for SCB differ from that of conventional banks;

Do corporate governance practices and implementation in SCB return more profits compared to conventional banking institution; and

If SCB do not invest in interest-based activities, how do they generate profits to pay their customers?

1.3 Objectives

In summary, the aim of this study is therefore:

To carry out a comparative study on the corporate governance structure in the SCB and the local conventional banks;

To highlight basic principles involved in SCB transactions as mentioned earlier; and

To investigate the realities associated with this method of banking which is growing at a much faster pace than its counterpart is, and is making its conventional competitors stand up and take a look.

1.4 Value of the study

The aim of the study will be to undertake a comparative study of the corporate governance practices between the SCB and conventional ones in Kenya. As a result, the management of the banks, the banks regulators, the Shari'ah Supervisory Board, the bank's customers and the academicians will be enriched in knowledge as follows:

1.4.1 The banks' management

Management will be guided on the key value adding aspects of governance and corporate governance practices and as a result appreciate the importance of the corporate governance practice in the operations of the firm. Such deeper understanding will enable these banks gain the benefits of a strategic board by accumulating intellectual capital.

1.4.2 The banks' regulators and the Shari'ah Supervisory Board

The findings of this study will be used by the policy makers especially the Ministry of Finance in formulation of regulation to guide the Central Bank of Kenya in drafting a regulatory framework for guiding SCB in enhancing performance. This will also help in providing an in-depth understanding of these banks regulatory requirement and provide an avenue of mutual regulatory framework for the banks regulators and Shari'ah Supervisory Board of SCB.

1.4.3 Academicians, researchers and practitioners

The results of the study will serve as a point of departure for further investigation into the corporate governance practices in banks and the material will form a source of reference in future by other scholars in the area of corporate governance.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The basic idea of corporate governance is explained as per different writers. Then follows the explanation of conventional banking model versus the principle of the Shari'ah economy and Islamic banking. Theoretical review is next elaborated with the various theories explained : agency, stakeholder, and resource dependency. Capital Markets Authority and guidelines on corporate governance follows. International and local empirical studies, their brief findings and a conclusion closes this chapter.

2.2 Theoretical Literature Review

Corporate governance has to do with those legal and organizational structures that look after the internal integrity of a corporation. According to (Choudury and Hoque,2006), a corporation is an organization and hence an institution. It is thereby a bundle of contracts and rules under which it functions, is legitimated by legal enactment and protected by the legal tenets of any government and state. The implications of such legal obligations and protection may be limited nationally or extended internationally under agreed upon globalization rules.

An organization is a group of individuals seeking to achieve some common goals, or, in a different language, to maximize an objective function. Each member has objectives of his own, in general not coincident with those of the organization. Each member also has some range of decisions to make within limits set partly by the external environment to the organization and partly by the decision of members. Finally, some but not all observations about the workings of

the organization and about the external world are communicated from one member to another (Peasnell et al., 2003).

(Dunn, 2004), observes that corporate governance system is the system of monitoring devices, internal and external, specific to each organization, that defines how these mechanisms are set up and how each will fulfill its monitoring role. (Niskanen, 2003) further notes that the corporate governance system is specific to each company, that different ownership structures may result in different structures, cultures, and outcomes based on their unique governance objectives. The overriding goal is the protection of outsider stakeholder interests. Stakeholder interests are protected in a variety of ways, i.e., by ensuring compliance with laws, regulations, and technical standards, by ensuring equitable allocation of economic rents, by monitoring management decision-making to ensure that decisions will create long-term value for the entity, and/or by ensuring that information prepared and provided by management is relevant and objective (of high quality).

Corporate governance practice covers all institutions across the board; government, private enterprises, profit and not-for-profit, secular and religious organizations. (Zingales, 1994) define corporate governance system as a “complex set of constraints that shape the ex-post bargaining over the quasi rent registered by the firm”.(Maati,1999) defines corporate governance as a whole set of measures taken within the social entity that is an enterprise to favour the economic agents to take part in the production process, in order to generate some organizational surplus, and to set up a fair distribution between partners, taking into consideration what they have brought to the organization. Corporate governance mechanism can be thought of as a process of establishing the nature of ownership and control of an organization within an economy.

2.2.1 Theory of Financial Intermediation

As per the modern theory of financial intermediation, financial intermediaries are active because market imperfections prevent savers and investors from trading directly with each other in an optimal way. The most important market imperfections are the informational asymmetries between savers and investors. Financial intermediaries - banks specifically, fill - as agents and as delegated monitors - information gaps between ultimate savers and investors. This is because they have a comparative informational advantage over the ultimate savers and investors. They screen and monitor investors on behalf of savers and this is their basic function, which justifies the transaction costs they charge to parties.

They also bridge the maturity mismatch between savers, and investors and facilitate payments between economic parties by providing a payment, settlement and clearing system. Consequently, they engage in qualitative asset transformation activities. To ensure the sustainability of financial intermediation, safety and soundness regulation has to be put in place. Regulation also provides the basis for the intermediaries to enact in the production of their monetary services. For example, (Diamond and Dybvig,1983) consider banks as coalitions of depositors that provide households with insurance against idiosyncratic shocks that adversely affect their liquidity position. Another approach is based on (Leland and Pyle, 1977). They interpret financial intermediaries as information sharing coalitions. (Diamond, 1984) shows that these intermediary coalitions can achieve economies of scale. (Diamond, 1984) is also of the view that financial intermediaries act as delegated monitors on behalf of ultimate savers.

2.2.2 Agency Theory

It is an acknowledged fact that the principal-agent theory is generally considered the starting point for any debate on the issue of corporate governance. According to this thesis, the fundamental agency problem in modern firms is primarily due to the separation between finance and management. Modern firms are seen to suffer from separation of ownership and control and therefore are run by professional managers (agents) who cannot be held accountable by dispersed shareholders.

In this regard, the fundamental question is how to ensure that managers follow the interests of shareholders in order to reduce cost associated with principal-agent theory? The principals are confronted with two main problems. Apart from facing an adverse selection problem in that they are faced with selecting the most capable managers, they are also confronted with a moral hazard problem: they must give agents (managers) the right incentives to make decisions aligned with shareholder interests (Jensen and Meckling, 1976).

According to (Jensen, 2001), agency costs include monitoring expenditures by the principal such as auditing, budgeting, control and compensation systems, bonding expenditures by the agent and residual loss due to divergence of interests between the principal and the agent. The share price that shareholders (principal) pay reflects such agency costs. To increase firm value, one must therefore reduce agency costs. In order to address opportunistic behavior from managers within the agency theory, there is a need to align the composition of board of directors. The board of directors is expected to be made up of more non-executive directors (NEDs) for effective control. It is argued that this reduces conflict of interest and ensures a board's independence in monitoring and passing fair and unbiased judgment on management.

The very clear implication of the agency theory on board composition is that adequate monitoring is needed to protect shareholders from agency costs (Fama and Jensen, 1983). Agency costs as applied leads to normative recommendation that boards should have a majority of outside and ideally, independent directors and that there is no duality in the leadership structure (OECD, 1999).

2.2.3 Savings/Lending: Irving Fisher Theory

According to (Fisher, 1930) the rate of interest is governed by the balance between the supply of capital, as determined by the psychology of savers, and the demand for capital, as determined by the possibilities of and the outlook for investment. At the outset, Fisher made the distinction between nominal interest and real interest. The major part of the book (chapters 4-18) is devoted to the theory of the determination of the real rate of interest. The theory of the real rate of interest is a synthesis of psychological theories, such as the theory of abstinence, and physical theories, such as the theory of productivity. The objectivity with which he accomplished this synthesis enabled him to give due weight to the significance of each of the different aspects.

Throughout his analysis, Fisher quite correctly distinguished two problems, namely, how the interest rate is determined and why it is always positive. He contended correctly, and in contrast to the approach taken by many earlier writers, that the determination problem should be the one studied first. He stressed, again quite correctly that from a psychological or technical viewpoint there is nothing in the nature of men or things that should lead one to expect that the rate of interest, expressed in terms of whatever good is chosen as unit, will be positive rather than negative.

2.2.4 Market Theory: Loanable Funds

The theory was first put forward by (Wicksell, 1898) and later on it was elaborated further by (Ohlin, 1936),(Robertson, 1926), (Pigou, 1927) and (Myrdal, 1939). According to the neoclassical economists:"The rate of interest is determined by the interaction of the forces of demand for loanable funds and the supply of it in the credit market".

The demand for loanable funds comes from households who need money for consumption purposes and from entrepreneurs who require it for productive purposes. The total money borrowed by consumers for consumption purposes forms only a small part of the total loanable funds, while a major portion of the funds is borrowed by businesspersons of all types. When an entrepreneur borrows money, he keeps in mind two things:

(a) The expected net return on newly invested funds, and (b) the interest, which has to be paid back to the lender.

So long as the marginal efficiency of capital is above the interest rate, the entrepreneur continues borrowing additional funds. When he finds that due to the operation of law of diminishing returns, the marginal efficiency of capital has fallen to the level of rate of interest, the entrepreneur stops borrowing additional funds. Because if he invests more, the interest rate will be higher than the marginal efficiency of capital and his profit will be adversely affected. The last unit which an entrepreneur has thought worthwhile to employ because the net revenue earned from it equals the prevailing rate of interest, is railed marginal unit and its productivity as marginal efficiency of capital. As all the units of capital employed are very similar and interchangeable to one another in a competitive market, so the rate of interest which- is paid to the marginal unit will also be paid to all other units. Thus, we conclude that on the side of demand, the rate of interest tends to be equal to the, marginal efficiency of capital.

The supply of loanable funds comes from savings by individuals, business concerns, discharging of idle cash balances, bank credit. Disinvestment is another source of the supply of loanable funds. All the sources of the supply of loanable funds are directly related to the rate of interest. The higher the rate of interest, the larger is the supply of the loanable funds and vice versa. There is no doubt that higher rate of interest usually induces people to save more but that is not always the case. There are people who will save even if the rate of interest is zero. But as their number is not very large, so the savings of these people will not meet the demand for loanable funds. Thus, rate of interest must be high to equate the supply of loanable funds with the demand for it.

2.2.5 Other Theories and CMA Guidelines

2.2.5.1 The Stakeholder Theory

One argument against the strict agency theory is its narrowness, by identifying shareholders as the only interest group of a corporate entity necessitating further exploration. By expanding the spectrum of interested parties, the stakeholder theory stipulates that, a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction (Abrams, 1951).

The stakeholder theory is therefore better in explaining the role of corporate governance than the agency theory by highlighting the various constituents of a firm. Thus creditors, customers, employees, banks, governments, and society are regarded as relevant stakeholders. Related to the above discussion (John and Senbet, 1998), provide a comprehensive review of the stakeholders' theory of corporate governance which points out the presence of many parties with competing interests in the operations of the firm.

Stakeholder theory has become more prominent because many researchers have recognized that the activities of a corporate entity impact on the external environment require accountability of the organization to a wider audience than simply its shareholders. For instance, (McDonald and Puxty, 1979) proposed that companies are no longer the instrument of shareholders alone but exist within society and, therefore, have responsibilities to that society. One must however point out that a large recognition of this fact has been a rather recent phenomenon. Indeed, it has been realized that economic value is created by people who voluntarily come together and cooperate to improve everyone's position(Freeman et al.,2004).

On his part (Jensen, 2001) critiqued the stakeholder theory for assuming a single-valued objective (gains that accrue to a firm's constituencies). The argument of (Jensen, 2001) suggests that the performance of a firm is not and should not be measured only by gains to its stakeholders but other key issues such as flow of information from senior management to lower ranks, inter-personal relations, working environment, etc are all critical issues that should be considered. Some of these other issues provided a platform for other arguments as discussed later. An extension of the theory called an *enlightened stakeholder theory* was proposed. However, problems relating to empirical testing of the extension have limited its relevance (Sanda et al., 2005).

2.2.5.2 Resource Dependency Theory

Stewardship model, 'managers are good stewards of corporations and diligently work to attain high levels of corporate profit and shareholder returns (Donaldson and Davis, 1994). (Tricker, 1984), points out that 'underpinning company law is the requirement that directors show a fiduciary duty towards the shareholders of the company' inherent in the role of directors having a fiduciary duty is that they can be trusted and will act as stewards over the resources of the

company. Proponents of this theory contend that superior corporate performance will be linked to the majority of inside directors as they work to maximize profit for shareholders. The reason advanced so far for this, is that inside directors understand the business they govern better than outside directors and therefore make superior decisions (Donaldson and Davis,1991).

(Donaldson and Davis, 1994), explain that managers are principally motivated by the achievement and responsibility need and therefore, given the needs of managers for responsible, self-directed work; organizations may be better served to free managers from subservience to non-executive director dominated boards. (Hawley and Williams, 2000), state that the “logical extension is either towards an executive dominated board or towards no board at all”. They contend that the non-executive board of directors is, by its design, an ineffective control device. They went further to support the view that “the whole rationale of having a board becomes suspect. Boards can therefore become redundant when there is a dominant active shareholder, especially when the major shareholder is a family or government”. In another study (Pfeffer, 1972) shows that the value of external directors is not so much how they influence managers but how they influence constituencies of the firm. He found out that the more regulated an industry, the more outsiders were present on the board to reassure the regulators, bankers, and other interested groups.

2.2.5.3 Capital Markets Authority guidelines on Corporate Governance

The Capital Markets Act (Cap 485A) guidelines on corporate governance practices by public companies in Kenya, defines corporate governance as a process and structure used to direct and manage business affairs of the company towards enhancing prosperity corporate accounting, with the ultimate objective of realizing shareholders’ long term value while taking into account the interest of the other stakeholders. The CMA guidelines on corporate governance cover such

areas as shareholders rights, equitable treatment of shareholders; role of stakeholders; disclosure; transparency; and board responsibilities. The CMA code of best practices is prescriptive on board characteristics for companies listed at the NSE.

2.2.5.4 Corporate Governance, and Banking Models

2.2.5.4.1 The Western Concept of Corporate Governance

(Becht and Barca, 2001) and (Lewis, 2005) provide literature review of a number of corporate governance models as possible solutions to solving the collective action problem among dispersed shareholders. The study however focuses only on two dominant corporate governance systems namely the Anglo-Saxon or “neo liberal” approach and the European models. Corporate governance issues arise in the corporation in two situations namely whenever there is an agency problem or conflict of interest involving members of the organization such as board of directors, managers and shareholders and cost of business are such that agency problem cannot be dealt with through a normal contract (Hart, 1995). Each system has its own features, represents different corporate structures and diverse aims of corporation.

2.2.5.4.2 The Anglo-Saxon Model

The Anglo-Saxon model of corporate governance which is also known as market based systems or shareholder-value system or principle-agent model is considered as the most dominant theory championed by the United States and the United Kingdom. Market-based system of the United Kingdom and the United States are characterized by arm’s length relationship between corporations and investors who are said to be concerned primarily about short-term returns (Frank and Mayer 2004).

2.2.5.4.3 The European Model

Since the publication of (Berle and Means, 1932), many have believed that there are significant problem with the Anglo-Saxon model. Another approach of corporate governance was introduced known as the Stakeholders or the European model. In this system, companies raise most of their external finance from banks that have close, long-term relationships with their corporate customers. The model is focused on a relationship-based model that emphasizes the maximization of the interests of a broader group of shareholders (Adams,2003). The model is practiced by majority of the European countries such as German, France, and Greece where many large firms are part of social and economic structure.

2.2.5.4.4 Islamic Corporate Governance Model

The main objective of the corporation including the Islamic corporation is to maximize the shareholder's value of wealth. This implies that in actual practice, many Islamic corporations adopt the Anglo-Saxon model of corporate governance (Lim 2007). The proponents of the Anglo-Saxon continuously attempt to define their model and the opponents strongly criticize them especially in the aspect of principle-agent relationship or the agency problems. In the context of Islamic corporate governance, there are a few studies have been carried out particularly IFIs to come up with alternative models of corporate governance.

The studies seem to suggest that Islamic corporation may adopt a totally different model of corporate governance or a modified version of the Stakeholder-oriented model as an alternative for its corporate governance framework. The former refers to the corporate governance model based on the principle of consultation where all stakeholders share the same goal of *Tawhid* or the oneness of Allah (Choudury and Hoque,2004) and the latter concerns on adopting the

stakeholders' value system with some modifications (Iqbal and Mirakhor, 2004) and (Chapra and Ahmed,2002).

2.2.5.4.5 The Conventional Banking Model

(Hassan,2007) defined banks as commercial entities that engage in any or all of the various functions of banking (i.e. receiving, collecting, transferring, paying, lending, investing, servicing money and claims to money both domestically and internationally). It also refers to institutions providing deposit facilities for the general public. Loans based on deposit funds provide financial support to a wide variety of business and industrial enterprises. Commercial banks accept deposits and use the proceeds to lend funds to consumers and businesses. The deposit represents a liability to the commercial bank and a financial asset owned by the depositor. The commercial bank has made a direct investment in the borrowing entity; the depositor effectively has made an investment in that borrowing entity. Interest income, interest and fee income are generated from the mortgage lending and credit card financing.

Through the process of financial intermediation between savers and investors, they exert immense employment and income generation effects, which ultimately help in economic advancement and social welfare. Indeed, a wise banking policy may go a long way toward mitigating the shocks of an economic crisis, while a banking system, if badly constructed or handled, is capable of inflicting great harm on trade and industry and may even upset the whole economy (Fabozzi and Petterson, 2003).

2.2.5.4.6 The Shari'ah economy and Islamic banking

The conceptual developments of SCB took cognizance in late 1940s and in the next two decades, they got to a point of yielding a model, which was adopted in the Middle Eastern

countries to fulfil their aspiration of having their own banks. Many reputable Islamic banks came into being in 1970s that included Nasser Social Bank Cairo (1972), Islamic Development Bank (IDB) (1975), Dubai Islamic Bank (1975), Kuwait Finance House (KFH) (1977), Faisal Islamic Bank of Sudan (1977) and Dar Al-Maal Al-Islami (1980). In early 1980s, the nascent industry took the world by surprise when three Muslim countries, namely, Iran, Pakistan and Sudan decided to transform their economies and financial sector on Islamic lines.

The Western financial market players such as Citibank, ABN AMRO, HSBC and others established their own Islamic windows or subsidiaries to attract petrodollars' deposits from the Middle East and Muslims clientele in local markets. The Islamic banking and finance system continued to grow by seeking innovation and diversity of products, clientele and markets. It has been growing in areas such as Sukuk, Takaful, hedging funds, mutual funds, private equity, assets management, wealth management, real estate, corporate finance, liquidity management, treasury, derivatives, swaps, future and forward market, Islamic Stock Exchange and Dow Jones Islamic Index.

According to (Khan and Bhatti, 2008), Islamic banking and finance activities are mainly clustered around three parts of the world that include the Middle East, South Asia and Southeast Asia. The Middle East, overwhelmingly populated by Muslims, is a motherland of SCB and finance. SCB enjoy strong support from rich individuals, governments and other state institutions in the Middle East. The majority of regulatory, other supporting bodies of the SCB and finance industry are located in the Middle East.

At end of the year 2007, there were about 300 Islamic banking and financial institutions across 75 countries, holding a paid-up capital of over US\$13 billion, controlling assets worth US\$300-

US\$500 and investments US\$500 billion-US\$800 billion, with an average annual growth of 15 per cent. It has been estimated that Islamic banking and finance industry will reach to US\$4 trillion by 2010. It will hold 40 per cent to 50 per cent of total savings of the Muslim population (estimated as large as 1.5 billion) worldwide within next eight to ten years (Cader, 2007). The World Islamic Bank – Eamar International Bank – with a paid-up capital of US\$100 billion was launched in 2008 to augment the growth in the sector (Kamil and Kamil, 2007).

The paying and receiving of interest in SCB is substituted by PLS contracts, which is also a form of a method of resource allocation. Major Islamic financing contracts by the PLS finance are trustee finance (Mudaraba), equity participation (Musharaka) and mark-up (Murabahah) transactions. Interest-based financial transactions are forbidden and all finance is to be conducted on a profit sharing basis. The business partnership technique of Murabahah was employed by prophet Muhammad (peace be upon him) when he was an agent (Mudarib) for his wife Khadija and his second successor Umar Ibin Al-Khattab invested the money of orphans with merchants engaged in trade between Medina and Iraq (Hassan and Lewis, 2007).

The economic critique of the institution of interest offered by Muslim scholars like Maududi was based on their challenges to the rationality of interest as a fixed rate of return on financial capital and the prohibition of interest by the Holy Quran.

2.3 Empirical Literature Review

Empirical studies in SCB are relatively scarce and focus on specific issues. Internationally, (Chapra et al., 2002), undertook a survey of corporate governance in Islamic financial institutions, with the objective of identifying the environment within which the SCB operate

and the overall state of corporate governance at three levels: regulatory, Islamic banking and depositors. Some regulators hailed from Azerbaijan, Sudan, and Algeria. The banks who responded to the questions were Bahrain, UAE, and Badr Forte Bank (Russia) and some depositors were Higher Institute of Banking and Finance and Finance in Sudan.

The findings for corporate governance were: while at one extreme, one had 27 board members, the other extreme consisted of 4 members and the average size of the board was 12 members. Two executive members from management were on the board. In addition, they discovered that corporate governance could be improved if different committees that supervise various aspects of governance are established. 10 banks had executive committees that were responsible for overall management of the institution, and 9 had audit committees. The largest 5 shareholders hold on average more than half of the total shares (51.7%), maximum percentage for largest shareholders was 91.7% while the corresponding figure for minimum shareholding was 14.75%.

Overall, they concluded that SCB operated in an unfriendly environment and some of their difficulties were perhaps because of this fact. Since these banks have not been able to make significant headway towards the PLS mode of financing, the regulators did not see any significant difference in the risks involved in SCB and conventional banks. This became reflected in the regulatory and supervisory environment. Consequently, there was considerable room to enable SCB to meet successfully the challenges that lay ahead. The results also indicated there was room for improvement in the composition of the board of directors, as well as in management and legal procedures.

(Bebchuk et al., 2004), have shown that well governed firms have higher corporate performance. The main characteristic of corporate governance identified in these studies include board size, board composition, and whether the CEO is the board chairman. There is a view that larger boards are better for corporate performance because they have a range of expertise to help make better decisions, and are harder for a powerful CEO to dominate.(Sanda et al., 2003), in a Nigerian study, found that firm performance is positively related with small, as opposed to large boards.

Related prior research in Kenya has focused mainly on compliance with or the state of the principles of corporate governance best practices. (Mululu, 2005) indicates findings that corporate governance structures are subject to more influence from the CEO and are correlated with higher levels of CEO compensation. Moreover, the boards' activity is positively related to the financial performance of firms suggesting that boards' activity is a value relevant to attribute in corporate governance. These findings are consistent with the presence of agency costs associated with weak governance, where the CEO exerts his bargaining power to extract rents at the expense of shareholders. There is (Muriithi, 2004), who performed both descriptive statistics analysis and cross sectional multiple regression analysis on 44 companies quoted on the Nairobi Stock Exchange in the period between 1999 and 2003. He used a number of governance variables, which included, block ownership, family ownership, foreign ownership, board size and board composition and concluded in the study that 'no measure of firm's performance has a significant relationship with the percentage of non-executive board members'.

(Chapra et al., 2002) concluded that SCB operated in an unfriendly environment and some of their difficulties were perhaps because of this fact. Consequently, there was considerable room

to enable SCB to meet successfully the challenges that lay ahead. The results also indicated there was room for improvement in the composition of the board of directors, as well as in management and legal procedures. (Bebchuk et al., 2004), have shown that well governed firms have higher corporate performance and (Sanda et al., 2003), found that firm performance is positively related with small, as opposed to large boards.

Locally, (Mululu, 2005) indicated findings that boards' positive activity is a value relevant to add quality to corporate governance. For (Muriithi 2004), though the importance of independent directors should not be put to question, the outcome of the studies was in conflict with the conventional wisdom that suggested a board's principle task is to monitor management and only independent directors can be effective monitors.

In summary, international studies have had positive findings, while the local ones indicate positive and negative findings. However, there is a lack of information currently about how Islamic institution corporate governance functions because there are no studies about SCB and corporate governance locally. Therefore, there is a knowledge and familiarity gap in the industry whereby the unique features of Islamic financial principles and its products are not well understood and appreciated. Such a gap is dangerous, as we have SCB already in place and the general public/investors should know of it, to promote economic well-being for our nation, because the core of their operations are oriented towards productive investment. Therefore, this comparative study of corporate governance in SCB versus conventional banks aims to reduce these gaps.

2.4 Conceptual Issues

The term “Islamic banking” refers to a system of banking or banking activity that is consistent with Islamic law (Shariah) principles and guided by Islamic economics. In particular, Islamic law prohibits usury, the collection and payment of interest, also commonly called ribá. In addition, Islamic law prohibits investing in businesses that are considered haraam(unlawful), (such as businesses that sell alcohol or pork, or those that produce media such as gossip columns or pornography, which are contrary to Islamic values).

In the late 20th century, a number of Islamic banks were created to cater to this particular banking market. Islamic banks’ general objective is to develop the economy within and according to Islamic principles. The banks can therefore under no circumstances engage in the payment and receipt of interest, in alcoholic beverage trade, in the gambling industry or in the pork meat trade, or any other activities explicitly prohibited by the Shariah (Al-Omar et.al., 1996).

Islamic banks operate based on profit and not on paying and receiving interest. The banks can earn profit from three areas: trading, leasing and by direct financing in profit-loss-sharing contracts. Different instruments are devised to earn profit in any of these ways. The structure and conditions of these transactions must conform to the Shariah and fulfill its devised objectives. This means that Islamic banks can extend loans only if interest or return is not earned on it. The only way to finance consumption activities, if at all, is through cost plus the capital, since there is no profit to be earned or shared. The banks advance money for commercially productive activities based on profit-sharing principles.

There are four principles of special importance for Islamic banking (Al-Omar et.al., 1996). Firstly, there must be some risk, whether funds are used in commercial or productive venture; and all funds should preferably finance socially productive activity. Secondly, financial risk must lie solely with the lender of the capital and not with the manager or agent who works with the capital; and lastly interest is forbidden - it is a predetermined, fixed sum owed to the lender irrespective of the outcome of the business venture in which the fund is used.

The Islamic banking system aims at developing new financial instruments to deal with the problems of the Muslim communities. This can be done by mobilizing internal resources into a banking system conforming to Islamic teaching and principles. The main objective is to make the financial system an efficient medium for intermediation between savings and investments. (Zineldin, 1990). The relationship between the bank and its clients is not the same for Islamic banks as for conventional banks. In the former, it is one of direct trading or equity participation while in the latter it is that of lender/borrower. Islamic banks do not trade in debts as conventional banks do.

2.4.1 Some Conceptual Shortcomings

2.4.1.1 Lack of Standardization

Interpretations of Islamic Shariah principles are left to Muslim scholars, for example, there is no agreement among different schools of thought on whether *ribá* and *interest* are synonymous terms. The fact that Muslim scholars disagree on such a basic issue highlights the lack of standardization of opinion in the field (El-Gamal, 1997). As a result, each Islamic bank appoints an Islamic Shariah Committee whose responsibility is to assess whether its bank transaction and activities are in accordance with the Islamic Shariah.(Shepherd,1996) argues

that lack of standardization between these committees' results in diverse interpretations and evaluations.

In the opinion of (Iqbal and Mirakhor, 1999), lack of standardization is not only time-consuming and costly, but it also leads to confusion about what Islamic banking really encompasses and, therefore, hinders its wide spread acceptance. In this context, (Ainley,1997) highlighted that the biggest problem of the Islamic banking system is that people are not clear about what Islamic banking constitutes. In Ainley's view, the confusion about Islamic banking is caused by the Islamic Shariah Committees' various interpretations of what is and is not Islamic banking. This lack of standardization and clarity also makes it difficult for Western regulators to understand the idea of Islamic banking.

On the other hand, (Al-Omar and Abdel-Haq,1996) argue that the idea of Islamic banking is still relatively young, and new circumstances and issues are likely to occur that will result in further clarification. This should not be used as an excuse for the lack of standardization but it does help in understanding why standardization on particular issues does not exist. As Islamic banking further evolves, it is expected to experience an increase in the standardization of its concepts and practices.

2.4.1.2 Accounting Practices

The accounting policies adopted by Islamic banks present another technical problem. (Abdel-Magid, 1981) indicated that International Accounting Standards (IASs) were set to reflect national differences and, therefore, were inapplicable to a large number of countries. Islamic banks are based on a different set of objectives, beliefs, and assumptions from conventional

institutions. These assumptions lead to different types of transactions such as Zakat funds, Profit and Loss sharing accounts, and so forth, all of which must be accounted for in the books.

2.4.1.3 Competition from Conventional Banks

(Shepherd, 1996) notes that as further developments and innovations occur in Islamic banking, large amounts will be moved from conventional banks to Islamic institutions. Hence, many of the key players in conventional western banking markets, such as Citibank, ANZ, and HSBC, have begun to move into the field, providing Islamic banking through Islamic windows (Cunningham, 1994). This means that many players have come into the market, and the provision of Islamic banking is no longer restricted only to Islamic institutions. In this case, it can be argued that the competition in the Islamic banking field has been greatly increased. In this respect, (Nienhaus, 1986) believes that it will be difficult for relatively new banking institutions to compete with the well-established conventional banks. As more players enter the field, the bigger challenge will be for the Islamic banks to survive.

2.5 Islamic Banking in the Kenyan Context

Although still new, Islamic banking appears to have caught root in Kenya and at least two fully-fledged banks (First Community Bank and Gulf African Bank) have been licensed to operate. Many other mainstream banks are opening Islamic banking windows. Banks offering Islamic banking have however had to contend with many legal hurdles, particularly because the doctrines of Islamic finance and banking laws in Kenya are at a variance. Islamic finance is a system of banking consistent with Islamic law, also called Sharia. The basic principle behind the banking is ethical capitalism and the operations of Islamic financial institutions are primarily based on a profit and loss sharing principle, as opposed to the interest charged by

conventional banks. An Islamic bank does not charge interest, but rather participates in the yield resulting from the use of these funds.

The all-important question is whether Shariah law is recognised in Kenya and whether Islamic banking products are in conformity with Kenyan banking laws. Although the Constitution provides that “the jurisdiction of a Kadhi’s court shall extend to the determination of questions of Muslim law relating to personal status, marriage, divorce or inheritance in proceedings in which all the parties profess the Muslim religion”, it is noteworthy that jurisdiction does not extend to contractual relations in the context of a banking relationship. Kenyan law does not, therefore, recognise Islamic financing law as forming part of the body of Kenyan law. In order for Islamic banking transactions to be enforceable in Kenya the transactions must conform to applicable laws in Kenya. The Banking Act and the Central Bank of Kenya Act regulate the country’s banking industry and Section 12 of the Banking Act prohibits banks from engaging in wholesale or retail trade or purchasing or holding any land or any interest or right in land and restricts a bank’s investment in other institutions. This prohibition greatly cripples operations of an Islamic bank.

In order to conduct such Islamic banking in Kenya therefore, a bank would need to obtain from the Central Bank exemptions from the provisions of the Banking Act prohibiting banks from engaging in trade or acquiring or holding land. It is understood that some banks have already obtained such exemptions from the Central Bank. There are many other complexities pertaining to Islamic banking, for instance, Islamic products such as Murabahah in which the bank acquires the asset and then resells it to the customer exposes the transaction to double taxation such as double payment of stamp duty and Ijara (leasing) transactions would also be subject to

VAT. It is therefore important to consider the tax and accounting treatment payments under such products.

2.6 Summary of Literature Review

In summary, corporate governance, principles and their tenets are elaborated per different authors. After that, the financial intermediation theory is explained and how this is an important role of banks today. Agency theory and the conflict between management and the owners was featured next. It was followed by the savings and lending theory by Irving Fisher which talks about capital in the market, the psychology of savers, supply and investments. Loanable funds theory was subsequently elaborated, with other theories being explained after that such as the stakeholder, resource dependency, and guidelines from the CMA followed.

Corporate governance and banking models were discussed consequently, and the western concept of corporate governance was elaborated with the Anglo Saxon and the European model taking focus. The Islamic corporate governance model was explained next versus the conventional model being discussed. A brief explanation was given for the Shariah economy and its workings, with a link to Islamic banking. Discussed next was the empirical literature review, and international and local researches/studies were highlighted, and their findings concluded the section.

The gap in this study is that because the conventional banking institutions charge interest on their loans/services the Muslim population in Kenya does not utilize these services fully, as interest dealings have been prohibited per Islamic Shariah laws. Therefore, there is a lot of expectation from both Muslims and non-Muslims for the Islamic banking form of alternative services, which can develop an available human capital base, and will ultimately enable a new

form of economic growth in the market. In addition, no other study has been done before to study corporate governance practices for SCB in Kenya, as this form of institution is relatively new in the banking sector. Lastly discussed were the conceptual issues and issues for Islamic banking in the Kenyan context.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlined the research design to be used in the study. The sections included in the chapter were research design; population of the study, the sample selected for the study, the data collection process, data analysis, data validity and reliability issues.

3.2 Research Design

The research design employed in the study was a comparative study where the corporate governance of SCB operating banks and conventional banks operating in Kenya were evaluated and compared. This study covered a period of four years from 2008 to 2011. There are few studies done on corporate governance practices in SCB and conventional banking institutions. One of these was the comparison of risk management practices and analysis between SCB banks and conventional banks in the Middle East (Hassan, W.M. 2011). The other was a survey done on the ownership structure and corporate governance and its effects on performance: a case of selected banks in Kenya (Mang'unyi, E.E. 2011).

3.3 Population and sample

The target population comprised of banking firms in Kenya listed in appendix 2 and for the purpose of this research, the 33 conventional banks, and the 8 non-SCB banks will be studied, because the number of SCB institutions involved are few (2), the whole population of Islamic banks and conventional banks with Islamic windows will be analyzed.

3.4 Data Collection

The study used primary and secondary data that were collected through a questionnaire and the latter was collected from the annual financial statements and reports of the commercial and SCB banks. Data on the leadership structure, board composition and directorate interlock was obtained from the company's annual reports filed with the CMA and the CBK library.

3.5 Data Analysis

Tools of analysis such chi-square and anova for data analysis was used in this study. The SPSS tool was used to code and further analyze the data.

3.6 Data Validity and Reliability

As the data was collected from primary (questionnaire) and secondary sources (financial statements), it was considered valid and reliable. The study evaluates the performance of SCB versus conventional banks for profitability, return on capital employed (ROCE), return on assets (ROA), cost of funds (COF), return of funds employed (ROFE), net interest margin, efficiency ratio, interest yield, non-interest income, and liquidity. The above ratios were calculated for each bank type and then compared with one another using chi-square and anova in determining the significance of the differential performance of the two groups. Level of significance is tested at 5%.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the data analysis based on the primary and the secondary data collected, which was addressing the research objectives raised earlier. This is followed by a presentation of the results and an attempt to explain the findings. Any significant results are discussed and analyzed in details closes the chapter.

4.2 Descriptive Analysis

This part presents the analysis of data collected from the questionnaires administered to the 43 banks and the researcher managed to obtain 32 completed questionnaires representing a 75% response rate. The questionnaire circulated contained fourteen different sections based on questions on the main objectives of the study.

The composition of the board in all the banks comprised of both executive and non-executive directors. This practice is within the guidelines set by the Central Bank through the prudential guidelines issued and the adherence to this policy by the banks can be taken to mean that all the banks are compliant with the rules.

The following table overleaf shows the results in summary.

Table 4.2 Composition of the board

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Executive directors	2	4.8	5.1	5.1
	Non-executive directors only	2	4.8	5.1	10.3
	Independent directors only	5	11.9	12.8	23.1
	Mix of 1, 2 & 3	30	71.4	76.9	100.0
	Total	39	92.9	100.0	
Missing	System	3	7.1		
Total		42	100.0		

Source: Research Data 2011

In addition, it was found out that in all the banks, there existed a mechanism of rotating the board members in average after three years. Remuneration committees in the banks have been established to manage the awards to the directors and employees. This committee is comprised of executive directors, non-executive directors and in most banks of independent auditors. The remuneration policy manual existed in majority of the commercial banks while all the SCB had the existence of the remuneration manuals.

On the need of directors declaring all their interest in the company, the researcher found out that all the banks had in place the necessary mechanism for the same to be achieved and adhered to. The disclosure requirements in majority of these banks are matters relating to the ownership of share on the company or subsidiary, dealings with the company and investment in the company. Over 97% of the respondents pointed out that, they keep the register of the interest held.

On the need to convey information to the public, a system to monitor the compliance with the corporate structure structures, majority of the respondents noted that the same exists in these

banks and will include the use of mailboxes, websites and e-mail. The system is annually reviewed by the board, managing directors as well as their external auditors.

The need of the business disclosure of all material business relationships and contracts with agencies is also being observed by both categories of commercial banks. However, it was evident from the response that the major commercial banks observed more this requirement by virtue of the many dealings they engage within their normal course of business than the smaller financial institutions. Further, it was discovered that, nomination committees existed in majority of the conventional banks compared to the SCB, who did not have nomination committees.

To ensure that board members have the potential to serve the board and are suitable, conventional banks as well as the SCB had put in place a nomination policy manual that spelt in detail what the qualification of a member to be appointed in the board had to be. Most of the requirements in the policy manuals were that the company secretary should have a degree in business related area, degree in law, degree in accounting and other related degrees were an added advantage.

4.3 Quantitative Analysis

The researcher used two methods here: the anova and the chi square to measure the significance of the differential performance of the two groups of banks and the degree of correlation between the two types of the banks. The objectives for the research were identified earlier in the study and are presented using tables. The p value used throughout the analysis will be less than 0.05, and if it is more than 0.05, then there is no difference between the group's means. Null hypothesis was the means are different and the level of significance was

tested at 5%. Financial ratios such as profitability, return on capital employed (ROCE), return on assets (ROA), cost of funds (COF), return of funds employed (ROFE), net interest margin, efficiency ratio, interest yield, non-interest income, and liquidity were calculated, then compared and contrasted to highlight any differences.

The following tables explain the findings.

4.3.1 Return on Assets (ROA)

Table 4.3.2 (a)

Anova test on Return on assets (ROA) versus corporate governance practices

	N	Mean %	Std. Deviation	Std. Error	95% Confidence interval for mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Conventional banks	41	1.829	1.968	0.311	1.200	2.459	-5.487	4.660
SCB	2	-5.924	0.528	0.373	-10.669	-1.179	-6.298	-5.550
Total	43	1.460	2.546	0.392	0.666	2.254	-6.298	4.665

Source: Research Data 2011

Table 4.3.3(b)

Chi-square test for ROA

	Return on assets
Chi-Square	1.818 ^a
Df	43
Assumed significance	1.000

Source: Research Data 2011

a. 43 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.0.

The above results show comparison of ROA between SCB and the conventional banks, with the ROA of conventional banks at 1.829 compared to that of SCB at -5.9245. This is primarily because SCB are still very young in our market. The conventional banks have invested high levels of assets while the SCB have just began operations recently, hence the former will experience better return on their investment at this point in time. It is statistically significant to say that there is a difference in the ROA mean of the two types of banks and as time goes by, this may tend to change. Table (b) above shows a chi-square analysis at significant level 0.1 which is higher than 0.05, therefore the two means are significantly different.

4.3.2 Return on Funds Employed (ROFE)

Table 4.3.2 (a)

Anova test on Return on funds employed (ROFE) versus corporate governance practices

	N	Mean%	Std. Deviation	Std. Error	95% Confidence interval for mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Conventional banks	41	22.910	29.469	4.659	13.485	32.335	-59.427	162.010
SCB	2	-43.626	4.619	3.266	-85.128	-2.123	-46.892	-40.360
Total	43	19.741	32.1292	4.957	9.729	29.754	-59.427	162.010

Source: Research Data 2011

Table 4.3.2 (b)

Chi-square test for ROFE

	Return On funds Employed
Chi-Square	1.818 ^a
Df	43
Assumed significance	1.000

Source: Research Data 2011

a. 43 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.0.

The average ROFE of the Islamic banks is -43.62 compared to 22.91 for the conventional banks. This goes hand in hand with the ROA earlier analyzed, this is quite significant, and a large difference exists due to the poor returns generated by the SCB. This may be due to the high competition in the banking market, given that the latter are relatively new market players. The chi square test above confirms that the means are statistically different.

4.3.3 Profit Expense Ratio (PER)

Table 4.3.3 (a)

Anova test on profit expense ratio (PER) versus corporate governance practices

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Conventional banks	41	1.572	0.639	0.101	1.367	1.777	0.551	3.434
SCB	2	1.158	0.184	0.130	-0.494	2.812	1.028	1.288
Total	43	1.552	0.630	0.097	1.356	1.749	0.551	3.434

Source: Research Data 2011

Table 4.3.3 (b)

Chi-square test: PER

	Profit expense ratio
Chi-Square	1.818 ^a
Df	43
Assumed significance	1.000

Source: Research Data 2011

a. 43 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.0.

The analysis of PER of SCB and conventional banks indicate that the latter have generated higher profits for every one shilling of expense during the period. The mean PER for SCB is 1.158 which is significantly less than the conventional banks. This difference in their respective means is significantly different at 5% significance level as seen on table 4.3.3 (b) above on the chi-square analysis. This indicates that the conventional banks are more profitable compared to SCB, again this is because of the idea of Islamic banking which took root just a few years ago. SCB require the consumers, other than Muslims to understand their products and take up banking with them and if possible to remove the above disparity between the two institutions.

4.4 Liquidity Ratios

4.4.1 Loan to Deposit Ratio (LDR)

Table 4.4.1 (a)

Anova test on loan deposit ratio (LDR) versus corporate governance practices

	N	Mean	Std. Deviation	Std. Error	95% Confidence interval for mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Conventional banks	41	269.689	466.598	73.775	120.463	418.914	1.895	2154.755
SCB	2	15.994	1.699	1.201	0.722	31.266	14.792	17.196
Total	43	257.608	458.349	70.724	114.776	400.440	1.895	2154.755

Source: Research Data 2011

Table 4.4.1 (b)

Chi-square test: LDR

	LDR
Chi-Square	1.818 ^a
Df	43
Assumed significance	1.000

Source: Research Data 2011

a. 43 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.0.

SCB have significantly lower LDR compared to conventional banks during the period which indicates that the former have been comparatively more liquid in nature. This LDR of SCB indicates them comparatively giving out of lower loan amounts (financings) and receiving higher deposits emphasizing higher liquidity position at any one time. The chi square test shows that the two means are significantly different since the p value is 1.

4.4.2 Loan to Asset Ratio (LAR)

Table 4.4.2 (a)

Anova test on loan to asset ratio (LAR) versus corporate governance practices

	N	Mean	Std. Deviation	Std. Error	95% Confidence interval for mean		Minimum	Maximum
					Lower Bound	Upper Bound		
					Conventional banks	41		
SCB	2	33.076	4.755	3.362	-9.653	75.807	29.713	36.439
Total	43	74.072	199.662	30.808	11.852	136.291	3.629	969.859

Source: Research Data 2011

Table 4.4.2 (b)

Chi-square test: LAR

	LAR
Chi-Square	1.818 ^a
Df	41
Assumed significance	1.000

Source: Research Data 2011

a. 41 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.0.

The LAR of SCB is 33.123% whereas that of the conventional banks is 76.12%. This shows evidence of less stress to Islamic banks because it makes adequate loans and holds more liquid assets compared to conventional banks, however this is an indication of potential deterrent in profitability and conforms to the previous results drawn from profitability ratios of SCB, as overall results indicate that SCB are more liquid than conventional banks. At 5% significance level, it is not true to say the means in both cases are the same. The two means are definitely different from each other as the significance is 1.0% as shown in table 4.4.2 (b).

4.4.3 Efficiency Ratio

Table 4.4.3 (a)

Anova test on efficiency ratio versus corporate governance practices

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Conventional banks	40	70.883	21.650	3.423	63.959	77.807	29.120	137.388
SCB	2	181.422	0.083	0.058	180.673	182.171	181.363	181.481
Total	42	76.146	31.835	4.912	66.226	86.067	29.120	181.481

Source: Research Data 2011

Table 4.4.3 (b)

Chi-square test: Efficiency Ratio

	Efficiency Ratio
Chi-Square	4.773 ^a
Df	37
Assumed significance	1.000

Source: Research Data 2011

a. 37 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.0.

The efficiency ratio of SCB is found to be higher than that of the conventional banks. The means are different with a big margin, shown in the table 4.4.3(a) above, conventional banks: 70.883% and for SCB: 181.422%. The nature of the systems, size and time it has been in the market contributes to the difference. The chi square is at a significant level of 1.0 showing that the two means are significantly different.

4.5 Interest Yield

Table 4.5 (a)

Anova test on interest yield versus corporate governance practices

	N	Mean%	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Conventional banks	41	10.042	2.987	0.472	9.087	10.998	6.660	20.050
SCB	2	3.462	4.896	3.462	-40.527	47.451	0.000	6.924
Total	43	9.729	3.329	0.513	8.691	10.767	0.000	20.050

Source: Research Data 2011

Table 4.5 (b)

Chi-square test: Interest Yield

	Interest yield
Chi-Square	1.818 ^a
Df	43
Assumed significance	1.000

Source: Research Data 2011

a. 43 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.0.

There is more interest yield in conventional banks at 10.042% compared to interest yield in SCB at 3.46% proving even more that the interest play an important role in the performance of the bank. The means are statistically different as shown by the chi-square analysis in Table 4.5 (b). Non-interest yield also gives similar trends as evidently given on the output on table 4.5 (c). Conventional banks have a higher mean of 36.874% and SCB have a mean of 26.415%.

The difference between the two means is slightly higher in non-interests yields compared to interest yields.

Table 4.5 (c)

Anova test on non interest yield versus corporate governance practices

	N	Mean%	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Conventional banks	41	36.874	21.420	3.386	30.023	43.725	7.699	81.428
SCB	2	26.415	0.000	0.000	26.415	26.415	26.415	26.415
Total	43	36.376	21.013	3.242	29.828	42.924	7.699	81.428

Source: Research Data 2011

4.6 Liquidity

Table 4.6 (a)

Anova test on liquidity versus corporate governance practices

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Conventional banks	40	45.057	16.243	2.568	39.862	50.252	20.000	98.460
SCB	2	34.315	10.344	7.315	-58.630	127.260	27.000	41.630
Total	42	44.545	16.092	2.483	39.531	49.560	20.000	98.460

Source: Research Data 2011

Table 4.6 (b)

Chi-square test: Liquidity

	Liquidity
Chi-Square	6.727 ^a
Df	35
Assumed significance	1.000

Source: Research Data 2011

a. 35 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.0.

Liquidity means for the two types of banks are significantly different. Conventional banks have a mean of 45.057% compared to a mean of 34.315% for the SCB. A chi square test in table 4.2.6 (a) gives a significant value that is higher than 0.05, thus we reject the null hypothesis.

4.7 Discussion of Findings

The results show that when the researcher tested and analysed ROA (return on assets) figures based on the last four year period, the SCB had -5.92% while the conventional banks had a figure of 1.825%. this may be because the conventional banks have invested highly in assets while the SCB are relatively new in the market, as they appeared on the scene in early 2008, hence the former will experience better returns on their investment at present. The ratio may present a better return for SCB in the future, which may change for the better.

On the analysis of ROFE (return on funds employed), conventional banks had 22.91%, compared to the SCB which had -43.62%, again this is the same as the ROA (return on assets), and also due to the high competition faced by the SCB in the market, given that the latter are relatively new market players. The PER (profit expense ratio), revealed that the conventional banks have made more profits compared to the SCB who have made lower profit in the last

four year period. This may be due to the SCB banking products, which have not taken off because the consumers – made up of Muslims and non-Muslims alike who need to understand how they function.

From the liquidity ratios analysed, it was evident from the loan to asset ratio (LAR), SCB suffer less stress than conventional banks as they make out adequate loans and receive more deposits and hence are liquid in nature. However, when the profitability for SCB was examined it was revealed that the ratios were lower compared to the conventional banks. Efficiency ratios revealed the SCB were more efficient than the conventional banks, this may be explained by the nature of the systems, size and time the former has been in the market.

Finally there was the interest yield which brought out that the conventional banks had more yield/returns compared to the SCB by a difference of 7%, showing that banking products that deal in interest bring in more returns rather than the SCB, whose concept of the profit/loss element has not been grasped yet fully by the consumers. In summary, therefore, the SCB have yet to gain momentum and strive to produce better financial results to compete effectively with the conventional banks that already command a huge following of consumers and ultimately market share.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides a summary of the study, discussions and conclusions. The researcher then presents the main limitations of the study, and recommendations both for the research as well as for the policy and practice.

5.2 Summary

This study sought to find out whether corporate governance practices in SCB and conventional banks in Kenya were different and if yes, what factors made have made it unique. SCB in Kenya has been facing challenges ever since it was introduced a few years ago and the economy may have slowed down due to Muslims who do not wish to bank with the existing conventional banks, due to the interest element involved. The research was also undertaken to increase understanding of the operations of the SCB, using their good corporate governance principles, therefore the intended beneficiaries of this study were the SCB, conventional banks, the Muslim community, other borrowers and the researchers.

The research study used both secondary and primary data. Quantitative data on the SCB and conventional banks was derived from annual financial reports (these statements were obtained from the commercial banks, published financial statements from local newspapers), profit and loss accounts, balance sheets and cash flow statements in the CBK and the CMA websites. These sources were used as they were both reliable and true and the secondary data in this analysis covered a period of 3 years from 2008 to 2011. The population of study was all the SCB and conventional banks in Kenya. Primary data was collected after administering a

questionnaire to the population of the 43 banks, and the response rate was a fair 75%, after some banks did not complete their questionnaires, which was taken into account in the analysis and recorded.

Data collected was analysed using chi-square and anova tests and some interesting correlations were noted, which the researcher attempted to explain. Financial ratios such as profitability, return on capital employed (ROCE), return on assets (ROA), cost of funds (COF), return of funds employed (ROFE), net interest margin, efficiency ratio, interest yield, non-interest income, and liquidity were calculated, then compared for both the SCB and the conventional banks. The researcher also attempted to find out if the underlying corporate governance practices give rise to good financial ratios and indicators ultimately, as this is one of the basic objectives of corporate governance. A varied pattern of correlations and patterns emerged from the data analysis, which used the SPSS tool.

5.3 Conclusion and Recommendations

Islamic banking has some challenges due to the intricate financial setup of the conventional banking system rules and regulations which are more compatible to the conventional banking system and some of them due to its early age in the financial sector. The relation between corporate governance and managerial behavior and organizational performance is of fundamental importance to practitioners, academics, and policy makers. Assumptions and strongly held beliefs about the importance of governance are shaping the current regulatory climate for the design of governance structures.

From the analysis, the primary data brought out that SCB and conventional banks do not differ much in the corporate governance practices, which are followed diligently to ensure

compliance with the CMA and the CBK rules. From the information that emanated from the study, it was not very evident that the SCB had other practices, which they may have formulated along the statutory corporate governance rules to necessitate the different Islamic banking rules/principles. In addition, being only two in number, the scope for investigating this further is limited currently, hence it can be concluded that the SCB are just as compliant and are using the same practices as the conventional banks.

The secondary data analysis can conclude that the ratios observed and the tests performed (chi-square and the anova), that the SCB has not been profitable as compared to the conventional banks. ROA, ROFE, PER, LDR, LAR, efficiency ratios, and interest yield all show a worsening performance than for the conventional banks, which are generating reasonable profits. The reason for this may be due to the relatively low market share, as mostly only Muslims opt to bank with these institutions. Other citizens need awareness of the principles of the SCB in order to also boost their business and benefit in the end. There is a need to also educate the Muslim community towards operations and principles of Islamic financial products; and financial service providers need to improve the information system within the communities, as the Islamic banking institution need to work hard for survival and compete with conventional banking system in the sector of regulations and supervisions.

Finally, it is concluded that though Islamic banking has some challenges in Kenya but with the corporation of the Muslim community and with the proper guidance of Islamic scholars, Islamic banking can easily turn these challenges to success.

5.4 Limitations of the Study

There are only two banks who are SCB, thus limiting the scope for investigation drastically, compared to 41 other conventional banks, which are well established in the Kenyan market place. The researcher encountered quite a number of challenges related to the research and most particularly during the process of primary data collection as some respondents were biased while giving information due to reasons such as privacy and busy schedules at their work place. This resulted to only 75% rate of respondency achieved.

In addition, financial challenges were experienced, as some of the respondents had to be pushed to assist with data. This was done through many calls and endless visits to remind them to complete the questionnaires using workplace phones. Also, the time allocated for the study was insufficient while holding a full time job and studying part time. However, the researcher tried to conduct the study within the period as specified.

5.5 Suggestions for Further Research

The study may have assumed that the efficient performance of all banks' relies on good basic principles of corporate governance. However, the study does not openly rule out the fact that some other variables in the environment could be critical for any financial institution's financial performance. Hence, future research could usefully focus on the macroeconomic conditions necessary to promote maximum performance within the Kenyan banking system and/or other firms in other industries i.e. causes of performance differences that are not related to ownership.

It is suggested that further research be done to investigate how the SCB corporate governance practices affect their profitability, by using other form of data collection such as personally

interviewing the board of directors who may be able to explain and shed light on how their financial instruments and products actually work and differ from the conventional banking products. After the collection of such data, the results could be tested to verify it.

5.6 Recommendations

It is suggested that since the study encountered some limitations these may be investigated/covered in further research studies. More SCB may be included in these studies and compared to the conventional banks from developed, developing, and under-developed nations from around the globe. In addition, if Islamic banking wants popularity and business then they may need to introduce *compatible financial policies and financial tools* to conventional banking. Many of the Muslims about to take up Islamic banking accounts are still confused because they are not satisfied that Islamic banking products will fulfil all their finance requirements.

Although the SCB have slightly improved their business over the four years time but they are not in a position to compete effectively with the conventional banking institutions. This is because the banking industry is growing at a very fast pace in Kenya and the SCB may need to improve banking services/products according to the normal standards of conventional banking that will help customers satisfy their needs. Although the marketing and research departments of Islamic banking are playing an important role, they should work harder to make Islamic banking a strong pillar in the Kenyan financial sector. Lastly, the Islamic banking sector needs to invest in teaching and training about Islamic products to existing staff to improve their knowledge to allow transparency, the search for information and industry connectivity.

References

- Abdel-Magid, M. (1981). Theory of Islamic banking: Accounting Implications. *The International Journal of Accounting*, pp.79-102.
- Abrams, F.W. (1951). ‘*Management’s Responsibilities in a Complex World*’ *Harvard Business Review* 29, pp. 29-34.
- Adams, I., (2003). *The Morality of Corporate Governance: Issues of Quality and Quantity*, Paper delivered at the Conference of the Economic Society of South Africa: “Africa’s Millennium: Trade, Investment And Growth”, Somerset West 17-19 September.
- Ainley, M. (1997). Under a veil of regulation. *The Banker*, 147(860), pp.73–74.
- Al-Omar, F., & Abdel-Haq, M. (1996). *Islamic banking: Theory, practice & challenges*. Karachi, Pakistan: Oxford University Press/London & New York: Zed Books.
- Banker, R. D., & Datar, S.M.(1989). “Sensitivity, Precision and Linear Aggregation of Signals for Performance Evaluation.” *Journal of Accounting Research*, pp.21-39.
- Bebchuk LA., Coates IV J.C., & Subramanian G. (2002). *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*. *Stanford Law Rev.*, 54, pp.887-951.
- Becht, M., and Barca, F. (2001). *The Control of Corporate Europe*, Oxford, Oxford University Press.

- Berle, A.A. Jr., and Means, G.C. (1932). *The Modern Corporation and Private Property*, New York: MacMillan.
- Brickley, J A., Coles, J.L., & Terry, R L. (1994). "Outside Directors and the Adoption of Poison Pills", *Journal of Financial Economics*, 35, pp. 371-390.
- Business Daily, 18 September 2011: "What Kenya must do to promote Islamic banking'", retrieved from <http://www.businessdailyafrica.com>.
- Cader, S.A. (2007). "The glass has yet to become full." *Islamic Finance News*, 4(20), pp.18-19.
- Chapra, M.U., & Ahmed, H. (2002). *Corporate Governance in Islamic Financial Institutions*, IRTI, Jeddah.
- Chiu, S., Newberger, R., & Paulson, A., (2005), *Islamic Finance in the United States*, Society. September/October, pp.64-8.
- Choudury, M.A. & Hoque, M.Z. (2004) *An Advanced Exposition of Islamic Economics and Finance*, New York, Edward Mellen Press.
- Choudury, M.A., & Hoque, M.Z. (2006). *Corporate Governance in Islamic Perspective*, Emerald Group Publishing Ltd, *Corporate Governance*, Vol. 6, Issue 2, pp. 116-128.
- Cunningham, A. (1994). The growth of Islamic financing. *Project & Trade Finance*, pp. 34-37.
- Diamond, D.W. (1984). Financial intermediation and delegated monitoring, *Review of Economic Studies* 51, pp.393-414.

- Diamond, D.W., & Dybvig, P. (1983). Bank runs, deposit insurance, and liquidity, *Journal of Political Economy* 91, pp.401-419.
- Donaldson, L., & Davis, J. (1991). "Stewardship Theory or Agency Theory: CEO governance and shareholder returns". *Australian Journal of Management*, 16(1).
- Donaldson, L., & Davis, J. (1994). Boards and Company Performance – Research Challenges the Conventional Wisdom, *Corporate Governance: An International Review*, 2(3), pp.151-160.
- Dunn, P. (2004). The Impact of Insider Power on Fraudulent Financial Reporting, *Journal of Management* 30(3): pp. 397-412.
- El-Gamal, M. (1997, February). *Can Islamic banking survive? A micro evolutionary perspective*. Working Paper, Social Systems Research Institute, University of Wisconsin. Retrieved April 27, 2004, from <http://www.ssc.wisc.edu/econ/archive/wp9704.pdf>.
- Fabozzi, F.J., Petterson, P.P. (2003). *Financial Analysis and Management*, John Wiley and Sons.
- Fama, E., F. & Jensen, M. C. (1983). 'Separation of ownership and control', *Journal of Law and Economics*, Vol. 26, 1983, pp. 301–49.
- Farinha, J., (2003). *Corporate Governance: A Survey of the Literature*. Paper presented at the meeting of the Universidade do Porto Economia, Discussion Paper No. 2003-06.
- Fisher, I. (1930). *The theory of interest*, New York: Macmillan.

- Frank, J., & Mayer, C. (2004). Corporate Ownership and Control in the UK, Germany and France, Stern, J.M., and Chew, D.H., Jr. (Ed.s), *The Revolution in Corporate Finance*, 4th Ed. United Kingdom, Blackwell Publishing, pp. 535-551.
- Freeman, R.E., Wicks, A., Parmar, B., Mcvea, J., (2004), "Stakeholder Theory: The state of the art and future perspectives", *Politeia*, 20, pp. 9-22.
- Gani, L., & Jermias, J. (2006). "Investigating the Effect of Board Independence on Performance Across Different Strategies", *The International Journal of Accounting*, 41, pp.295-314.
- Hart, O. (1995). Corporate Governance: Some Theory and Implications. *The Economic Journal*. 105, pp.678-689.
- Hassan, K., & Lewis, M. (2007). *Handbook of Islamic Banking*, Cheltenham, UK, Northampton, MA,USA, Edward Elgar.
- Hassan, W.M. (2011). Risk Management Practices: A Comparative Analysis Between Islamic Banks And Conventional Banks In The Middle East. *International Journal of Academic Research Vol. 3. No. 3. May, 2011, I Part*.
- Hawley, J.P., & Williams, A.T. (2000).*The Rise of Fiduciary Capitalism: How Institutional Investors can make America more Democratic*", Philadelphia.
- Hendry K., &Kiel, G. (2004). The Role of the Board in Firm Strategy: Integrating Agency and Organisational Control Perspectives, *Corporate Governance: An International Review*, 12 (4), pp.400-52.

- Henry, C.M., & Wilson, R. (2004). *The Politics of Islamic Finance*, Edinburgh University Press, Edinburgh.
- Hermalin, B. & Weisbach, M. (1998). "Endogenously Chosen Boards of Directors and their Monitoring of the CEO," *American Economic Review*, 88, pp. 96-118.
- Hutchinson, M. (2002). "An Analysis of the Association between Firms' Investment Opportunities, Board Composition, and Firm Performance", *Asia Pacific Journal of Accounting and Economics*, 9, pp.17-39.
- Iqbal, M., & Molyneux, P. (2005). *Thirty years of Islamic Banking*, Palgrave Macmillan.
- Iqbal, Z., & Mirakhor, A. (1999). Progress and challenges of Islamic banking. *Thunderbird International Business Review*, 41, pp.381–405.
- Iqbal, Z., & Mirakhor, A. (2004). Stakeholders Model of Governance in Islamic Economic System, *Islamic Economic Studies*, Vol. 11. No. 2, pp. 43-64.
- Jebet, C. (2001). A study of corporate governance: the case of quoted companies in Kenya, Unpublished project – University of Nairobi.
- Jensen, M. C. (2001). 'Value maximization, stakeholder theory, and the corporate objective function', *Journal of Applied Corporate Finance*, Vol. 14.
- Jensen, M.C., & Meckling, W.H. (1976). *Journal of Financial Economics: Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*.

- Jiang W, Brav, A.P., Randall S. Thomas, R.S., & Partnoy, F. (2008). ‘‘Hedge Fund Activism, Corporate Governance, and Firm Performance’’, *Journal of Finance*, Vol. 63, pp. 1729.
- John, K., & Senbet, L.W. (1998). *Journal of Banking and Finance*, Vol.22, No.4, pp. 371-403(33), Elsevier.
- Kamil, N., & Kamil, M. (2007).*Islamic banking and finance slides*. Malaysia: International Islamic University Malaysia.
- Khan, M.M., & Bhatti, M.I. (2008). ‘‘Development in Islamic Banking: a financial risk allocation approach’’, *Journal of Risk Finance*, Emerald Group Publishing, Vol. 9(1), pp.40-51.
- Krivogorsky, V. (2006). ‘‘Ownership, Board Structure, and Performance in Continental Europe’’, *The International Journal of Accounting*, 41, pp.176-197.
- Lee, C, Rosenstein, S, Rangan, N &Davidson III, W.N. (1992). ‘‘Board Composition and Shareholder Wealth: The Case of Management Buyouts’’, *Financial Management*, 21, pp.58-72.
- Leland, H.E., &Pyle, D.H. (1977). Informational asymmetries, financial structure, and financial intermediation, *Journal of Finance* 32, 371-387.
- Lewis, M.K. (2005). Islamic Corporate Governance. *Review of Islamic Economics*. Volume 9. No. 1. pp. 5-29.

- Lim, P.K., (2007) Corporate Governance Reforms In Malaysia: The Key Leading Players' Perspective, *Corporate Governance*, Vol. 15, Issue 5, pp. 724-740.
- Maati, J. (1999), *The Government Enterprise*, Boeck University, Brussels.
- Mang'unyi, E.E. (2011). Ownership Structure and Corporate Governance and Its Effects on Performance: A Case of Selected Banks in Kenya *International Journal of Business Administration Vol. 2, No. 3; August 2011*. Catholic University, Nairobi.
- Mcdonald, D., & Puxty, A.G. (1979). *An Inducement – Contribution Approach to Corporate Financial Reporting: Accounting, Organisations and Society*, 4(1/2), pp.53-65.
- Mrydal, G. (1939). *Monetary Equilibrium*, translated by R.B. Bryce and N. Stolper. London: W. Hodge.
- Mululu, A. K. (2005). The relationship between board activity and firm performance: A study of firms quoted on the Nairobi Stock Exchange. [Unpublished].
- Muriithi A.K. (2004). The relationship between corporate governance mechanism and performance of firms quoted on the Nairobi Stock Exchange. [Unpublished].
- Mwangi, M. (2003). Determinants of corporate board composition in Kenya: An agency perspective. Unpublished project – University of Nairobi.
- Nienhaus, V. (1986). Islamic economics, finance and banking - Theory and practice. In Butterworths Editorial Staff (Eds.), *Islamic banking and finance* (pp. 38–49). London: Butterworths.
- Niskanen, W.A. (2003). The Real Governance Challenges. *Chief Executive* 194, pp.46.

- Organisation for Economic Cooperation and Development (OECD), (1999), OECD Principles of Corporate Governance, Paris: OECD Publications.
- Park, Y.W., & Shin, H.H. (2003). "Board Composition and Earning Management in Canada", *Journal of Corporate Finance*, 185, pp.1-27.
- Peasnell, K.V., P.F. Pope, & Young, S. (2000). Managerial Equity Ownership and the Demand for Outside Directors, *European Financial Management* 9(2), pp.231-250.
- Peterson, P.P., Robert A. & Wilson R. (1992). Measuring Customer Satisfaction: Fact and Artifact, *Journal of the Academy of Marketing Science* 20, pp.61-71.
- Pfeffer, J., & Salancik, G. (1978). *The External Control of Organisations*, New York: Harper and Row.
- Pigou, A.C. (1927). *Industrial Fluctuations*. London: Macmillan.
- Robertson, D.H.(1926). *Banking Policy and the Price Level*, London: P.S. King.
- Sanda, A.U., Mukaila, A.S., & Garba, T. (2003). *Corporate Governance Mechanisms and Firm Financial Performance in Nigeria*. Final report presented to the bi-annual workshop of the AERC, Nairobi, pp.24-29.
- Shepherd, W. G. Jr. (1996). Integrating Islamic and Western finance. *Global Finance*, 10(5), pp.44-50.
- Shleifer, A.,& Vishny R.W.(1997). A Survey of Corporate Governance (April 1996). *Journal of Finance Volume 52, No. 2*.

Siddiqi, M. (2002). “*Comparative Advantages Of Islamic Banking And Finance*,” Presented at Harvard University Forum on Islamic Finance.

Tricker, B. (1984). *Corporate Governance*. Gower Press, Aldershot.

Vancil, R. (1987). *Passing the Baton: Managing the Process of CEO Succession*. Boston Business School Press.

Wicksell, K. (1898). *Interest and Prices*, English translation by R.F.Kahn, London: Macmillan, For the Royal Economic Society, 1936, Reprinted New York: Augustus M. Kelley, 1962.

Wicksell, K. (1898). *Interest and Prices*, English translation by R.F. Kahn with an introduction by Bertil Ohlin, London: Macmillan, For the Royal Economic Society, 1936.

Young, B. (2003). “Corporate Governance and Firm Performance: Is there a Relationship?” *Ivey Business Journal Online*, 1-4.

Zineldin, M. (1990). *The Economics of Money and Banking*, Almqvist & Wiksell International: Sweden, pp.185-199

Zingales, L. (1994). ‘The value of the voting rights: a study of the Milan Stock Exchange experience’, *Review of Financial Studies*, Vol. 7, pp. 125-48.

Appendix 2 was retrieved from the following websites:

The Cadbury Report (1992), Greenbury Report (1995) and Hampel Report (1998): Retrieved
from: http://www.ecgi.org/codes/country_pages/codes_uk.htm

Sarbanes Oxley Act 2002: http://en.wikipedia.org/wiki/Sarbanes%E2%80%93Oxley_Act

Principles of Corporate Governance in Kenya:

http://www.ecgi.org/codes/documents/principles_2.pdf

Kuwaiti Corporate Governance Code: [http://www.capstandards.com/CSR_CG-Code\(2\).pdf](http://www.capstandards.com/CSR_CG-Code(2).pdf)

Appendix 1: Questionnaire

A COMPARATIVE STUDY ON CORPORATE GOVERNANCE PRACTICES OF SHARIAH COMPLIANT BANKS AND CONVENTIONAL BANKS IN KENYA

Name : Sayyida Nishat Jaweed

Date.....

Please take a few minutes to complete this questionnaire. Your honest answers will be completely confidential, but your views in combination with those of others are extremely important in building knowledge on corporate governance practices of SCB and conventional banks in Kenya. Please tick on the relevant answer, or write where necessary.

General

1. What is the main business of the company?

.....

2. What is the nature of the company?

- (i) Private
- (ii) Public
- (iii) Listed
- (iv) State owned
- (v) Others.....

RESPONSIBILITY

3. To what extent do members of the board understand their responsibilities?

- (i) Strongly
- (ii) Moderately
- (iii) Not at all

4. Are board members and management staff responsibilities clearly set out in writing?

- (i) Yes
- (ii) No

If no, please state the reasons for omitting to do so.....

5. Does the company differentiate between what the board can do, and what managers and employees of the company can do?

- (i) Yes
- (ii) No

6. Do the Board and the relevant sub-committees have clearly defined roles

- (i) Yes
- (ii) No
- (iii) Not applicable

AUDIT

7. Is there an Audit committee?

- (i) Yes
- (ii) No

8. Is there an external auditor of the company?

- (i) Yes
- (ii) No

9. Is there an independent internal audit function within the company?

- (i) Yes
- (ii) No

10. Are there any provisions in the Company's Articles of Association mandating rotation of external auditors?

- (i) Yes
- (ii) No

11. Does the Audit Committee produce a report on the internal audit function?

- (i) Yes
- (ii) No
- (iii) Not Applicable

12. Is it mandatory to prepare an internal audit plan?

- (i) Yes
- (ii) No

13. Is the internal audit plan reviewed on an annual basis?

- (i) Yes
- (ii) No

COMPOSITION OF THE BOARD

14. What is the size of the board?

- (i) 5
- (ii) 7
- (iii) 10
- (iv) Others.....

15. What do you think should be the ideal size of a board?

.....

16. What is the composition of the Board?

- (i) Executive directors only
- (ii) Non-executive directors only
- (iii) Independent directors only
- (iv) Mix of ii, iii & i
- (v) Others.....

17. Does the organization have any kind of mechanism for rotating board members? If the answer is No, please skip Q. 18.

- (i) Yes
- (ii) No

18. How often are board members rotated?

- (i) Every one year
- (ii) Every two years
- (iii) Every three years
- (iv) Others

BOARD AND SENIOR MANAGEMENT REMUNERATION

19. Is there a remuneration committee?

- (i) Yes
- (ii) No

20. What is the composition of the remuneration committee?

- (i) Executive directors only
- (ii) Non-executive directors only
- (iii) Independent directors only
- (iv) Others

21. What is the size of the remuneration committee?

- (i) 3 directors
- (ii) 4 directors
- (iii) 5 directors
- (v) Others

22. Is there a written remuneration policy?

- (i) Yes
- (ii) No

23. Does the company disclose the remuneration policy in the annual report?

- (i) Yes
- (ii) No

24. Does the company disclose remuneration of individual board members and senior management?

- (i) Yes
- (ii) No

MEETINGS

25. Is there a set quota for meetings of the board?

- (i) Yes
- (ii) No

26. How often do board and sub-committees conduct meetings?

- (i) Every one month
- (ii) Every quarter
- (iii) Twice a year
- (iv) Others

27. What are the quorum requirements for board and board committees?

- (i) Majority
- (ii) Two Third of the members
- (iii) Others.....

INFORMATION

28. How are the public kept informed of company information(s)?

- (i) News bulletin
- (ii) Daily newspapers
- (iii) Website
- (iv) Email
- (vi) Others.....

29. Is there an information disclosure policy, which dictates the type of information that could be disclosed to the public? If the answer is No, please skip Q 30.

- (i) Yes
- (ii) No

30. What type of information can be disclosed to the public pursuant to the information disclosure policy?

- (i) Company's success stories
- (ii) Business contracts
- (iii) Change in key management position
- (iv) Others

31. What information is provided to the board of directors in advance of board meetings?

- (i) Agenda
- (ii) Board papers
- (iii) Minutes of previous meetings
- (iv) Others

32. What information is revealed to shareholders in advance of the Annual General Meeting (AGM)?

- (i) Agenda
- (ii) Annual Reports
- (iii) Minutes of previous meetings
- (iv) Others

33. Who is responsible for recording minutes of meetings?

- (i) Managing Director
- (ii) Company Secretary
- (iii) Clerk
- (iv) Others

34. Are minutes of the previous meeting approved at the following meeting?

- (i) Yes
- (ii) No

35. Is responsibility for action clearly indicated in the minutes?

- (i) Yes
- (ii) No

36. Does the organization undertake a review to ensure that actions decided at meetings have been taken?

- (i) Yes
- (ii) No

37. How does the company disclose transactions made by directors or management that conflicts with the interests of the company or that has the potential for Conflict of interest?

.....

REGISTER OF INTERESTS

38. Are there policies/ rules, which require directors to disclose personal interest in the company?

- (i) Yes
- (ii) No

39. What type of personal interest is required to be disclosed?

- (i) Ownership of Shares of the company/subsidiary companies
- (ii) Dealings with the company
- (iii) Investments in the company/subsidiary companies
- (iv) Others

40. Does the company maintain a register of interests? If the answer is No, please skip Q. 40 and Q.41.

- (i) Yes
- (ii) No

41. How is the register of interest reviewed and updated?

- (i) Annual basis
- (ii) Every two years
- (iii) Others

42. Is it mandatory for members to sign the register?

- (i) Yes
- (ii) No

SYSTEM TO RAISE CONCERNS

43. Does the organization have an established system to raise concerns? If the answer is No, please skip Q 43, Q. 44, and Q. 45.

- (i) Yes
- (ii) No

44. What type of system has been established to raise concerns?

- (i) Suggestion box
- (ii) Website
- (iii) Email
- (iv) Others

45. Is the system reviewed regularly to ascertain effectiveness?

- (i) Yes
- (ii) No

46. Who is responsible for reviewing the system?

- (i) Board of Directors
- (ii) Managing Director
- (iii) Auditors
- (iv) Others

PERFORMANCE MEASUREMENT/REVIEW

47. How is the performance of the board/ subcommittees/ management reviewed?

48. Does the organization undertake a review of terms of reference of Board, subcommittees? If the answer is No, please skip Q. 49.

- (i) Yes
- (ii) No

49. How often is the review undertaken?

- (i) Annually
- (ii) Every two years
- (iii) Others

50. Are there set performance indicators?

- (i) Yes
- (ii) No

51. Are reports produced detailing the Board's/subcommittees/management's objectives for the year and progress against these objectives?

- (i) Yes
- (ii) No

52. Who evaluates the Board?

- (i) Board members themselves
- (ii) Independent party
- (iii) External Auditor
- (iv) Others

53. How often is the review undertaken?

- (i) Annually
- (ii) Semi annually
- (iii) Others

54. Does the organization benchmark the policies for review of the board against international Best Practices?

- (i) Yes
- (ii) No

VOTING AT SHAREHOLDERS MEETINGS

55. Does the company have proxy voting guidelines or rules?

- (i) Yes
- (ii) No

56. Are shareholders allowed to vote in absentia?

- (i) Yes
- (ii) No

57. How are resolutions put before shareholders for voting?.....

58. Are there separate resolutions for separate matters?

- (i) Yes
- (ii) No

FINANCIAL STATEMENTS

59. Does the company apply International Accounting Standards (IAS) in the preparation of financial statements?

- (i) Yes
- (ii) No

60. Are financial statements, balance sheets and profit and loss accounts signed by Chairman, CEO and CFO?

- (i) Yes
- (ii) No

61. How does the company maintain accounting records?

- (i) Manually
- (ii) Software
- (iii) Excel sheet
- (iv) Others

62. Do the periodic financial statements and footnotes meet the internationally recognized financial reporting standards and practices?

- (i) Yes
- (ii) No

63. Are any deviations reported from and, changes in, the accounting methods applied.

- (i) Yes
- (ii) No

64. Is disclosure of all material business relationships, and material provisions of contracts, with agencies/consultants/banks (for example, credit rating agencies, investment banks and research analysts), who provide information (in the form of opinions/views/recommendations/analysis) on the company done?

- (i) Yes
- (ii) No

BOARD APPOINTMENT

65. Does the organization have a Nominations Committee, which is responsible for Board nominations? If the answer is No, please skip Q. 63.

- (i) Yes
- (ii) No

66. Does the organization have a written nomination policy for board appointments?
 (i) Yes
 (ii) No
67. Who makes recommendations for the appointment of board directors?
 (i) Shareholders
 (ii) Directors
 (iii) Chairman
 (iv) Others
68. Is there a formal process for application to the Board?
 (i) Yes
 (ii) No
69. How does the nomination committee ensure that potential members are suitable to serve on the board?
 (i) Based on the requirements set forth in the nomination policy
 (ii) Through interview
 (iii) Others
70. Is the background of the potential board members investigated?
 (i) Yes
 (ii) No
71. How is it ensured that only individuals with the right skills and attitudes are selected?

72. How are members inducted?

73. Are the board members trained during their term of office? If the answer is No, please skip Q. 70.
 (i) Yes
 (ii) No
74. How does the organization ensure that training is suitable or effective?
 (i) Yes
 (ii) No

COMPANY SECRETARY

75. Is the company secretary required to have formal qualifications pursuant to the Articles of Association of the Company? If the answer is No, please skip Q. 73.
 (i) Yes
 (ii) No

76. What kind of qualification is required for Company Secretaries by the Articles of Association?

- (i) Degree in Business or related area
- (ii) Degree in law
- (iii) Degree in Accounting
- (iv) Others

77. Are there clearly written down responsibilities for the company secretary?

- (i) Yes
- (ii) No

78. Does he/she hold any other posts in the company or provide any other services to the Company? If the answer is yes, please state the posts or services provided by the Company Secretary.

- (i) Yes
- (ii) No

Appendix 2: List of Shariah Compliant and Conventional Banks in Kenya

The first SCB in Kenya

1. First Community Bank Ltd
2. Gulf African Bank Ltd

Shariah compliant banking products

1. Barclays Bank of Kenya
2. CFC Stanbic Bank
3. Chase Bank Ltd
4. Dubai Bank Kenya Ltd
5. Fidelity (Commercial) Bank Ltd
6. Habib Bank Ltd
7. National Industrial Credit Bank Ltd
8. Standard Chartered Bank

Conventional banks

1. African Banking Corporation
2. Bank of Africa Kenya
3. Bank of Baroda
4. Bank of India
5. **Error! Hyperlink reference not valid.**
6. **Error! Hyperlink reference not valid.**
7. Co-operative Bank of Kenya
8. Commercial Bank of Africa
9. Consolidated Bank of Kenya Ltd
10. Credit Bank Ltd
11. Development Bank of Kenya
12. Diamond Trust Bank
13. Equatorial Commercial Bank Ltd

14. Equity Bank
15. Family Bank
16. FINA Bank Ltd
17. Giro Commercial Bank Ltd
18. Guardian Bank
19. Habib Bank A.G. Zurich
20. Housing Finance Co. Ltd
21. Imperial Bank
22. I&M Bank Ltd (former Investment & Mortgages Bank Ltd)
23. K-Rep Bank Ltd
24. Kenya Commercial Bank Ltd (*listed on the NSE*)
25. Middle East Bank
26. National Bank of Kenya
27. Oriental Commercial Bank Ltd
28. Paramount Universal Bank Ltd
29. Prime Bank Ltd
30. Southern Credit Banking Corp. Ltd
31. Trans-National Bank Ltd
32. UBA Kenya Bank Ltd
33. Victoria Commercial Bank Ltd

Appendix 3: Checklist of Corporate Governance Principles in Islamic Countries & the Western Countries

A. Combined Code – United Kingdom (From the Cadbury Report)

1. Directors

The Board

Every company should be headed by an effective board, which is collectively responsible for the success of the company.

2. Chairman and chief executive

There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.

3. Board balance and independence

The board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.

4. Appointments to the Board

There should be a formal, rigorous, and transparent procedure for the appointment of new directors to the board.

5. Information and professional development

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

6. Performance evaluation

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

7. Re-election

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. The board should ensure planned and progressive refreshing of the board.

8. Remuneration

- The Level and Make-up of Remuneration
 - a. Levels of remuneration should be sufficient to attract, retain, and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose.
 - b. A significant proportion of executive directors' remuneration should be structured to link rewards to corporate and individual performance.

- c. There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

9. Accountability and Audit Financial Reporting

The board should present a balanced and understandable assessment of the company's position and prospects.

10. Internal Control

The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

a. Audit Committee and Auditors

The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.

i. Relations with Shareholders

a. Dialogue with Institutional Shareholders

There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.

b. Constructive Use of the AGM

The board should use the AGM to communicate with investors and to encourage their participation.

ii. Institutional Shareholders

a. Dialogue with companies

Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives.

b. Evaluation of Governance Disclosures

When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional shareholders should give due weight to all relevant factors drawn to their attention.

c. Shareholder Voting

Institutional shareholders have a responsibility to make considered use of their votes.

B. Sarbanes - Oxley Act of 2002 - USA (From Wikipedia)

1. Rights and equitable treatment of shareholders

Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by openly and effectively

communicating information and by encouraging shareholders to participate in general meetings.

2. Interests of other stakeholders

Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policy makers.

3. Role and responsibilities of the board

The board needs sufficient relevant skills and understanding to review and challenge management performance. It also needs adequate size and appropriate levels of independence and commitment to fulfill its responsibilities and duties.

4. Integrity and ethical behavior

Integrity should be a fundamental requirement in choosing corporate officers and board members. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.

5. Disclosure and transparency

- a. Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders with a level of accountability.
- b. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting.
- c. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

C. Capital Markets Authority- Kenya

1. Authority and Duties of Members [or Shareholders]

Members or shareholders [as owners] of the corporation shall jointly and severally protect, preserve, and actively exercise the supreme authority of the corporation in general meetings. They have a duty, jointly and severally, to exercise that supreme authority of the corporation to:

- a. Ensure that only competent and reliable persons, who can add value, are elected or appointed to the Board of Directors;
- b. Ensure that the Board is constantly held accountable and responsible for the efficient and effective governance of the corporation so as to achieve corporate objectives, prosperity and sustainability.
- c. Change the composition of a Board that does not perform to expectation or in accordance with the mandate of the corporation.

2. Leadership

Every corporation should be headed by an effective Board that should exercise leadership, enterprise, integrity, and judgment in directing the corporation so as to achieve continuing prosperity and to act in the best interest of the enterprise in a manner based on transparency, accountability and responsibility.

3. Appointments to the Board

Appointments to the Board of Directors should, through a managed and effective process, ensure that a balanced mix of proficient individuals is made and that each of those appointed is able to add value and bring independent judgment to bear on the decision-making process.

4. Strategy and Values

The Board of Directors should determine the purpose and values of the corporation, determine the strategy to achieve that purpose and implement its values in order to ensure that the corporation survives and thrives and that procedures and values that protect the assets and reputation of the corporation are put in place.

5. Structure and Organization

The Board should ensure that a proper management structure [organization, systems and people] is in place and make sure that the structure functions to maintain corporate integrity, reputation, and responsibility.

6. Corporate Performance, Viability, and Financial Sustainability

The Board should monitor and evaluate the implementation of strategies, policies and management performance criteria and the plans of the corporation. In addition, the Board should constantly review the viability and financial sustainability of the enterprise and must do so at least once every year.

7. Corporate Compliance

The Board should ensure that the corporation complies with all relevant laws, regulations, governance practices, accounting, and auditing standards.

8. Corporate Communication

The Board should ensure that the corporation communicates with all its stakeholders effectively.

9. Accountability to Member

The Board should serve the legitimate interests of all members and account to them fully.

10. Responsibility to Stakeholders

The Board should identify the corporation's internal and external stakeholders; agree on a policy or policies determining how the corporation should relate to, and with them, in creating wealth, jobs and the sustainability of a financially sound corporation while ensuring that the rights of stakeholders [whether established by law or custom] are respected, recognized and protected.

11. Balance of Powers

The Board should ensure that no one person or group of persons has unfettered power and that there is an appropriate balance of power on the Board so that it can exercise objective and independent judgment.

12. Internal Control Procedures

The Board should regularly review systems, processes, and procedures to ensure the effectiveness of its internal systems of control so that its decision-making capability and the accuracy of its reporting and financial results are maintained at the highest level at all times.

13. Assessment of Performance of the Board of Directors

The Board should regularly assess its performance and effectiveness as a whole and that of individual members, including the Chief Executive Officer. A summary of the major findings together with a statement confirming that the Board has carried out a self-assessment exercise should be made to the annual general meeting.

14. Induction, Development and Strengthening of Skills of Board Members

The Board should recognize the need for new members to be inducted into their roles and for all Board members to develop and strengthen their governance skills in light of technological developments, changing corporate environment and other variables. The Board should accordingly organize for the systematic induction and continuous development of its members.

15. Appointment and Development of Executive Management

The Board should appoint the Chief Executive Officer and participate in the appointment of all senior management, ensure motivation and protection of intellectual capital crucial to the corporation, ensure that there is appropriate and adequate training for management and other employees and put in place a succession plan for senior management.

16. Adoption of Technology and Skills

The Board must recognize that to survive and thrive it has to ensure that the technology, skills and systems used in the corporation are adequate to run the corporation and that the corporation constantly reviews and adopts the same in order to remain competitive.

17. Management of Corporate Risk

The Board must identify key risk areas and key performance indicators of the corporation's business and constantly monitor these factors.

18. Corporate Culture

The Board should define, promote and protect the corporate ethos, ethics and beliefs on which the corporation premises its policies, actions and behaviour in its relationships with all who deal with it.

a. Social and Environmental Responsibility

The Board should recognize that it is in the enlightened self-interest of the corporation to operate within the mandate entrusted to it by society and shoulder its social responsibility.

b. Recognition and Utilization of Professional Skills and Competencies

The Board should recognize and encourage professional development and, both collectively and individually, have the right to consult the corporation's professional advisers and, where necessary, seek independent professional advice at the corporation's expense in the furtherance of their duties as directors.

c. Recognition and Protection of Members' Rights and Obligations

Members of the corporation have a right to receive any information that would materially affect their membership, to participate in any meeting of members and to participate in the election of directors and be facilitated to fully participate in all other resolutions of interest to them as members.

d. The attention of the Boards of Directors is increasingly being drawn to the need to ensure that:

- i. The governance framework takes account of gender and children's rights and the special needs of disabled and/or handicapped citizens.
- ii. The corporation promotes the interests, rights, and welfare of host communities.
- iii. The corporation protects and preserves the environment.

D. Kuwait

1. Rights of Shareholders

- Secure methods of ownership registration;
- Convey or transfer shares;
- Obtain relevant and material information on the company on a timely and regular basis;
- Participate and vote in general shareholder meetings;
- Elect and remove members of the board; and
- Share in the profits of the company.

2. Facilitation of Basic Shareholder Rights

Companies should address, at a minimum, all the basic rights of shareholders, and the procedures and precautions for exercising these rights in their corporate governance policy.

3. Rights related to General Shareholder Meetings and Voting

General shareholder meetings should be organized once a year, at least within the six months following the end of the company's financial year.

4. Dividend Rights

Clearly define and adopt a stable dividend policy, which should be announced to the shareholders at the general shareholder meeting and also included in the company's annual report, prospectus and circulars.

5. Ownership Structure

Disclosure of the names of major shareholders, who own more than 5%, directly or indirectly (through subsidiaries, portfolios, or funds) in a table with the amount and proportion of shares held, share class, and percent of total voting rights. Such ownership table should also be incorporated into the annual report and disclosed on the company website.

6. Equitable Treatment of Shareholders

Disclose capital structures and strategies/mechanisms which grant some shareholders higher proportions of control than their effective participation in the capital.

7. Role of Stakeholders

The Board of Directors should identify each group of stakeholders (internal and external) and recognize their legal rights. Stakeholders should be sufficiently informed about the company's policies and procedures, which aim to protect stakeholders' rights.

8. Disclosure & Transparency

Establish an information policy & procedure and disclose it to the investors and stakeholders. Such policy should cover the category/type of information that should be disclosed to the public or in general shareholder meetings, and the form, frequency and method of disclosure.

9. Related to Financial Disclosure

Periodic financial statements and footnotes should meet the internationally recognized financial reporting standards and practices, and report any deviations from and, changes in, the accounting methods applied.

10. Related to Non - Financial Disclosure

Disclosure of all material business relationships, and material provisions of contracts, with agencies/consultants/banks (for example, credit rating agencies, investment banks and research analysts), who provide information (in the form of opinions/views/recommendations/analysis) on the company.

11. Related to Corporate Governance

The Board of Directors should disclose the corporate governance practices in the company, and report any deviations from the recommended best practices, describe the solution it has adopted instead and explain the reason in each case. This information should be disclosed in a separate "Corporate Governance" section in the annual report.

12. Responsibility of the Board

The Board of Directors, with approval from the general assembly, should set the appropriate number of members that suits the company's operations, phase of development and other relevant circumstances. General rules in this respect should be incorporated in the Articles of Association of the company.

13. Separation of the Chairman's Role

To ensure an appropriate balance of power, increased accountability and greater capacity of the board for independent decision-making, it is recommended that companies separate the position of the Chairman from any other executive position in the company, such as the Chief Executive Officer (CEO) or the managing director or the general manager.

14. Committees

Three different committees be created, namely an Audit Committee, a Compensation Committee, and a Nomination Committee. The Board of Directors should determine the advisability of adding other committees (such as risk management, investments, corporate governance etc.) with the conditions and necessities of the company.

15. Roles & Responsibilities of the Board

The role and responsibilities of the Board of Directors should be defined and clearly stated in the company's Articles of Association or By-Laws in consistence with its functions, and include the following:

- a. Review and approve key business matters such as the vision and mission of the company, strategy, financial targets, risks, major business plans and annual budgets. The board should also monitor the implementation of those business matters by management to ensure efficiency.
- b. Set and approve a written unique corporate governance policy for the company, review the implementation, and level of compliance to the policy on an annual basis.

16. Board Meetings

Meetings of the Board of Directors should be held at least once every two or three months, upon a written request of the Chairman, or upon a written request submitted by the majority of the directors.

17. Evaluation & Training

The Board of Directors and the board committees should annually (or as deemed necessary) self evaluate its size, composition, organization, tasks, and performance, as well as the contribution made by each of its members, the Chairman, using a systematic and structured process, with the aim of developing and improving the board's working methods and efficiency.

18. Management Effectiveness

The executive management team conducts the day-to-day management of the company and, therefore, is responsible for achieving the goals and implementing the strategy and policies of the company.

Appendix 4: Sample Frame Summary

The following table shows the sample frame in summary:

Table 1. Sample frame						
Strata	Population	Average performance indicators				Sample population
		ROA	ROE	
SCB	2					100%
Conventional banks	41					100%
	43					

Source: Research Data 2011