

**EFFECT OF CORPORATE GOVERNANCE ATTRIBUTES ON
FINANCIAL PERFORMANCE OF TIER-TWO COMMERCIAL BANKS
IN KENYA**

BY


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**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE
REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTER OF SCIENCE IN
FINANCE AT THE SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI.**

NOVEMBER 2022

DECLARATION

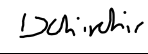
This research project is my own original work and has not been presented for a degree at any other university.

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ACKNOWLEDGEMENT

I would like to extend my sincere appreciation to Mr. Dan Kibet Chirchir, my supervisor, for your continuous support in addition to invaluable guidance in developing this paper. Your patience with my limitations, advice and recommendations are graciously appreciated. In addition, I would want to use this opportunity to express my gratitude to Dr. Kennedy Okiro, my co-supervisor, for the essential help you have provided. In addition, I would want to use this opportunity to convey my appreciation to my family and friends for their never-ending prayers, words of encouragement, and support during the time that I was working toward obtaining my degree.

DEDICATION

This endeavor is dedicated not only to my mother and father but also to the rest of my family and friends in recognition of the unending love, support, and encouragement they have shown me throughout my life.

TABLE OF CONTENT

DECLARATION.....	ii
ACKNOWLEDGEMENT.....	iii
DEDICATION.....	iv
LIST OF TABLES	viii
LIST OF FIGURES	ix
LIST OF ABBREVIATION	x
ABSTRACT.....	xi
CHAPTER ONE: INTRODUCTION.....	1
1.1 Background	1
1.1.1 Corporate Governance Practices	2
1.1.2 Financial Performance	3
1.1.3 Financial Performance and Corporate Governance	4
1.1.4 Commercial Banks in Kenya	5
1.2 Research Problem	6
1.3 Research Objective.....	7
1.4 Value of the Study.....	7
CHAPTER TWO	9
LITERATURE REVIEW	9
2.1 Introduction.....	9
2.2 Theoretical Review	9
2.2.1 Agency Theory.....	9
2.2.2 Resource Dependency Theory	9
2.2.3 Stewardship Theory	10
2.3 Factors affecting Financial Performance	11
2.3.1 Corporate Governance and Financial Performance	11
2.3.2 Bank Size	11
2.3.3 Bank Liquidity	12
2.4 Empirical Studies	13

2.4.1 Board Composition and Financial Performance	13
2.4.2 Board Size and Financial Performance	14
2.4.3 CEO Tenure and Financial performance.....	15
2.5 Conceptual Framework	16
2.6 Summary of Literature Review	17
CHAPTER THREE	18
RESEARCH METHODOLOGY	18
3.1 Introduction	18
3.2 Research Design.....	18
3.3 Study Population	18
3.4 Sample Design	18
3.5 Data Collection	19
3.6 Data Analysis	19
3.6.1 Diagnostic Test	19
3.6.1.1 Normality Test	19
3.6.1.2 Multicollinearity Test.....	19
3.6.1.3 Autocorrelation Test	20
3.6.2 Multiple Correlation Model	20
3.6.3 Significance Test.....	21
CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND INTERPRETATION	22
4.1 Introduction	22
4.2 Proportion of Tier Two Banks Analysed	22
4.3 Descriptive Statistics.....	22
4.4 Diagnostic Tests.....	27
4.4.1 Normality Test.....	28
4.4.2 Multi-Collinearity Test.....	35
4.4.3 Autocorrelation.....	35
4.5 Multiple Regression Analysis	37
4.5.1 Regression of Beta and Coefficient.....	38

4.6. Interpretation and Discussion of Findings	39
CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS.....	41
5.1 Introduction.....	41
5.2 Summary	41
5.3 Conclusions.....	41
5.4 Policy Recommendations.....	41
5.5 Limitations of the Study.....	42
5.6 Areas for further Study	42
REFERENCES.....	44
APPENDICES	52
Appendix I: List of Tier-2 Banks.....	52
Appendix 2: Raw Data.....	53

LIST OF TABLES

Table 3.1: Measurement of Variables	20
Table 4.1: Test of Normality	28
Table 4.2: Multi-Collinearity Test Table	35
Table 4.3: Test for Autocorrelation	36
Table 4.4: Correlation of Variables	36
Table 4.5: Regression Analysis.....	37
Table 4.6: Model Summary	37
Table 4.7: Analysis of Variance.....	37
Table 4.8: Beta Coefficients	38

LIST OF FIGURES

Figure 2.1: Conceptual Framework	16
Figure 4.1: Board Size of Bank over the Study Period.....	23
Figure 4.2: Bank Size Over the study period.....	24
Figure 4.3: Liquidity of Bank over the Three-Year Period	24
Figure 4.4: CEO Tenure over the study Period.....	25
Figure 4.5: Board Composition over the 3 Year Period	25
Figure 4.6: Bank Performance based on various Metrics	26
Figure 4.7: Return on Assets of Banks over the 3year Period	27
Figure 4.8: QQ plot Board size.....	29
Figure 4.9: Histogram Board Size	29
Figure 4.10: QQ plot Board Composition.....	30
Figure 4.11: Histogram Board Composition.....	30
Figure 4.12: Return on Assets.....	31
Figure 4.13: Histogram Return on Assets.....	31
Figure 4.14: QQ plot Bank Size.....	32
Figure 4.15: Histogram Bank Size.....	32
Figure 4.16: QQ plot Liquidity	33
Figure 4.17: Histogram Liquidity	33
Figure 4.18: QQ plot CEO Tenure.....	34
Figure 4.19: Histogram CEO Tenure.....	34

LIST OF ABBREVIATION

BOD:	Board of Directors
CBK:	Central Bank of Kenya
CEO:	Chief Executive Officer
EBIT	Earnings Before Interest and Taxes
NSE:	Nairobi Securities Exchange
OECD:	Organization for Economic Cooperation and Development
PSICG:	Private Sector Initiative for Corporate Governance
ROA:	Return on Assets
ROE:	Return on Equity
SMEs:	Small and Medium-Sized Enterprises
SPSS:	Statistical Package for Social Sciences
SSA:	Sub-Sahara Africa
US:	United States

ABSTRACT

Corporate governance dysfunctions have been linked to failures of several financial institutions. The managerial problems triggered the 2008-2010 global financial crisis that led to devastating effects on the economy for several years. In Kenya, Chase and Imperial Banks collapsed because the managed failed to implement appropriate liquidity control and risk management structures. The study aimed at exploring the correlation between the selected corporate governance mechanisms (board size, composition, CEO's tenure and liquidity) and financial performance of tier two commercial banks in Kenya between 2017 and 2019. Census method was utilized to collect data on the corporate governance styles and financial performance of all tier-two banks in Kenya. Kolmogorov-Smirnov's normality tests and Durbin-Watson's autocorrelation tests were further administered to derive the multiple correlation model for predicting the relationships between the studied corporate governance practices and the bank's ROA. Durbin Watson's test result was 1.835 and all the variables had a weak correlation of below 0.05. Consequently, the studied corporate governance mechanisms hardly affect the ROA of the tier-two banks. The tier-two banks should restructure their corporate governance practices accordingly and embrace lean board sizes, comprehensive liquidity control procedures and appoint high performing CEO's and provide ample time for the executives to deliver their mandates.

CHAPTER ONE

INTRODUCTION

1.1 Background

Organizations of all kinds incorporate the use of Corporate governance (CG) as it is one of the critical success factors. The concept provides a systematic framework for achieving entities' short and long-term goals, internal control mechanisms for ensuring accountability and corporate disclosure techniques. As Michire (2017) explains, corporate governance harmonizes the interests of organization's external and internal hence guarantee a smooth run of the company. CG includes the structures, policies and systems put in place to create value for the stakeholders. Kumar and Singh (2016) argue that the corporate law places a fiduciary duty on the board to prioritize the shareholders' interests over those of the management teams. This ultimately influences a firm's profitability. According to Wanyama and Olweny (2013), many corporations globally are prone to corporate failures arising from every day managerial dysfunctions. Good examples include the 2007-2010 global financial crisis. According to Bermpei and Mmatzakis (2015), the affected mortgage firms (AIG, Lehman, Merrill and others) that triggered the 2008 crisis failed to provide the checks needed to promote sound business practices. As a result, they issued non-performing loans including to non-credit-worthy customers.

In contrast, the entities with sound CG practices maintained financial stability despite the recession. As Conyon *et al.*, (2011) cite, many studies that compared the operations of the sub-prime mortgage-lending firms against the industry leaders. The study found that the executives of the sub-prime lenders had limited time to monitor their firm's risk profile since they served in the boards of several firms, some also had few years' experience thus lacked financial risks management skills and were less diverse in gender. The results highlight the critical roles of having experts with vast knowledge and skills to ensure diverse dialogue in their boardrooms and eliminate uncalculated risk-taking behaviour.

Similarly, the collapse of number of Kenyan banks in the recent past has been linked with CG problems. Imperial and Chase banks did not adhere to disclosure requirements outlined by Central Bank of Kenya/CBK (Osebe and Chepkemoi, 2016). However, when banks managers enjoy unchecked freedom with minimum control and supervision, they get a chance to advance their

interests more compared to debt holders' interests (Caprio and Levine, 2002). Such executives instead engage in activities that derive personal benefits (Shabi *et al.*, 2014). While exercising prudence in management, it leads to low capital costs, accelerated capital accumulation, as well as, high productivity. Banks with exemplary corporate governance styles such as Barclays, Standard Chartered, Citi Group, United Community Banks are key contributors to the world's economic growth. Citi Group, for example, sealed the loopholes that exposed it to liquidity risks prior to the 2008 financial crisis and currently has the third biggest assets in U.S (Benhamou, *et al.*, 2021). Locally, the strengths of Equity Bank, Cooperative Bank, Housing Finance corporations in terms of board characteristics, risk management, transparency in financial reporting allow the firms to excel in their markets. Equity Bank earned over 20 accolades in 2020 alone due to its innovativeness in utilizing the shareholders' investment to maintain steady growth.

Historically, bankruptcies of the banks often trigger devastating effects such as inflation, crippled economies, and rise in poverty rates. This is because the financial institutions play important role in socio-economic development such as providing access to capital, employment creation, offering stocks exchange trading platforms among other means of enhancing the entrepreneurial ecosystems. Tier two banks in this case are critical in ensuring the country socioeconomic prosperity (Levine, 2014). However, empirical evidence indicate that they are more vulnerable to failures due to poor corporate governance practices as compared to other industry players. As a result, the purpose of this study is to investigate the effects of corporate governance standards such as board size, board makeup, and CEO tenure on the rate of financial growth experienced by tier two banks, as measured by return on assets (ROA).

1.1.1 Corporate Governance Practices

Corporate governance involves changing the board characteristics, implementation of financial disclosure and transparency policies, and procedures for recruiting board members (OECD, 2015). Various scholars have defined the term differently. Adam and Mehran (2003) argue that CG is the methodology through which the shareholders creates frameworks to safeguard their investments by ensuring that executives prioritize all stakeholders' interests. The frameworks specify responsibilities in addition to the rights of the stakeholders, shareholder, agents, and directors, modes of disclosing financial statements and risk management policies. On the other hand, OECD

(2015) views CG as not only the means by which the firms' strategic goals are formulated but also the strategies for monitoring performance in order to ensure accomplishment of the targeted goals.

In Kenya, corporate governance is heavily influenced by Anglo-US model that prescribes the, ownership structures and legal systems defining the stakeholder's responsibilities (Koech *et al.* 2016). It aims at fostering trust, transparency and accountability needed to achieve financial prosperity and business integrity and inclusive societies (OECD 2015). As Barr (2004) explains, sound CG generate investor confidence and promote organizational profitability. Kenya private sector governance trust (1999) affirms that is the responsibility of the shareholder to elect competent directors and to ensure that elected directors govern the organization in a manner consistent with their role as stewards.

Studies further show strong positive correlation between CG and growth in banking institutions' financial prosperity. For example, study by Mang'unyi (2011) showed that banks with excellent corporate governance styles were better off in maintaining long-term profit growth than their poorly managed peers. Similarly, (Miring'u and Muoria's (2011) research involving 30 state corporations found a strong link between ROE and board characteristics. Owing to these pieces of empirical evidence, regulatory agencies such as CBK and CMA, as well as, financial management experts advise the banks to invest in regular corporate governance reforms in response to changes in their macro-economic environments.

1.1.2 Financial Performance

Bank's financial health relates to their ability to maintain high profit margins, generate sufficient wealth and maintain consistent growth in monetary values created to all the stakeholders (Leah, 2008). It is measured by the effectiveness of the firms in utilizing resources in attracting revenues. Overall, the metric shows entities' financial fitness over a given time-period. The corporate governance has been shown to elevate organizations' financial wellbeing and market valuation (OECD, 2015). This is because sound corporate governance practices reduce exploitation of a firm's assets by top managers and increase anticipated cash flows.

According to Athanasoglou *et al.* (2016), bank's financial performance depends on both external and internal environmental fluctuations. The internal factors can be managed and often vary from one bank to the next. They include governance structures, size of an institution, and liquidity status. Corporate governance, therefore, enable banks to reorganize their internal features in line with the changes in the external events so as to achieve the financial targets (Ponce, 2011).

Firms can employ various metrics such as ROA, ROCE and net profit margin and many others to monitor the trends in their financial performance (Heentigala and Armstrong, 2011). In this case, ROA is the profitability ratio indicating the net revenues generated per one unit of assets (Epps and Cereola, 2008). According Mohamad *et al.*, (2011), ROA can effectively indicate the strengths of an entity's corporate governance in leveraging the assets to generate returns for the stakeholders. Ideally, the higher the ROA ratio the greater the efficiency at which a firm converts the resources into revenues. Wepukhulu (2016) concurs that ROA is ideal for evaluating banks management efficiency because financial institutions are service providers and mostly rely on liquid assets (cash and cash equivalents) to maintain a competitive edge in their respective markets. As profit maximization hypotheses posits, sufficient net margin is a prerequisite for firm's survival (Mohammad *et al.*, 2011). In contrast, net losses arising from underutilization of assets increase the risk of bankruptcy.

1.1.3 Financial Performance and Corporate Governance

Good leadership policies and structures increases firms' likelihood of surpassing financial targets (Lapie and Perilleux, 2008). Conyon *et al.*, (2011) argue that implementation of sound corporate governance practices can enhance better resource utilization, efficiency in operations and increase in performance. Hence, failure of corporate governance can result into poor financial performance to any organization. However, effective CG help firms to create the good will and confidence to investors (Murerwa, 2015). The World Bank (2003) also argues that corporate governance practices are necessary for developing countries as a measure of reducing transaction costs, financial crisis and cost of capital. On the other hand, poor corporate governance discourages outside investors and reduces their will and confidence to the firm (Abdullahi, 2000). Therefore, sound corporate governance practices are necessary in Kenya banking sector to restore investors' confidence, attract foreign direct investment and investments (Kilonzo, 2008).

The banks with adequate structures for ensuring accountability of directors, and adequate risk management structure and transparency of financial disclosures are better positioned to maintain high growth rates than their poorly managed peers. Evidence shows that exclusion of good corporate governance styles adversely affects firm's financial position (Mwalati and Chitiavi, 2013). A case point is the Kenyan banking sector in the 1990's and 2000's that occasioned a number of bank failures resulting in depositor's woes. Similarly, recent cases of failures by Kenyan banks shows the connection between the institution's performance and CG practices. A good example is Chase and Imperial Banks that collapsed in 2016 and 2015 after the management failed to establish adequate internal controls and policies to regulate the conduct of the executives (Osoro and Muriithi, 2017; Abdulla, 2018). Globally, Trust, Euro, charter, and Dubai banks went under in 2001 2003, 2007 and 2015 respectively. Charter Bank was placed under receivership due to a series of corporate governance failures characterized by mismanagement, money laundering and fraud (Audrino *et al.*, 2019). Consequently, there is need to evaluate whether the tier two banks are making adequate adjustments in their CG approaches.

1.1.4 Commercial Banks in Kenya

One of the sectors that has been growing significantly in size and complexity over the years is the Kenyan banking. Banks play a huge role in terms of marshalling funds required for investment purpose through giving credit to individuals, investors and businesses. Banks offer services such as allowing customer deposits, lending services, interbank borrowing, forex exchange services et cetera. CBK and Capital Markets Authority as stipulated in the Banking Act regulate the sector. The agencies involve corporate governance rules that the commercial banks operating in the country must follow (Koech *et al.*, 2016).

As per CBK report (2017), the Kenyan banking industry is comprised of three tiers of banks namely tier one, tier two and tier three banks. The classification of these three tiers is based on the net assets of each bank and these three tiers all make up 42 registered commercial banks. Tier one controls a total market share of 49.88% and assets of Ksh. 1.6 trillion (CBK, 2015). Tier two bank comprises of medium size lenders and they control 41.7% of the market share and total net assets of Ksh. 1.4 trillion. The smaller banks are classified under tier three with a market share of 8.4%

with net assets of Ksh. 0.27 trillion (CBK, 2016). Tier two banks in Kenya represent institutions in the fast-growing section of the banking industry targeting all segments of the market therefore the need for regulators to ensure control by providing laws and guidelines (CBK, 2017). There are more than 14 banks in this category as shown in appendix 1. The project concentrated on the tier 2 banks based on the fact they tend to engage in risky behaviours in order to prosper. Tier 1 is referred as going concern while tier 2 is regarded as gone concern. Tier 2 banks have supplementary capital such as undisclosed reserves, hybrid financial instruments and subordinated debts (Fidrmuc and Lind, 2020).

1.2 Research Problem

Many banks have had various corporate failures due to inadequate management systems. Charter Bank went into receivership in 2007 due to poor management, and money laundering. Similarly, Imperial Bank and Chase Bank's failures are attributable to corporate governance issues. While sound corporate governance practices requiring firms by making decisions to maximize values for all stakeholders, the affected banks engaged in insolvent trading exposing the shareholders to significant losses. For example, Imperial Bank allotted bond to investors on September 21, 2015 while the board members had full knowledge that the bank was going bankrupt (Osoro and Mureithi, 2017).

Currently, mobile phone influx and related digital technologies are enabling institutions to offer loans to consumers that were previously seen as un-credit worthy. According to Bharadwaj *et al.*, (2019), the default rates among the digital borrowers have quadrupled over the past half a decade. On the other hand, statistics indicate that board of director's reluctance to create systems to eliminate the non-performing loans and related risks increases chances of poor financial health. Chase Bank's corporate governance lacked transparency hence did not disclose insider loans of more than Ksh.8 billion (Business Today, 2016). Similarly, the upcoming investment institutions such as Cytonn that has been on the spotlight due to their corporate governance failures (Owino, 2021). In most cases, the CG dysfunctions are followed by financial difficulties, decline in performance and a successful turnaround that rarely are achieved in Kenya. Customer are usually deeply concern about their deposits and speculations resulting in hurried withdrawal of funds and asset from 'unstable banks' to more thought as 'stable banks' in tier-one. On the other hand,

Nyarige (2012) found that proper corporate governance increases firms' efficiency, profitability, as well as, their ability to maximize wealth for shareholders.

Bank also lend to individuals, businesses, investors and governments. Therefore, the impact of their failure is felt throughout the economy with long-term impact. Such impacts include depositors' woes, reduced lending capacity and decrease in investors' confidence. Good example is Cytonn's board of management has been accused of misleading the shareholders to invest over ksh.10 billion into risky venture that may not attract significant returns (Owino, 2021).

As such, the finding of this study will inform regulators on future policy guides and regulation aimed to improve the level of confident and trust for local and foreign investors and stakeholder in the banking industry. It aims at filling the knowledge gap hindering the tier two banks from sustainable financial growth. Wepukhulu (2016) conducted a similar study but the focus was on all Kenyan commercial, therefore, did not adequately explore the specific corporate governance issues facing tier 2 banks. Consequently, the management teams of tier-2 banks, as well as, the regulatory bodies (CBK and CMA) needs access to timely empirical data to cope effectively with the fluctuations in internal and external environments. The purpose of this study is to determine whether or not there is a connection between good corporate governance and the financial performance of Kenya's tier-two banks.

1.3 Research Objective

The purpose of this research is to investigate the extent to which certain corporate governance standards are related to the financial performance of Kenya's tier two commercial banks between the years 2017 and 2019.

1.4 Value of the Study

This project's result intends to enhance knowledge on corporate governance roles in two-tier commercial banks growth. The study benefits all financial institutions especially tier-two banks with regard to identifying key influences of their performance, mitigation strategies and areas that they need to improve on concerning corporate governance practices. The outcomes help to safeguard against future failures' even within other tiers.

In addition to this, it plans to provide academics and researchers with a wide range of knowledge concerning the relationship between the structure of financial regulation and the expansion of the economy. The result outlines the strategic framework for tier two banks especially on how to improve their performance through corporate governance. Furthermore, the findings are of benefit to policymakers, customers, stakeholder and regulators in the banks sector through the establishment of the best oversight policies for safeguarding the innocent investors from corporate greed like in the case of Imperial and Chase banks.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

In-depth analysis of ideas and empirical research governance on tier-two banks' ROA is conducted in this chapter. Additionally, it explores pertinent study factors such the correlation between board features and improvements in banks' financial performance as well as numerous schools of thought that have been articulated in empirical studies on corporate governance.

2.2 Theoretical Review

Agency, Stewardship and Resource dependency theory will be employed throughout the project due to their relevance to the study topic.

2.2.1 Agency Theory

Alchian and Demsetz presented the concept in 1972, while Jensen and Meckling expanded upon it in 1976. Both of these events took place in 1972. The agency model has its origins in economic theory, although it is most commonly used in corporate governance (Gompers et al., 2003). The link between business owners or shareholders (principle) and corporate leaders and managers is discussed in the agency theory (agents). According to Clarke (2012), shareholders frequently engage the agent to manage their companies on their behalf. In other words, the principle hands up control of the company to managers or directors, who are responsible for making decisions that will increase shareholder wealth. However, some directors often pursue selfish goals thereby leading to conflict of interest (Chrisman *et al.*, 2015). In this case, the managers of the tier-two banks should implement corporate governance procedures that would attract high returns and maintain financial growth of their organizations (Fama and Jensen, 2016). However, the agency theory does not cover the contents of the corporate governance policies required to eliminate the bad relations between the management and shareholders. The behavioural assumptions concentrate on opportunistic character of managers but not some critical attributes of corporate governance like the board characteristics.

2.2.2 Resource Dependency Theory

The theory was postulated by Pfeffer and Salancik in 1978. RDT is based on economics and sociology principles relating to the power distribution throughout an organization. According to

Biermann, and Harsch (2017), the theory shows the importance of the board in sourcing the internal and external environment resources needed by the firms to achieve their targeted goals. For example, appointment of independent representatives makes it easy for of a company to save on costs and period of nurturing new talents until they gain the appropriate skills set required to fill the senior executive levels (Wan *et al.*, 2012).

Even though the efficiency level of the management teams enhances firms' profitability, it is important to recruit board members with diverse knowledge and experiences. Highly qualified executives enable organizations to acquire knowledge and build sustainable competitive edges. RDT emphasizes that having executives with the right business connections increases firm's ability to advocate for appropriate changes in policy formulation (Pfeffer, 1978). Overall, human, technological and financial resources are critical in the success of organizations of all kinds. The tier-two banks can employ the theory to allocate the resources in ways that generates the highest possible ROA. However, by assuming that the material factors impact on the firms' success, RDT ignores the important role of cultural, institutional and ideological factors in the prosperity of organizations (Sherer *et al.*, 2019). The theory, nevertheless, comprehensively covers the connection between corporate governance and firms' long-term growth.

2.2.3 Stewardship Theory

In 1997, Donaldson and Davis founded the theory of Stewardship. It complements but also serves as a contrast to agency theory (Davies, 1997). That is, stewardship theory contrasts the self-seeking motives emphasized in the agency theory and suggests that performance is driven not by the greed of executives but by personalities that contradicts with aims and objectives of an organization. The theory emphasizes that stewards entrusted by shareholders should aim optimizing values for the shareholders by maintaining high level profit growth. Stewards in this case are the executives and managers working on behalf of shareholders. Their joy and motivation is associated to the firm's success in terms of maximizing shareholders' wealth through profits from firm's operations (Nyarige, 2012).

Stewardship theory advocates that top management should act as stewards by, assimilating their roles with the organization aims rather than that of their own (Kyere and Ausloos, 2021). It also

depicts the importance of good structures within an organization. Appropriate structures within an organisation empowers stewards and ensure they achieve maximum control of the firm thereby reducing cost of monitoring manager and operational (Kirui, 2016). Therefore, the framework helped to identify the appropriate changes needed by the management boards of the studied tier-2 banks to be stewards or ambassadors of financial excellence at their organizations.

2.3 Factors affecting Financial Performance

Bank's financial success rely on the efficiency at which the management responds to the fluctuations in the internal and external factors. Each bank faces unique internal factors while external factors are general and result from prevailing industrial and macroeconomic conditions.

2.3.1 Corporate Governance and Financial Performance

Theoretical and empirical statistics indicate that prudent often results into growth in organizations' financial position. In contrast, weak corporate governance often subjects organizations into bankruptcy. As Bermpei and Mamatzakis (2015) found, CG elements such as capital structures foster efficient resources utilization that in turn translate into sustainable increment in profitability. The CG practices serves as mechanism upon which checks, and balances are established and maintained to reduce mismanagement and corporate stability amidst a more competitive business environment.

2.3.2 Bank Size

The outcomes from economies of scale that enable banks to accumulate the resources needed to appoint experts into their managing boards. At the same time, bigger banks are able to save on running costs, improve their operations through increased efficiency and ultimately enhance their performance. Kyere and Ausloos (2021) argue that the large corporations can diversify their loans portfolio and offer range of services thereby increasing their net margins. The industry leaders are also viewed by customers as more stable and ideal investment choices. Consequently, the banks achieve consistency in financial performance and growth. However, financial institutions that have become extremely big experience significant corporate governance dysfunctions (Sharma and Gounder, 2015). Various costs of running large financial institutions such as overheads, operation and agency costs reduce their profitability. According to Phillips *et al.*, (2018), the diversity in

interests among the stakeholders of the large corporation translates into complexities in dealing with barriers to seamless coordination such as competing demands, cultural stereotypes and other diseconomies of scale. As such, the correlation between bank size and financial growth seems inconclusive. Therefore, this project would add new insights into how the of the tier two banks affects their corporate governance and profitability in the long run.

2.3.3 Bank Liquidity

Liquidity level is a critical success factor. Literature indicates that liquidity crunch of one financial institution can have spiral and devastating effect on the entire economy because of their interconnectedness of the industry players (Pervan *et al.*, 2015). In this case, liquidity levels of the financial institutions show the firms' ability to finance acquisition of resources, as well as, meet their financial obligations as they mature. According to Musiega *et al.*, (2017), solvency/liquidity risk occurs whenever the banks fail to settle their outstanding debts that have matured. The big portion of capitalization in total assets can constitute prudential policy frameworks (Pervan *et al.*, 2015). Ideally, the banks that have increased their capitalization relative to total assets achieve greater success.

2.3.4 Board of Directors Composition

Boards' composition refers to various members serving in an organization's managerial board such as non-executive and executive directors. According to Connelly and Limpaphayom (2004), corporate governance aims at guiding the executives in performing assigned duties. Banks like other institutions have non-executive (dependent) and executive (independent) directors (Shah *et al.*, 2011). Beasley, (1996) argues that dependent executives have access to business secrets that are not available to outsiders. However, this can lead to business malpractices such as insider trading. As a result, CBK advocates for cooperate governance structure that promotes professionalism among all the board members (Chepkosgei, 2013). The functions of such executives as a pillar for corporate governance in banks is very important in an environment of low competition, tightened government regulation, and digitalization of banking systems due to the ever-increasing complexity of operating a bank. Thus, the board composition is an important success factor. In Fidrmuc and Lind's (2020) view, well-designed corporate governance systems not only monitor behavior of senior managers but increases business access to advices on business strategies and

opportunities to pursue at the right time. Other studies have also shown that, the executives' achievement rely on size of the board, cultural and gender diversity, average age of directors, board tenure and skills set (Bermpei and Mamatzakis 2015; Sherer *et al.*, 2019; Omware *et al.*, 2020). Therefore, having board from diverse backgrounds and with vast knowledge and experience on cooperate banking sector enhances chances of long-term financial growth.

2.3.5 Board Size

The number of executives constituting the board makes the board size. Its primary function is to monitor, supervise, discipline and replace non-performing executives. Studies have related corporations failures such as Nakumatt Kenya, Enron, and WorldCom with the board characteristics (Morten et. al 2006). A study by Sanda *et al.*, (2005) indicate that having several and experienced board members makes firms more efficient. However, scholars are indifferent on the right number of board of directors. While Yermack (1996) recommended between eight and ten members, Sanda (2005) prefers 10 executives. The changes have been necessitated by the desire to reduce agency problems, increase financial success and generate the highest possible values to the shareholders (Bermpei and Mamatzakis 2015).

However, the studies concur that board comprising members of diverse backgrounds, gender, knowledge, experience, and expertise leads to exceptional management and performance (Belkhir, 2009; Sharma and Gounder, 2015). Due to the complexities of the banks' business environment, CBK (2013) advices banks to recruit board members with vast knowledge and experience. Similarly, the executives serving in various committees such as lending, audit and credit risk should be experts with reputable records of accomplishment (Nganga, 2017).

2.4 Empirical Studies

The expansion of knowledge and its application to issues of corporate governance play important roles in both the developed and developing economies. This is clear from the several research that will be mentioned further down.

2.4.1 Board Composition and Financial Performance

Several researchers have indicated that board composition directly affects the profitability of banks both in the short and long runs. Hülya (2016) in his study on 63 Borsa Istanbul-100 Index indicated

that well constituted boards posted high book value and ROE as compared to their counterparts that lacked some key skills in their management teams. A similar conclusion was reached by Kalu (2016) in his study involving randomly selected firms in Nigeria Stock Exchange. It was found that there was a correlation between the composition of the board and financial success. Locally, Ondigo (2016) did more research on the connection between the financial performance of Kenyan commercial banks and the board structure of those banks. It was found that board structure significantly predicted bank future financial prospects. Top players with agile corporate governance styles achieve steady growth as the board members' business networks and knowledge come in handy in creating new market niches, enhancing customer bases and lowering risks. An earlier study by Wachira (2014) on the link between the board structure and share return of firms listed in Nairobi Securities Exchange also reached the same verdict. However, the study was limited to share returns and more research can be done on other performance measures. Moreover, banks are operating under new environments characterized by digital revolution and high risks of nonperforming loans among the tier-two institutions

2.4.2 Board Size and Financial Performance

Although there is no consensus on the right board size, empirical literature indicates positive relationship between having more than six qualified directors with financial success. According to the findings of Belkhir (2009), expanding the size of corporate boards in banking organizations does not always achieve the results that are expected to occur. However, businesses with a sizable number of board members benefit from the diversity of viewpoints, which allows for in-depth consideration of strategic choices. Bredart (2014) conducted a study in the US to look at how the board configuration affected financial distress. The increasing number of businesses that declared bankruptcy between 2007 and 2014 served as the impetus for the investigation. According to Bredart (2014), companies that chose legal protections had significantly larger boards than those that did not. Wah et al(2015) .'s study likewise found a somewhat negative correlation between board size and ROA. In other words, the two study variables did not significantly correlate with one another (board size and financial health). According to Michire (2017), the size of the board did not play a significant role in Kenya's financial issues affecting commercial banks.

On the other hand, Husni *et al.*, (2020) raised concern that the directors' compensation may subject firms to financial constraints as the firms spend heavily in salaries thereby lowering retained

profits, as well as, ability to pursue emerging opportunities in the market. The findings imply that entities with smaller boards may encounter financial distress as compared to their counterparts with larger boards. Nevertheless, boards with many members experience slow decision-making on because all the executives must be consulted. Therefore, García *et al.*, (2018) prefer firms with small boards. Such firms are more effective in monitoring, oversight and connectedness (Dzingai and Fakoya, 2017).

2.4.3 CEO Tenure and Financial performance

Studies suggests that as much as rotation of chief executive officers increases transparency and shifts in corporate governance approaches, having one CEO for adequate amount of time promotes stability, investor confidence and overall growth in a firm's financial stators. A research by Zona Fabio (2016) showed that CEO's term affected returns on investment in research and development (R&D) differently over time. For example, the returns on R&D investment during the CEOS's first few years of appointment is negatively affected by stock options, low trust levels. In contrast, the CEOS who manage to stay at a firm for a long period navigates through the challenges and earns the management confidence thereby leading to high returns. Glowka *et al.*, (2021), that disclosed the CEO involvement play a significant role in risk management, that in turn, affects financial performance. Appointing independent directors to manage family businesses leads to accountability and persistent growth.

Mandala et al. (2017) conducted a study to evaluate the influence of board structure on the performance of Kenyan banks in order to gain further insight into this topic. Despite the fact that the study did not uncover a connection between the length of time a CEO has served and financial success, it does show that executive position rotation is important, especially when a CEO is lacking in key skill sets. For example, an old school director lacking digital skills in unlikely to motivate his/her team to launch the financial technology products and tap into the lucrative opportunities in the emerging fields.

2.5 Conceptual Framework

The relationship between the independent (corporate governance practices) moderating variables and the dependent variables is depicted in the conceptual framework, which may be found below in figure 1. (financial performance).

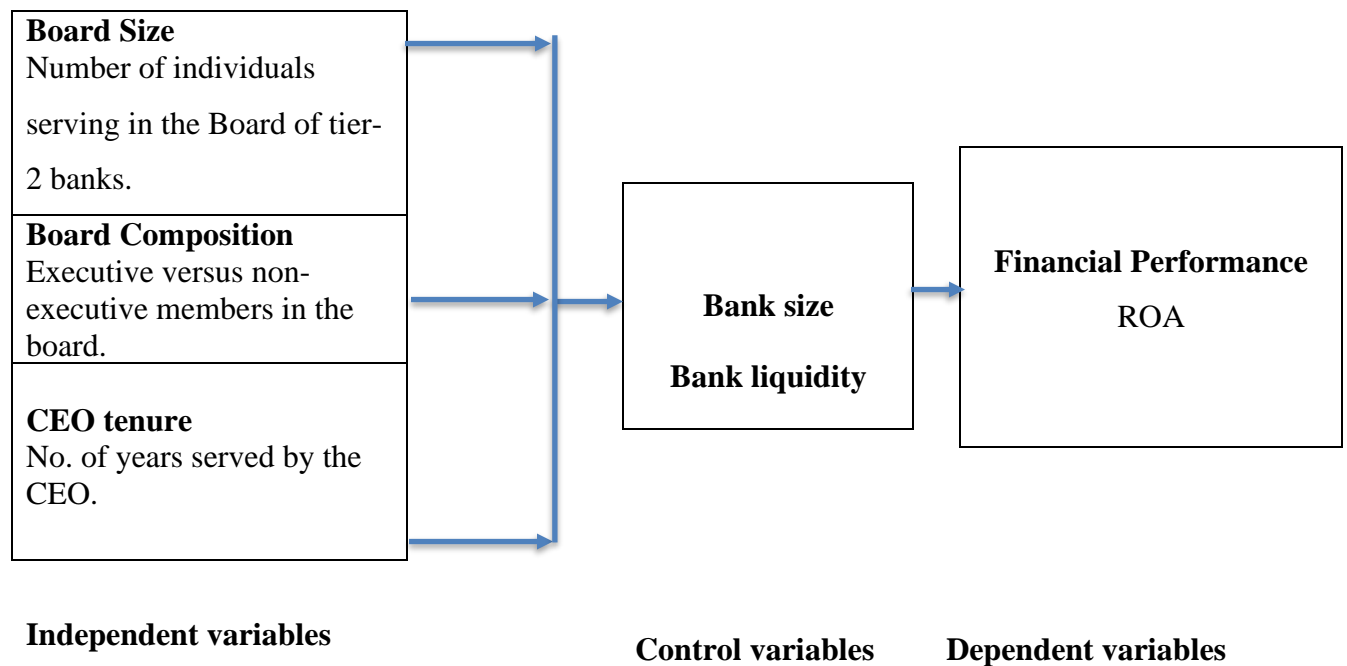


Figure 2-1: Conceptual Framework

(Source: Researcher, 2021)

2.6 Summary of Literature Review

Many scholars have explored the corporate governance roles practices performance trends of the firms. However, there is a significant research gap on the influences of CEO tenure, board size and composition on the profitability of tier-2 banks in Kenya. The banks operational environment are undergoing massive changes arising from changes in laws, consumer interests and digital technologies. This project, therefore, sought to fill this gap by employing agency, resource dependency and stewardship theories to monitor tier-2 banks corporate governance styles between 2017 and 2019.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter examines the procedures that are used in the process of gathering data, as well as the methods that are utilized in the process of analysis and interpretation. It discusses the participants in the research, the process of gathering the data, how the data will be analyzed, and how the findings will be presented.

3.2 Research Design

The plan that is developed in connection to the actual measurements that are used to investigate the relationship between the variables is referred to as the research design (Kothari, 2008). This study employed a correlational technique. According to Kiragu (2018) the technique helps to discover the connection of variables through statistical analysis. The researcher does not manipulate the variable in order to support or disagree with a hypothesis instead use existing data to establish the connection. Like in this case, the trends in corporate governance styles practiced by the tier-2 banks and their performance trends in the fiscal periods that ended on 31st December 2017, 2018 and 2019 helped to make conclusions on the relationship.

3.3 Study Population

The entirety of the people, activities, or things that are the subject of an observation is referred to as a population (Mugenda and Mugenda, 2013). In contrast to a target population, which is a specific subset of the phenomenon in which a researcher is interested, a sample population encompasses the entire population. Tier-two banks licensed in Kenya under the Banking Act were the intended audience in this case. The CBK's 2017 report has listed 14 tier-2 banks shown in appendix 1.

3.4 Sample Design

Census method is used as the number of studied firms are manageable. According to Vijayakumar and Prabhakar (2018), census have several advantages over sampling. First, there is high confidence interval since all the items in the study population are investigated as compared to sampling where conclusions are made on few items. Secondly, there are no room for sampling

errors that often affect the accuracy of study findings. However, census is more time consuming and may hinder the researcher from studying specific issues in detail.

3.5 Data Collection

This the process of gathering evidence to confirm the insight of a phenomenon (Mugenda and Mugenda, 2013). The secondary data for this study came from the annual reports that were provided by the banks. It also involved the CBK annual bank supervision report. Data collection form in appendix 2 was used in gathering data from the corporate governance practices in the studied organisations. Data targeted includes the information on the banks' board size, composition, and CEO tenure. Similarly, data relating to the financial stators such as total assets, loans issued, customers' deposits, operating revenues and expenses are available in the published statements.

3.6 Data Analysis

Data analysis refers are measures or procedures employed to make sense of the gathered information (Tully, 2014). The researcher used MS Excel 2016 and version 27 of Statistical Software for Social Scientists (SPSS) to monitor the impacts related to selected corporate governance attributes. The tools have special software that will help to generate data output, tables and graphs.

3.6.1 Diagnostic Test

In order to determine the nature of the correlation as well as the degree to which it exists between corporate governance and ROA, tests for normality, multicollinearity, and autocorrelation were carried out (Kiragu, 2018; Ghasemi and Zahesial, 2012).

3.6.1.1 Normality Test

The research adopted Kolmogorov- Smirnov's normality test, as well as, graphical technique to determine whether the data is distributed normally (Kiragu, 2018). This is because it is challenging to draw precise and trustworthy conclusions regarding whether the population is distributed regularly in reality.

3.6.1.2 Multicollinearity Test

Multi-collinearity refers to when a variable in a multiple regression model helps to linearly predict its effects in the equation with a degree of accuracy (Kiragu, 2018). The test was crucial in this

case for determining the effects of each of the examined corporate governance attributes on the banks' financial growth (Saunders *et al.*, 2015).

3.6.1.3 Autocorrelation Test

Autocorrelation refers to a mathematical representation of level of similarity between the data over the studied period (Khan, 2012). This is critical to determine whether the observations changes over time or will be adequate to predict future performance. According to Khan (2012), Durbin-Watson (DW) test is ideal for this type of study. The model's value ranges between 0 and 4 where 2.0 indicates no autocorrelation, a figure below 2 means that there is positive autocorrelation and 3 to 4 indicates negative autocorrelation.

3.6.2 Multiple Correlation Model

The correlation between the variables identified in conceptual framework in figure 1 above was expressed using multiple correlation equation shown below.

$$Y_{it} = \alpha + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{4it} + \beta_5 X_{5it} + \epsilon_i$$

Where:

α	Constant
Y_i	Financial Performance (ROA)
X_1	Board Size
X_2	Executive and non-executive directors
X_3	CEO tenure
X_4	Bank Size
X_5	Bank Liquidity
$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5,$	co-efficient of the model
ϵ_i	the stochastic error term
I	Tier 2 Bank
T	Time

Table 3-1: Measurement of Variables

Variable	Measurement
----------	-------------

Y_i	Return on Assets	$\frac{\text{Net income}}{\text{Total Assets}}$
$X1_{it}$	Board size	Number of directors on bank i board during a fiscal period
$X2_{it}$	Board composition	The ratio of non-executive directors to their executive counterparts at firm i during the studied fiscal period
$X3_{it}$	CEO tenure	logarithm of the number of years served by the CEO for firm i in period t .
$X4_{it}$	Bank Size	Log (total assets) at the end of the financial year
$X5_{it}$	Bank liquidity	$\frac{\text{Total Loans}}{\text{Total Deposits}}$

3.6.3 Significance Test

The study used a 95% confidence level T-test and an F-test to determine the combined significance of the coefficients.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND INTERPRETATION

4.1 Introduction

4.2 The results of the investigation are presented in this section for the very first time. After that, the findings are explained by utilizing the data from the multiple regression analysis.

4.3 Proportion of Tier Two Banks Analysed

All the tier-two banks in Kenya were studied except NIC Bank, Chase Bank and Imperial Banks. NIC engaged in a strategic alliance with CBA while Chase and Imperial Banks collapsed therefore were excluded from the study. The data from the remaining tier-2 financial institutions which accounts for 92% of the studied banking segment were collected using the data extraction sheet in appendix 2 and summarized in the raw data in appendix 2.

4.4 Descriptive Statistics

The analysis reveals the strengths of corporate governance of some banks over their counterparts. The ROA ranges from as low as 3% to 20.46%. The banks with recommended corporate governance styles such as I&M and Prime Bank recorded a relatively higher financial performance than the other industry players. The average ROA for the firms were 7.22%. Other descriptive statistics are as shown below.

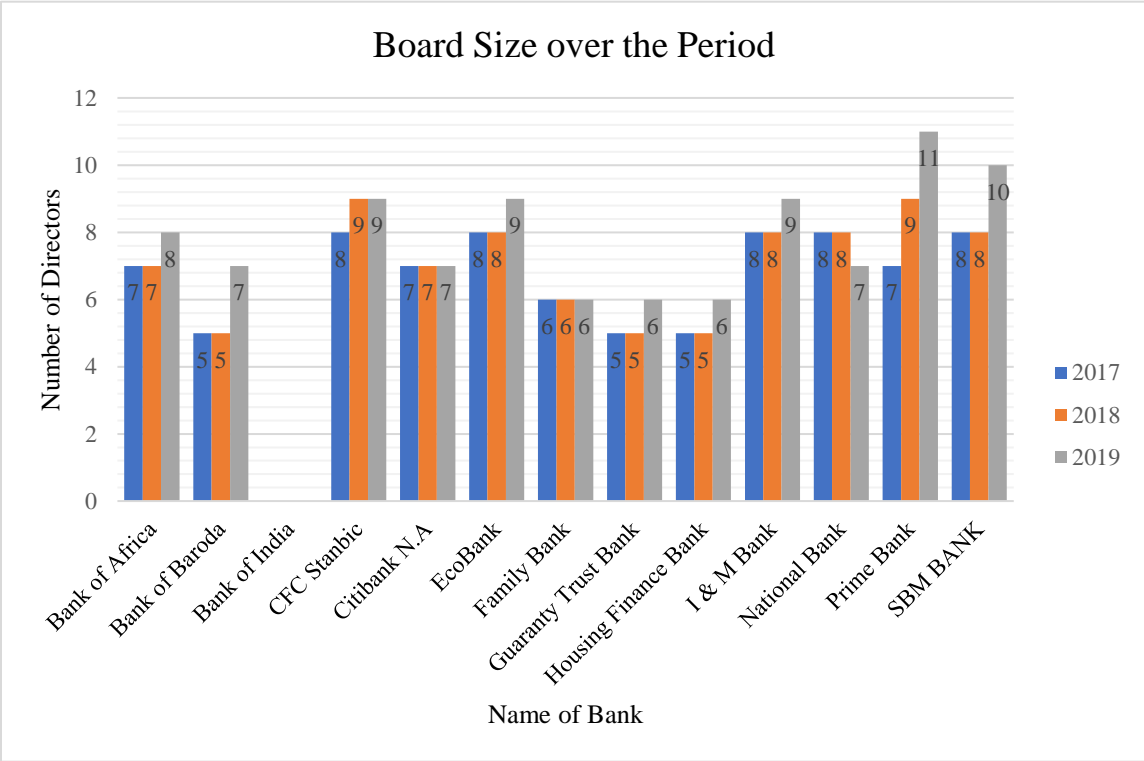


Figure 4.1: Board Size of Bank over the Study Period

(Source: Researcher, 2021)

Over the three-year period Prime Bank, SBM Bank, I&M Bank, Eco Bank, CFC Stanbic, Bank of Africa and National Bank had relatively large Board Size whereas Bank of Baroda, Guaranty Trust Bank, Housing Finance Bank had relatively small Board Size. Citi Bank and Family Bank maintained the same Board Size over the three-year period. Majority of the banks maintained the same Board Size in the first two years (2017 & 2018) and increased the board size the following year (2019). Bank of India had no Board over the three year period because most of the decisions were made by the executive directors based in Mumbai India. The Kenyan branch is a subsidiary hence is guided by the decisions made at the bank’s head office.

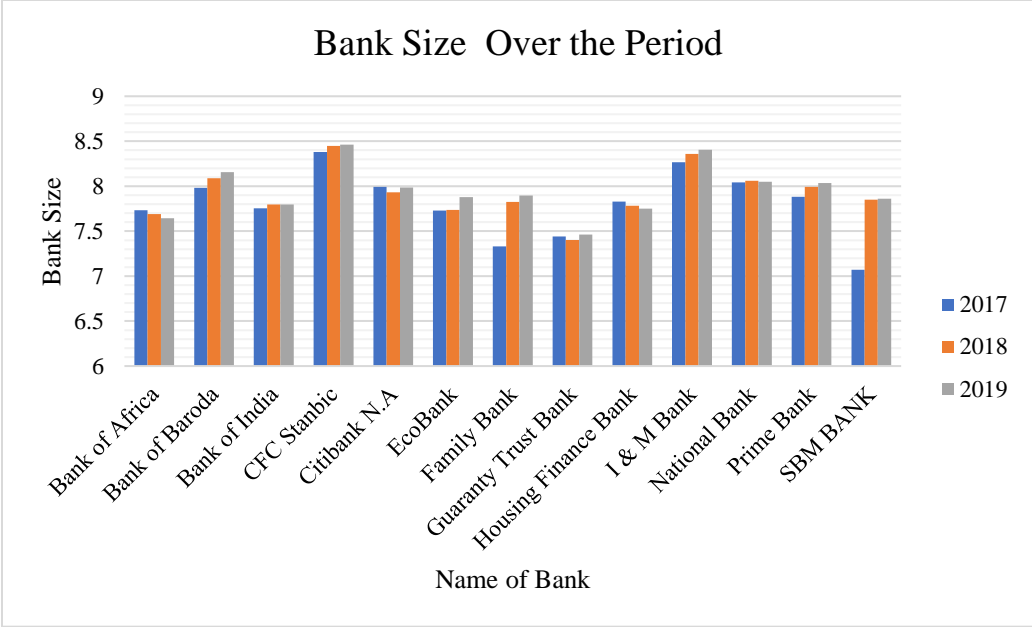


Figure 4.2: Bank Size Over the study period

(Source: Researcher, 2021)

I &M Bank, CFC Stanbic Bank, Prime Bank and Citi Bank were the top three in terms of their size. In the top three banks there is no much significance difference in their sizes. The bank size of the remaining banks is relatively the same over the three-year period with just slight differences.

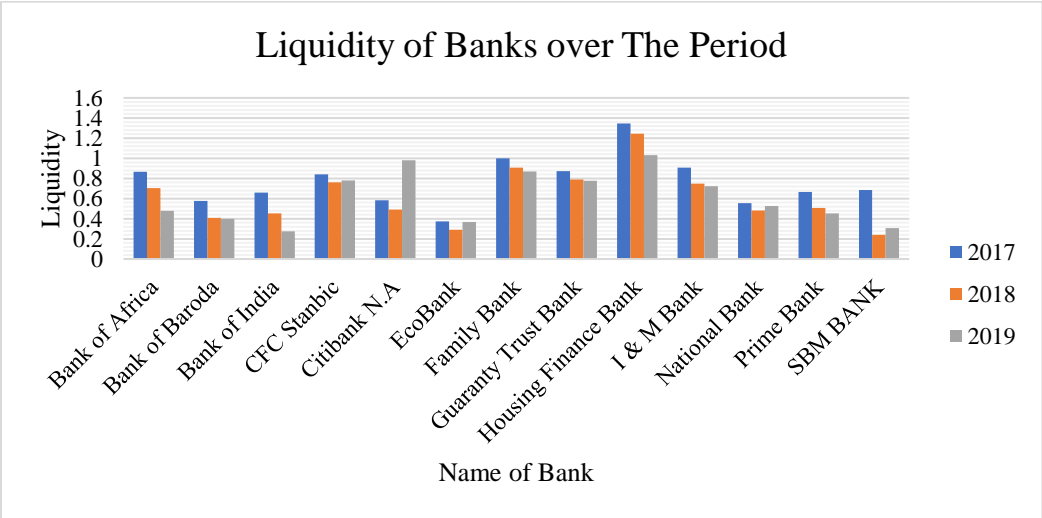


Figure 4.3: Liquidity of Bank over the Three-Year Period

(Source: Researcher, 2021)

Housing Finance Bank and Family Bank had the highest liquidity over the three-year period. SBM Bank, Eco Bank and Bank of India had the lowest liquidity over the period.

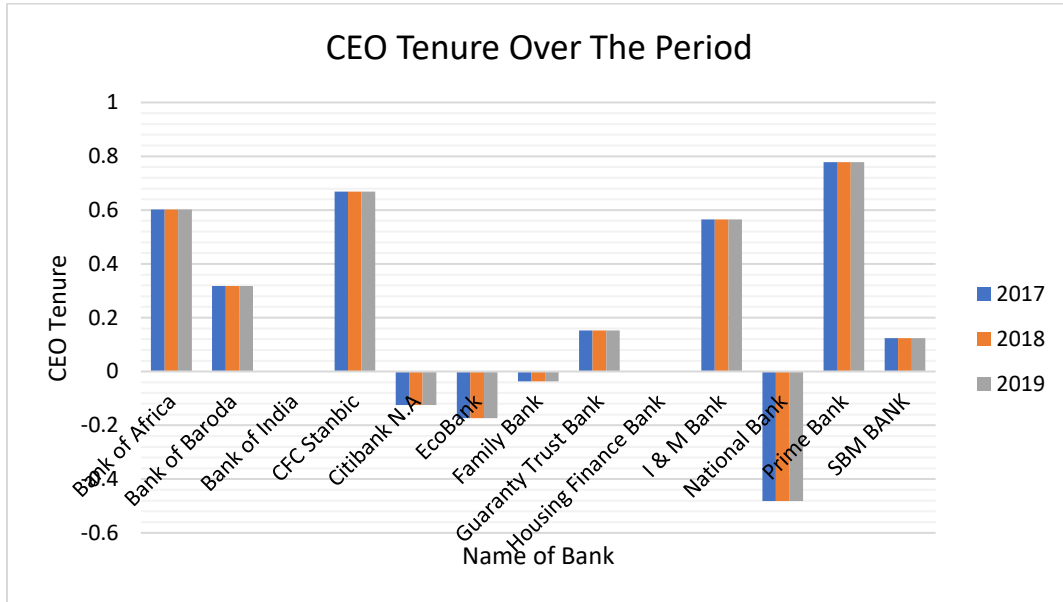


Figure 4.4: CEO Tenure over the study Period

(Source: Researcher, 2021)

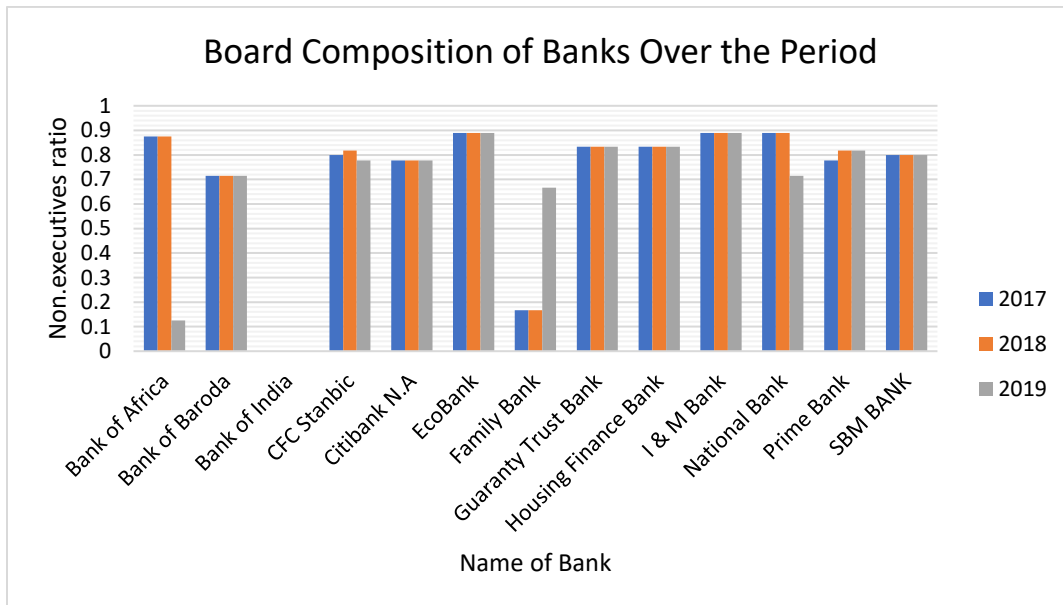


Figure 4.5: Board Composition over the 3 Year Period

(Source: Researcher, 2021)

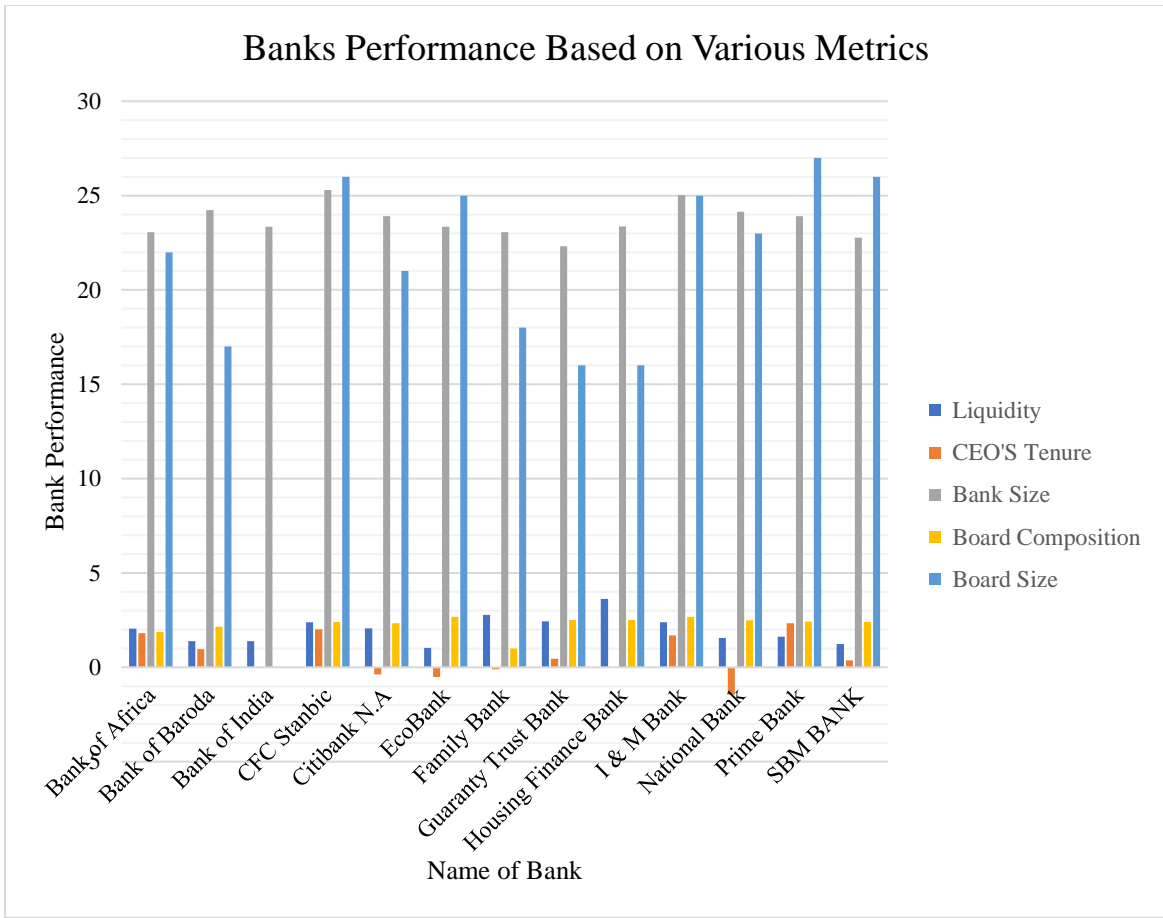


Figure 4.6: Bank Performance based on various Metrics

(Source: Researcher, 2021)

Board Size, Bank Size, and Board Composition are regarded as key determinants of banks' success, whilst CEO's Tenure and Liquidity are shown as being among the least significant determinants of banks' performance.

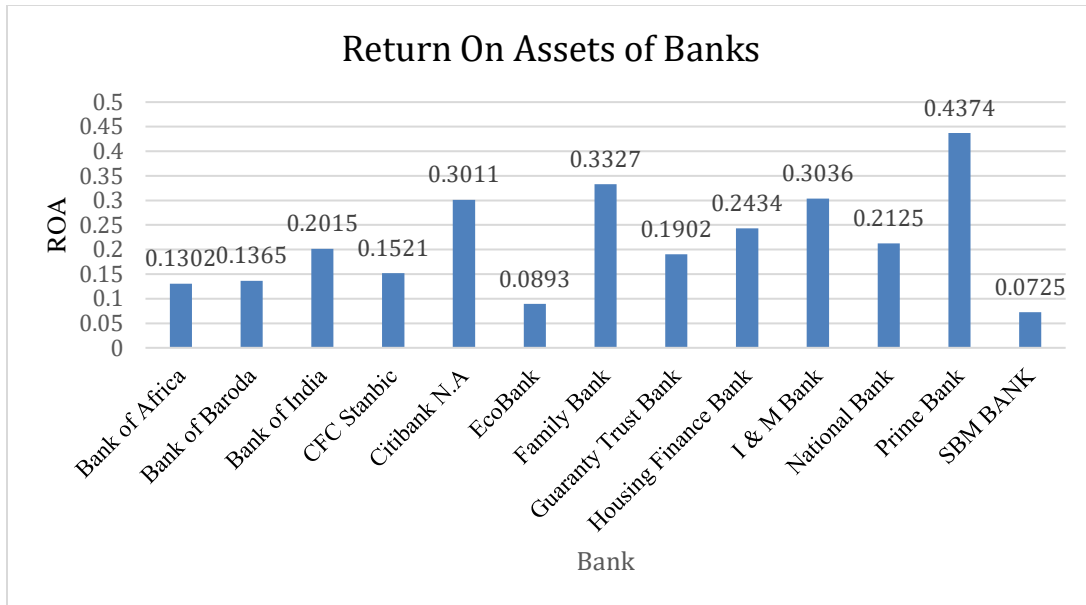


Figure 4.7: Return on Assets of Banks over the 3year Period

(Source: Researcher, 2021)

As depicted from the graph Prime Bank has the highest Return on Assets. It is followed by Family Bank, I & M Bank and Citibank respectively. SBM Bank and Ecobank have the lowest Return on Assets.

4.4. Diagnostic Tests

The tests for normality, multi-collinearity, and autocorrelation were included in the diagnostic procedures.

4.4.1. Normality Test

As can be seen in table 1 below, the outcomes of the Kolmogorov-Smirnov and Shapiro-Wilk tests are as follows.

Table 4.1. Test of Normality

Tests of Normality						
	Kolmogorov-Smirnov			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	df	Sig.
Board Size	.155	36	.030	.937	36	.041
Board Composition	.313	36	.000	.587	36	.000
Bank Size	.100	36	.200*	.969	36	.400
Liquidity	.088	36	.200*	.971	36	.447
CEO'S Tenure	.166	36	.014	.932	36	.028
Return on Assets	.150	36	.039	.901	36	.004

(Source: Researcher, 2021)

A p-value of >0.05 in Kolmogorov-Smirnov test indicates that the data is normally distributed while of < 0.05 means that there is no normal distribution. (Mishra *et al.*, 2019). From the table the variables Board Size p-value=0.030 <0.05 , Board Composition p-value=0.001 <0.05 , CEO Tenure p-value 0.014 <0.05 and Return on Assets p-value=0.039 <0.05 are not normally distributed. Their p-values is less than 0.05. This could be attributed to small population size under the study. The variables Bank Size p-value =0.200 >0.05 and Liquidity p-value 0.200 >0.05 are normally distributed.

The limitation here is the small population size. Examining the variables graphically using the normal QQ plots yields the following results:

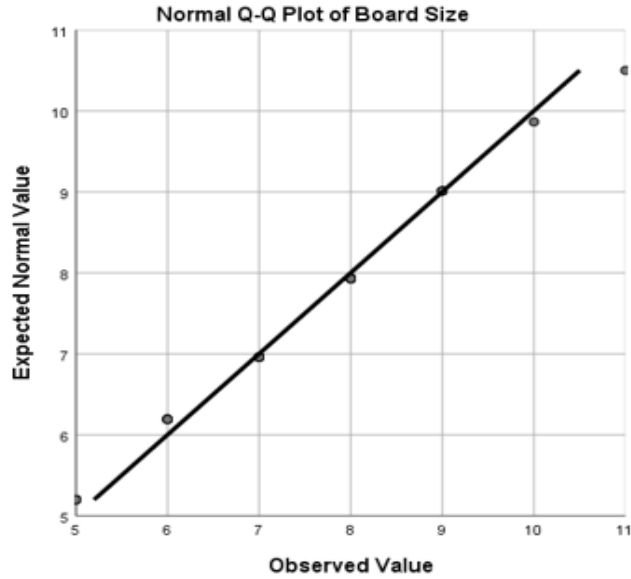


Figure 4.8: QQ plot Board size

(Source: Researcher, 2021)

As depicted from the graph the data points lie close to the line indicating that the data of the variable (Board Size) is normally distributed. The histogram below further proves that the data is normal

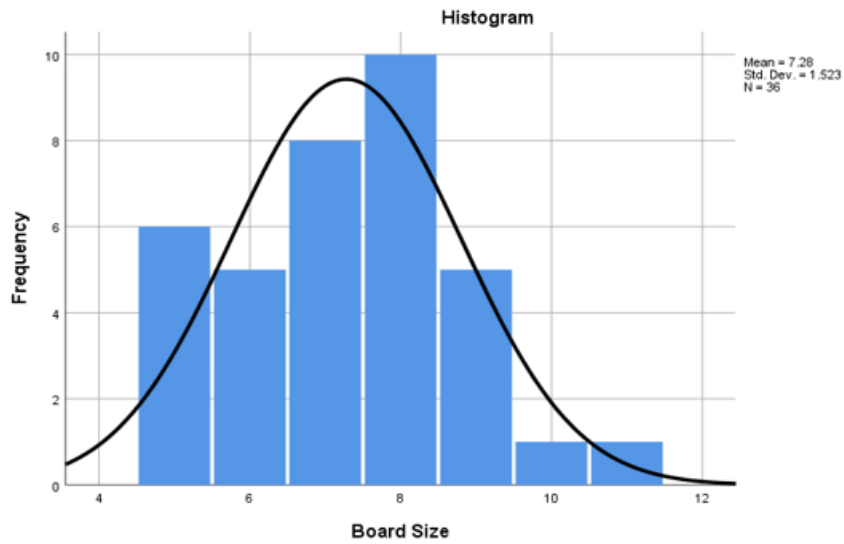


Figure 4.9: Histogram Board Size

(Source: Researcher, 2021)

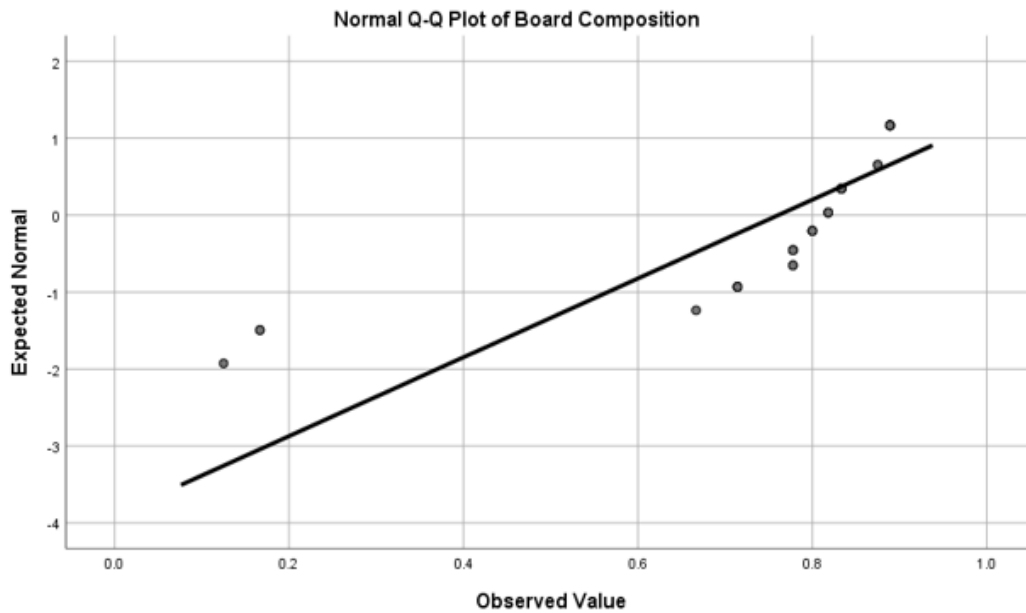


Figure 4.10: QQ plot Board Composition

(Source: Researcher, 2021)

From the graph the data points are spread away from the horizontal line indicating that the data of this variable is not normally distributed. From the histogram it is depicted that the data is not normally distributed.

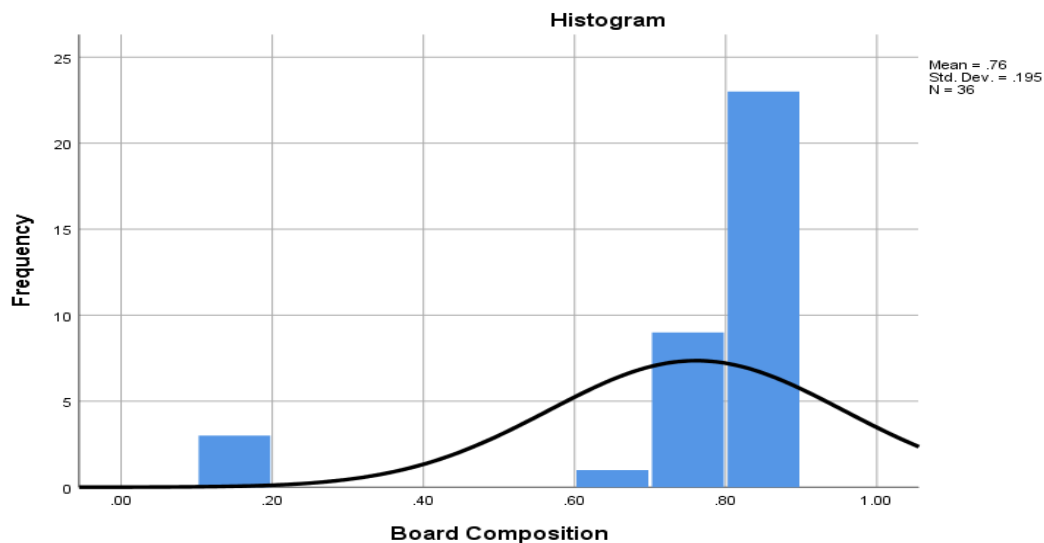


Figure 4.11: Histogram Board Composition

(Source: Researcher, 2021)

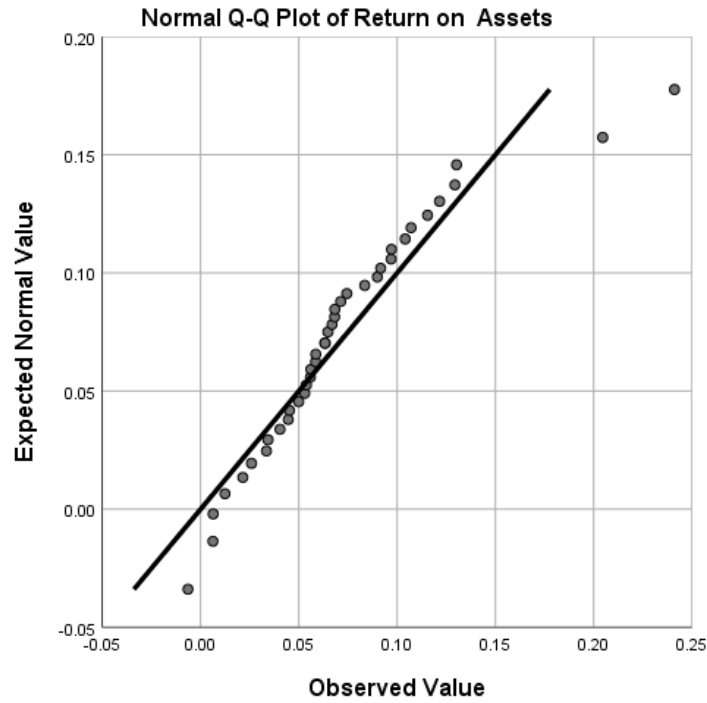


Figure 4.12: Return on Assets

(Source: Researcher, 2021)

From the graph the data points are spread almost close to the line indicating there is normality in the data of this variable. The histogram below reinforces this assumption of normality.

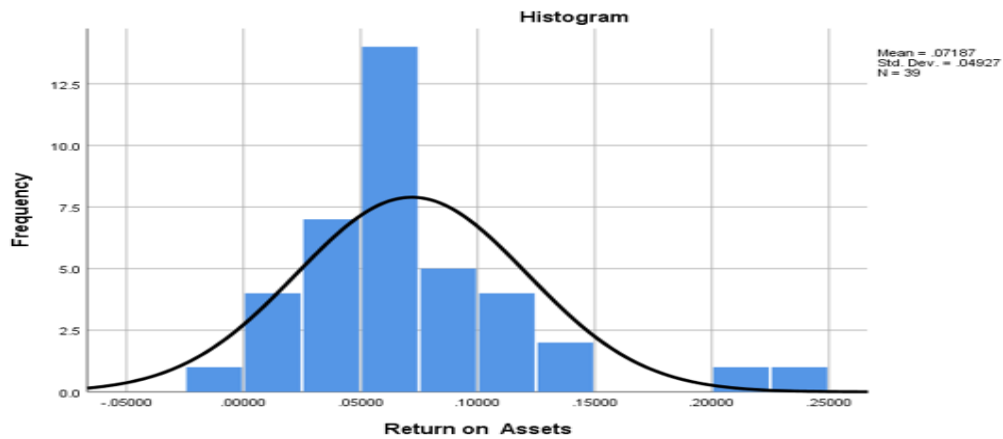


Figure 4.13: Histogram Return on Assets

(Source: Researcher, 2021)



Figure 4.14: QQ plot Bank Size

(Source: Researcher, 2021)

From the graph the data points are slightly spread away from the horizontal line depicting there is no normality (Mishra *et al.*, 2019). The histogram below shows how the data points deviate from the normal curve.

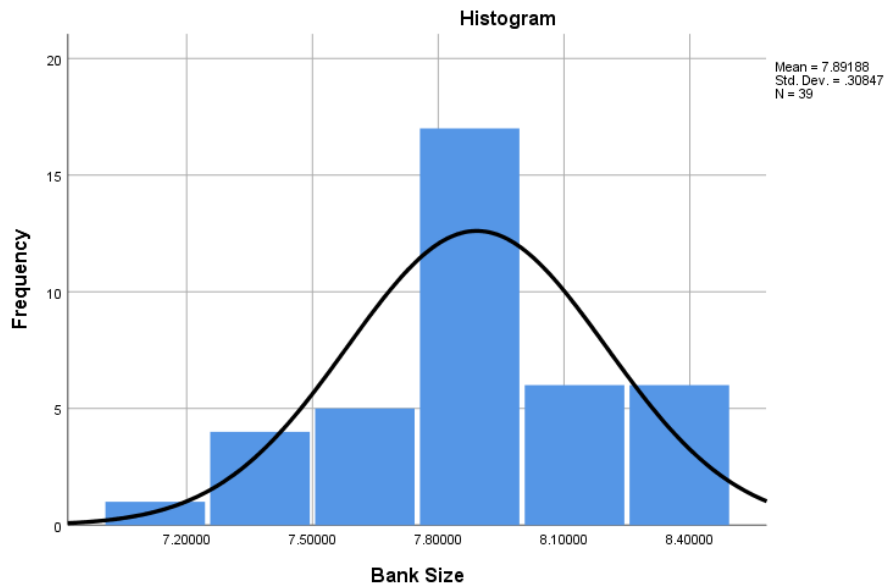


Figure 4.15: Histogram Bank Size

(Source: Researcher, 2021)

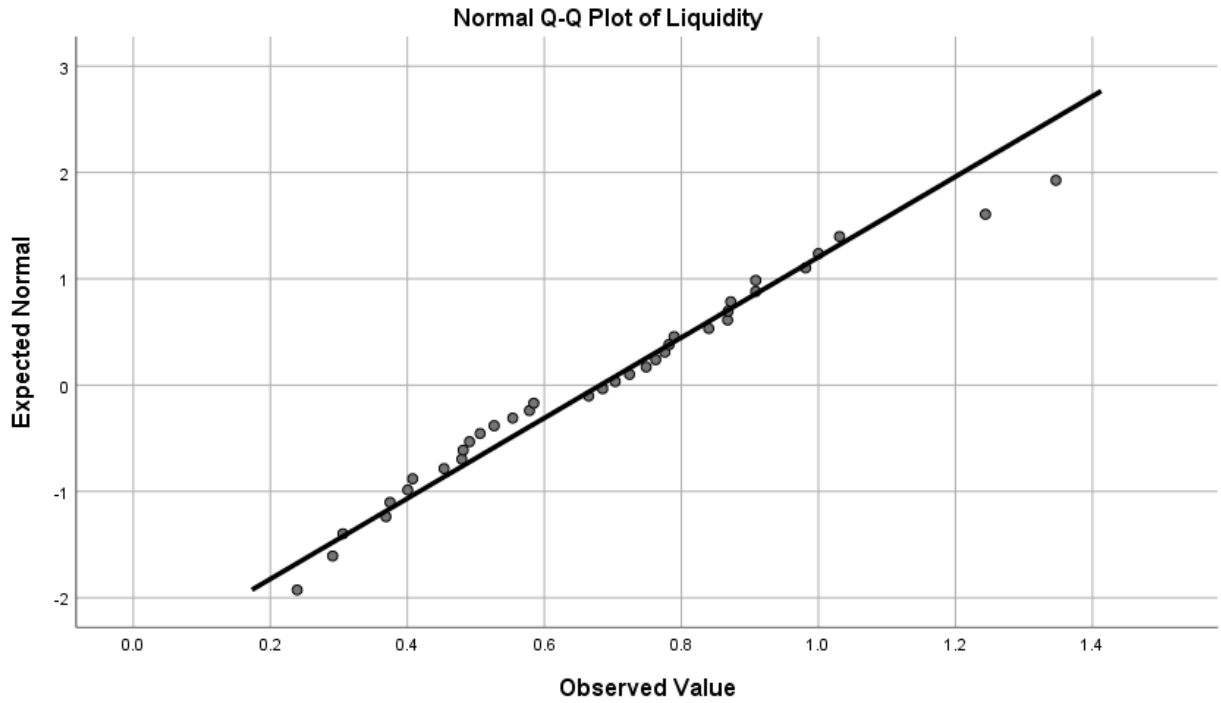


Figure 4.16: QQ plot Liquidity

(Source: Researcher, 2021)

From the graph some data points are spread away from the horizontal line though it can be seen most of the data points lie near the line and distributed normally. The outliers in the data is likely the cause of slight deviation from the normal distribution. The histogram below illustrates this.

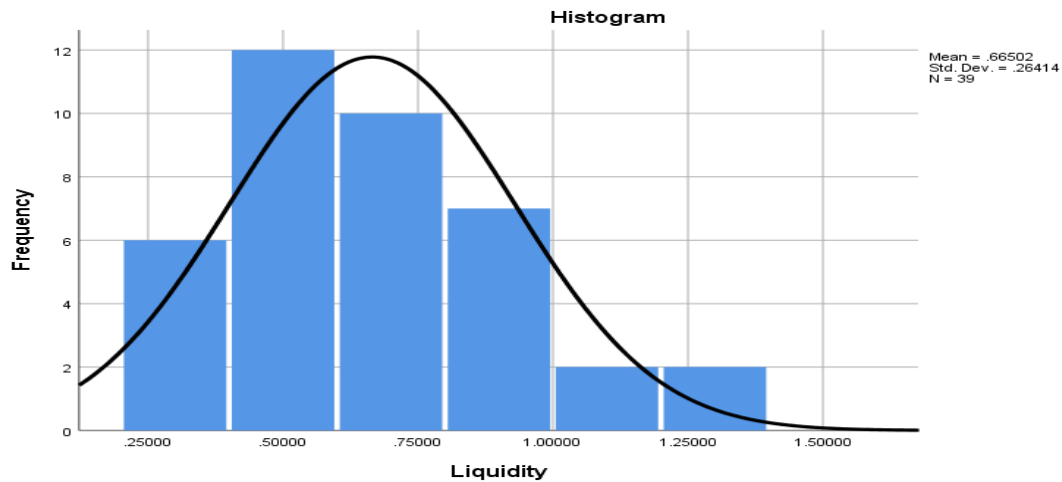


Figure 4.17: Histogram Liquidity

(Source: Researcher, 2021)

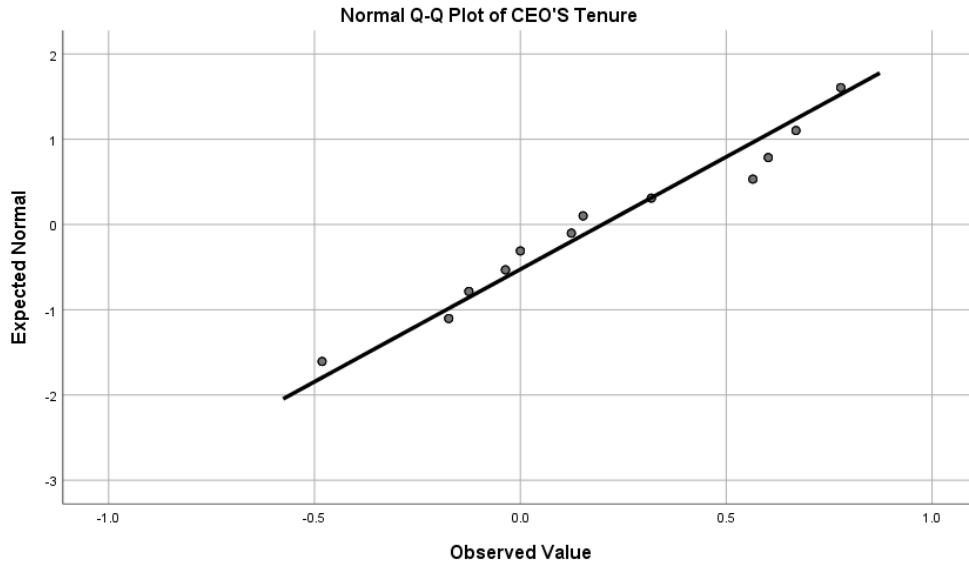


Figure 4.18: QQ plot CEO Tenure

(Source: Researcher, 2021)

From figure 19, the data points are spread away from the line which implies that data of the variable is distributed but not normally (Ghasemi and Zahesial, 2012). The histogram in figure 20 below further shows that there is no normality

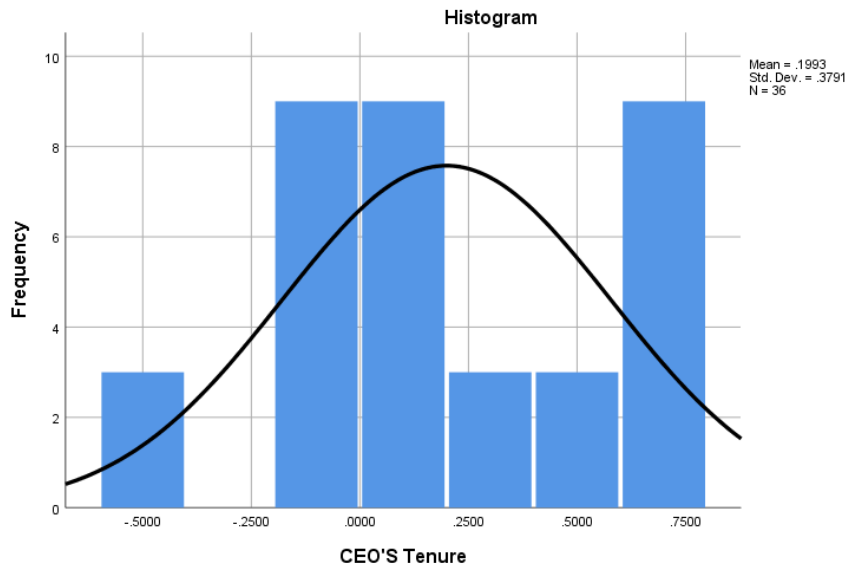


Figure 4.19: Histogram CEO Tenure

(Source: Researcher, 2021)

4.4.2. Multi-Collinearity Test

Multi-collinearity is a situation in which two or more predictor variables are significantly associated with one another and do not supply unique or independent information in the regression model. This can occur with any number of predictor variables (Kiragu, 2018). The Variance Inflation Factor (VIF), a variable, is used to look for multi-collinearity. A predictor variable's VIF value of 1 denotes that it has no association with any other predictor variables in the model. There is a moderate connection between the predictor variables if the value is between 1 and 5. (Ghasemi and Zahesial, 2012). An indicator of possibly strong correlation between the predictor variables is a value larger than 5.

Table 4-2: Multi-Collinearity Test Table

Coefficients of Independent Variables			
M		Collinearity Statistics	
		Tolerance	VIF
1	Board Size	.551	1.815
	Board Composition	.916	1.092
	CEO'S Tenure	.817	1.225
	Bank Size	.761	1.315
	Liquidity	.680	1.471
a. Dependent Variable: Return on Assets			

(Source: Researcher, 2021)

From table 2 above, there is no multi-collinearity in our predictor variables. This means that these variables are suitable in our regression model in predicting the return on assets.

4.4.3. Autocorrelation

The degree of correlation between the values of the same variable across various data observations is referred to as autocorrelation. To check for autocorrelation, use the Durbin Watson Test. The range of Durbin Watson values is 0 to 4. There is no serial correlation between the variables if the value is less than 2, and there is correlation if the value is greater than 2.

Table 4-3: Test for Autocorrelation

T					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.361 ^a	.131	-.014	.05143155	1.835
a. Predictors: (Constant), Liquidity, CEO'S Tenure, Board Composition, Bank Size, Board Size					

(Source: Researcher, 2021)

The Durbin Watson in this case is 1.835 indicates that there is no serial correlation among the variables. Similarly, from table 4 below, no variable has a correlation greater than 0.5. All variables have a correlation of less than 0.05 indicating that they have a very weak correlation. This is desirable in including these variables in our regression model.

Table 4.4: Correlation of Variables

		Correlations					
		Return on Assets	Board Size	Board Composition	Bank Size	Liquidity	CEO'S Tenure
Return on Assets	Pearson Correlation	1	.106	-.152	.041	.210	.129
	Sig. (2-tailed)		.540	.377	.803	.199	.454
	N	39	36	36	39	39	36
Board Size	Pearson Correlation	.106	1	.203	.405*	-.515**	.293
	Sig. (2-tailed)	.540		.234	.014	.001	.083
	N	36	36	36	36	36	36
Board Composition	Pearson Correlation	-.152	.203	1	.252	-.099	.010
	Sig. (2-tailed)	.377	.234		.138	.564	.953
	N	36	36	36	36	36	36
Bank Size	Pearson Correlation	.041	.405*	.252	1	-.077	.301
	Sig. (2-tailed)	.803	.014	.138		.641	.074
	N	39	36	36	39	39	36
Liquidity	Pearson Correlation	.210	-.515**	-.099	-.077	1	.063
	Sig. (2-tailed)	.199	.001	.564	.641		.714
	N	39	36	36	39	39	36
CEO'S Tenure	Pearson Correlation	.129	.293	.010	.301	.063	1
	Sig. (2-tailed)	.454	.083	.953	.074	.714	
	N	36	36	36	36	36	36

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

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

(Source: Researcher, 2021)

4.5. Multiple Regression Analysis

The results of the regression analysis are as shown in table 5 while summary is depicted in table 6 below.

Table 4.5: Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error			
1	(Constant)	.003	.231		.012	.991
	Board Size	.011	.008	.318	1.385	.176
	Board Composition	-.047	.047	-.179	-1.005	.323
	CEO'S Tenure	.003	.025	.020	.108	.915
	Bank Size	-.002	.031	-.014	-.073	.942
	Liquidity	.066	.040	.342	1.655	.108

a. Dependent Variable: Return on Assets

(Source: Researcher, 2021)

Table 4.6: Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.361 ^a	.131	-.014	.05143155

Predictors: (Constant), Liquidity, CEO'S Tenure, Board Composition, Bank Size, Board Size

(Source: Researcher, 2021)

The model explains 36.1% of the variance in the prediction made using the dependent variable. R Square is a statistical tool that measures the proportion of observed variance that can be explained by the presence of independent variables. In this particular case, the prediction of the dependent variable is accounted for by the independent variables to the extent of 13.1%.

Table 4.7: Analysis of Variance

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.012	5	.002	.901	.493 ^b
	Residual	.079	30	.003		
	Total	.091	35			
a. Dependent Variable: Return on Assets						
a. Predictors: (Constant), CEO'S Tenure, Board Composition, Liquidity, Bank Size, Board Size						

(Source: Researcher, 2021)

The overall regression model's fit to the data is evaluated using the F ratio in the ANOVA table. If the p-value is less than 0.05, the model is well-fitted. The table demonstrates that there is no significant relationship between the independent variables and the dependent variable ($F(5,30)=0.901$, p-value $0.493 > 0.05$).

4.5.1. Regression of Beta and Coefficient

Table 4.8: Beta Coefficients

Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	.003	.231		.012	.991	-.469	.475
	Board Size	.011	.008	.318	1.385	.176	-.005	.026
	Board Composition	-.047	.047	-.179	-1.005	.323	-.142	.048
	Bank Size	-.002	.031	-.014	-.073	.942	-.066	.061
	Liquidity	.066	.040	.342	1.655	.108	-.015	.147
	CEO'S Tenure	.003	.025	.020	.108	.915	-.049	.055
a. Dependent Variable: Return on Assets								

(Source: Researcher, 2021)

When all other independent variables are held constant, unstandardized coefficients show how much the dependent variable varies with an independent variable. According to the table, board

size, liquidity, and CEO tenure are all positive variables, which means that as they increase while holding other variables constant, the dependent variable is more likely to be predicted by their corresponding values.

The regression Model

$$Y_{it} = 0.003 + 0.011X1_{it} - 0.047X2_{it} - 0.002X3_{it} + 0.066X4_{it} + 0.003X5_{it} + \epsilon_i$$

4.6. Interpretation and Discussion of Findings

The analysis shows no correlation between the corporate governance practices of the tie-2 banks and the banks' ROA. The findings of the Durbin Watson test show a poor correlation between the size of the board, the length of the CEO's tenure, liquidity controls, and the banks' return on assets. This suggests that the corporate governance practices of the analyzed banks have little effect on the net revenues produced per asset owned by the companies. Due to the fact that the quality of the board's composition, experience, and personal characteristics of the CEO matter more than the total number of executives and non-executives on the board, the negative association might be attributed to these factors. The results is in line with earlier studies that have emphasized on the comprehensiveness and appropriateness of the corporate governance over having multiple but non-performing executives. Dzingai and Fakoya (2017) found that small boards usually generate better results since it eliminates the problem of free ridding which is often popular among large boards. Similarly, research by Bredart (2014), Wah *et al.*, (2015) and Michire (2017) reached similar conclusions. Therefore, having few but qualified directors can lead to superior results as compared to firms with many executives. As Husni *et al.*, (2020) put it, the more the directors the higher the expenditure on compensation packages thereby lowering net income. At the same time, the close monitoring like in Family, CFC, Stanbic and other banks with small board size leads to high performance and easy communication. A weak coefficient of 0.011 indicates that adding more members to the board would not add any value to the firms' financial health as measured by ROA. Similarly, a coefficient of -0.002 implies that CEO's tenure does not necessarily translates into high profitability. Only the highly performing chief executives attracts high returns. According to Mandala *et al.* (2017), the rotation of the CEO leads to new ideas, skills set and higher chances of better performance. At the same time, short CEO's tenure also pose risk to the sustainability of the financial growth of the studied banks. For example, Family Bank's current CEO Rebecca Mbithi

has been in office for less than two years and needs adequate time to implement the strategic ambitions (Family Bank, 2020). Appointment of a new CEO would lead to low investor's confidence and internal conflicts that will in turn lower returns.

On the other hand, positive coefficients of bank size and liquidity of 0.66 and 0.003 respectively show that the variables can boost the long run of institutions. As a control variable bank size translates into lucrative opportunities and rise in customer bases hence the institutions will achieve continued performance. The results indicate that smaller banks such as Guaranty Trust Bank and SBM banks are unlikely to match the performance levels of larger banks with adequate corporate governance styles such as CFC Stanbic and I&M bank unless they come up with more innovative mechanisms for gaining competitive edges. Liquidity control also plays significant role because a larger percentage of the banks' revenues come from interests on loans. The implementation of comprehensive procedures for eliminating risks such as bad debts and non-performing loans enables the two tier-banks to invest the customers' deposits into profitable credit instruments. Although Housing Finance Corporation and Family Banks have the highest liquidity positions, their ROA are below that of Prime Bank. Therefore, financial performance moves beyond liquidity control to incentives used to maximize returns (Musiega *et al.*, 2017).

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This section provides the summary of the study findings, concluding remarks, its limitations and discusses the implications of the results to the future growth of the tier-2 banks in Kenya and beyond.

5.2 Summary

This section summarizes the study's findings, makes some final observations, points out its limitations, and discusses how the findings may affect the future development of tier-2 banks in Kenya and elsewhere.

5.3. Conclusions

Durbin Watson's test result was 1.835 while the multiple correlation tests indicates that all the variables had a weak correlation of below 0.05 meaning that the studied corporate governance mechanisms hardly affect the ROA of the two-tier banks. The results are in line with several previous studies hence it is high time the tier-2 banks restructured their corporate governance practices accordingly. Shifts from regular management approaches to having quality and innovative directors, as well as, timely launch of credit facilities would boost the firms' long-term success.

5.4 Policy Recommendations

The stakeholders of the Kenyan banking industry should implement a number of policies in order to enjoy the multiple gains associated with the leading corporate governance styles. First, the focus should be more on the quality than the quantity of the board of directors. I&M Bank, National Bank, SBM Bank and Ecobank all have 8 executive directors but while I&M bank has maintained high financial performance throughout the years Ecobank's and SBM's ROA was the least among the studied firms. Therefore, the banks should have structures to guide in the appointment of directors with diverse skills set. In Kumar and Singh's (2016) view, the bank directors must have a wealth of knowledge, abilities and talents to ensure that the strategic plans formulated has appropriate risk-reward profile. An ideal board composition should include executive and non-

executive directors with financial, technical, marketing, risk management and operational skills. Secondly, agility in liquidity and risk management is an essential success factor not only for the tier two banks but also to all the players in the banking industry. This is because opportunities often come as hidden chances of success. Right strategies attract high returns on investment while a miscalculation of the risks associated with the new investment can lead to significant financial deterioration.

Big appetites for emerging opportunities such as digital lending and mobile banking pose unprecedented challenges. This could be why Ecobank's low liquidity is a barrier to financial performance. Similarly, the insider deals such as offering loans to the executives led to the failure of Chase and imperial banks. As a result, the stakeholders should advocate for tougher rules such as impromptu audits of the books of account and corporate governance practices by a special team of experts appointed by CBK. Above all, each bank should create human resource management systems for enhancing sense of responsibility among all the board members. Monitoring the track record of the executives would help to identify those with high integrity and abilities to execute the strategies needed to achieve the desired performance goals.

5.5 Limitations of the Study

Corporate governance has broad aspects some of which are only accessible through long term observations of the bank's operations. For example, the practices such as risks controls guiding the issuance of non-performing loans may exist in policy documents but not in real life. However, such misreporting and dysfunctions are often discovered at a time whenever a firm is deep into financial distress like the case of collapsed Chase and imperial banks.

5.6 Areas for further Study

The findings indicate that continued investments in risk management, board composition and characteristics results into sustainable financial growth. A future survey that benchmarks the studied firms against the industry leaders such as Equity, Cooperative and KCB banks is recommended to enable the institutions to seal the loopholes in their management styles. Moreover, the industry is undergoing rapid transformation characterized by digitalization of most

of the operations triggered by the ongoing coronavirus pandemic. There is need for further research concerning the impacts of the technological revolutions on corporate governance.

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APPENDICES

Appendix I: List of Tier-2 Banks

S/N	TIER-TWO BANKS IN KENYA
	Bank of Africa
	Bank of Baroda
	Bank of India

CFC Stanbic
 Chase Bank-in receivership
 Citibank N. A
 EcoBank
 Family Bank
 Guaranty Trust Bank
 Housing Finance Bank
 I & M Bank
 Imperial bank Kenya-in receivership
 National Bank
 NIC Bank
 Prime Bank
 SBM Bank Kenya

Appendix 2: Raw Data

Year	Bank	Return on Asset (Y)	X1 (Board Size)	X2 (Exec vs non.exec directors)	CEO'S Tenure (X3)	X4 (Bank Size)	X5 (Liquidity)
2017	Bank of Africa	0.0452	7	0.875	0.6021	7.7339	0.86748
2017	Bank of Baroda	0.0682	5	0.71428571	0.3181	7.9828	0.578143
2017	Bank of India	0.0916				7.753	0.659769

2017	CFC Stanbic	0.0064	8	0.8	0.6693	8.3791	0.839967
2017	SBM BANK	0.0259	8	0.8	0.1239	7.0698	0.68512
2017	Citibank N. A	0.0969	7	0.7778	-0.125	7.9922	0.584536
2017	EcoBank	0.0343	8	0.88888889	-0.1739	7.7279	0.374743
2017	Family Bank	0.2046	6	0.16667	-0.0362	7.3299	1
2017	Guaranty Trust Bank	0.0586	5	0.83333333	0.1523	7.4413	0.872084
2017	Housing Finance Bank	0.0063	5	0.83333333	0	7.8295	1.346642
2017	I & M Bank	0.1302	8	0.88888889	0.5647	8.2647	0.908554
2017	National Bank	0.1041	8	0.88888889	-0.4815	8.0412	0.553825
2017	Prime Bank	0.0669	7	0.77777778	0.7782	7.8833	0.66468
2018	Bank of Africa	0.0446	7	0.875	0.6021	7.6909	0.703399
2018	Bank of Baroda	0.0559	5	0.71428571	0.3181	8.09	0.407724
2018	Bank of India	0.0538				7.7972	0.45345
2018	CFC Stanbic	0.0713	9	0.81818182	0.6693	8.4486	0.762538
2018	SBM BANK	0.053	8	0.8	0.1239	7.8486	0.239204
2018	Citibank N. A	0.1071	7	0.7778	-0.125	7.9326	0.490676
2018	EcoBank	0.0335	8	0.88888889	-0.1739	7.7361	0.291033
2018	Family Bank	0.0648	6	0.16667	-0.0362	7.8255	0.908449
2018	Guaranty Trust Bank	0.0683	5	0.83333333	0.1523	7.4035	0.789459
2018	Housing Finance Bank	0.1216	5	0.83333333	0	7.7821	1.243815
2018	I & M Bank	0.0835	8	0.88888889	0.5647	8.3601	0.748609
2018	National Bank	0.0499	8	0.88888889	-0.4815	8.0612	0.481527
2018	Prime Bank	0.1294	9	0.81818182	0.7782	7.9936	0.506204
2019	Bank of Africa	0.0404	8	0.125	0.6021	7.6434	0.479553
2019	Bank of Baroda	0.0124	7	0.71428571	0.3181	8.1562	0.40062
2019	Bank of India	0.0561				7.7961	0.276433
2019	CFC Stanbic	0.0744	9	0.77777778	0.6693	8.4634	0.781931
2019	SBM BANK	-0.0064	10	0.8	0.1239	7.8605	0.30593
2019	Citibank N. A	0.0971	7	0.7778	-0.125	7.9848	0.981411
2019	EcoBank	0.0215	9	0.88888889	-0.1739	7.8772	0.368765
2019	Family Bank	0.0633	6	0.6667	-0.0362	7.8968	0.868193
2019	Guaranty Trust Bank	0.0633	6	0.83333333	0.1523	7.4636	0.775824
2019	Housing Finance Bank	0.1155	6	0.83333333	0	7.7517	1.030802
2019	I & M Bank	0.0899	9	0.88888889	0.5647	8.4052	0.724359
2019	National Bank	0.0585	7	0.71428571	-0.4815	8.0493	0.526708
2019	Prime Bank	0.2411	11	0.81818182	0.7782	8.0365	0.453601