THE EFFECT OF CORPORATE GOVERNANCE PRACTICES ON THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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DECLARATION

This research project is my original work and has not been presented for a degree in any other University.

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This research project has been submitted with my approval as the University Supervisor.

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DEDICATION

This research paper is dedicated to my beloved mother Petronilla, my siblings Anastacia and Joseph for the invaluable support, encouragement and understanding especially when I had to sacrifice family time for this project and also for the motivation to further my academic level.

I am immensely grateful and may our good Lord bless you always and forever.
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May the Almighty God Bless you all and reward you efforts abundantly.
ABSTRACT

The study examined the effect of corporate governance practices on the financial performance of commercial banks in Kenya. The corporate governance practices discussed include the number of non-executive directors, board size and board diversity—gender. Control variables affecting financial performance were also assessed. These included asset quality and management efficiency. The study sought to draw a relationship between these variables and financial performance.

The study was based on a quantitative and exploratory research design used to evaluate objective data consisting of numbers. The data gathered was from secondary sources. This was later tabulated, analyzed and presented in tables and graphs to draw meaningful findings. A multiple linear regression model was used to show the relationship between the independent and dependent variables. ANOVA analysis was also used to test the overall significance of the model.

The study found that most the variable showed a positive relationship with financial performance. For instance, board size was seen to have medium negative correlation of -0.56 which implied that as board size increased, the financial performance of banks reduced. This was in line with literature review where various scholars advocated for a reasonable board size. An optimal board was considered most efficient and depicted better performance. The study also found that there was no significant relationship between the financial performance of commercial bank and gender diversity of the board. This was shown by the strong negative correlation of -0.90. This therefore implied that other factors had an effect on the financial performance while gender diversity of the board did not have. ANOVA indicated the significance of the model with a P value of 0.002 which was lower than the conventional 5% significance level. This analysis implied the variables in the model were good joint predictors of financial performance. The coefficient of determination (R square) was 70.8% and this showed a good regression on the variables. This analysis implied the variables in the model were good joint predictors of financial performance.

Finally the conclusion drawn from the study indicates that indeed corporate governance practices affect the financial performance of commercial banks in Kenya specifically, board size and the number of non-executive directors. The gender diversity of the board on the other hand may sound conventionally upright but does not depict a relationship with financial performance. It does not affect the performance of the firm. This could be because the
banking industry is male dominated and the boards specifically comprise of men who are in the top management of the in the industry. From this, I would recommend that the CBK introduced a regulation to hold a certain percentage of board positions for women then further research to be conducted based on this recommendation to show whether the all inclusion of female directors on boards would therefore have an effect on the financial performance of the commercial banks in Kenya.
List of Abbreviations

BOD  Board of Directors
CBK  Central Bank of Kenya
CCG  Centre for Corporate Governance
CEO  Chief Executive Officer
CGPR Corporate Governance Practices
CMA  Capital Market Authority
DPF  Depositors Protection Fund
GOK  Government of Kenya
NEDs  Non-Executive Directors
NIM  Net Interest Margin
NPLs  Non Performing Loans
NSE  Nairobi Stock Exchange
ROA  Return on Assets
ROE  Return on Equity
USE  Uganda Security Exchange
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CHAPTER ONE
INTRODUCTION

1.1 Background of the study

Governance is concerned with structures and processes for decision making, accountability, control and behavior at the top of organizations. Corporate governance is a concept that involves practices that entail the organization of management and control of companies.

Corporate governance helps in defining the relation between the company and its general environment, the social and political systems in which it operates. Corporate governance is linked to economic performance. The way management and control are organized affects the company’s performance and its long term competitiveness. It determines the conditions for access to capital markets and the degree of investor’s confidence (Brownbridge, 2007).

Improvements in the management and administration of many organizations are essential if the global efforts to halt corruption and other types of irregularity are to achieve desired results. An appropriate legal framework is necessary to define the roles of governing bodies, and chief executives and the related framework of authorities and responsibilities of each level of corporate governance.

Corporate governance is the set of processes, customs, policies, Laws and institutions affecting the way a corporation is directed, administered or controlled. This chapter gives a basis for the entire study.
### 1.1.1 Corporate Governance

According to Cadbury (2002), corporate governance is concerned with “the system by which companies are directed and controlled, which is clearly the responsibility of their boards of directors”. Monks and Minow (2004) have defined it as “the structure that is intended to make sure that the right questions get asked and that checks and balances are in place to make sure that the answers reflect what is best for the creation of long-term, sustainable value”. Specifically these authors highlight the relationships among shareholders, directors and the management as the core object of corporate governance.

Colley et al (2005) engages in a longer explanation of the phenomenon when they say that “today, the public corporation itself operates as a form of representative government. The owners (shareholders) elect directors as their representatives to manage the affairs of the business. The directors, who as a group are referred to as the board of directors, then delegate responsibility for actual operations to the CEO, whom they hire. The CEO is accountable to the BOD, which collectively and individually, is accountable to the shareholders. In addition, to its role in selecting the CEO, the board also advises on and consents to the selection of businesses and strategies of the firm as well as oversees results. In sum, this system of authoritative direction, or government, is known as corporate governance”.

It is also believed that good governance generates investor goodwill and confidence. Again, poorly governed firms are expected to be less profitable. Claessens et al. (2002) also points that better corporate framework benefits firms through greater access to financing, lower cost of capital, better financial performance and more favorable treatment of all stakeholders. They argue that weak corporate governance does not only lead to poor firm financial performance and risky financing patterns, but are also conducive for macroeconomic crises like the 1997 East Asia crisis.
In the banking industry, corporate governance involves the way banking institutions’ business and affairs are managed by the board of administration and the top management, which affects how the bank works out the bank's objectives, plans and policies, taking into consideration making appropriate economic returns for founders and other shareholders, day-to-day work management, protection of the rights and interests of recognized stakeholders (shareholders and depositors), companies' commitment to sound and safe professional behaviors and practices which are in conformity with regulations and legislations, (Linyiru, 2006). Recently there has been considerable interest in the corporate governance practices of modern corporations, particularly since the high-profile collapses of large U.S. firms such as Enron Corporation and WorldCom (Nambiro, 2007).

In this view, corporate governance is concerned with critical corporate issues, particularly corporate finance that is financial structure of the firm, capital markets, creditors and credit agencies as well as risk management.

1.1.2 Financial Performance

According to Heremans (2007), financial performance is the employment of financial indicators to measure the extent of objective achievement, contribution to making available financial resources and support of the bank with investment opportunities. Rutagi, (1997) defines financial performance as to how well an organization is performing. Other researchers define performance of the organization as the extent to which an organization achieves its intended outcome, Namisi, (2002).The general assumption among both researchers and practitioners is that effective boards lead to effective organization. From either an internal long-term profitability or external shareholder perspective, there is an indication that good boards may be able to add value to the organization, Epstein et al., (2003).
The financial performance of commercial banks in Kenya is determined by both internal and external factors.

Internal determinants of profitability, which are within the control of bank management, can be broadly classified into two categories, i.e. financial statement variables and nonfinancial statement variables, (Linyiru, 2006). While financial statement variables relate to the decisions which directly involve items in the balance sheet and income statement; non-financial statement variables involve factors that have no direct relation to the financial statements. The examples of non-financial variables within this category are number of branches, status of the branch (e.g. limited or full-service branch, unit branch or multiple branches), location and size of the bank, Sudin (2004).

External factors are those factors that are considered to be beyond the control of the management of a bank. Among the widely discussed external variables are competition, regulation, concentration, market share, ownership, scarcity of capital, money supply, inflation and size Sudin (2004). Some of the ratios used to measure the financial performance of banks in Kenya include; ROA, ROE and NIM.
1.1.3 Relationship between CGPR and the financial performance of commercial banks in Kenya

Different authors have argued that corporate governance requires laid down procedures processes, systems and codes of regulations that ensure implementation in organizations (Altunbas, Evans and Molyneux, 2001).

Matama, (2005) in the study of Corporate Governance and financial performance on selected commercial banks, obtained a positive relationship between Corporate Governance and financial performance. Masibo, (2005) researched on Board Governance and firm performance of selected state owned corporations and in listed organizations on USE, obtained a positive direct and indirect link between Board Governance and Firm financial Performance through Board effectiveness. Piesses, (2005), carried out empirical research on Corporate Governance and firm performance in an international perspective and obtained conflicting results on the link between Corporate Governance and Firm performance.

There are several reasons to expect that better governed banks may have more efficient operations and better performance. First, governance may reduce the incidence and amounts of related parties’ transactions and other “self-dealing” practices. Since such transactions are usually sub-optimal from the efficiency point of view, the reduction in such transactions should translate into improved performance. Second, better governed banks may have lower cost of capital, especially if they employ subordinated debt financing. Third, better governance may translate into more efficient and streamlined operations, as the supervisory board and management functions are separated and modernized.

Banks with a larger board tend to perform better than those with smaller ones. This is because they have better expertise to enable them enhance their decision making. However, Fama and Jensen (1983), advocate for the contrary. They argue that larger boards are less effective and
are easier for the CEO to control. Small boards are easier to coordinate and discourage free riding thus enhancing the performance of the bank.

The diversity of the board is also a factor of corporate governance that affects the performance of banks in Kenya. It is argued that diversity increases board independence because people with a different gender, ethnicity, or cultural background might ask questions that would not come from directors with more traditional backgrounds. In other words, a more diverse board might be a more activist board because outside directors with nontraditional characteristics could be considered the ultimate outsiders and as such positively affect the performance of the bank.

Good practice recommendations on corporate governance require boards to be composed of a majority of NEDs (ASX Corporate Governance Council 2003; Cadbury 1992; Hampel 1998) because investors consider boards composed of NEDs as an important determinant of firm performance. Fama (1980) and Fama & Jensen (1983) consider the board as an important element of corporate governance and acknowledge the role of outside directors as monitors of management and providers of “relevant complementary knowledge”.

However, the principle of the code of best practice on corporate governance states that it is preferable for the board to have a balance of executive and NEDs such that no individual or small group of individuals can dominate the board’s decision-making. Furthermore, the board should include NEDs of sufficient caliber and number for their views to carry significant weight in the board’s decisions. Decisions made from such comprised boards would surely have a positive effect on the performance the banks for which such boards sit.
1.1.4 Commercial Banks in Kenya

The Company’s Act, CBK Act and the Banking Act are the main regulators and governors of the banking industry in Kenya. These Acts together with prudential guidelines issued by the CBK from time to time have greatly enhanced the depth of reporting by commercial banks.

Despite tight regulatory framework, corporate governance in Kenya’s banking industry continues to weaken to some extent. According to CCG (2004), focus on corporate governance in the financial sector is crucial mostly because the banking industry became highly exposed to scrutiny by the public and many lessons were learnt because of the risks involved including adverse publicity brought about by failings in governance and stakeholder relations for instance, the collapse of banks such as Euro bank, Trust bank and Daima bank just to mention a few cases (CCG, 2004).

Two factors that influenced corporate governance in the banking industry were; the government relaxing rules governing issuance of licenses to banks in 1982 and by the privatization process that began in the 1980’s and gained momentum in the 90’s. This led to the growth of many banks that did not put into practice proper corporate governance structures resulting into poor governance and management culture in the industry (Mwangi, 2002). A case in point was in the year 1984 when the Rural Urban Credit Finance was placed in interim liquidation. The GOK through the Central Bank made changes in the Central Bank Act and the Banking Act to curb instability in the banking industry. This was for example, through raising the capital requirements and the creation of the DPF. Regardless of efforts made to streamline the banking sector, many banks have been liquidated or put under receivership. The collapse mainly due to weak internal controls, poor governance and management practices. For example, Continental Bank of Kenya and Continental Credit Finance Ltd collapsed in 1986. In 1987 Capital Finance went under.
The Government then formed Consolidated Bank by merging seven banks that had collapsed (Nambiro, 2007). The major reasons for the collapse of these banking institutions in Kenya as outlined by the CCG, (2004) were; insider lending and conflict of interest, weaknesses in regulatory and supervisory systems, poor risk management strategies, lack of internal controls and weak CGPR. As a result, the CBK intervened by outlining bolder and elaborate measures to curb these problems and also to strengthen its arm of supervisory role it plays in the industry.

Corporate governance in the banking sector in Kenya largely relates to the responsibility conferred to and discharged by the various entities (banks) and persons responsible for and concerned with the prudent management of the financial sector (Central Bank of Kenya, 2006). The corporate governance stakeholders in the banking sector include the BOD, management, shareholders, CBK, external auditors and CMA (CCG, 2004). It is believed that good governance in banks reduces investor risks, generates investor goodwill and confidence and improves the performance of banks.

1.2 Research Problem

There has been worldwide attention on the importance of incorporating corporate governance norms and practices to improve the strategic health of organizations. Hence the need to enrich corporate governance in banks by expanding the framework of analysis beyond the conventional criteria to incorporate the norms and values to the organizations processes. Brown and Caylor (2004) provide insights to relationships between good corporate governance and corporate performance. Research indicates that companies with better corporate governance guarantee the payback to the shareholder and limit the risk of the investment. The association between quality of corporate governance and firms' profitability is quite a major focus in corporate governance studies, but one cannot predict much on the
direction as prior literatures show mixed results. Better governed banks tend to have more efficient operations resulting to higher expected future cashflow streams Jensen and Meckling (1976). A number of studies have sought to investigate the relation between corporate governance mechanisms and financial performance (e.g. Berglof, von Thadden, 1999) Most of the studies have shown mixed results without a clear-cut relationship. E.g. a study by Bechtet al., (2002) show that corporate governance practices positively influences the profitability of the organization while MacAvoy and Millstein (2003) found that board composition does not have any effect on financial performance. Further, the limited studies in the area have focused mainly on developed economies (Bechtet al., 2002) hence the need to perform the study on a developing economy context.


Through its prudential regulators and circulars, CBK has greatly enhanced the depth of reporting by banks and financial institutions particularly regarding bad loans portfolios and credit practices. Banks are required to publish their audited financial statements in the national newspaper. This has revealed unpleasant performance in the early 2000 but there has been significant improvement since 2007. However, this doesn't mean that all banks are profitable, there are banks declaring losses (Oloo, 2010). Studies have shown that bank specific and macroeconomic factors affect the performance of commercial banks (Flamini et al. 2009). In this regard, studies done on corporate governance and financial performance present a gap on the board composition since they do not pay much attention to the diversity of the board and the number of non-executive directors when in fact, it is seen that a mix in the board in terms
of gender, age, race has a positive influence in a firms’ performance. Actually, Lord Davies (2011) recommended that boards should aim at 25% female representation by 2015. It is therefore on this premise that this research study’s the effect of corporate governance practices on the financial performance of commercial banks in Kenya. This is with further analysis on board composition to scrutinize board size, board diversity and the non executive directors of the banks.

The research will be guided by the following question;

i) What is the effect of board size, board diversity and non executive directors on the financial performance of commercial banks in Kenya?

1.3 Research Objective

The objective of this study is to determine the effect of board size, board diversity and non-executive directors on the financial performance of commercial banks in Kenya.

1.4 Value of the Study

The findings of this study will be beneficial to various stakeholders in the industry such as:

The management would identify how various aspects of corporate governance practices affect the operations of commercial banks in Kenya. They would also identify the impediments that face these banks in approaching various corporate governance practices that affect their financial performance.

The policy makers would obtain knowledge of the banking sector dynamics and the responses that are appropriate; they will therefore obtain guidance from this study in designing appropriate practices that would regulate the shareholders participation in affecting the financial performance of the banks in Kenya.
The study would provide information to potential and current scholars with regard to the relationship between corporate governance and financial performance of the commercial banks in Kenya and possibly for a basis for their further research on corporate governance and Kenyan banks.
2.1 Introduction

This chapter presents the review of various literature related to the area of study. It covers theoretical literature and review of empirical studies. Theoretical literature focuses on Agency, stewardship and stakeholder theories.

2.2 Theoretical Review

The study reviews the following theories to have an understanding of various factors that affect the financial performance of commercial banks in Kenya.

2.2.1 Agency Theory

Agency theory is the relationship between the principals, such as shareholders and agents such as the company executives and managers. In this theory, shareholders who are the owners or principals of the company, hires the agents to perform work. Principals delegate the running of business to the directors or managers, who are the shareholder’s agents (Clarke, 2004). 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.

Agency theory suggests that there are several mechanisms to reduce the agency problem in the firm. For example, managerial incentive mechanism compensates managerial efforts to serve the owners’ interests; dividend mechanism reduces managerial intention to make an over investment decision which will be financed by internal free cash flow; bonding mechanism reduces managerial moral hazard which potentially occurs when they are not restricted by bond contract and bankruptcy risk. Other owners’ efforts to reduce agency cost
of equity, potentially created by moral hazard managers, include the intention of owners to choose reputable board of directors; direct intervention by shareholders, the threat of firing, and the threat of takeover (Sanda et al., 2005).

Through this theory, the banking sector in Kenya follows the outline framework of corporate governance to ensure that competent agents are appointed/elected in the management of these banks on behalf of the principals.

2.2.2 Stewardship Theory

Stewardship theory has its roots from psychology and sociology and is defined by Davis, Schoorman & Donaldson (1997) as “a steward protects and maximizes shareholders wealth through firm performance, because by so doing, the steward’s utility functions are maximized”. In this perspective, stewards are company executives and managers working for the shareholders, protects and make profits for the shareholders.

Unlike agency theory, stewardship theory stresses not on the perspective of individualism, but rather on the role of top management being as stewards, integrating their goals as part of the organization. The stewardship perspective suggests that stewards are satisfied and motivated when organizational success is attained.

This theory inculcates the views and goals of the steward to those of the bank at large. In so doing, the aspirations of the steward acting for the institution are not suppressed thus empowering and offering maximum autonomy that is built on trust. This in return would enhance the bank’s financial and operational performance. This can minimize the costs aimed at monitoring and controlling behaviors.
2.2.3 Stakeholder Theory

Stakeholder theory evolved from Freeman’s (1984) stakeholder approach to strategic management in the mid 1980s. Freeman argued that monitoring and satisfying the interests of relevant stakeholders ultimately leads to improved corporate performance and sustainability. Stakeholder theory expanded to include descriptive ways of modeling and understanding organizations, ethical considerations of how organizations should interact with society and finally to provide evidence supporting the benefits of stakeholder management (Donaldson & Preston, 1995). The theory has spread to several disciplines, including e-Government where the theory has been applied related to managing the ongoing e-transformation (Scholl, 2005) and has been suggested as a suitable approach for investigating both ethical and practical aspects of changes in the relationship between governments and their constituents caused by implementation of new technology (Flak & Rose, 2005).

The origin of the stakeholder concept lies in the business science literature (Freeman, 1984), and may be traced back even as far as Adam Smith and his The Theory of Moral Sentiments. Its modern utilization in management literature was brought about by the Stanford Research Institute, which introduced the term in 1963 to generalize and expand the notion of the shareholders as the only group that management needed to be sensitive towards (Jongbloed et al., 2008). Within this perspective, Freeman (1984) argued that business organizations should be concerned about the interests of other stakeholders when taking strategic decisions.

Although a relatively longstanding term, the development of stakeholder theory was set in motion by the work of Freeman (1984). The objective of his work was to outline an alternative form of strategic management as a response to rising competitiveness, globalization and the growing complexity of company operations. As time went by, the stakeholder concept has taken on greater importance due to public interest, greater coverage
by the media, concerns about corporative governance and its adoption as a policy within the scope of the “Third Way” (Hutton, 1999; Greenwood, 2008).

The ideas of Freeman (1984), which culminated in stakeholder theory, emerged out of an organizational context in which the company was perceived as not being self-sufficient and actually dependent on the external environment made up of groups external to the organization, as Pfeffer and Salancik (1978) had earlier observed. These were the external groups that Freeman (1984) termed “stakeholders”.

According to Jones and Wicks (1999), the basic premises of Stakeholder Theory are:

The organization enters into relationships with many groups that influence or are influenced by the company, i.e. “stakeholders” in accordance with Freeman’s (1984) terminology.

The theory focuses on the nature of these relationships in terms of processes and results for the company and for stakeholders.

The interests of all legitimate stakeholders are of intrinsic value and it is assumed that there is no single prevailing set of interests.

This was advanced by Donaldson (1990) and is an alternative to the agency theory. It argues from the view of managerial motivation. The main reasoning is that executive manager, far from being an “opportunistic shirker”, essentially wants to do a good job, to be a good steward of the corporate assets. The stewardship theory therefore holds that performance variations arise from whether the structural situation in which the executive is located facilitates effective action by the executive. The issue becomes whether or not the organization structure helps the executive to formulate and implement plans for high corporate performance. It suggests that structures will assist shareholders to attain superior
performance by their corporations to the extent that the CEO exercises complete authority over the corporation and that their role is unambiguous and unchallenged.

This situation is attained more readily where the CEO is also chair of the board. Thus, stewardship theory focuses on facilitating, empowering structures, and holds that fusion of the incumbency of the roles of chair and CEO will enhance effectiveness and produce, as a result, superior returns to shareholders than separation of the roles of chair and CEO. The weakness in this theory is that holding many people accountable ignores the importance of taking responsibility.

2.3 Determinants of financial performance of Commercial Banks

The determinants of bank performances can be classified into bank specific (internal) and macroeconomic (external) factors (Al-Tamimi, 2010; Aburime, 2005). These are stochastic variables that determine the output. Internal factors are individual bank characteristics which affect the banks performance. These factors are basically influenced by internal decisions of management and the board. The external factors are sector-wide or country-wide factors which are beyond the control of the company and affect the profitability of banks. Financial profitability of a firm will boost the income of its employees, bring better quality products for its customers and the high returns would mean more future investments which would in turn generate employment opportunities and enhance the income of people. The factors are as discussed below;

2.3.1 Management Efficiency

Management Efficiency is one of the key internal factors that determine the bank profitability. It is represented by different financial ratios like total asset growth, loan growth rate and earnings growth rate. Yet, it is one of the complex subject to capture with financial ratios. Moreover, operational efficiency in managing the operating expenses is another dimension for
management quality. The performance of management is often expressed qualitatively through subjective evaluation of management systems, organizational discipline, control systems, quality of staff, and others. Yet, some financial ratios of the financial statements act as a proxy for management efficiency. The capability of the management to deploy its resources efficiently, income maximization, reducing operating costs can be measured by financial ratios. One of these ratios used to measure management quality is operating profit to income ratio (Rahman et al. in Ilhomovich, 2009; Sangmi and Nazir, 2010). The higher the operating profits to total income (revenue) the more the efficient management is in terms of operational efficiency and income generation. The other important ratio is that proxy management quality is expense to asset ratio. The ratio of operating expenses to total asset is expected to be negatively associated with profitability. Management quality in this regard, determines the level of operating expenses and in turn affects profitability (Athanasoglou et al. 2005).

2.3.2 Board Size

The Board is responsible for the governance of the bank and is committed to ensuring that its business and operations are conducted with integrity and in compliance with the Law, internationally accepted principles and best practices of corporate governance and business ethics.

The largely shared wisdom about the optimal board size is that the larger the board size, the lesser the performance of the organization Belkhir, (2006). Limiting board size to a particular level is widely believed to improve the performance of the firm at all levels. Benefits arising from increased monitoring by larger boards are outweighed by poorer communication and cumbersome decision making. Empirical studies on board size seem to provide the same conclusion: A big board is likely to be less effective in substantive discussions of major issues
among themselves in monitoring management. Large boards are less effective and are easier for CEO to control (Lipton and Lorsch, 1992). Jensen (1993) and Lipton and Lorsch (1992) suggest that as board size increases beyond a certain point, these inefficiencies outweigh the initial advantages from having more directors to draw on, leading to a lower level of corporate performance. Consistent with this, Coles et al. (2008) find that the impact of board size on firm value is positive for large firms, and hence large board size may be an optimal value maximizing outcome for such firms. In this case, Board size plays a major role on the performance of every prospering organization. However, measuring the size and compensation of the board which is a variable that goes hand in hand with board size remains a difficult task because compensation is provided under many different guises: salary, bonus, equity options and retirement benefits.

Therefore, we scale the amount of compensation by the firms total assets to account for productivity as a factor of firms size. This would show whether there is a positive relationship between small board size and the financial performance of banks in Kenya.

2.3.3 Asset Quality

The bank's asset is another bank specific variable that affects the profitability of a bank. The bank asset includes among others current asset, credit portfolio, fixed asset, and other investments. Often a growing asset (size) related to the age of the bank (Athanasoglou et al., 2005). More often than not the loan of a bank is the major asset that generates the major share of the banks income. Loan is the major asset of commercial banks from which they generate income. The quality of loan portfolio determines the profitability of banks. The loan portfolio quality has a direct bearing on bank profitability. The highest risk facing a bank is the losses derived from delinquent loans (Dang, 2011). Thus, non performing loan ratios are the best proxies for asset quality. Different types of financial ratios used to study the performances of
banks by different scholars. It is the major concern of all commercial banks to keep the amount of nonperforming loans to low level. This is so because high nonperforming loan affects the profitability of the bank. Thus, low nonperforming loans to total loans shows the good health of the portfolio a bank. The lower the ratio the better the bank performing (Sangmi and Nazir, 2010).

2.3.4 Board diversity

It is argued that diversity increases board independence. Board diversity includes gender, race and cultural composition of the board of directors. Diversity promotes a better understanding of the marketplace because demographic projections indicate the marketplace is becoming more diverse, matching the diversity of the banks to the diversity of the bank’s potential customers and increases the ability to penetrate markets. Diversity also increases creativity and innovation. According to this view, “attitudes, cognitive functioning, and beliefs are not randomly distributed in the population, but tend to vary systematically with demographic variables such as age, race, and gender” (Robinson and Dechant, 1997). Diversity produces more effective problem-solving. While heterogeneity may initially produce more conflict in the decision making process, the variety of perspectives that emerges cause decision makers to evaluate more alternatives and more carefully explore the consequences of these alternatives. It also enhances the effectiveness of corporate leadership. The result of diversity at the top is a better understanding of the complexities of the environment and more astute decisions that enhance the profitability of the firm. Finally, diversity promotes more effective global relationships.

The role of the board in an agency framework is to resolve agency problems between managers and shareholders by setting compensation and replacing managers that do not create value for the shareholders. One of the key elements of an agency view of the board is that
outside board members will not collude with inside directors to subvert shareholder interests because directors have incentives to build reputations as expert monitors. Board independence is critical for boards to function in the best interests of shareholders.

2.3.5 Non-executive directors

The focus on board independence is grounded in agency theory (Fama and Jensen, 1983). In fact, it has long been argued in the finance literature that boards with a majority of independent directors are more effective in monitoring management (Baysinger and Butler, 1985; Morck and Nakamura, 1994; Kaplan and Minton, 1994; Bhagat and Black, 2002) and are more likely to replace poorly performing CEOs (Weisbach, 1988). More independent boards are also more likely to opt for a clean slate when company performance deteriorates significantly, and to hire a replacement CEO from outside the firm rather than promote an internal candidate (Borokhovich et al., 1996; Huson, 2001). Another research stream relies on the hypothesis that greater disclosure enhances stock market liquidity, thereby reducing the cost of capital (Coombs and Watson, 2001). The commitment of management teams to increase the level of disclosure should lower the information asymmetry between managers and shareholders and lower the cost of capital. As a result of a reduced cost of capital, firm valuation will increase.

Though the issue of whether directors should be employees of or affiliated with the firm (inside directors) or outsiders has been well researched, no clear conclusion is reached. On one hand, inside directors are more familiar with the firm's activities and they can act as monitors to top management especially if they perceive the opportunity to advance into positions held by incompetent executives. On the other hand, outside directors may act as “professional referees” to ensure that competition among insiders stimulates actions consistent with shareholder value maximization (Fama, 1980). John and Senbet (1998), argue that
boards of directors are more independent as the proportion of their outside directors increases. Though it has been argued (Fama and Jensen, 1983; Baums, 1994) that the effectiveness of a board depends on the optimal mix of inside and outside directors, there is very little theory on the determinants of an optimal board composition.

2.4 Empirical Review

Previous empirical studies have provided the relationship between corporate governance and firm financial performance (Gompers et al., 2003; Black et al., 2003 and Sanda et al. (2003) with inconclusive results). Others, Bebchuk and Cohen (2004) have shown that well-governed firms have higher firm performance. The main characteristic of corporate governance identified in these studies include board size, board diversity, and whether the CEO is also the board chairman. Rosenstein and Wyatt (1990) showed that the market rewards firms for appointing outside directors. Brickley et al. (1994) found a positive relation between proportion of outside directors and stock-market reactions to poison pill adoptions. However, Forsberg (1989) found no relation between the proportion of outside directors and various financial performance measures. Bhagat and Black (2002) found no significant relationship between board composition and financial performance. Yermack (1996) also showed that, the percentage of outside directors does not significantly affect firm financial performance.

Agrawal and Knoeber (1996) suggest that boards expanded for political reasons often result in too many outsiders on the board, which does not help financial performance. Some recent empirical papers appear to focuses on the relationship between corporate governance ratings and firm financial performance: Gompers et al. (2003), Brown and Caylor (2004), for the USA; Drobetz et al. (2003) and Bauer et al. (2004) for Europe; Foerster and Huen (2004) for Canada. Ricart et al. (2005) considered the relationship between corporate governance systems and sustainable development of DJSI leading companies.
Bauer et al. (2004) argued whether good corporate governance leads to higher common stock returns, firm value or operating performance using a sample of 269 firms from the FTSE Eurotop 300 over the period 2000-2001. The authors used Deminor's corporate governance ratings in order to measure the firms' quality of corporate governance. Deminor's rating can be attributed to four categories: shareholder rights, takeover defenses, disclosure on corporate governance and board structure and functioning. They argue that good corporate governance will increase investor trust and subsequently lower corporate risk and a lower expected rate of return; furthermore a lower expected rate of return leads to a higher firm valuation. However, they found an insignificant relationship between corporate governance and firm valuation. Finally, the relationship between corporate governance and firm performance is statistically negative.

Empirical evidence on the association between (NEDs) and firm financial performance is mixed. Studies have found that having more outside independent directors on the board improves financial performance (Daily and Dalton, 1994), while other studies have not found a link between independent NEDs and improved firm financial performance (Hermalin and Weisbach, 1991). The point that can be made from these studies is that there is no clear benefit to firm financial performance provided by independent NEDs. Petra (2005) argues that the mixed results may be reflective of a corporate culture wherein corporate boards are controlled by management and the presence of independent NEDs has no discernable impact on management decisions.

Locally several studies have been done on the effect of corporate governance on financial performance. Muriithi, (2004) studied the relationship between corporate governance mechanisms and performance of firms quoted on the NSE and found that the size and the composition of the board of directors together with the separation of the control and the management have the greatest effect on the performance. Ngugi (2007) did a study on the
relationship between corporate governance structures and the performance of insurance companies in Kenya and found that inside directors are more familiar with the firm's activities and they can act as monitors to top management especially if they perceive the opportunity to advance into positions held by incompetent executives. The study also found that the effectiveness of a board depends on the optimal mix of inside and outside directors concluding that an optimal board composition lead to better performance of the companies.

Gatauwa (2008) studies the relationship between corporate governance practices and stock market liquidity for firms listed on the Nairobi Stock Exchange. The study found that greater disclosure enhances stock market liquidity, thereby reducing the cost of capital. The commitment of management teams to increase the level of disclosure also lower the information asymmetry between managers and shareholders and lower the cost of capital. Matengo (2008) also conducted a study on the relationship between corporate governance practices and performance the case of banking industries in Kenya. The study found that good corporate governance will lead to lower firm risk and subsequently to a lower cost of capital. The study also found that separation of ownership and control maximizes shareholders wealth.

2.5 Summary of Literature Review

Several studies discussed in this topic are an indication that corporate governance practices affect the financial performance of commercial banks in Kenya. Governance theories such as agency, stakeholder and stewardship theories reveal the relationship that binds the institutions (Banks) and individuals steering the institution’s management.

Agency theory describes the relationship between the principal and the agent and it focuses on the individual perspective of management whereas stewardship theory aims at consolidating the individual interest of the steward to those of the overall organization-bank to enhance
better performance and higher rate of returns. Stakeholder theory on the other hand concentrated on the interests of the stakeholder. It argued that by satisfying stakeholder interest, out rightly, the financial performance of commercial banks in the sector also improved proportionately if not more.

Good Corporate Governance aims at increasing profitability and efficiency of organizations and their enhanced ability to create wealth for shareholders, increased employment opportunities with better terms for workers and benefits to stakeholders. Indicators of Good Corporate Governance identified in the study include independent directors, independence of committees, board size, split chairman/CEO roles and the board meetings. Thus, the main tasks of corporate governance refer to: assuring corporate efficiency and mitigating arising conflicts providing for transparency and legitimacy of corporate activity, lowering risk for investments and providing high returns for investors and delivering framework for managerial accountability.

These theories also suggested several mechanisms that can be used to overcome the problems associated with separation of ownership and control: alignment of shareholders’ interest with managerial interests (compensation plans, stock options, bonus schemes); board monitoring by large shareholders and lenders; legal protection of (minority) shareholders from managerial expropriation through shareholder rights and the market for corporate control as an external device. The heterogeneity of the board of directors is seen to have an influence on performance of the firm. Banks that inculcate the heterogeneity in their board composition together with other characteristics such as a small and competent board and ensuring that there is a reasonable number of non executive directors surely improve their bank’s operational and financial performance. Such boards also carefully assess the most profitable loaning portfolio to ensure a strong asset base form which financial performance can be measured. This study therefore seeks to fill this gap by investigating the relationship between
corporate governance practices and financial performance of commercial banks in Kenya with particular reference to board diversity and other board characteristics.
CHAPTER THREE

METHODOLOGY

3.1 Introduction

This chapter presents a description of how the study will be approached. It presents the plan of the research. This involves the research design, data collection techniques, target population, the study sample and subsequent analysis techniques in order to generate meaningful findings of the study.

3.2 Research Design

In order to look at corporate governance and its effects on the financial performance of Kenyan Commercial Banks, this research study will use quantitative research design. Quantitative research will evaluate objective data consisting of numbers. It’s based on exploratory design and will thus allow the researcher to take the rich empirical data yielded from subjects and apply either qualitative or quantitative methods to the data.

3.3 Population

Population consists of the study’s subjects, which include individuals, groups, organizations, products or events. The target population of this study will be 44 commercial banks in Kenya as shown in appendix 1. Since the population of the banks under study is not very big, the whole population will be considered for the purpose of the study.

3.4 Data Collection

Secondary data will be used to collect data and information provided in the annual returns of some of the commercial banks as suggested in appendix 2 to show the performance of these
banks and then analysis will be done to weigh the correlation of the performance vis-à-vis corporate governance practices as presented by the banks.

### 3.5 Data Analysis

Data collected will be analyzed to give meaningful information. This study will use a quantitative method of data analysis which will be conducted using descriptive statistics. This will be used to show central tendencies such as mean and measures of dispersion like standard deviation.

I will adopt a linear regression model to show the nature and magnitude of relationship established between independent, intervening and dependent variables thus make inference from the data collected.

The regression analysis model is as follows;

\[
Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon
\]

Where:

- \( Y \) = Financial performance of the commercial banks
- \( \alpha \) = Constant
- \( \beta_1, \beta_5 \) = Beta coefficients which will measure the effect of each independent variable
- \( X_1 \) = Board Size measured by ROA
- \( X_2 \) = Loan portfolio to represent asset quality measure by non performing loans:Total loans
- \( X_3 \) = Total asset growth to represent management efficiency measure by Cost:Income
- \( X_4 \) = Board diversity
- \( X_5 \) = Non-executive directors measured by the proportion of independent directors to total directors
- \( \epsilon \) = Error term
The relevant ratios will be calculated from the collected data so as to get the independent variable.

The coefficient of determination $R^2$ will be used to show how the model fits the data and thereby presenting a measure of the usefulness of the model in predicting $Y$ only if the sample contains substantially more data points than the number of $\beta$ parameters in the model. Where: $R^2=0$ would imply a complete lack of fit of the model to the data while $R^2=1$ would imply a perfect fit with the model passing through every data point. Analysis of variance will be used to test the hypothesis of all the $\beta$ parameters except $\alpha$.

A test would finally be applied to determine whether each individual independent variable will be significant in explaining the financial performance of commercial banks in Kenya.
CHAPTER FOUR
DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

This chapter presents analysis and findings of the study as set out in the research methodology. The analysis was based on financial data collected by use of financial reports of commercial banks in Kenya and CBK supervisory report 2013/2012. The objective of this study was to investigate the effect of corporate governance practices on the financial performance of Commercial Banks in Kenya.

4.2 Corporate governance practices in Commercial banks

The study sought to find out the level of agreement of various corporate governance practices of commercial banks in Kenya. From the findings below, it was noted that commercial banks do practice corporate governance.

4.2.1 Board size

It was noted that the board should neither be too large nor too small so as not to compromise the interactive discussions during board meetings or to limit inclusion of a wider expertise and skills that are necessary for the board to be effective. The table in Appendix III reflect the percentages.

The table shows highest percentage of 20.51% with a frequency of 8 implying that 8 banks under study had 7 BODs and lowest percentage of 2.56% with a frequency of 1. From the findings above, it is evident that most commercial banks in Kenya have a board composition of seven directors.

The relationship is further evident from the correlation coefficient of -0.56 which shows a medium negative correlation between board size and the financial performance of commercial
banks in Kenya. This implies that as the board size increases the financial performance reduces significantly.

4.2.2 Board diversity

Board diversity was looked at in one main front, gender composition of the board members. The aim was to ascertain whether a well represented board with both male and female members causes bank performance to change. The table in Appendix IV presents the data.

The results show that most banks under study do not have female directors. This was represented by 47.67% of the bank’s board composition. Further analysis revealed that only 33% had 2-3 female directors in their boards. This is a low representation and from this it can be deduced that gender diversity may not have a financial implication to the financial performance of commercial banks in Kenya. This is because among the boards with no female representation, are banks showing good financial performance.

The correlation coefficient was -0.90 which showed a strong negative correlation between board diversity with reference to gender and financial performance of commercial banks in Kenya. This implies that financial performance of banks is not really affected by an increase in board diversity.

4.2.3 Non-Executive Directors

The findings presented in the table in Appendix V shows a high percentage frequency of 31.58% whereby 12 banks had their number of NEDs being 5. On the other hand, 2.63% was the percentage frequency on 3 banks with the number of NEDs being 4, 9 and 13 each. It is therefore evident that most commercial banks preferred a reasonable number of NEDs on their boards. Total frequency was taken to be 38 banks since 6 of the banks did not disclose the
number of NEDs in their boards. Therefore, for purposes or accuracy and elimination of error, a population of 38 banks was considered substantive for this research study.

The correlation coefficient for this variable was -0.55 which showed a medium negative correlation between the number of NEDs and financial performance of commercial banks. The implication was that, as the number of NEDs increases, the financial performance of commercial banks reduces and vice versa. Therefore this further asserts the need to have a reasonable number of NEDs on the board preferably 5.

4.3 Performance of Commercial banks

ROA is the major ratio used to indicate the profitability of the banks studied. It is a ratio of Income to its total asset (Khrawish, 2011). It measures the ability of the bank management to generate income by utilizing company assets at their disposal. In other words, it shows how efficiently the resources of the company are used to generate the income. It further indicates the efficiency of the management of a company in generating net income from all the resources of the institution (Khrawish, 2011). Wen (2010), states that a higher ROA shows that the company is more efficient in using its resources. A representation of the banks ROAs is as follows.

From the graph in Appendix VI, most banks recorded a positive ROA with Equity bank having a consistently high ROA of 7.7% in 2013 compared to 7.4% in 2012. this as attributable to the increase in its profit before tax and growth in net assets.

The positive ROAs for these banks are further analyzed by the following determinants of financial performance.
4.3.1 Asset quality

Loans are the major assets of commercial banks from where they generate income and the loan portfolio of these banks contributes largely to their profitability. Nonperforming loans were used as proxies for asset quality. It was stated that the lower the non performing loans: total loans the better the health of the portfolio. This study indicated the findings below.

It was observed that there was a general increase in NPLs which was partly attributed to high interest rates and slow down of economic activities during the period towards and after the march 2013 general elections. Consequently, NPLs increased by 32.3% from Ksh 61.9B in 2012 to Ksh 81.9B in 2013. Similary, the ratio of gross NPLs to gross loans increased from 4.7% to 5.2% in 2013 as shown in Appendix VII. It is worth noting that the net assets increased from Ksh 2,330.335B to Ksh 2,703.394B thus the ratio of gross loans to net assets followed the same trend. This was a clear indication of the positive growth in asset quality and performance in the commercial banks with the market showing an improved average ROA of 3% 2013 from 2.53% in 2012.

Further, the correlation coefficient was -0.27 which showed a weak negative relationship between asset quality (NPLs) and financial performance of commercial banks. This implies that the lower NPLs the better the financial performance.

4.3.2 Management Efficiency

The capability of bank management to deploy its resources efficiently, maximize income and reduce operating costs was measured using expense to asset ratio. Management efficiency in this regard was determined by the level of operating expenses which would in turn affect profitability. The findings are as tabulated in the Table in Appendix VIII.
From the findings, it was deduced that management efficiency had improved from 0.104 in 2012 to 0.085 in 2013. This reduction in expense to asset ratio indicates efficient resource utilization in banks which eventually lead to increased profitability as seen in the improved average ROA in 2013.

The correlation coefficient was 0.16 which showed a positive weak relationship between management efficiency and financial performance of commercial banks in Kenya. This implies that as management efficiency increases, the financial performance increases significantly as well.

4.4 Regression Model Fitness

The coefficient of determination, $R^2 = 70.8\%$, shows that the regression model is well explained by the variables. This implies that the financial performance is explained by the independent variables (Board Size, Asset Quality, Management Efficiency, Board Diversity and NEDs) upto 70.8% while the rest is explained by other variables not captured in this model.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Co-efficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>R</td>
<td>0.842</td>
</tr>
<tr>
<td>R Square</td>
<td>0.708</td>
</tr>
</tbody>
</table>

Table 4.6 coefficient of determination

Source: Research findings
ANOVA statistics indicate that the overall model was significant. This was supported by an F statistic of 6.80083 and p value of 0.002. The reported probability was less than the conventional probability of 0.05 (5%) significance level. The ANOVA results imply that the independent variables are good joint predictors of financial performance.

<table>
<thead>
<tr>
<th>Source: Research findings</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>4.5 Summary and Interpretation of Findings</strong></td>
</tr>
</tbody>
</table>

From the findings, the relationship between the financial performance of commercial banks and board size, number of NEDs, asset quality and management efficiency indicated a positive relationship. This was seen from their correlation coefficients which indicated that a unit change in the variables causes a positive significant change in the financial performance. This was consistent with the studies reviewed earlier.

The findings agree with Belkhir (2006) in literature review who conducted a research on board composition and bank performance. The result showed that the larger the board size the lesser the performance of the organization. The study suggested that as board size increased beyond a certain point, inefficiencies outweighed the advantages of having more directors.

Accordingly, Oyoga (2010) in his findings concluded that good corporate governance practices will lead to higher financial performance of commercial banks in Kenya in his study of corporate governance and firm performance.
However, board diversity showed contrary results in that there was no significant relationship between board diversity and financial performance of commercial banks in Kenya. This implied that the financial performance in commercial banks was not affected by the absence of female directors. This was inverse to the study done by Robbinson and Dechant, (1997).
CHAPTER FIVE

SUMMARY CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter of the study highlights some of the findings, conclusions, recommendations and suggestions for further study.

5.2 Summary

One of the main findings of this study was that board gender as an element of board diversity had no significant effect on the performance of commercial banks in Kenya. This is shown by a statistically insignificant relationship between board gender diversity and bank performance. These findings suggest that diversity could be an important corporate governance concept in other business facets as opposed to boardrooms. This finding could be like this because most of the banks are male dominated.

Board size on the other hand impacts on the financial performance of banks. It was seen that as the board size increased beyond 7, the financial performance reduced since the board became less effective. The medium negative correlation implied that as the board size reduced below optimal level, taken to be 7 in this study, then the financial performance would reduce. The number of non executive directors also depicted a similar trend and thus an optimal number of both the board size and NEDs needed to be observed in order to have the financial performance of commercial banks at a higher level.

The findings on asset quality showed that as the number of NPLs reduced, the financial performance of banks improved significantly. The reduction in NPLs meant a stronger asset base for the banks and thus improved profitability.
Management efficiency also drew positive relationship in that the operating efficiency of commercial banks improved over the years (2011-2013) thus leading to higher financial performance.

These findings were in line with the objective of establishing the effect of corporate governance practices on the financial performance of commercial banks even in the case of board diversity since if depicted an inverse relationship.

5.3 Conclusion

The independent variables that is board size, number of non executive directors, asset quality and management efficiency show a positive relationship to the dependent variable aside from gender diversity which is seen not to impact on the financial performance of banks. The possible interpretation of the this phenomenon could be that there may be glass ceiling in majority of the banks in Kenya. Since board members are the most senior people in organizations as some of them rise above the ranks and become board members. If this is the case, then many female employees face glass ceiling (i.e. promotion to a certain level but not beyond) in those organizations (Williams 1992).

The trend in ROA between 2012-2013 shown in fig 4.1 shown that there has been a tremendous improvement in the financial performance of commercial banks. These results can be attributed to the adoption and implementation of corporate governance practices in to the operation of the banks that have seen the increase in profit before tax and subsequent growth in net assets. This shows that the corporate governance practices have an effect on the financial performance of commercial banks in Kenya.

The results of the study show that good corporate governance practices enhance corporate performance and when these factors are capitalized, they enhance firm value.
5.4 Limitations of the study

Notwithstanding of the above findings, the study had some limitations. No research can be comprehensive and this research addresses only some elements of corporate governance and is restricted to commercial banks in Kenya.

The main limitation of the study was that the data was collected through publicly available data sources such as annual reports mainly from the Central Bank of Kenya. If there were any problems relating to data disclosures or professional accounting practices, then that would limit the validity of the findings.

Also, the entire population comprised of only 44 banks, which is relatively small. Out of these, the data obtained was exhaustive on all variables and for all the 44 banks. Therefore, the information and findings were taken to be sufficient representation of the whole population though not the case in real sense.

The research used only three variables of corporate governance of banks in the model yet there are many other alternative measures that may have provided different results from the ones provided by the variables used.

Time was also a limiting factor since the study was involving and required a lot of attention especially when gathering data which was also scarcely available. Therefore the information obtained represents that which was available within the limited time frame. Probably, the findings would have been different if time was available to gather more data.
5.5 Recommendations

The study recommendations were as follows.

5.5.1 Policy Recommendations

Commercial banks in Kenya should embrace corporate governance practices for them to enhance shareholder wealth maximization and corporate profitability. CBK through their prudential regulations should ensure that commercial banks follow these regulations which ensure adequate risk management measures are followed not only in writing but in day to day operations in the banks.

It is also recommended that the Institute of Certified Public Secretaries in conjunction with Kenya Bankers Association come up with awards to those banks that practices best corporate governance to encourage and root the culture of corporate governance in commercial banks in Kenya.

In a bid to improve female representation in boards of commercial banks in Kenya, CBK should introduce a regulation requiring a given percentage of female representation in boards. In as much as the findings don’t draw a positive relationship between board-gender diversity and financial performance, it may help break the male dominance, empower women to top positions and perhaps this could form a basis of further study on effect of female representation vs male representation in board of commercial banks in Kenya.

The regulators should also improve on the mechanisms of ensuring that the corporate governance disclosures in the annual reports are not simply statement of good intentions but are actually implemented at firm level. This will greatly improve the level of corporate governance and by extension firm performance.
5.5.2 Suggestions for further research

The information obtained for the research study was limited due to unavailability of data and the choice statistical analysis was determined by the period and banks covered. It would therefore, be desirable to extend the present study by complementing it with other studies using other methods and including comparative data and other sources to make it all inclusive.

The inclusion of other corporate governance to increase the variables under study should be conducted to see if similar results can be obtained thus make a valid conclusion on effect of corporate governance on financial performance of commercial banks in Kenya.

Further study should be conducted giving more emphasis to time spent on collecting the data on the independent variables, preferably future studies should focus on specific corporate governance practices in relation to financial performance so as to get a detailed report on the effect of each variable independently.

Also the scope of future studies should be reduced maybe to one bank so as to carefully scrutinize the effect of the corporate governance practices adopted by the bank under study. Perhaps this would draw more insight on the financial performance.
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APPENDIX I  List of Registered Commercial Banks in Kenya

1. ABC Bank (Kenya)
2. Bank of Africa
3. Bank of Baroda
4. Bank of India
5. Barclays Bank
6. CFC Stanbic Bank
7. Chase Bank (Kenya)
8. Citibank
9. Commercial Bank of Africa
10. Consolidated Bank of Kenya
11. Cooperative Bank of Kenya
12. Credit Bank
14. Diamond Trust Bank
15. Dubai Bank Kenya
16. Ecobank
17. Equatorial Commercial Bank
18. Equity Bank
19. Family Bank
20. Fidelity Commercial Bank Limited
21. Fina Bank
22. First Community Bank
23. Giro Commercial Bank
24. Guardian Bank
25. Gulf African Bank
26. Habib Bank
27. Habib Bank AG Zurich
28. I&M Bank
29. Imperial Bank Kenya
30. Jamii Bora Bank
31. Kenya Commercial Bank
32. K-Rep Bank
33. Middle East Bank Kenya
34. National Bank of Kenya
35. NIC Bank
36. Oriental Commercial Bank
37. Paramount Universal Bank
38. Prime Bank (Kenya)
39. Standard Chartered Kenya
40. Trans National Bank Kenya
41. United Bank for Africa
42. Victoria Commercial Bank
43. HDFC Bank Limited
44. FirstRand
APPENDIX II   Introduction Letter from the university

UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
MBA PROGRAMME

DATE: 15 SEP 2014

TO WHOM IT MAY CONCERN

The bearer of this letter is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

PATRICK NYABUTO
MBA ADMINISTRATOR
SCHOOL OF BUSINESS
**APPENDIX III**  
**Board size in Banks**

<table>
<thead>
<tr>
<th>No. of Directors</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>5</td>
<td>12.82</td>
</tr>
<tr>
<td>6</td>
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<td>7</td>
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<td>8</td>
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</tr>
<tr>
<td>12</td>
<td>2</td>
<td>5.13</td>
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<tr>
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<td>1</td>
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</tr>
<tr>
<td>19</td>
<td>2</td>
<td>5.13</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>39</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Source: Research findings

**APPENDIX IV**  
**Gender composition in Banks**

<table>
<thead>
<tr>
<th>Number of Women</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
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<td>47.67</td>
</tr>
<tr>
<td>1</td>
<td>8</td>
<td>22.22</td>
</tr>
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<td>2</td>
<td>6</td>
<td>16.67</td>
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<tr>
<td>3</td>
<td>6</td>
<td>16.67</td>
</tr>
<tr>
<td>5</td>
<td>1</td>
<td>2.78</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>36</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Source: Research findings
### APPENDIX V  Number of Non-Executive Directors

<table>
<thead>
<tr>
<th>Non executive Directors</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
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<td>3</td>
<td>8</td>
<td>21.05</td>
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<tr>
<td>4</td>
<td>1</td>
<td>2.63</td>
</tr>
<tr>
<td>5</td>
<td>12</td>
<td>31.58</td>
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<td>6</td>
<td>6</td>
<td>15.79</td>
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<tr>
<td>7</td>
<td>7</td>
<td>18.42</td>
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<tr>
<td>8</td>
<td>2</td>
<td>5.26</td>
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<tr>
<td>9</td>
<td>1</td>
<td>2.63</td>
</tr>
<tr>
<td>13</td>
<td>1</td>
<td>2.63</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>41</strong></td>
<td><strong>100.00</strong></td>
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Source: Research findings
APPENDIX VI  A Graph of ROA for commercial banks between 2012-2013

Source: Research Findings
APPENDIX VII  
Asset Quality and Provisions

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
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</thead>
<tbody>
<tr>
<td>Net Assets</td>
<td>2,020,818</td>
<td>2,330,335</td>
<td>2,703,394</td>
</tr>
<tr>
<td>Gross Loans</td>
<td>1,190,985</td>
<td>1,330,365</td>
<td>1,578,768</td>
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<td>Total Loans</td>
<td>1,180,956</td>
<td>1,318,570</td>
<td>1,564,635</td>
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<td>Net Loans</td>
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<td>1,296,452</td>
<td>1,532,387</td>
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<tr>
<td>Gross Non-Performing Loans</td>
<td>52,958</td>
<td>61,917</td>
<td>81,857</td>
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<tr>
<td>Interest in Suspense</td>
<td>10,029</td>
<td>11,795</td>
<td>14,133</td>
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<tr>
<td>Total Non-Performing Loans</td>
<td>42,928</td>
<td>50,122</td>
<td>67,724</td>
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<tr>
<td>Specific Provisions</td>
<td>28,945</td>
<td>27,185</td>
<td>32,247</td>
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<tr>
<td>Net Non-Performing Loans</td>
<td>13,983</td>
<td>22,937</td>
<td>35,476</td>
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<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Loans/Net Assets (%)</td>
<td>58.9%</td>
<td>57.1%</td>
<td>58.4%</td>
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<tr>
<td>Gross NPLs/Gross Loans (%)</td>
<td>4.4%</td>
<td>4.7%</td>
<td>5.2%</td>
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<tr>
<td>Net NPLs/Gross Loans (%)</td>
<td>1.2%</td>
<td>1.7%</td>
<td>2.2%</td>
</tr>
</tbody>
</table>

Source: CBK
## APPENDIX VIII Expense/Asset Ratio

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Assets</td>
<td>2,020,818</td>
<td>2,330,335</td>
<td>2,703,394</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>163,103</td>
<td>243,967</td>
<td>231,885</td>
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<tr>
<td>Expense/Assets</td>
<td>0.081</td>
<td>0.104</td>
<td>0.085</td>
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</tbody>
</table>

**Source:** CBK