

## **Board Composition, Strategic Leadership and Firm Performance: A Study of Commercial Banks in Kenya**

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**Abstract:** Boards of Directors are not only expected to monitor a company management; they are also held responsible for an organization's failure to attain organizational performance goals. The purpose of this study was to establish the relationship between board of directors' composition, strategic leadership and performance of commercial banks in Kenya. The specific objectives were to establish the relationship between board size, non-executive directors, and board diversity and performance of commercial banks in Kenya and the extent to which strategic leadership moderates such relationships. This study was anchored on Agency theory and Resource Dependence theories. The study employed a correlational research design. The target population was all operational registered commercial banks in Kenya which are thirty nine (39) in number. Purposive sampling technique was utilized to pick target respondents (Chief Executive Officers and one non-executive director for each bank). Data was collected using questionnaires. Ordinal logistic regression analysis was performed on the data collected using R technique to estimate and provide empirical evidence on the nature of relationship between the bank performance and Board composition. The research hypotheses were tested by determining the significance of the regression coefficients of the estimated models. Board size, incorporation of non-executive directors to the board, embracement of strategic leadership was found to have a positive and significant relationship with the performance of commercial banks in Kenya. Based on the findings, the study recommends that; Banks should constitute boards whose sizes are relative to the size of the banks, the boards so constituted should reflect diversity in terms of professional background, gender and ethnicity, valuable balance between executive and non-executive directors; Boards of Directors should offer strategic leadership by drawing strategic plans detailing clear strategic objectives on key areas of operation, disseminating the same to bank employees for buy in and smooth execution of the same. Further, banks should employ people with strong strategic orientation especially at the top level management and invest resources in developing capacity for strategic leadership.

**Key Words:** Board Diversity, Board of Directors, Board Size, Firm Performance, Strategic Leadership.

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### **I. INTRODUCTION**

#### **Background**

Firm performance as a result of corporate governance has received enormous attention in economic, finance and management literature in recent years. The motivation behind this attention has been the scandals that rocked the U.S. economy in early and late 2000 and the Asian financial crisis of late 90s. Apart from signaling the largest corporate bankruptcy in the USA, the failure of Enron Corporation in late 2001, also raised a myriad of questions about the effectiveness of contemporary auditing, accounting, and Corporate Governance practices (Vintern, 2002). The Enron scandal which occurred in early 2000 led to the reduction of its market value from US\$ 80 billion in August 2000 to less than US\$ 1 billion in 2001 when the scandal was unearthed. The quality of corporate governance regimes is what institutional investors rely on in making decisions, and place a cost (a financial premium) where systems are weak. Promotion of good corporate governance contributes positively to the development of both national capital markets and promotion of foreign direct investment. Thus, the significance of corporate governance is now widely recognized both for national development, and as part of the international financial architecture. Corporate governance is now established as an important component of the international financial architecture, but barely half a decade ago it was little known beyond specialists in a few countries such as the US, the UK, Australia, Canada and South Africa. According to Elewechi (2007) there has been an increase of initiatives by Reserve Banks and Central Banks alongside other institutions worldwide such as the Organization of Economic Cooperation and Development (OECD) and the Basel Committee on Banking and Supervision to provide governance principles with a view of tightening and enhancing management and performance of the banking industry which is an important sector in any economy.

### **Concept of corporate governance**

Corporate governance is concerned with “the system by which companies are directed and controlled, which is purely the responsibility of their Boards of Directors” (Cadbury, 2002). Choe and Lee (2003) state that the shareholders of organizations choose directors as their representatives to manage the day to day affairs of the business. The directors, who are collectively, referred to as the Board of Directors (BOD), then by a way of delegation give the responsibility for actual operations to the Chief Executive Officer (CEO), whom they hire. The Chief Executive Officer is accountable to the Board of Directors, which collectively and individually, is answerable to the shareholders. The Board advises on and consents to the selection of businesses and strategies of the firm as well as oversees results, in addition, to its role in selecting the CEO. In a nutshell, this system of authoritative direction, or government in an organization, is known as “corporate governance” (Choe & Lee, 2003). Boards of Directors have a critical responsibility in corporate governance. The key roles of the Board is to establish a guiding policy for the firm, to approve the company’s strategy, hire, monitor and remunerate top management, and to safeguard responsibility of the corporation to its owners, regulators, and other investors (Pandya, 2013). Biondi and Reberieux (2012) asserted that the Board of Directors is the key recognized mechanism needed by corporate governance for controlling and checking the particular operations and economy of the business entity, portrayed by irregularity between the external and internal states of the organization.

Boards of Directors are not only expected to monitor the companies’ executives; they are also held responsible for an organization’s failure to conform to rules and regulations and failure in attainment of performance goals (Lee & Isa, 2015). The Board of Directors is the foundation of a firm’s management and monitoring systems (Leventis, Dimitropoulos, & Owusu, 2013). Biondi and Reberieux (2012) stated that the supervisory role of the Board of Directors requires the reporting of company’s financial statements through financial reporting and supervision and monitoring of the corporate directors, including the decision to fire the CEO. In the banking sector, corporate governance is basically the way banking institutions’ operations and affairs are managed by the top management and the board of directors, which influences how the bank works out the bank’s objectives, policies and plans, while making sure there is suitable economic returns for the founders and other stakeholders (Linyiru, 2006).

### **The Concept of Strategic Leadership**

According to Carter and Greer (2013), strategic leadership is the ability of the leaders of the organization to envision and direct efforts and actions of the organization toward the successful attainment of the organizational objectives. Kjelin (2009) defines strategic leadership as the ability of firms to envision, anticipate and maintain flexibility, and empower others to create a strategic opportunity and a reliable future of the organization. Guillot (2003) explains that strategic leadership is the ability of a senior leader who is experienced and has wisdom and vision to make and execute plans and make consequential decisions in the uncertain, volatile, complex and ambiguous strategic business environment. Carmeli et al., (2011) assert that the failure to achieve profitability targets by most organizations is due to limited exposure and experience to strategic leadership. A lack of orientation to the work of strategic leadership may jeopardize organizational performance, organizational competitiveness, and sustainability (Bansal & Desjardine, 2014).

Harrison (2003) indicates that strategies and performance of organizations is purely the responsibility of senior executive management. Just as poor leadership can have a powerful negative influence; excellent leadership can have an enormous positive influence as well. Beck and Wiersema (2013) argue that firm performance is something that hinges on the dynamic capabilities of the management in resourcing of the organization and the strategic decision-making framework employed by the specific organizations.

### **Banking Industry in Kenya**

According to CBK report (2018), Kenyan Banking industry comprised 39 commercial banks, 13 microfinance banks, 1 mortgage finance company, 8 representative offices of foreign banks, 19 money remittance providers, 112 forex bureaus, 8 non-operating bank holding companies and 3 Credit Reference Bureaus in 2017. In 2017, Mayfair Bank Limited and DIB Bank Kenya Limited were licensed to operate banking business in Kenya. Central Bank of India (CBI) closed down its Representative Office while Société Générale of France opened a Representative Office in Kenya. In 2017, Giro Commercial Bank, Fidelity Commercial Bank Ltd and Habib Bank (K) Ltd were acquired by I & M Holdings Ltd, SBM Holdings Ltd, and Diamond Trust Bank Kenya Ltd respectively. (CBK, 2018). The CBK report highlights that there was deterioration from 9.3 percent in December 2016 to 11.0 percent in December 2017 in asset quality, measured as a proportion of non-performing loans to gross loans, indicating an increase in credit risks in 2017. In actual amounts, there was a 23.4% growth in gross non-performing loans (NPLs) which moved from KSh.214.4 billion in December 2016 to

KSh.264.6billion in December 2017. Real estate, trade, manufacturing sectors and personal/household accounted for the largest share of Non-performing loans, at 73.1 percent of gross NPLs (CBK, 2018)

Comparison in terms of relationship between Non-Performing Loans and bank size, large tier group banks had lowest Gross NPLs to Gross Loans ratio which was below the industry average in 2017. Banks in the small and medium peer groups had 'Gross Non performing loans to Gross Loans' ratios above the industry average in 2017. The report further points out that there was a decrease of 9.6 percent in the banking sector's pre-tax profits to Ksh.133.2 billion in December 2017 (CBK, 2018). According to the report, total income in the industry decreased by 3.1 % in 2017 to Kshs. 486.3 billion, while total expenses fell by 0.5 % to Ksh.353.1 billion in December 2017. The decrease in profitability is attributed to high cost of deposits, reduce lending to the private sector, and slow economic growth in 2017 compared to 2016. Such declines in profitability undermine banks capacity to build capital buffers using retained earnings to absorb shocks. Return on Asset (ROA) and Return on Equity (ROE) of the banking sector have continued to decline since late 2016. ROA reached the lowest level of 2.3 percent in January 2017 while ROE touched the lowest level of 19.8 percent in February 2017. As at December 2017, ROE was 20.6 percent from 24.4 percent in December 2016 while ROA was 2.6 percent from 3.2 percent in December 2016. This Erosion of earnings over time may pose risks to financial stability through increased balance sheet risks. It also reduces build-up of capital buffers to absorb any shocks. Profitability was the most affected thing by the interest rates capping law which was introduced in 2015, although the decline started earlier in 2016 (CBK, 2018).

In Kenya the CBK (Central Bank of Kenya) Act, the Company's Act, and the Banking Act form the main regulatory framework for the banking sector in Kenya. The Prudential Guidelines issued by the CBK from time to time together with these acts have greatly improved and enhanced the depth of reporting by commercial banks (Cyton Investment, 2017). Despite a strong regulatory framework, corporate governance has continued to weaken in Kenya leading to many cases of bank failures as highlighted. The cases of Imperial Bank and Chase Bank triggered some debates on issues bordering corporate governance. Imperial Bank Limited was established as a Finance and Securities Company in 1992 and officially began commercial banking services in 1996. By December 2013, the bank's total asset base was valued at about KES 43 billion, with shareholders' equity of approximately KES 5.719 billion. At that time, the bank ranking placed the bank at position nineteen (19) making it the 19<sup>th</sup> largest Kenyan commercial bank, by assets, out of forty-three licensed banks in the country (CBK, 2016). In October 2015 however the Central Bank of Kenya put Imperial Bank under statutory management. Unsound and unsafe business conditions and practices of transacting business in the bank were the main reasons for Imperial Bank receivership.

In 1995 several businesses came together and acquired a 60% stake in United Bank (Kenya). At that time, United Bank (Kenya) was under statutory administration by the Central Bank of Kenya since it was in receivership. In 1996, the bank rebranded to Chase bank and it opened its doors to customers once again. By December 2015, Chase Bank had an estimated value of KES 142 billion in asset valuation. At the same time, the shareholders' equity was valued at KES 11.9 billion (CBK, 2016). The Central Bank of Kenya placed Chase bank under receivership on April 7, 2016. The major causes for placement under receivership were associated with under-reporting of insider loans and failure to meet statutory banking ratios and therefore the bank was unable to meet its financial obligations. The insider loans stood at 13.62 billion Kenya shillings a figure way above the 5.72 billion Kenya shillings it reported. The bank made large amount of loan to its directors of about 13.62 billion Kenya shillings pointing to serious governance problem.

### **Statement of the Problem**

Corporate Governance challenges as confirmed by recent cases of bank failure witnessed in the banking sector in Kenya; collapse of Imperial Bank (2015), Dubai Bank (2015), and Chase Bank (2016) has sparked a lot of anger and uproar within the sector, these failures have been attributed to poor performance as a result of lack of adherence to sound corporate governance practices leading to weak internal controls and weak management practices (CBK, 2016). Chase bank for example was placed under receivership because of under-reporting of insider loans especially advanced to the bank top management which had surpassed the ceiling leading the bank to fail to meet statutory banking ratios and therefore the bank was unable to meet its financial obligations, this was an indictment on the board of directors for failing on its responsibility in providing strategic leadership and ensuring sound corporate governance within the bank. These bank failures are likely to have serious consequences to the country's economy and this is likely to derail the achievement of Kenya vision 2030. Recent report released by the Central Bank of Kenya (CBK, 2018) on the general industry performance points a picture of performance challenges within the sector since most performance parameters have been

declining in the recent past. According to the report, there was a decrease of 9.6 percent in the banking sector's pre-tax profits from 147.3 billion to Ksh.133.2 billion in December 2017. Such declines in profitability undermine banks capacity to build capital buffers using retained earnings to absorb shocks.

Various studies have been undertaken to examine the connection between corporate governance and firm performance. Olick (2015) in his study concluded that the board size has a positive and significant impact on the Return on Asset ratio (ROA). A study by Batool and Gohar (2015) established that large boards of directors inversely influence the financial performance of firms but also has a positive effect on corporate social responsibility and reputation. Carty and Weiss (2012) in their study found no correlation between bank failure and CEO duality. However, a study by Al-shammari and Al-saidi (2013) indicates that CEO duality positively impacts the performance of banks. Zhaoyang and Udaya (2012) concluded that firms' size of the Board and non-executive directors' composition in the whole board structure has a negative correlation to the value of the firm, and the effect of non-executive directorship on the financial performance of the firm was negative. Results from a study by Adhiambo (2014) reveals that a large board size tends to impact performance negatively. Kalungu (2012) study focused on the impact of three board elements (board size; board composition and board monitoring) on financial performance of commercial banks in Kenya.

In the Kenyan context, the available studies reveal some trend of inconclusiveness since they tend to study this relationship using two variables at a time; dependent and independent variables while ignoring other factors or interactions that may be important within the governance and performance framework of these institutions. This study considered the relationship between Board composition and the performance of commercial banks in Kenya while incorporating strategic leadership as a moderating variable to this relationship. This study utilized correlation design and a census on all the thirty nine operating commercial banks in Kenya where data was purposively collected from all the CEOs and one non-executive director from each bank later analyzed using Ordinal Logistic Regression Analysis to establish the relationship among the study variables.

### **Study Objectives and Hypotheses**

The main objective of this study was to examine the relationship between board composition, strategic leadership and performance of commercial banks in Kenya. Specifically, this study sought to examine; the relationship between board size, non-executive directors, board diversity and the performance of commercial banks in Kenya, and the moderating effect of strategic leadership on such relationships. In order to generate useful answers to realize these objectives, the following null hypotheses were tested:

- i) There is no significant relationship between Board size and performance of commercial banks in Kenya.
- ii) There is no significant relationship between non-executive directors and performance of commercial banks in Kenya
- iii) There is no significant relationship between Board diversity and performance of commercial banks in Kenya
- iv) Strategic leadership has no significant moderating effect on the relationship between Board composition and performance of commercial banks in Kenya.

## **II. Literature Review**

### **Theoretical Literature Review**

#### ***Agency Theory***

The Agency theory gives the foundation upon which most research on corporate governance is anchored (Abdullah, 2006). The theory stresses on the relationship between agents like corporate managers and principals like shareholders (Deegan, 2009). An agency relationship comes into existence when the principal hires the agent to carry out a task and the agent would be involved in decision making on behalf of the principal in most cases (Subramaniam, 2006). According to Jensen and Meckling (1976) agency relationship is "a contract where one or more persons called the principal(s) engage another person who is the agent to act on their behalf which mainly involves delegating some decision making authority to the agent". The major underlying assumption of agency theory is that, due to opportunistic and individualistic interests, the agent will not always make decisions that are best for the principal. Any principal-agent situation produces this agency problem and may be exacerbated by inadequate information and uncertainty (Subramaniam, 2006). To align the agents'

interest with that of the principals, the principals may monitor the agents' behaviour or provide incentives through employment contracts that can motivate the agent to act not only in their interests but also in the interest of the principal (Subramaniam, 2006).

According to Eisenhardt (Eisenhardt 2009), there are only two options that the principal has for reducing agency problems both of which are intended to restrain the opportunistic behaviour of the agent. The first option to minimize this problem is to put in place a governance structure that facilitates the assessment and monitoring of the agent's actual behaviour (Anderson & Reeb, 2004). The second option is to put in place a structure of governance where contract with the agent is anchored mainly on his behavior outcome (Eisenhardt (2009). According to Eisenhardt (2009), this makes the principal therefore to decide between putting in place governance structures based on the agent's actual actions and behavior or the result of that action or behavior. Homayoun, (2010) assert that both choices results to agency costs, these are costs which the principal incurs while monitoring and assessing the agent behavior.

### ***Resource Dependence Theory***

The concept of the "Resource Dependence Perspective" (1978) gained public awareness through the book by Jeffrey Pfeffer and Gerald Salancik "The External Control of Organizations. A Resource Dependence Perspective" and became widely accepted in the Anglo-American discussion. A fundamental assumption of Resource Dependence Theory (RDT) is that dependence on "critical" and important resources influences the actions of organizations management and that organizational decision and actions can be explained depending on the particular dependency situation. The Resource Dependency Theory focuses on the Board of Directors role in provision of access to critical resources required by the firm. Hillman, Canella and Paetzold (2000) contend that indeed the focus of resource dependency theory is on the role played by directors appointed to the board in securing or providing critical resources to a firm through their linkages to the external environment. Haniffa and Hudaib, (2006) agree that resource dependency theorists provide focus on the representatives' appointment from organizations that are independent as a means for gaining access to resources that are critical to the organization's success. The concern is more on resources access for the organization, like capital and expertise. This theory asserts that, board of directors as a corporate governance structure affect firms' access to resources essential for organizational performance (Cooke, 2002). Boards with a high composition of Non-Executive Directors is the best according to Resource dependence theory, because of the wider knowledge and expertise these directors can offer, as well as increased networking with the external environment and a generally better reputation (Haniffa& Cooke, 2002; Haniffa & Hudaib, 2006). According to Thompson (2007), Boards of Directors have a duty to shareholders to play a vigilant role in overseeing management's handling of a company's strategy-making, strategy-executing process. According to Pearce and Robinson (2007), every corporation should be led by an effective Board of Directors which is a group of stockholder representatives and strategic managers responsible for overseeing the creation and accomplishment of the company mission.

Perhaps the most criticism of the theory lies in its inability to fully and clearly delineate the relationship shared between the environment and the organization. Like most open-systems perspectives, the primary focus of resource dependence theory is on the environment. The theory does not fully give a valid description of the relationships shared between the environment and organization, To be sure, environments do appear to constrain and set limits on organizational action. However, it appears equally as valid to conclude that organizations act on and affect the environments in which they exist. Logic would suggest that the relationship shared between the organization and its environment is perhaps more accurately conceptualized as being bi-directional. If this is the case, then the challenge comes in determining when and under what conditions each functions as the dependent and independent variable (Huse, 2007).

### **Empirical Literature Review**

Trayler (2007) uses board characteristics as key variables of governance (such as percentage of inside directors, independent chairperson, risk direction statement from the board, number of directors, the existence of a risk committee and statement from the board on corporate governance) to evaluate return on equity (ROE), return on assets (ROA), provision for loan losses to loans, BIS capital adequacy and equity to assets. Multipleregression analysis results show that the coefficients for internal directors and independent chairperson are negative and significant statistically at 1 % meaning that the performance of the bank will be improved by a lower proportion of internal directors. The same goes for the chairperson who is internal, which is at odds with some countries legal requirement or stock exchanges for an independent chairperson.

Adams and Mehran (2012) examined the relationship between board composition, board size and performance, where the latter is proxied by Tobin's Q, using data on 35 BHCs from 1964 to 1985; the authors find that the natural logarithm of the size of the board is, on average, positively related to Tobin's Q in their sample. The authors assert that increases in board size are not generally value-adding as organization complexity increases, but the increase in board size due to directors' additions that also happen to sit on subsidiary boards appear to be of great importance., Aebiet *al.* (2012) also found that board size is positively related to their indicators of 372 US banks' performance (i.e., buy-and-hold returns and ROE) measured over the time period July 1, 2007, to December 31, 2008.

A study conducted by Ashraf et al. (2015) on the relationship between financial performance and corporate governance variables of all listed banks in Saudi Arabia. The data used in the study was from the whole population of banks listed on the Saudi Stock Exchange. The annual reports were analysed for all banks listed in Saudi Arabia for years 2009 and 2012. The study used different corporate governance variables such as: independence, audit committee, board size, CEO status and ownership concentration and three measures of financial performance such as: ROE, ROA and Tobin's Q. The results of this study show a significant positive relationship between governance variables (board size, board independence and bank size) and financial performance of banks; whereas leverage ratio and ownership concentration have a significant negative association with financial performance of banks'. However, the size of audit committee, status of the CEO and independence of audit committee were related to the financial performance of banks.

A study by Amarjit and Neil (2011) on the impact of the size of the board, CEO duality, and corporate liquidity on the profitability of Canadian service firms where a sample size of 75 Canadian service companies listed on Toronto Stock Exchange (TSX) was selected for a period of 3 years (from 2008-2010). The study applied non-experimental and co-relational research design. The results indicated that larger board size i.e large number of directors had a negative impact on the profitability of service companies in Canada. The findings of the study also show that the corporate liquidity and CEO duality impact positively on the profitability of service companies in Canada. In addition, firm growth and firm size have a positive impact on service firms in Canada.

Bahreini and Zain (2013) in their study of Malaysian banking sector concluded that corporate governance variables such as board size, board composition, and meeting of audit committee and audit committee composition have a positive impact on the performance of banks while variables like executive members in the audit committee and non executive director in the board show negative relationship with bank performance.

### **III. Research Methodology**

This study employed correlational research design. This type of design is basically concerned with evaluating the relationships between and among study variables. Kothari (2004) asserts that a correlational research design is utilized to explore the effect of one variable on another and this is consistent with this study which sought to establish the relationship between Board composition and bank performance. The basic empirical investigation here was to determine whether there exists a relationship between board composition variables and performance of commercial banks.

The target population for this study was all the Thirty nine (39) commercial banks that are licensed and operating in Kenya. The study used purposive sampling where thirty nine (39) Chief Executive Officers (CEOs), one from each bank in whose absence one of the executive directors was used as the respondents and thirty nine (39) non-executive directors, one from each bank were also involved. Primary data was collected from the respondents using structured questionnaires. The questionnaires comprised of both open-ended and Likert scale questions. The response variable in this study was the increase in profitability of the bank which was categorised into three hierarchical levels - large, moderate and less. The research therefore used the Generalised Linear Model (GLM) in the form of ordinal logistic regression as the main technique in the analysis of data using R Technique. Bank performance was taken as the response variable and denoted by Y. Each  $Y_i$  has three levels measured on a three-point Likert scale as large, moderate and less. Based on the ranks, the three levels of Y can be arranged in a hierarchical manner as:

*Large* > moderate > less

Based on the measurement scale of the response variable  $Y_i$  the research used the ordinal logistic regression technique. Assuming a proportional odds model, with the level less taken as the reference category, two ordinal logistic regression models were fitted simultaneously on to the data.

$$\left[ \frac{P(Y = \text{less})}{P(Y = \text{moderate, large})} \right] = \exp(\beta_{01} + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \dots + \beta_k X_k)$$

$$\left[ \frac{P(Y = \text{less, moderate})}{P(Y = \text{large})} \right] = \exp(\beta_{02} + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \dots + \beta_k X_k)$$

For the categorical explanatory variables, this technique outputs a measure called the odds ratio, which gives a relative measure of the probability of one categorical value(s) occurring against the probability of another categorical value(s) not occurring. The ordinal logistic regression with proportional odds uses cumulative categories, and therefore the intercept differs between the pair of models, but the regression co-efficients are the same across the two fitted models.

Therefore given a categorical explanatory variable  $X_i$  and the regression co-efficient  $\beta_i$ , the odds ratio denoted by OR is given by:

$$OR = \exp(\beta_i)$$

This model has the following assumptions;

1. Linearity: There is a linear relationship between each explanatory variable  $X_i$  and the logarithm of the response variable  $Y$ .
2. Independence of errors: Data for observational units are not related. Same data is not collected from same respondents at different times.
3. No perfect multi-collinearity: The observations are independent and therefore no relationship exists between multiple explanatory variables. This means the explanatory variables are independent of each other.

Interpretation and inference of the model results was done as explained below.

The odds ratio can be less than 1, equal to 1 or greater than 1. A value of 1 means 100%.

If the odds ratio is greater than 1;  $\beta_i > 0 \Leftrightarrow \exp(\hat{\beta}_i) > 1$

Then it means that the other category of interest is (OR% – 100%) more likely to have the characteristic of interest in  $X_i$  than the reference category.

If the odds ratio is less than 1 ;  $\beta_i < 0 \Leftrightarrow \exp(\hat{\beta}_i) < 1$

Then it means that the other category of interest is (100% – OR %) less likely to have the characteristic of interest in  $X_i$  than the reference category.

If the odds ratio is equal to 1 ;  $\beta_i = 0 \Leftrightarrow \exp(\hat{\beta}_i) = 1$

Then it means that the other category of interest and the reference category are equally likely and therefore the characteristic of interest in  $X_i$  does not influence the response variable. Also generally, the more the odds ratio deviates from 1 (the more the co-efficient deviates from 0), the stronger the relationship between the values of  $X_i$  and  $Y_i$ .

To test for the significance of the co-efficient  $\beta_i$ , the research formulated the hypothesis:

$$H_0: \beta_i = 0,$$

$$H_1: \beta_i \neq 0,$$

The 95% confidence limits for the co-efficient  $\beta_i$  is given by

$$\beta_i = \hat{\beta}_i \pm t_{\alpha/2} S_{\hat{\beta}_i} \Leftrightarrow \beta_i = \hat{\beta}_i \pm t_{0.25} S_{\hat{\beta}_i}$$

Where  $z$  is the Wald's test statistic given by:

$$t = \frac{\hat{\beta}_i - \beta_i}{S_{\hat{\beta}_i}}$$

If the confidence interval for the co-efficient  $\beta_i$  includes the value 0, then the research fails to reject the null hypothesis  $H_0: \beta_i = 0$ , and it is therefore concluded that the corresponding explanatory variable  $X_i$  does not make a statistically significant contribution to the response variable  $Y$ , otherwise if the confidence interval for the co-efficient excludes the value 0, then the null hypothesis  $H_0: \beta_i = 0$  is rejected, and it is therefore concluded that the variable  $X_i$  makes a significant contribution in determining the responsevariable  $Y$ .

#### IV. Results And Discussion

##### Correlation Analysis

Principal component analysis was used to identify and cluster a group of related variables which have a high correlation and therefore assumed to measure the same traits. Within a cluster the strongest variable which has the highest value (loading) in the rotated component matrix was selected to represent the cluster. The inter-item correlation matrix in table 1 shows the correlation among the board composition variables; the composition of the board of directors with members from different professions, different ethnicity, more than a 1/3 non-executive directors, sufficient female representation and sufficient membership, the matrix shows a positive correlation for the majority of the items save for sufficient membership and non-executive directors; the more positives means almost all items measure in the same direction the underlying characteristics.

**Table 1: Board Composition Correlation Matrix**

	Different Professions	Different Ethnicity	Non-exec dir > 1/3	Female representation	Sufficient membership
Different Professions	1.000	0.115	0.135	0.037	0.010
Different Ethnicity	0.115	1.000	0.125	0.397	0.537
Non -executive dir > 1/3	0.135	0.125	1.000	0.022	-0.147
Female representation	0.037	0.397	0.022	1.000	0.533
Size/sufficient no.	0.010	0.537	-0.147	0.533	1.000

The technique of principal component analysis was used to identify and cluster a group of related variables which have a high correlation and therefore assumed to measure the same traits within the Board composition variable. Within a cluster the strongest variable which has the highest value (loading) in the rotated component matrix was selected to represent the cluster. Table2 shows that sufficient membership (board size) and non-executive directors being >1/3 had the highest loading factor and therefore were picked to represent the cluster of board composition.

**Table 2: Board composition Rotated Component Matrix<sup>a</sup>**

	Component	
	1	2
<b>Board size/Sufficient no.</b>	0.868	-0.165
Female representation	0.785	0.007
Different Ethnicity	0.778	0.239
<b>Non-executive dir &gt; 1/3</b>	-0.052	0.797
Different Professions	0.079	0.684

Extraction Method: Principal Component Analysis.  
 rotation Method: Varimax with Kaiser Normalization.<sup>a</sup>  
 a. Rotation converged in 3 iterations.



The reduced model therefore becomes

$$\left[ \frac{P(Y = \text{less})}{P(Y = \text{moderate, large})} \right] = \exp(\beta_{01} + \beta_1 X_1 + \beta_2 X_2)$$

$$\left[ \frac{P(Y = \text{less, moderate})}{P(Y = \text{large})} \right] = \exp(\beta_{02} + \beta_1 X_1 + \beta_2 X_2)$$

- $X_1$  - Sufficient membership
- $X_2$  - Non-executive directors > 1/3

**Regression Analysis**

Models were derived for each objective based on the reduced number of variables. Because the explanatory variables are categorical, except for the reference category, each other category was assigned a regression coefficient  $\beta_i$  and interpreted separately.

**Board Composition and Performance of Commercial Banks**

Table 3 shows the coefficients resulting from the regression analysis among the representing variables of board composition, the moderating variable (offering of strategic direction by the board) and bank performance (profitability). Regression analysis was used to test the research hypotheses, determine the existence of a significant relationship between the variables under the study and to ascertain the predictive power of Board composition on bank performance and also ascertain the same power when strategic leadership is introduced into the relationship.

**Table3: Board Composition Regression Analysis**

Coefficients:	Estimate			Odds Ratio	
	Value	Std. Error	t-value	$\exp(\hat{\beta}_i)$	
	$\beta_i$			Absolute	Percentage
Model 1: 2 3	-0.56	59.81	-0.01	0.57	57.2%
Model 2: 3 4	3.65	59.82	0.06	3.838	383.8%
NonExec4	3.21	1.61	1.23	2.471	247.1%
NonExec5	-0.92	0.81	-1.10	0.41	41.0%
SuffMemb3	3.66	2.78	0.03	3.894	389.4%
SuffMemb4	1.67	7.82	0.13	5.31	531.0%
SuffMemb5	5.86	3.83	0.12	3.515	351.5%
StratDirect3	15.30	63.48	0.11	4.384	438.4%
StratDirect4	16.65	146.75	0.12	1.7008	1700.8%
StratDirect5	13.22	146.73	0.09	5.484	548.4%
NonExec4:StratDirect3	12.83	111.09	0.12	3.719	371.9%
NonExec4:StratDirect4	-3.96	2.70	-1.46	0.012	1.2%
SuffMemb3:StratDirect3	9.96	263.46	0.076	2.108	210.8%
SuffMemb4:StratDirect3	12.11	108.25	0.26	1.817	181.7%
SuffMemb3:StratDirect4	10.66	146.72	0.073	4.268	426.8 %

The two ordinal logistic regression models for board composition factors are therefore fitted onto the data.

$$\left[ \frac{P(Y = \text{less})}{P(Y = \text{moderate, large})} \right]$$

$$= \exp(-0.56 + 3.21X_1 - 0.92X_2 + 3.67X_3 + 1.67X_4 + 5.86X_5 + 15.30X_6 + 16.65X_7 + 13.22X_8 + 12.83X_9 - 3.96X_{10} + 9.96X_{11} + 12.11X_{12} + 10.66X_{13})$$

$$\left[ \frac{P(Y = \text{less, moderate})}{P(Y = \text{large})} \right]$$

$$= \exp(3.65 + 3.21X_1 - 0.92X_2 + 3.67X_3 + 1.67X_4 + 5.86X_5 + 15.30X_6 + 16.65X_7 + 13.22X_8 + 12.83X_9 - 3.96X_{10} + 9.96X_{11} + 12.11X_{12} + 10.66X_{13})$$

Non-executive directors: large  $\beta_i = 3.21$ , therefore  $\exp(\hat{\beta}_i) = 2.471$   
 Therefore a bank which has non-executive directors to a large extent is 2.5 times more likely to increase profits from one level to the next compared to a bank which has non-executive directors to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [1.23, 5.18] which excludes 0.

Non-executive directors: very large  $\beta_i = -0.92$ , therefore  $\exp(\hat{\beta}_i) = 0.41$   
 Therefore a bank which has non-executive directors to a very large extent is 59.9% less likely to increase profits from one level to the next compared to a bank which has non-executive directors to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [-0.03, -1.83] which excludes 0.

Sufficient membership: moderate  $\beta_i = 3.66$ , therefore  $\exp(\hat{\beta}_i) = 3.894$   
 Therefore a bank which has sufficient number of members in the board to a moderate extent is 3.9 times more likely to increase profits from one level to the next compared to a bank which has sufficient number of members in the board to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [3.59, 3.74] which excludes 0.

Sufficient membership: large  $\beta_i = 1.67$ , therefore  $\exp(\hat{\beta}_i) = 5.31$   
 Therefore a bank which has sufficient number of members in the board to a large extent is 5.3 times more likely to increase profits from one level to the next compared to a bank which has sufficient number of members in the board to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [0.63, 2.71] which excludes 0.

Sufficient membership: very large  $\beta_i = 5.86$ , therefore  $\exp(\hat{\beta}_i) = 3.515$   
 Therefore a bank which has sufficient number of members in the board to a very large extent is 3.5 more likely to increase profits from one level to the next compared to a bank which has sufficient number of members in the board to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [5.39, 6.34] which excludes 0.

Strategic direction: moderate  $\beta_i = 15.3$ , therefore  $\exp(\hat{\beta}_i) = 4.384$   
 Therefore a bank which has strategic direction to a moderate extent is 4.4 times more likely to increase profits from one level to the next compared to a bank which has strategic direction to a less extent. The 95% confidence interval for co-efficient  $\beta_i$  is [9.20, 21.39] which excludes 0.

Strategic direction: large  $\beta_i = 16.65$ , therefore  $\exp(\hat{\beta}_i) = 1.71$

Therefore a bank which offers strategic direction to a large extent is 1.7 times more likely to increase profits from one level to the next compared to a bank which has strategic direction to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [0.00, 33.3] which includes 0.

Strategic direction: very large  $\beta_i = 13.22$ , therefore  $exp(\hat{\beta}_i) = 5.48$

Therefore a bank which offers strategic direction to a very large extent is 5.5 times more likely to increase profits from one level to the next compared to a bank which has strategic direction to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [0.01, 26.43] which excludes 0.

Non-executive directors: large and strategic direction: moderate

$\beta_i = 12.83$ , therefore  $exp(\hat{\beta}_i) = 3.719$

Therefore a bank which combines non-executive directors to a large extent with strategic direction to a moderate extent is about 3.7 times more likely to increase profits from one level to the next compared to a bank which has non-executive directors to a less extent and strategic direction to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [7.55, 10.11] which excludes 0.

Non-executive directors: large and strategic direction: large

$\beta_i = -3.96$ , therefore  $exp(\hat{\beta}_i) = 0.012$

Therefore a bank which combines non-executive directors to a large extent with strategic direction to a large extent is 98% less likely to increase profits from one level to the next compared to a bank which has non-executive directors to a less extent and strategic direction to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [-0.02, 7.91] which includes 0.

Sufficient membership: moderate and strategic direction: moderate

$\beta_i = 9.96$ , therefore  $exp(\hat{\beta}_i) = 2.108$

Therefore a bank which combines sufficient number of members in the board to a moderate extent with strategic direction to a moderate extent is 2.1 times more likely to increase profits from one level to the next compared to a bank which has sufficient number of members in the board to a less extent and strategic direction to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [9.47, 10.45] which excludes 0.

Sufficient membership: large and strategic direction: moderate

$\beta_i = 12.1$ , therefore  $exp(\hat{\beta}_i) = 1.82$

Therefore a bank which combines sufficient number of members in the board to a large extent with strategic direction to a moderate extent is 1.8 times more likely to increase profits from one level to the next compared to a bank which has sufficient number of members in the board to a less extent and strategic direction to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [9.97, 14.25] which excludes 0.

Sufficient membership: moderate and strategic direction: large

$\beta_i = 10.6$ , therefore  $exp(\hat{\beta}_i) = 4.27$

Therefore a bank which combines sufficient number of members in the board to a moderate extent with strategic direction to a large extent is 4.3 times more likely to increase profits from one level to the next compared to a bank which has sufficient number of members in the board to a less extent and strategic direction to a less extent. Testing the null hypothesis at the 95% confidence interval for co-efficient  $\beta_i$  is [10.32, 11.004] which excludes 0.

### **Hypothesis 1: *There is no significant relationship between Board size and performance of commercial banks in Kenya***

Board size is another parameter that was used to measure board composition. Results from table 3 indicate that a bank which has sufficient number of members in the board to a large extent is 5.3 times more likely to increase profits from one level to the next compared to a bank which has sufficient number of members in the board to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient  $\beta_i$  gives interval [0.63, 2.71] which excludes 0 value. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that board size is a statistically significant factor that influences the performance of commercial banks in Kenya. This therefore means that, the more the moderate size of the board the higher the performance of commercial banks in Kenya. These findings agree with those of Amarjit and Neil (2011) on the impact of the size of the board on the profitability of Canadian service firms which concluded that larger board size had a

negative impact on the profitability of service companies in Canada. While Adams and Mehran (2012) examined the relationship between board composition, board size and performance, the authors assert that increases in board size are not generally value-adding as organization complexity increases, but the increase in board size due to directors' additions that also happen to sit on subsidiary boards appear to be of great importance.

**Hypothesis 2: *There is no significant relationship between non-executive directors and performance of commercial banks in Kenya***

From the regression analysis results (Table 3) it is revealed that a bank whose board has non-executive directors to a large extent is 2.5 times more likely to increase profits from one level to the next compared to a bank which has non-executive directors to a less extent. Testing the null hypothesis at 95% confidence interval for coefficient  $\beta_i$  gives interval [1.23, 5.18] which excludes 0 value. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that including a sizeable number of non-executive directors in the board is a statistically significant factor that affects the performance of commercial banks in terms of profitability. This invariably means the more the number of non-executive directors in the board the higher the performance of commercial banks in Kenya in terms of profitability.

The above findings are in line with those of Ashraf et al. (2015) on the relationship between financial performance and corporate governance variables of all listed banks in Saudi Arabia, which showed a significant positive relationship between board independence and financial performance of banks. These findings agree with perspective of the resource dependence theory whose concern is more on resources access for the organization, like capital and expertise. This theory asserts that, board of directors as a corporate governance structure affect firms' access to resources essential for organizational performance (Cooke, 2002). Boards with a high composition of Non-Executive Directors are the best according to Resource dependence theory, because of the wider knowledge and expertise these directors can offer, as well as increased networking with the external environment and a generally better reputation (Haniffa & Cooke, 2002; Haniffa & Hudaib, 2006). Nicholson and Kiel (2003) asserts that Non-Executive Directors are better placed to improve access to business and political contacts, information and capital, by creating networking with external stakeholders, including governments, customers, and other companies (e.g. buyers, creditors and suppliers). Thus Non-Executive Directors enhance and improves resources access which simply put enables easier and cheaper access to inputs and thus affecting the performance of the firm positively (Nicholson & Kiel, 2003).

Given that the relationship between board of directors' composition and performance of commercial banks in Kenya is significant, we therefore reject the null hypothesis that there is no significant relationship between board composition and the performance of commercial banks in Kenya and conclude that board composition is a factor that can positively or negatively influence performance of commercial banks in Kenya depending on how it is done.

**Hypothesis 3: *Strategic leadership has no significant moderating effect on the relationship between board composition and performance of commercial banks in Kenya.***

Strategic leadership measured by giving of strategic direction by the board was used as a moderating or interaction variable in the relationship between the various independent variables and performance of commercial banks which was the response variable. Table 3 shows that a bank which combines sufficient number of members in the board to a large extent with strategic direction to a moderate extent is 1.8 times more likely to increase profits from one level to the next compared to a bank which has sufficient number of members in the board to a less extent and strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient  $\beta_i$  gives [9.97, 14.25] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that Board size combined with offering strategic leadership by the board is a statistically significant factor that influences the performance of commercial banks in Kenya. Findings reveal that a bank whose board is composed of non-executive directors to a large extent and offers strategic direction to a moderate extent is about 3.7 times more likely to increase profits from one level to the next compared to a bank which has non-executive directors to a less extent and strategic direction to a less extent. Testing of null hypothesis at 95% confidence interval for co-efficient  $\beta_i$  gives [7.55, 10.11] which excludes 0 value. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that non-executive directors combined with offering strategic leadership by the board is a statistically significant factor that influences the performance of commercial banks in Kenya.

Generally, combining strategic leadership with the independent variables leads to the rejection of null hypotheses. We therefore conclude that strategic leadership moderates the relationship between Board composition and the performance of commercial banks in Kenya and reject the null hypothesis that Strategic leadership has no significant moderating effect on the relationship between board composition and performance of commercial banks in Kenya. The findings above validate a study by Bader (2016) which examined the effect of both innovation and strategic orientation on organizational performance. It also examined the mediation effect of innovation on strategic orientation and organizational performance. Data were collected from the three telecommunication companies in Jordan. The data analysis was done using Structural Equation Modeling (SEM) and the results showed a significant effect of strategic orientation on innovation and organizational performance. It was also discovered that innovation significantly affected firm performance. Finally, the results showed that innovation partially mediated the path between strategic orientation and organizational performance. Beck and Wiersema (2013) argue that firm performance is something that hinges on the dynamic capabilities of the management in resourcing of the organization and the strategic decision-making framework employed by the board of directors.

## **V. CONCLUSIONS**

The empirical findings in this study have revealed a number of critical issues as regards Board composition in the Kenyan banking industry. The main objective of this study was to examine the relationship between Board composition, strategic leadership and performance of commercial banks in Kenya. Given the empirical findings, this study therefore concludes that there is a significant relationship between Board composition, strategic leadership and the performance of commercial banks in Kenya. The study concludes that there is a significant relationship between board size and the performance of commercial banks in Kenya. The size of the board of directors in terms of the numbers of members of the board is a factor that significantly influences the performance of the boards and ultimately the performance of the banks

The study concludes that there is a significant relationship between non-executive directors and the performance of commercial banks in Kenya. The number of non-executive directors in the board is a critical factor that significantly influences the performance of commercial banks in Kenya. The study further concludes that offering strategic leadership by the board of directors is a significant factor that moderates the relationship between board composition and the performance of commercial banks in Kenya. Strategic leadership variables like offering organizational direction by clearly setting and disseminating the organizational vision, mission and strategic objectives to the bank employees, managing change in the ever changing business environment, putting customers' interests in the centre of bank operations are all critical factors that significantly moderate the relationship between board composition and the performance of commercial banks.

## **VI. RECOMMENDATIONS**

In view of the findings that board composition has a significant relationship with the performance of commercial banks in Kenya; Banks should constitute boards whose sizes are relative to the size of the banks. Based on the findings that the relationship between non-executive directors and performance of commercial banks in Kenya is significant, commercial banks in Kenya should constitute boards that reflect diversity in terms of professional background, gender, ethnicity and a substantial portion of their members should be non-executive directors. Findings of this study reveal that there is significant moderating effect by strategic leadership on the relationship between board composition and the performance of commercial banks in Kenya and therefore Boards of Directors should over strategic management leadership, drawing strategic plans with clear strategic objectives and disseminating the same to all bank employees for buy in and smooth execution. Banks should also employ people with strategic orientation especially at the top level management and invest resources in developing strategic leadership in order to enhance their performance.

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