# CORPORATE GOVERNANCE PRACTICES, STRATEGIC LEADERSHIP AND PERFORMANCE OF COMMERCIAL BANKS IN KENYA

**BY**

**BARANTE MASAGA DANIEL**

A Thesis Submitted to the School of Business and Economics in Partial Fulfillment of the Requirement for the Award of the Degree of Doctor of Philosophy in Business (Strategic Management Option) of Machakos University.

**JULY 2020**

## DECLARATION

**Declaration by candidate:**

This thesis is my original work and has not been presented for an award of a degree in any other University or any other award.

……………………..……….                              ……………………..

**Signature** **Date**

**Barante M. Daniel**

**Reg. No: D86-7312-2016**

**Declaration by supervisors:**

We confirm that the work reported in this thesis was carried out by the student under our supervision

……………………..……….                              ……………………..

**Signature** **Date**

**Prof. Robert Arasa**

**School of Business and Economics**

**Machakos University**

……………………..……….                              ……………………..

**Signature** **Date**

**Dr. Susan Nzioki**

**School of Business and Economics**

**Machakos University**

# DEDICATION

I dedicate this work to my family which has been a great pillar for me throughout my entire studies, specifically to my Children; son Linus Masaga and my Daughter Claris Masaga, My brothers Samuel and Tom who cheered me on and my Mum and Dad, thank you all for your steadfast love and support, your warm presence keeps me moving.

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## ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| **AU** | African Union |
| **BHCs** | Bank Holding Companies |
| **BMF** | Board Meeting Frequency |
| **BODs** | Board of Directors |
| **BS** | Board Size |
| **BSC** | Balanced Score Card |
| **CBI** | Central Bank of India |
| **CBK** | Central Bank of Kenya |
| **CG** | Corporate Governance |
| **CCG** | Centre for Corporate Governance |
| **CDS** | Credit Default Swap |
| **CEO** | Chief Executive Officer |
| **CG** | Corporate Governance |
| **CMA** | Capital Market Authority |
| **CRR** | Capital Reserve Ratio |
| **DMBs** | Deposit Money Banks |
| **DPFB** | Deposit Protection Fund Board |
| **EPS** | Earnings Per Share |
| **FSAP** | Financial Sector Assessment program |
| **GLM** | Generalised Linear Model |
| **KDIC** | Kenya Deposit Insurance Corporation |
| **KES** | Kenya Shillings |
| **KYC** | Know Your Customers |
| **M&A** | Merger and Acquisition |
| **NACOS** | National Commission for Science, Technology and |
| **TI** | Innovation |
| **NBFI** | Non-Bank Financial Institutions |
| **NEDs** | Non Executive Directors |
| **NIC** | National Industrial Credit |
| **NII** | Net Interest Income |

**NIM** Net Interest Margin

**NPLs** Non-Performing Loans

**NSE** Nairobi Stock Exchange

**OD** Odds Ratio

**OECD** Organization for Economic Cooperation and Development

**OLS** Ordinary Least Squares

**PCA** Principal Component Analysis

**RDT** Resource Dependence Theory

**ROA** Return On Assets

**ROE** Return On Equity

**SCs** State Corporations

**SME** Small and Medium Enterprise

## OPERATIONAL DEFINITION OF TERMS

**Board Composition** It is how a group of Board of Directors for an organization is constituted in terms of Board size, Board diversity and Board independence.

**Corporate Governance** The systems through which firms are controlled and directed, which is purely the responsibility of their boards of directors.

**Board Committees** These are sub-board groups established by the board to help in its oversight roles and responsibilities in specific areas of operation within the organization, such sub-committees in the banking sector include Audit committee, Credit committee, Compensation committee and Human resource committee.

**Executive Compensation system** Rewards given to the senior members of management to compensate and motivate them; they include cash payments, optional grants, bonuses and executive perks.

**Firm Performance** Is a set of non-financial and financial indicators that give information on the extent of achievement of organizational objectives and results.

**Risk Management** Is the identification, assessment and prioritization of risks followed by coordinated and economical application of resources to monitor, minimize and control the probability or impact of unfortunate events.

**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.

# ABSTRACT

Boards of Directors are not only expected to monitor a company management; they are also held responsible for an organization's failure to conform to rules and regulations or failure to attain organizational performance goals. There has been an upsurge of Bank failures in Kenya sparking a lot of debate on the existence of sound corporate governance practices within the banking sector in Kenya. The main objective of this study was to establish the relationship between Corporate Governance practices, strategic leadership and commercial banks performance in Kenya. The specific objectives of this study are: to establish the relationship between Board of Directors' composition and commercial banks performance in Kenya; to determine the relationship between establishment of board committees and commercial banks performance in Kenya; to determine the relationship between compensation system and the commercial banks performance in Kenya; to establish the relationship between risk management and commercial banks performance in Kenya and to examine the extent to which strategic leadership moderates the relationship between Corporate Governance practices and commercial banks performance in Kenya. This study is anchored on Agency theory, Stakeholder theory, Stewardship theory and Resource Dependence theories. The philosophical orientation of this study is positivist paradigm with an epistemological element. The research design for the study is correlational design. The target population was 273 directors of all the boards of operating commercial banks in Kenya, the sample size was obtained using purposive sampling where all the thirty nine (39) Chief executive officers (CEOs) one from each bank and thirty nine (39) non-executive directors, one from each bank were involved in the study thereby giving a sample size of seventy eight (78). A pilot study was carried out with the view of identifying and correcting any weaknesses in the research instrument. Data was collected using questionnaires. Ordinal logistic regression analysis was performed on the data collected using SPSS software and R technique to estimate and provide empirical evidence on the existence of relationship between bank performance and corporate governance practices and whether strategic leadership moderates this relationship. The research hypotheses were tested by determining the significance of the regression coefficients of the estimated models. Based on the findings, the study concludes that there is a significant relationship between Board of Directors' composition and commercial banks performance in Kenya; establishment of board committees has no significant relationship with commercial banks performance in Kenya; Compensation system for the top bank management has a significant relationship with commercial banks performance in Kenya; the study further concludes that there is a significant relationship between risk management and commercial banks performance in Kenya and offering strategic leadership by the board enhances performance by moderating the relationship between all the study variables and commercial banks performance except for board committees. Given the findings, the study recommends that; Banks should constitute boards whose sizes are relative to the size of the banks, to be able to cover their key areas of operations, these boards should reflect diversity in terms of professional background, gender and ethnicity; Board of Directors should establish a system of compensation that is performance based and top management should be allowed share ownership of these banks, that way their interests will be aligned with those of the shareholders; commercial banks should invest in risk management systems that are able to detect risky transactions as opposed to the generic methods of Know Your Customers (KYC), that way they will significantly reduce risky transactions like non-performing loans; Boards of Directors should offer strategic leadership, drawing strategic plans detailing clear strategic objectives on key areas of operation, while disseminating the same to all bank employees. Banks should employ people with strategic orientation especially at the top level management and invest resources in developing capacity for strategic leadership.

# CHAPTER ONE

# INTRODUCTION

## 1.1 Background of the Study

Firm performance as a result of corporate governance has been given great focus in management, finance and economic literature in recent decades. The motivation behind this focus is attributed to the early and late 2000 US economy company scandals and the late 90s crisis that hit the Asian economy. Failures in the corporate reporting process has been cited as the reason behind the fall of high profile companies in the USA, UK and other parts of the world (IFAC, 2013). 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, 2011).

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. In the words of the President of the World Bank: “The proper governance of companies will become as crucial to the world economy as the proper governance of countries” (Godfrey, 2013).

Godfrey (2013) posits that in addition to the South African King Report, there has been a rapid growth in the development of African thinking on corporate governance. New thinking is to attack on the supply side of corruption (company bribes) by complementary anti-corruption measures by the state. The recent initiative of the African Union (AU) to develop an AU Convention on Combating Corruption addresses the importance of declaring public officials' assets, and also breaks ground by targeting unfair and unethical practices in the private sector. 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) Reserve Banks and Central Banks across the globe together with other institutions concerned with Corporate Governance such as the Basel Committee on Banking and Supervision and the Organization of Economic Cooperation and Development (OECD) have all increased initiatives to give principles of governance in the bid to tighten and enhance governance and performance of the banking industry which is an important sector in any economy.

### 1.1.1 Corporate Governance Practices

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, 2013).

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 Reberioux (2012) assert 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 Reberioux (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 Central Bank of Kenya through its prudential guidelines (2013) issued the following corporate governance principles that highlight the Corporate Governance Practices within the banking sector in Kenya: Establishment of Board committees: To increase efficiency and allow deeper focus in specific areas, the board shall establish specialized board committees; however, the whole board remains accountable (CBK, 2013). Risk Management Framework**:** The Board must ensure that the banking institution has adequate systems to identify , measure, monitor and manage key risks facing the banking institution and adopt and follow sound policies and objectives which have been fully deliberated.

Compensation Systems: The Board should actively oversee the compensation system's design and operation, and should monitor and review the compensation system to ensure that it operates as intended. The Board may constitute a board compensation committee (may be referred as remuneration committee) as an integral part of their governance structure to oversee the compensation system's design and operation on behalf of the Board of Directors (CBK, 2013).

### 1.1.2 The Concept of Strategic Leadership

Strategic leadership according to Carter and Greer (2013) 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. The failure to achieve profitability targets by most organizations is due to limited exposure and experience to strategic

leadership (Carmeli et al., 2011). Pearce and Robinson (2007) assert that Strategic leadership is about coping with change (change management); and more changes always demand more leadership. Hitt, Ireland, and Hoskisson (2007) define strategic leadership as the ability to envision, anticipate and maintain flexibility by the leader, in ensuring empowerment to others so as to create the necessary strategic changes, it involves managing through others.

Strategic leadership Knowledge is crucial for the top management teams because the demands from shareholders and stakeholders including customers (customer focus) have increased in both complexity and intensity (Carter & Greer., 2013). A lack of orientation to the work of strategic leadership may jeopardize organizational performance, organizational competitiveness, and sustainability (Bansal & Desjardine, 2014).

Kjelin (2009) defines Strategic leadership as the ability of firms to envision (offer organizational direction), anticipate and maintain flexibility, and empower others to create a strategic opportunity and a reliable future of the organization. Strategic leadership as defined by Guillot (2003) 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.

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. Business organizations with a perspective approach will have management that has shared view and vision and create a positive impact on the

environment where it operates. Therefore strategy is required to focus effort within the organization and promote coordination of activities. In the absence of strategy a firm becomes a bunch of individuals, hence strategy is needed to ensure people's collective efforts and concentration of actions towards achieving organizational objectives and plans.

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. Managerial capabilities are comprised of different managerial competencies that are dynamic and have a significant influence in directing the company's strategy (Tubs & Schulz, 2006).

The Banking sector environment which is fast changing and increasingly complex requires strategic and visionary leadership and top leaders who are willing to experiment, learn and engineer organizational change (Meyer & Botha, 2000).White (2004) advocates for flexible organizational plans that are capable of adjustment to suit ever changing business environment.

### 1.1.3 Firm Performance

Success is the motivation behind any firms' engagement in business. The measurement of this success comes in several ways. The level of success is measured in terms of business performance (Waweru, 2008). In order to measure the extent of success, firms measure among other things profitability using traditional financial performance measures and nonfinancial measures.

Firm performance according to Lebans and Euske (2006) is a set of nonfinancial and financial indicators that give information on the extent of achievement of organizational objectives and results (Lebans & Euske, 2006). The common performance indicators used are financial performance, operational performance, and overall effectiveness. Overall profitability is the hall mark of financial performance indicated by ratios such as Return on Investment, Return on Equity, Return on Sales, Return on Assets, earnings per share, profit margin, stock price and sales growth. Indicators for Operational performance include both product-market outcomes including efficiency, market share, innovation and new product introduction, and service or product quality and internal process outcomes like productivity, employee retention, and satisfaction.

According to Collis, Holt and Hussey, (2012), Kaplan and Norton (1992) came up with balanced score card approach in measuring performance of firms from a broader perspective. Firm performance relates to the efficiency and effectiveness of the organization. In the face of business environment changes and dynamism, strategies formulated and different leadership styles firms have to continuously monitor their performances for survival.

Central banks and reserve banks worldwide in collaboration with other institutions of Corporate Governance such as OECD and Basel committee on Banking and supervision have intensified initiatives to avail Corporate Governance principles that enhance performance and management of the banking institutions which are key to economic development of Nations. Developed countries like Germany, U.S.A, Canada, France, United Kingdom and others have taken these initiatives with South Africa leading the developing nations in addressing issues relating to Corporate Governance (Elewechi,

2007). According to Sanda, *et al. (2005*), the desire to tighten and enhance Corporate Governance in developed countries as well as developing countries has been awakened by global events regarding poor organization performance and resulting collapse of some banks alongside other highly ranked companies like World.com, Enron, Credit International and Bank of Commerce among others.

In view of the critical role of Corporate Governance, and the need to consolidate stability and ultimately good performance in this critical sector, there is therefore a great need on the part of banks to embrace Corporate Governance practices that are uniform and this is something that has been underscored by the Basel II committee on banking and supervision. The above highlighted measures notwithstanding, between 1984 and 2005, there were 34 bank failures recorded in Kenya all of them resulting from poor performance stemming from Corporate governance failures (Upadhyaya, 2011).

The great wave of Bank failures that resulted to many mergers and acquisitions in the banking sector across the world and even in Kenya prompted the central bank of Kenya to enhance great vigilance by strengthening its bank supervision arm (CBK, 2013). So as to realize its supervisory role, the Central Bank of Kenya on different times have had to issue Corporate Governance prudential guidelines to help institutions working within the Banking Act Cap 488 laws of Kenya, these prudential guidelines are supposed to be strictly adhered by all these institutions.

### 1.1.4. Banking Industry in Kenya

In Kenya Commercial Banks accept deposits from individuals and make profit by using the deposits to give loans to businesses with a high interest rate. The CBK Act, the Company's Act, and the Banking Act are 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).

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, 2 banks 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.264.6 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. 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. This Erosion of earnings over time may pose risks to financial stability through increased balance sheet risks (CBK, 2018).

## 1.2 Statement of the Problem

A number of theories have shown that, shareholders' objectives and corporate managers' objectives differ significantly and are contradictory as far as their individual interests are concerned and this has given rise to a system where a Board of Directors is constituted for the firm to be able to check and monitor the managers' actions and behavior as well as provide support and guidance to the managers.

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) sparked a lot of uproar within the sector, these failures have been attributed to poor financial 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 a huge indictment on the Board of Directors for failing on its responsibility in providing strategic leadership and ensuring sound Corporate Governance within the bank.

These failures signal inability on the part of the board of director within the banking sector to deal with risks that face the industry. Furthermore, bank failures are likely to have serious consequences to the country's economy and this will derail the achievement of Kenya vision 2030. Failing to offer Strategic Leadership by the Boards of Directors to save the sector from failures is an issue of concern that made this study to adopt Strategic Leadership as a moderating variable to the relationship between Corporate Governance practices and commercial banks performance in Kenya.

Recent report (Appendix iv) released by the Central Bank of Kenya (CBK, 2018) on the general industry performance paints 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 (CBK, 2018).

In a bid to find out the connection between Corporate Governance and bank performance and whether strategic leadership moderates this relationship, this study considered the relationship between corporate governance practices (board composition, board committees, compensation system and risk management) and performance of commercial banks in Kenya while incorporating strategic leadership as a moderating variable to this relationship.

## 1.3 Study Objectives

The main objective of this study was to examine the relationship between corporate Governance Practices, strategic leadership and performance of commercial banks in Kenya.

Specifically, this study sought to address the following specific objectives:

i) To establish the relationship between Board of Directors' composition and commercial banks performance in Kenya.

ii) To determine the relationship between Board Committees and commercial banks performance in Kenya

iii) To determine the relationship between Compensation System and commercial banks performance in Kenya

iv) To establish the relationship between Risk Management and commercial banks performance in Kenya

v) To examine the moderating effect of Strategic Leadership on the relationship between corporate Governance practices and commercial banks performance in Kenya.

## 1.4 Research Hypotheses

The following null hypotheses were tested so as to generate the required answers to research objectives:

**i)** There is no significant relationship between Board of Directors' composition and performance of commercial banks in Kenya.

**ii)** There is no significant relationship between establishment of Board Committees and performance of commercial banks in Kenya.

**iii)** There is no significant relationship between Compensation System and performance of commercial banks in Kenya.

**iv)** There is no significant relationship between Risk Management and performance of commercial banks in Kenya.

**v)** Strategic Leadership has no significant moderating effect on the relationship between Corporate Governance practices and commercial banks performance in Kenya.

### 1.5 Justification of the Study

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 been attributed to poor performance as a result of weak internal controls and weak management practices (CBK, 2016); this shows dealing with bank risks is still a challenge to managers in the sector, if something is not done to safeguard the bank, it is clear that important stakeholders: depositors, creditors, employees and other stakeholders are likely to continue incurring great financial losses in the event the sector continues to experience governance challenges that may lead to failing of more banks.

Furthermore, bank failures are likely to have serious consequences for the country's economy and this will derail the achievement of Kenya vision 2030. It was therefore important that this study be carried out so that it can make recommendations that the various banking sector stakeholders could draw from and safe the industry from performance challenges.

### 1.6 Significance of the Study

This study is beneficial to various stakeholders in the industry such as:

**Banking Sector Management:**

This study could help the banking sector management identify how various aspects of corporate governance practices affect the operations and ultimate performance of commercial banks in Kenya. The management could also identify the impediments that face these banks in approaching various corporate governance practices that affect their performance.

The Kenya commercial banks management could also gain from the findings of this study by enabling them put in place responsible governance mechanism that promotes better performance through sustainable productivity. The literature review in this study could also help bank management identify better international governance practices that can be adopted locally to enhance their bank performance.

**Policy Makers**

The study findings could also be of value to various policy making institutions in Kenya including the Central Bank of Kenya, the Kenya Bankers Association and other regulatory authorities to generate policies, which will help to enhance Corporate Governance of banking industry in Kenya as well as ensure they attain their commercial objectives.

This study provides valuable information on Corporate Governance to the central bank of Kenya as the regulator and other decision makers within the commercial Banks, this information will help these parties develop financial and economic perspective of the individual institution and the whole banking sector in Kenya which will help cement their performance. Policy makers could also obtain knowledge of the banking sector dynamics

and the responses that are appropriate, for example, they could obtain guidance from this study in designing appropriate executive compensation package that will motivate the bank executive and ultimately enhance the performance of commercial banks.

**Researchers**

The study provides information to potential and current scholars with regard to the Corporate Governance, strategic leadership and commercial banks performance in Kenya and possibly forms a basis for further research on Corporate Governance and other sectors other than the banking sector. This study also contributes to the enriching of existing literature on Corporate Governance and firm performance thereby serving as a reference to other researchers, hence this study will provide information for future research.

## 1.7 Scope of the Study

The main objective of this study was to examine the relationship between Corporate Governance Practices, Strategic Leadership and commercial banks performance in Kenya. Specifically, the Corporate Governance Practices studied are; Board composition, Board Committees, Compensation System and Risk Management.

The study was undertaken in the head offices of all the 39 operating commercial banks in Kenya because this is where Boards of Directors operate from. The study adopted purposive sampling where a sample size of 78 respondents comprising members of the Board of directors of these banks particularly all the CEOs and one non-executive director from each bank provided the data required by filling questionnaires presented to them. The study was carried out between the months of April 2019 to August 2019.

### 1.8 Limitations of the Study

The assumption of this study that good organization performance is hinged on corporate Governance practices does not negate the fact that some variables outside the scope of this study like economic, social, corruption, bureaucracy, and political disruptions could also be instrumental in determining performance within the Kenyan banks. However, Corporate Governance study is critical and therefore it's expected that corporate governance system that is well structured will help deal with these negativities and ultimately lead to increased organization performance. However, the validity of the conclusions was not compromised by the above limitations.

There are generally many variables relating to corporate governance whose underlying effects on performance should be understood by managers. These variables include: Audit Committees, Board of Directors, insider Ownership, ordinary and executive director, director characteristics, director compensation, progressive practices and corporate by-laws, among others. This study however, was limited to only four variables of corporate governance since data accessibility, availability, and measurability of some corporate governance variables may not be easy and considering that some of these variables are not easy to model for data analysis.

The study was conducted in the banking sector, an industry with a lot of internal bureaucracies in releasing information and this slowed down the rate of data collection, a factor that contributed to some questionnaires not being returned by the respondents. However, the number of the questionnaires not returned was too small to affect the overall findings of the study.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 Introduction

The chapter begins with a discussion of the theories on which the study is grounded and then follows a review of empirical literature highlighting relationships between the various variables of the study, the research gap in knowledge from the literature reviewed is provided as well as the conceptual framework depicting the relationship between the variables of the study.

## 2.2 Theoretical Foundations of the Study

The main focus of this study was on commercial banks performance in Kenya and therefore the study borrows from the Balanced Scorecard Model approach which is a model on holistic firm performance. The moderating variable of this study is anchored on the Contingency theory of leadership while the independent variables are anchored on the four main sets of theories that have each played an important part in shaping the governance system namely: Agency theory, Stakeholders theory, Stewardship theory and Resource Dependence theory. In most cases individuals involved in corporate governance apply what they believe is common sense, when in reality they draw sub-consciously on long-established economic theory and assumptions that are challengeable.

### 2.2.1 The Balanced Scorecard Model

In the year 1992, Kaplan and Norton developed the Balanced Scorecard (BSC) model as a performance measurement system in order to address the limitations that faced the use of traditional financial performance measurement systems (Sinha, 2006). Return on

Equity (ROE), Return on Investment (ROI) and the Earnings per Share (EPS are the general financial accounting measures that are used by companies. According to Sinha, (2006), these financial measures produce results by relying on past performances.

This kind of information may be misleading or insufficient in today's competitive environment especially in areas relating to the development and the innovation of the organization. The main characteristic of BSC is that it employs the use of both non-financial and financial measures so as to give a complete view regarding the organization's performance (Sinha, 2006).

The BSC according to Collis, Holt and Hussey (2012) includes a number of measures that allow managers to have a quick but complete view of the organization. Specifically, they asserted that 'the BSC translates the company's mission and strategy into a comprehensive set of performance measures that gives the framework for a strategic measurement and management system' in addition, the Balanced Score Card has the ability to align the management processes of a business and gives emphasis to the implementation of long-term strategy (Collis, Holt & Hussey 2012) .

The Balanced Score Card model has been improved and advanced over the years into a serious performance measurement system but more importantly into a strategic management system and is a dynamic tool that can be used to implement an organization's strategy from theory into practice.

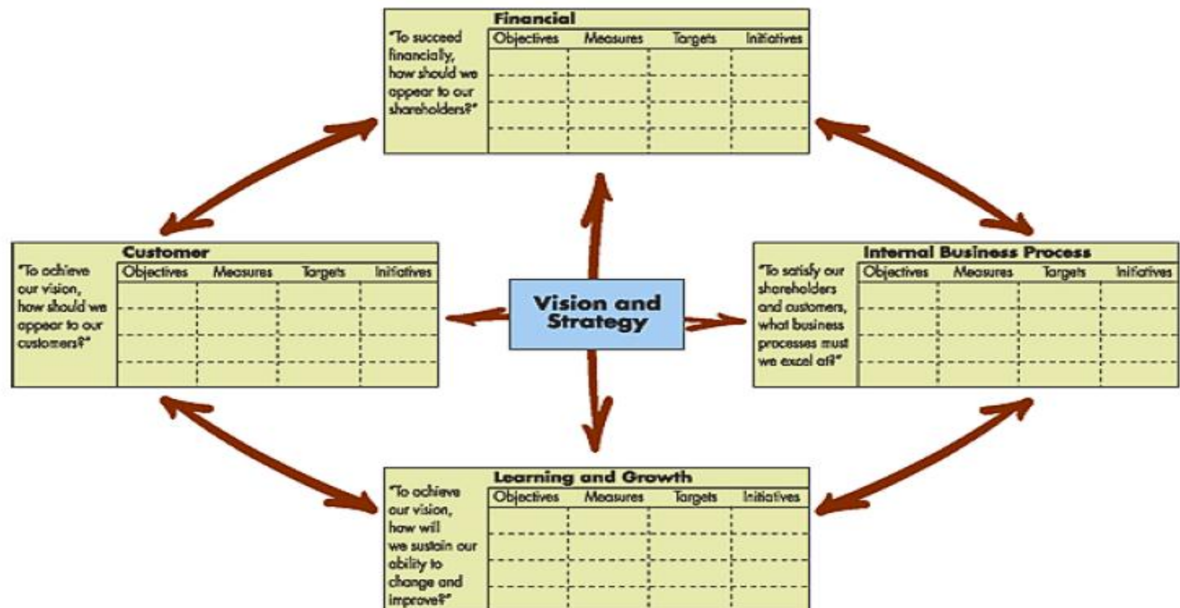


**Figure 2.1: The Four Perspectives of the Balanced Score Card**

**Source:** Sinha (2006)

### The Four Perspectives of the Balanced Score Card

The Balanced Score Card is divided into four perspectives as mentioned before; internal business perspective, innovation and learning perspective, customer perspective, and financial perspective. In order to give the full meaning of the Balanced Score Card as a measurement system the four perspectives are analyzed and discussed below. In the BSC, the internal business perspective puts focus on the activities an organization undertakes to satisfy its customers. For example, in banking institutions, processing of a customer loan is an internal business perspective (Norreklit, 2000).

The innovation and learning perspective in the BSC put focus on the skills and capabilities that the company must excel at in order to achieve superior internal business

processes that create value for customers and shareholders. Some of the performance measures that can be used to measure this perspective of innovation and learning include employee skill level and education, employee satisfaction and retention rates (Sinha 2006).

In the BSC model, the customer perspective put focus on the customers' opinion for the organization, and how the organization wants to be viewed by its customers (Norreklit, 2000). Customer satisfaction is a priority to many businesses organizations, especially in the today's more competitive business environment usually; customers have four main concerns in respect to the product or service that is offered by a business: quality, time, performance & service and cost. Therefore, the organization has to align its goals according to these four elements, and subsequently transform these goals into specific measures (Collis, Holt & Hussey, 2012).

The last perspective of the BSC model is the financial perspective. This perspective is about the financial view of the organization as presented to its shareholders and whether the strategy implementation of the organization is contributing to bottom-line improvement (Sinha, 2006). The financial performance measures of a company provide information based on company results of past events. This measure as well as the objectives of the other three perspectives of the Balanced Score Card focuses on the goals and objectives, which generally have to do with profitability, growth and shareholder value (Sinha, 2006).

However, Collis, Holt and Hussey (2012) insist that because the financial indicators do not necessarily influence customer's and employee's satisfaction the businesses therefore should not use them as metrics to direct them to their strategic vision. As a result,

organizations should not use only financial data but also non-financial measurements that emphasize on the totality of the business's strategy. According to Collis, Holt and Hussey, (2012) some of the financial measures that can be used are: Earnings per share, cost reductions in key areas, return on capital employed and return on investment.

The Balanced Score Card has many advocates. However, there are criticism to the Model and its approach. Norreklit (2000) argues that the cause-and-effect relationship between measures from the four perspectives of the Balanced Score Card which Kaplan and Norton explained (1996) is problematic. The measurement of cause and effect that exist between the four perspectives is done at the same time and any time lag that might exist is ignored and the fact that time dimension is not part of the Balanced Score Card model makes the tool problematic. However, the consequences of the measures will arise at different times, and this is because the consequences of each different area have different time scales.

The Balanced Score Card should help the businesses to develop and improve the four perspectives at the same time but the effects will appear at different points of time. For example, when new, more efficient processes are introduced in the business, they may improve the customer satisfaction within a three months period but on the other hand financial results may not be affected until few years have passed (Norreklit, 2000).

Furthermore, the Balanced Score Card ignores technological developments and the competition which are critical factors for organizations nowadays. The fact that the Balanced Score Card does not take into account continuous examination of the technological developments and the actions of the competitors, makes the tool more static instead of dynamic. Moreover, the Balanced Score Card has risks which are too rigid

because although it measures what the strategy requires to be set, it does not ask about what may cause problems or hinder the strategy. As a result the failure to identify problems to the strategy will create a gap among the strategic plan and the actual strategy that is adopted (Norreklit, 2000).

The Balanced scorecard Model directly connects to the dependent variable of this study which is bank performance, as the model clearly shows four critical areas that one needs to examine to be able to determine an all round organizational performance rather than just using the financial performance metrics which just give a one sided approach about organizational performance.

Many studies in the area of Corporate Governance: Muganda and Umulkher (2015), Al-Manaseer *et al.* (2012), Ajanthan, Balaputhiran, and Nimalathashan (2013), Adeusi (2011) and Taiwo, et al. (2017) have tended to assess the relationship between corporate governance and firm performance from a narrow performance perspective, this study however incorporated the Balanced Score card Model perspective in order to look at bank performance from a wider perspective namely: Financial, customer, learning and growth and internal processes.

### 2.2.2 Contingency Theory

This is a leadership theory that was postulated by House (1996) where he indicated that the contingency approach to management is premised on the idea that there is no specific way of managing an organization by planning, organizing, staffing, controlling and leading, instead the approach of management employed must be tailored to suit the specific circumstances facing the organization. Lutans (2011) asserts that a strategic

leader's effectiveness is highly depended on how he navigates and manages the demands imposed by specific situations.

The contingency theory states that rather than using a "one size fits all" method to handle situations, leaders make managerial decisions depending on the situation at hand. According to this theory the best leadership style is flexible and dynamic. A participative leadership approach should be adopted by a leader where they should involve their employees in key decisions concerning performance management by clearly explaining to them how important their performance is, its impact on them and how it impacts the organization as a whole (Lutans, 2011).

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. Strategic leadership as defined by Guillot (2003) 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.

Pearce and Robinson (2007) assert that coping with change is the hallmark of strategic leadership and more leadership is always demanded when more change is needed. According to Hitt, Ireland, and Hoskisson (2007) strategic leadership is the ability on the part of the leader to envision, anticipate and maintain organizational flexibility, by empowering others in order for the necessary strategic changes to be created, it entails managing through others.

Strategic leadership according to Capon (2008) is the ability to positively influence a group of people towards achieving goals. He affirms that good leadership carries strategic vision that is clear and persuasive at implementing the stated strategy to achieve tangible results for the organization. Lynch (2009) views strategic leadership as one which involves communicating with and listening to those within the organization with a great aim of creating and spreading knowledge, creation and innovation of new ideas in specific areas and provision of solutions to problems.

Lynch (2009) clarifies that Strategic leadership involves a multifaceted balancing act among a number of factors. It entails dealing with variations and pressures from the environment outside the organization while at the same time dealing and managing the critical human resources within the organization.

Strategic leadership according to Rowe et al. (2001) is the ability of the leader to drive other people to voluntarily make conscious decisions that enhance the institution viability while still maintaining the financial stability of the organization in the short-term. He further points out that to be effective; a strategic leader must be in a position to visualize their ideas into images that create excitement among people as they work.

According to Hitt et al. (2007) efficient and effective strategic leadership obligation rests at the top of the organization, specifically with the firm's chief executive officer (CEO). However, the other generally known strategic leaders within the organization are the board of directors (BOD), divisional general managers, and off course the entire top management team. These leaders have extensive decision-making tasks that cannot be delegated.

According to Kumar et al. (2002), the concept of *Client centricity* entails strategic leadership attributes that stimulates an organizational culture that places the customer at the center of the organization's business while focusing and thinking about strategy and operations as well. Hence, this concept puts focus on the environment and deals with the exploitation of current client accounts.

Colgate and Danaher (2000) state that in a highly competitive business environment, one of the most crucial business tenets is customer retention, without senior leadership support, a customer orientation is unlikely to take root in an organization. Liao and Subramony (2008) stated that oriented values and beliefs are uniquely the responsibility of top management, only the Chief Executive Officer can take responsibility for defining customer values that are harmonious with customer satisfaction to the organization stakeholders.

The organizational behavior must be consistent with customer-oriented mandates (Liao & Subramony 2008).The resulting strategic leadership model is composed of four quadrants, i.e. Organizational creativity, Business development, Client centricity and Operational efficiency along the two dimensions Exploration-Exploitation and Organization-Environment (Hester, 2013) .

Contingency theory, although having several strengths, generally falls short in trying to explain why leaders with certain leadership styles are effective in some situations but not in others. Contingency theory also fails to adequately explain what should be done about a leader/situation mismatch in the workplace (Northouse, 2007). Figure 2.2 shows the strategic leadership model.

**Figure 2.2**: Strategic Leadership Model

**Source:** Hester, D (2013)

This theory is relevant for this study because it directly links with the moderating variable; strategic leadership, since it clearly highlights the role that strategic leadership plays in the organizational performance and the strategic leadership model shown in figure 2.2 clearly points out the four pillars of strategic leadership: organizational creativity, business development, operational efficiency and client centricity.

### 2.2.3 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 who are the 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 the 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' behavior 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 (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). This governance structure according to Anderson and Reeb, (2004) involves for instance, creating procedures for reporting, additional management, or a board of directors to monitor the agent.

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). Compensation plan incentive and pay is a good example of this type of structural mechanism, where the agent's pay is as an incentive for high organizational performance (Chrisman et al., 2007). With this arrangement, the risk is therefore moved or transferred to the agent and this creates the motivation for the agent to align his actions and behaviour with the principal's interest (Chrisman et al., 2007). 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.

Hawley and Williams (1996) highlight that the main Corporate Governance issue lies in crafting of rules and giving incentives which make the agents align their behaviour with the wishes of the principal. Organizations are taken to be network of contracts among different parties, the contracts between managers and shareholders being the greatest of all (Watts & Zimmerman, 1986).

There has been highlight on the impact of separation of management and ownership and the arising governance issues in the finance theory, commonly called the principal-agent problem (Berle & Means, 1932; Jensen & Meckling, 1976). This issue often leads the engaged managers in maximizing their own satisfaction at the expense of the firm's interests thereby making investors skeptical of managers' decisions in relation to their interests (Mansourinia *et al.* 2013).

Spong and Sulivan (2011) assert that in order to ensure that managers make decisions and render their services in the interest of the shareholders, the firm shareholders have to agree to incur agency costs. All over the world financial and management economists have been disturbed on how to mitigate the said agency costs. The reason behind this concern is that when left unchecked, managers' unwarranted self –dealing can result to negative repercussions which are negative on corporate values and ultimate organizational performance and the capital markets functioning may be jeopardized and the greatest question therefore is and always will be "Are the shareholders' assets safe in

the managers' hands? And how do shareholders know their assets are not being mismanaged? (Monks & Nell, 2004). In response to this question, the financial literature proposes different mechanisms, the most fundamental answer being Corporate Governance. Different ways have been given to define Corporate Governance. Shleifer and Vishny, (1997) define Corporate Governance as the way in which corporate finance suppliers assure themselves of fair return out of their investments.

While Rezaee, (2009) clarifies that Corporate Governance is a system by which shareholders induce managers of corporations to act in the best interest that guarantees investor confidence which is critical for the organization and the effective functioning of the capital market.

Cadbury (2002), states that Corporate governance is "the system by which companies are directed and controlled, which is purely the responsibility of their boards of directors"

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.

According to Dow and Raposo (2005), as a way to reward their managers, corporations that are seeking to implement executive compensation plans based on performance usually define more ambitious strategies and difficult to achieve than companies that do not adopt this model of incentives. What is verified is that the various market players will react positively when these incentive plans are announced publicly, since they believe that managers will join efforts to achieve the expected performance, thus leading to the

value creation for the corporation (Morgan & Poulsen, 2001). Homayoun and Abdul (2010) highlight that the Agency theory views that information imbalance exist between the shareholders and managers, the information that the managers have is different from the information that the shareholders have.

Mehran (1995) stated that the informational imbalances that occur in the financial markets are due to the carelessness of the corporate managers. In order to shield the shareholders' rights, it is important that companies follow up on the performance of firm managers and increase their actions on accountability by showing compliance with disclosure requirements and the other corporate governance codes.

Abdelsalam *et al*. (2007) stated that where the ownership in corporations is more diffused then high level of information dissemination is needed. The need to minimize the agency costs that exist between managers and principals is the reason behind more disclosures (Abdelsalam *et al*. 2007)). Agency costs are increased in the diffused ownership environments due to the high level of agency disagreements between the principal and agents (Homayoun, 2010)).

In contrast, the interests of managers and shareholders do not diverge much in the companies with concentrated ownership environments, there is therefore need to make minimal disclosures. More disclosures are necessary since in the absence of information, managers can harm the shareholders by taking advantage of information through making self centered decisions at the expense of the shareholders (Homayoun, 2010).

There is however criticism that the theory is narrow (Coleman, 2008) since it only identifies the shareholders as the only interest group of a corporate entity when in real sense there are many interested parties to a corporation like the suppliers, the

government, employees, creditors among others whose interests if not considered can jeopardize the performance of the organization and therefore derail the achievement of its vision. The Agency Model is as shown in figure 2.3

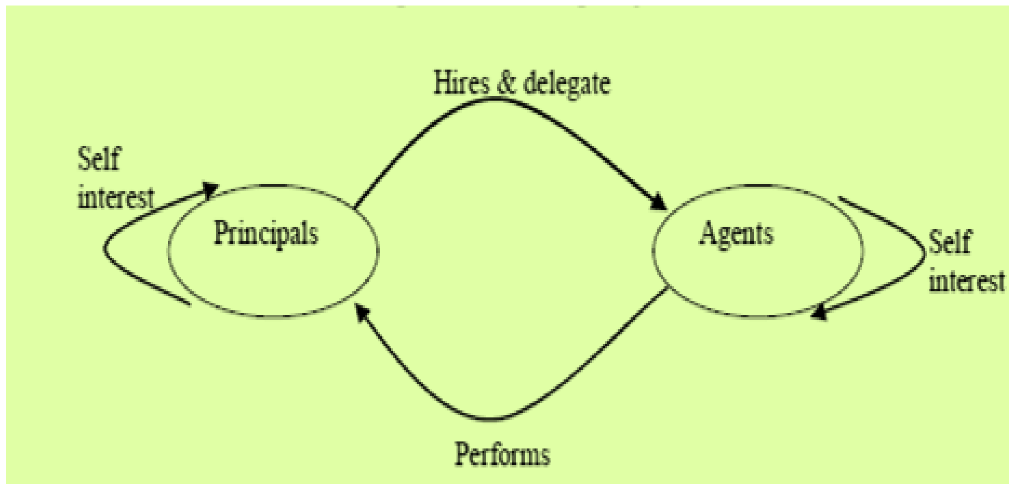


**Figure 2.3: The Agency Model**

**Source:** Abdoullah and Valentine (2009)

This theory informs this study by connecting with the Board composition as one of the independent variables of this study since the agency role of the executive directors in the governance function of the board of directors is to serve the shareholders by interpreting the decisions made by the board and monitoring the implementation of those decisions within the organization.

### 2.2.4 Stakeholder Theory

The origin of this theory is in Freeman's (1984) *seminal book on Strategic Management*: A stakeholder approach published in 1984. In this book, Freeman argues that the hallmark of a successful organization is to create value for all its stakeholders, that is, for customers, communities, employees, suppliers and financiers like banks and

shareholders. To fully evaluate and measure a firm's performance and its success, it is important to take a broad approach study that includes all stakeholders, rather than studying only one stakeholder in isolation. Subsequently, the firm's purpose is defined by the complete creation of value for stakeholders (Freeman, 1994).

The responsibility to articulate business and define the relationship with stakeholders and how value will be created by a firm's management, is held in this view. Accordingly, the role of an employee is not the only role of the manager, but is also one's responsibility to safeguard the welfare of the organization through mutual understanding and balancing of various stakeholder interests (Jansson (2005)). According to the theory, managers' decisions should incorporate the interests of each and every stakeholder in a company' (Jensen, 2001). However, to put together and reconcile the interests of different stakeholders in a firm is the real challenge.

One of the shortcomings of this approach is defining the criteria of who qualifies to be a firm's stakeholder. Stakeholders are "those groups or parties without whose support the firm would cease to exist (Taylor, 2006)". Freeman (1984) gives another definition and states that "any group or individual, who is affected or can affect the achievement of organization's objectives, is a stakeholder."

According to Jansson (2005), each organization is unique and stakeholder groups have to be defined for each case. Jansson also highlights that there is no collective way in which stakeholders are given the decision making rights. According to her, in cases where these rights are granted to stakeholders, it is highly country specific and not universally done. In the United Kingdom and the United states, the stakeholders sometimes have representatives on the board of directors. There will always be a supervisory board for

Countries with two-tier systems including worker representatives who in certain countries make up to one third of the board (Taylor, 2006). There is however criticism of the theory that the ambiguous way in the stakeholders definition by a firm and their maintenance of rights to make decisions has a great bearing on the system of governance. “Any corporate decision-making theory must inform the decision makers, in this case, board of directors and managers, how to choose from among many parties with conflicting interests and, in some cases competing” (Jensen, 2001).

Giving any principled criterion to executives and company boards in organization for them to decide how to allocate stakeholder privilege to different groups is something the theory does not do (Jensen, 2001).The potential of stakeholder model is something that has been explored by other researchers; however, they seem to have realized a number of negative rather than positive attributes. Contrary to shareholder approach, others give the two accounts on which the stakeholder society fails. Firstly, it gives stronger incentives and more focus to firm managers; secondly there is Undivided control which prevents deadlock and foot-dragging in decision-making (Tirole, 2001).

Hansman and Kraakman (2001) asserts that, the interest of the shareholders only should be protected by corporate governance while other corporate constituencies such as consumers, creditors, suppliers and employees should be protected by contractual and regulatory means. They however, in their opinion allow boards of directors in special situations such as mounting takeover defenses to consider interests of other stakeholders.

Preston (2005) argues that the relationship networks with many groups and can easily jeopardize the processes of decision making since stakeholder theory is concerned with

the nature of these relationships in terms of both processes and outcomes for the organization and its stakeholders. According to Donaldson and Preston (2005) this theory puts focus on decision making by management and takes into account the interests of all firm stakeholders and these have intrinsic value, and no sets of interests is assumed to dominate the others. The stakeholder Model is as shown in figure 2.4

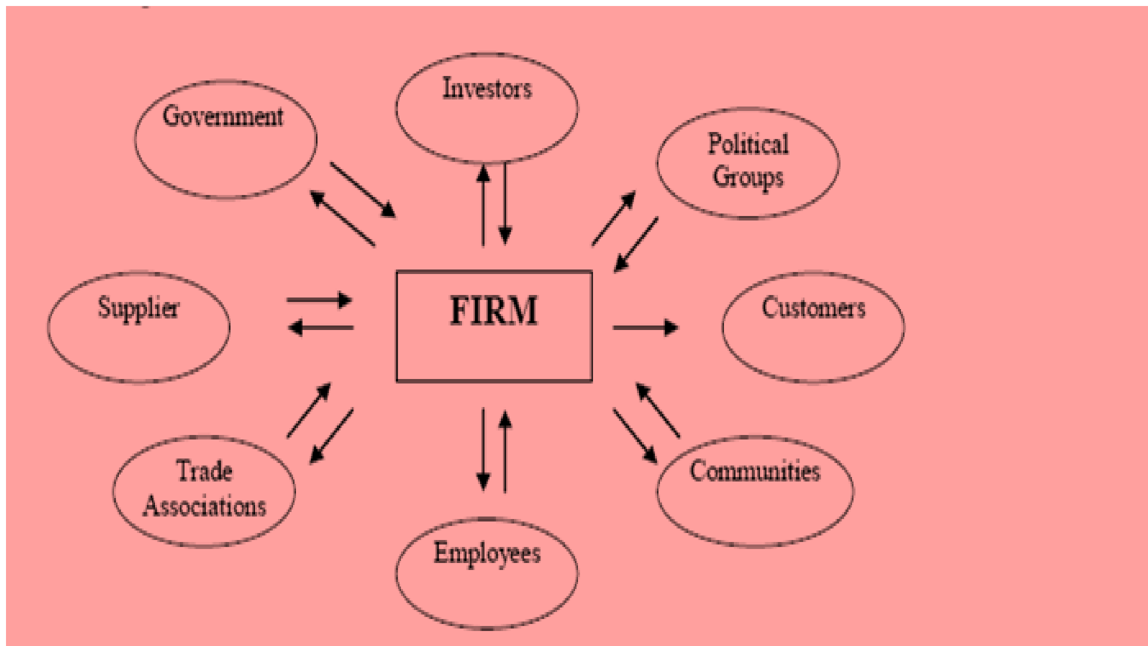


**Figure 2.4: The Stakeholder Model (Donaldson and Preston, 2005)**

The stakeholder theory informs this study by clearly showing the various stakeholders that are critical to corporate governance and whose contributions or lack of it could affect the performance of the banks and it also indicates the various stakeholders whose interests the Boards of Directors should take care of while running the affairs of the organization.

### 2.2.5 Stewardship Theory

This theory presents a different model of management where managers are seen to be good stewards who will always act and take decisions in the best interest of the shareholders (Donaldson & Davis, 1991). Social psychology, which mainly majors on the executives' behavior, is the fundamental of stewardship theory. The stewards' behavior is collectivists and pro-organizational, and the behavior of the steward will not depart from the interest of the firm since the steward always seeks to attain the objectives of the firm (Eddleston and Kellermanns (2007).

Smallman (2004) is of the opinion that, there is maximization of the steward's utilities where there is maximization of shareholder's wealth, because most requirements will be served by organizational success and hence the stewards will have a clear mission. He also states that, the steward will balance tensions between different beneficiaries and other interest groups in a firm. Therefore stewardship theory is an argument put forward in the performance of the firm that satisfies the interested parties' requirements leading to dynamic performance equilibrium for balanced governance. According to Stewardship theory, managers protect and maximize shareholder wealth through firm performance and therefore, the theory sees a strong relationship between success of the firm and the managers.

Corbetta and Salvato (2004) assert that Successful performance improvement by a steward satisfies most stakeholder groups in an organization, when these groups have interests that are well served by increasing organizational wealth. The power to determine strategy and the fate of the organization is the responsibility of a single person when the position of the chairman and the CEO is held by a single person in an organization, thus

rather than control and monitor the focus of stewardship theory is on structures that empower and facilitate the management (Corbetta & Salvato, 2004). Therefore stewardship theory does not see the need to separate the position of the CEO and chairman, and it supports the appointment of a single person for the role of CEO and chairman and a majority of specialist executive directors rather than non-executive directors (Clarke, 2004).

According to Zahra et al. (2009) Stewardship theory focuses on a two party contract of employment relationship; the owner of the business who is the principal and the steward who is the manager. It also looks at this relationship from a behavioral perspective and structural perspective.

Zahra et al., (2009) states that the proposal by this theory is that because managers are stewards, they will act in a manner that is pro-social, actions which are aligned with the principal's interests and that of the organization. Corbetta and Salvato (2004) continues to affirm that this steward's behavior is reinforced by three things; quality of the relationship between the steward, principal and the organizational environment.

A stewardship perspective is about maximum organizational performance, which is reflected in sales growth and profitability as they are the desired outcome of any performance (Tosi et al., 2003). This outcome according to Eddleston and Kellermanns (2007) is achieved when both the principal and the manager in the employment relationship decide to behave and make decisions that reflect the element of stewardship. The heart of this theory is the assumption that the steward- principal relationship is based on a choice.

Eddleston and Kellermanns (2007) assert that when both parties choose to behave like stewards by placing the interest of the principal first, then, there is a positive effect on performance because the two parties are working on a common goal.

Vallejo (2009) indicates that the choice of stewardship behavior is as a result of both situational factors and psychological factors such as intrinsic motivation, high identification, and personal power which steers the behavioral choice to stewardship. Intrinsic motivation provides satisfaction in and of itself since it exists within individuals (Ryan & Deci, 2000). Intrinsic motivation is a psychological attribute of stewardship theory because managers who are stewards are motivated by intangible, higher order rewards (Lee & O'Neill, 2003).

The suggestion by the theory is that involvement-oriented, low power distance collectivist and cultures help influence the stewardship choice of behaviour (Vallejo, 2009). An involvement oriented management philosophy is portrayed by an environment where employees are trusted with opportunities, responsibility and challenges (Eddleston et al., 2012; Vallejo, 2009).

Individuals give priority to the goals of the collective rather than individual personal goals in organizations typified by collectivism; the emphasis is on capturing, belonging and displaying loyalty due to the tight-knit organizational social framework present in the firm (Davis et al., 1997; Nicholson, 2008).

Stewardship theory suggests that to have a greater role of stewardship in the organization and good management then the role of the CEO and the chairman should be unified so as to minimize agency costs. It is evident that there would be better safeguarding of the interest of the shareholders (Vallejo, 2009).

Stewardship theory focuses on the motivation and empowerment of the Company CEO and structures which integrate the CEO's roles and that of the Chairman of the Board that promotes efficiency and effectiveness that leads to superior organizational performance. According to the Stewardship theorists, there is increased social cohesion and participation among members of the Boards that are small in size unlike large boards which often hinder consensus on important management decisions (Vallejo, 2009).

They further argue that, Boards which are dominated by executive directors should be favored because these executives have the ability to easily access information that is current on organizational operations, technical expertise, depth of knowledge and their commitment to the daily company operations which potentially and positively impacts performance (Letting *et al.* 2012).

The Central Bank of Kenya (CBK) strongly advocates for banks to embrace boards whom 1/3 of their membership should be women and at least more than 1/3 of the members should be non-executive directors obtained from different professional backgrounds to provide varied professional knowledge and to incorporate gender balance that is needed for efficient functioning of the boards to promote performance (CBK, 2013).

A drawback with stewardship theory is seen to be the fact that a greater transaction cost outlay will be made as there will be more investment of time for the principal in involving the steward in resolving problems, joint decision-making and information exchange (Van , 2006). The theory is sometimes criticized on the basis that it gives directors carte blanche when it comes to exercising their discretion, but it must be acknowledged that boards are constrained by a number of factors such as the availability

of an appropriate workforce, the demand for the products of the company and the cost and availability of finance (Blair & Stout 2001).The stewardship Model is as shown in figure 2.5 below:

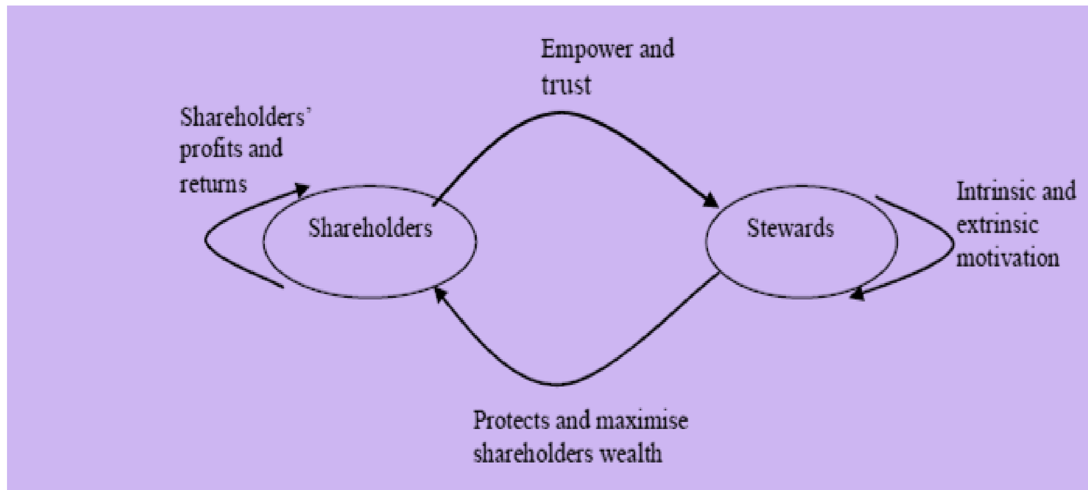


**Figure 2.5:** The Stewardship Model **Source**: Abdoullah & Valentine (2009)

This theory informs this study by holding that Board composition results in having the executive directors in the governance function of the board of directors who serve the shareholders by interpreting the decisions made by the Board of Directors and monitoring the implementation of those decisions within the firm as well as protecting and maximizing shareholder wealth through firm performance and therefore, the theory sees a strong relationship between success of the firm and the managers.

### 2.2.6 Resource Dependence Theory

The concept of "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 focus of stakeholder theory is on many groups for individual benefits, resource dependency theory on the other hand 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. For example, the appointment of independent directors who are partners to a law firm out there provide legal advice, either in private communication or board meetings with the executives of the organization that may otherwise be more expensive for the organization to secure.

The perspective of the resource dependence theory is less organization-centred and more materialistic.

The concern is more on resource 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 (NEDs) 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).

Nicholson and Kiel (2003) assert 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 (buyers, creditors and suppliers); thus NEDs enhance and improve resource access which simply put enables easier and cheaper access to inputs and thus affecting the performance of the firm positively (Nicholson & Kiel, 2003).

According to Hillman, et al., (2000) board diversity, board size, and the non-executive directors' background are very essential components in managing the needs of the firm for any future capital or to manage environment contingency. Board diversification will help the company to survive by gaining from its external environment and the exchange of company resources (Pearce & Zahra 1992). In addition, they report that the inclusion of the outside directors to the board will lead to improvement of the firm's efficient strategies by providing the firm with new perspectives and viewpoints, which will eventually improve the performance of the organization.

The composition of the committees include expert board members in certain critical areas who technically deal with specialized issues that will otherwise waste much time of the board should the board as a whole try to handle them. Because of the controlling nature of these committees, the agency theory suggests that, they must be independent and as such be filled with majority independent outside directors who do not posses any contractual relationship like is the case with inside directors (Zubaidah, 2009).

According to Zubaidah (2009) the agency theory views the composition of board committees with majority independent outside director as a mechanism to solving the agency problem. DeKluyver (2009) asserts that Board committees provide three benefits. First, specialization through committees can allow for a more efficient task allocation to directors, leading to task-division efficiency. Second, committees can increase the accountability of the board to the firm by reducing individual free-riding and enabling outside directors to perform their monitoring duties more effectively through greater separation from management.

Third, committees—through the process of decentralization—can allow for knowledge specialization which benefits firms because the monitoring and advising tasks of boards are complex and require firm-specific knowledge (Kim et al., 2014)

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.

Carcello and Neal (2003) agree that Audit committee independence has its benefits and also risks. On the one hand, having an audit committee which is independent within the corporation facilitates more effective monitoring of financial reporting and external audits (Abbott *et al.,* 2002; 2004; Carcello & Neal, 2003).

While on the other hand, being completely separate from management could mean that the audit committee members independence makes them see less industry issues and are

more likely to side with the auditor requiring less negotiations and deliberations and thus fewer meetings. Negative impact can result from this on the level of monitoring (Sharma *et al.,* 2009).

Additionally, the resource dependence theory puts clear the methods used by firms in order to gain financial resources access. Especially when faced with solvency problems, firms' are mostly advised to appoint representatives of the financial institutions on their boards (Mizruchi & Stearns, 1988). However, if a company is faced with increased levels of bank debt, it is advisable to appoint an officer of the creditor bank to the board to enhance access to finance. In other words, it is a simpler way of credit access (Nicholson and Kiel, 2007).

According to Hitt et al. (2000) emerging market countries often suffer from high costs, low availability of capital, and volatility in economic development and poorly developed financial markets. As a result there is always a resource gap between organizations in developed markets and the emerging markets. Therefore, companies are pushed to find creative ways to benefit from the external linkages of the board. Therefore, it is always important to have links with external resources in developing countries.

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).

This theory informs this study as it links with board composition as one of the variables of this study since it holds that the operational environment of the firm is reflected in its board structure which entails that directors are appointed on their ability to facilitate access to the required resources. Thus, it should be possible to identify firm dependencies from the composition of the board; for example, the presence of financiers in the board of directors suggests that firms seek cheap access to capital, from which it can be inferred that they are in financial difficult or plan large investment (Hillman et al., 2000).

Generally, a board with diverse members with different links to external resources can be expected to have much access to such resources, which enhances firm value and performance.

**Table 2.1: Summary of the four theoretical perspective and implications for Boards**

| Theory | Role of Board | Implications for Boards |
|---|---|---|
| **Agency** | Managerial control | Independent boards of directors are a mechanism for shareholders to retain ownership control rights and monitor management performance |
| **Stakeholder** | Uphold interests of all stakeholders | Shareholder returns maximization is not sole objective; interests of all other stakeholders should be equally honored. |
| **Stewardship** | Managerial empowerment | The board controlled by executive management is empowered and manages corporate assets responsibly |
| **Resource dependence** | Co-optation | Board with strong external links like more independent directors is a co-optation mechanism for companies to access external resources |

## 2.3 Empirical Literature Review

### 2.3.1 Board Composition and Firm Performance

Al- Manaseer *et al.* (2012) did an empirical investigation on effects of corporate governance on firm performance; they involved 15 banks listed on Amman Stock Exchange in Jordan for the period 2007 to 2009 with a total of 45 bank-year observations. The estimation method used by this study was pooled data and OLS together with panel data methodology.

Profit margin, earnings per share, ROA and ROE were used as measures of performance (dependent variables) while independence of the Board, size of the Board, status of the CEO, size of the bank and foreign ownership represented independent variables. Results yielded negative significant relationship between size of the board and banks performance which was measured by earnings per share and return on equity, but negative insignificant relationship of return on asset with profit margin and board size and. From the study, bank size is the only one found to be related to earning per share significantly and positively.

A positive association was also revealed between foreign ownership, board independence and bank performance measures like ROE, ROA, EPS and PM. Additionally, results showed status of the CEO having a significant negative influence on the bank profit margin (Al- Manaseer *et al.,* 2012)

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. Results from multiple regression analysis 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. Aebi*et al*. (2012) also found that board size is positively related to their indicators of 372 US banks' performance (i.e., buyand-hold returns and ROE) measured over the time period July 1, 2007, to December 31, 2008.

During the credit crisis (July 2007 – December 2008), Beltratti and Stulz (2012) investigated the relation between bank performance and corporate governance with an international sample of 164 large (i.e. more than $50 billion of assets) banks. They use data on attributes of the board collected by Institutional Shareholder Services (ISS), such as independence, size, transparency and composition of committees to construct an index for boards that are shareholder-friendly in 2006.

Beltratti and Stulz (2012) found that banks with more shareholder-friendly (i.e. small) boards during the crisis had lower buy-and-hold returns. They therefore concluded that "Either conventional wisdom is wrong, or this evidence is consistent with the view that banks that grew more in sectors that turned out to be poorly performing during the crisis were pursuing policies favored by shareholders before the crisis as their boards were more shareholder-friendly but they suffered more during the crisis when these risks led to unexpectedly large losses."

However, international sample of financial institutions, by Erkens*et al*. (2012) did not find the size of the board to be related to the performance of the bank during the crisis. Likewise, Berger *et al.* (2012) have argued that structures of management of commercial banks in US , including the size of the board, were not decisive for the stability of the banks' (i.e.: default to propensity ) especially during the recent financial crisis.

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 (size of the Board, independence of the board and bank size) and banks performance; whereas leverage ratio

and ownership concentration have a significant negative association with financial performance of banks. Ajanthan, Balaputhiran, and Nimalathashan (2013) carried out a study on Banking Performance and Corporate Governance: the Study was Comparative between State and Private Banking Sector in Sri Lanka, the main study objective was to find out the relationship between banking performance and corporate governance. The focus of the study was on four board practices namely: Board Meeting Frequency (BMF), Board Size (BS), Outside Directors Percentage (OSDP) and Board Diversity (BD). Performance of Banks was measured through Return on Assets (ROA) and Return on Equity (ROE).

The study utilized a correlational research design and used multiple regressions as a method of estimation. The results showed positive correlation between all corporate governance variables and ROE in both private banks and state banks. Except BMF and BD, other variables had strong negative relation with ROE, which was at 5 percent level of significance. Similarly, all other governance variables in state banks had a negative relationship with ROA except BMF. Also except the variable BD, Private Banks also show the same relation. In state banks, BD has strong negative relationship with ROA which is at 5 percent level of significance, but in private banks; positive relationship is denoted by insignificant BD. Further, it was generally observed that board governance has a moderate impact on performance of both state and private 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.

Ajala, Amuda, and Arulogun (2012) study on the Effects of Corporate Governance on the Nigerian Banking Sector; secondary source of data was sought from annual reports of the quoted banks that were already published. In examining the level of corporate governance disclosure of the sampled banks, guided by the code of governance of the Central Bank a disclosure index was developed. To find out whether there is a relationship between the variables of corporate governance and performance of the firms, regression analysis and Pearson Correlation were used.

The study showed a negative but significant relationship between financial performance and board size of these banks while a positive and significant relationship was observed between performance of sampled banks, directors' equity interest and level of disclosure of corporate governance. The study recommended that efforts to improve corporate governance should focus on the stock ownership value of board members and that adequate measures should be taken for mandatory compliance with the corporate governance code (Ajala, Amuda, & Arulogun ,2012).

Adeusi (2011) using pooled OLS regression analysed empirically the relationship between board structure and bank performance with panel data from the banking industry in Ghana. A sample size of 17 out of 26 universal banks was used in this study. ROE and cost income ratio were used as dependent variable of the study and board independence

and board size as independent variables of the study. Bank age and bank size, were used as a control variable of the study, the study utilized a correlational research design and Using multiple regressions as a method of analysis, the results showed the size of a bank's board of directors' decreases with its increase in profitability. Additionally, there is negative, but statistically insignificant correlation between board independence and bank profitability. No significant relationship between the financial performance of the bank and its size was found. He therefore recommended that banks seeking some improvement in their performance should constitute small sized boards of directors composed of few directors who are independent.

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.

Ajanthan et al. (2013) did a study on corporate governance in Sri Lanka's banking sector; they found a moderate impact of corporate governance on Sri Lanka's banking sector performance. They further explained that board diversity has positive impact on the performance of private sector banks in the country but have negative impact on the performance of state bank in Sri Lanka.

Muganda and Umulkher (2015) undertook a study on mechanisms of corporate Governance Mechanisms of Kenyan Commercial Banks and financial performance. This study sought to examine the impact of corporate governance mechanisms like board gender diversity, audit committee size and board size on the profitability of these

commercial banks; based on the annual reports of forty two banks in Kenya in the period 2014.The study was based on agency theory and utilized a correlational research design. Using multiple regressions as a method of estimation, the results reveal that board gender diversity, audit committee size and bank capital have no significant impact on profitability of banks in the selected sample.

The regression results indicate that bank size is positively associated with financial performance while board size negatively influences financial performance. The study suggests that banks with effective corporate governance mechanisms may improve financial performance depending on the measure used since not all corporate governance mechanisms are significant.

Khatab *et al.* (2011) conducted an investigation on the relationship between organizations' performance and corporate governance. 20 companies listed at Karachi Stock Exchange from year 2005 all the way to 2009 were examined. The method of estimation adopted by this study was OLS method together with panel data set from the period of those 5 years; data was collected from the sampled twenty firms.

Return on asset, Tobin's q, and return on equity as measures of performance were used to represent dependent variables while organization size, growth and leverage represented independent variables. Study results indicated that organization leverage significantly and positively affects return on asset and Tobin's q while organization leverage significantly and positively impacts return on equity (ROE). However, growth was found to have a negative and significant effect on ROE as the size of organizations remained insignificant.

A study by Ashenafi *et al.* (2013) looked at the effects of mechanisms of corporate governance on performance of commercial banks in Ethiopia when there was no organized stock exchange. The study adopted some selected mechanisms of corporate governance namely: (capital adequacy ratio, loan loss provision allowance and government supervision and regulation and supervision,) and mechanisms of internal corporate governance like board size, audit existence, structure of board of directors, ownership type, and bank size were adopted as independent variables.

Return on assets (ROA) and Return on equity (ROE) as performance measures were adopted as dependent variables. Board characteristic data was obtained from individual banks while performance of banks data was collected from audited annual financial statements from 2005 to 2011 period which obtained from National Bank of Ethiopia.

The number of commercial banks involved in the study was nine banks, two of which were owned by the government and 7 were owned by private individuals. Both quantitative and qualitative methods of data analysis were done. The study findings revealed audit committee existence in the board and board size had statistically positive significant effect on banks performance (i.e. on ROE and ROA).

Equally, as external corporate governance proxy, the ratio of capital adequacy had significant positive effect on banks performance (ROE and ROA) and high government intervention, lack of stock exchange that is organized, lack of national corporate governance standards, absence of accounting, auditing and lack of corporate governance awareness, and a weak protection of shareholder rights as a result of weak legal framework in Ethiopia negatively affected corporate governance and performance of

banks (Ashenafi *et al.* 2013). Nyarige (2012) did an analysis on the influence of commercial banks' corporate governance on their financial performance in Kenya. 9 banks that were listed on NSE between year 2005 and year 2010 were the focus of this study. Board meetings, Board size, executive compensation and board independence were the independent variables whereas Tobin's q ratio representing financial performance was the dependent variable.

A Cross-sectional survey was used for this study and sought a clarification on the differences between listed banks' corporate governance structures which appreciated in value and those declined in value and those which maintained stability in the period 2005 to 2010. Study results indicated that the size of the board negatively impacts on market performance of the banks but independence of the board positively impacts banks market performance.

### 2.3.2 Board Committees and Firm Performance

A study by Ghabayen (2012) investigated the link between audit committee composition, audit committee size, board size and board composition with firm performance in Saudi Arabia. Data relating to 2011 sample of 102 non-financial listed companies was analysed. The results of analysis show that audit committee composition, audit committee size and board size do not impact firm performance.

According to Adams et al. (2015) 52 percent of board activities in S&P 1500 firms take place at the committee level. Within board committees, the Specific tasks include both "advising" tasks and"monitoring" tasks (such as management compensation and auditing) and therefore getting understanding how board committees are structured, gives us deeper insights into the role of boards and their optimal design.

Puni (2015) examined the effect of board committees on corporate financial performance among companies listed on the Ghana Stock Exchange (GSE). The study adopted quantitative research approach to study the prognostic influence of board committee on corporate financial performance for companies listed on the Ghana Stock Exchange from 2006-2010. Data collection was from annual reports of listed companies and a static panel regression model was utilized to analyze the presence and effect of various committees on corporate financial performance. The findings from the analysis indicated that board committees had no statistical significant effect on the corporate financial performance of listed companies.

Fallatah and Dickens (2012) conducted a study in Saudi Arabia on the association between corporate governance index and firm performance, the study examined nine corporate governance characteristics and firm performance and firm value for a sample of listed firms. The Corporate Governance characteristics included in the study were board independence, CEO duality, board size, presence of nomination, remuneration and audit committees comprising of only independent directors, presence of policies relating to insider, board and executive stock ownership, the study utilized a correlational research design, using multiple regressions. The results from this study show that corporate governance and return on assets are not related while it is positively associated with firm value.

Mohammad and Faudziah (2018) examined the association between audit committee and firm performance of the Jordanian firms. The study used OLS regression to test the relationship between independent variable and dependent variable. The data comprised of 228 companies services and industrial. The results of the findings indicated a positive

direction but insignificant relationship between audit committee size and return on Assets (ROA).Whereas, the results showed a positive direction and significant relationship between audit committee size and Earnings per share. The result further showed significant positive direction between audit committee meetings and Return on Assets. Correspondingly, AC meetings with EPS represent positive direction but insignificant.

Al-Matari et al. (2012) did a study in Saudi Arabia on non-financial listed companies in 2010,the study analysed the connection between corporate governance tools namely audit committee independence, audit committee size, audit committee meetings, board composition and board size with the financial performance of these firms. The study found that none of the audit committee characteristics other than audit committee size and board characteristics influences firm performance. Firm performance was found to decline when the audit committee gets larger.

A study by Mohammad and Faudziah (2018) examined the relationship between the remuneration and nomination committee and the corporate financial performance of the companies in Jordan. The study used OLS regression to test the relationship between dependent variables and independent variable. The data was obtained from 228 firms; services and industrial. The findings of this study indicated a significantly positive relationship between the remuneration and nomination committee and the corporate performance.

Reeb and Upadhyay (2010) examine how committees can resolve coordination problems of large boards. Other recent research uses committees as a proxy for a board's monitoring or advising ability, Klein (2002) examines how audit committee characteristics affect earnings management, and finds that audit committee independence

is negatively related to abnormal accruals. Some studies look at committees in aggregate; for example, Faleye et al. (2011) use committee assignments as a proxy for “intensive monitoring,” finding that boards with intensive monitoring have worse advising performance. Finally, concurrent emerging work signals a shift towards a holistic understanding of board committees. Adams et al. (2015) utilize textual analysis of proxy statements to study delegation of work to committees by corporate boards, and they conclude that “board committees are important for board functioning and can no longer be ignored

### 2.3.3 Compensation system and firm performance

Dessler (2011) defines employee compensation as all forms of rewards or pay going to employees arising from their employment which may be direct financial payments (Pay in the form of salaries, wages, incentives, bonuses and commissions,) and other financial payments which are indirect (Pay in the form of financial benefits such as insurance). Milkovich and Newman (1999) states Compensation as all forms of financial returns and benefits employees receive as part of an employment relationship such as compensation surrounded by the employee salaries and wages, incentive-payments, commissions and bonuses. Snell and Bohlander (2010) assert that “Employee compensation contains all forms of rewards and pay received by employees for the performance of their jobs”.

A study by Mehul and Surenderrao (2016) examined the relationship between executive compensation and firm performance among Indian firms, time series data was analysed using multiple linear regression models. The evidence suggests that executive compensation significantly affects firm performance measured by accounting, as well as market-based measures. Sanders and Boivie (2004) investigated the case of corporations

designated as Internet Firms of the United States. The research design employed descriptive and cross-sectional analysis. From the results they concluded that the market valuation of those corporations was strongly related with the level of compensation incentives based on stocks.

Nuray and Moazzam (2016) conducted a study in Bangladesh to investigate the effect of compensation on job performance. Various items of compensation and Job Performance items were taken into consideration for measuring their effect. The study used a questionnaire to collect data from 261 respondents who were working in twenty different readymade garment organizations. The quantitative analysis results indicated that there is a strong and positive relationship between compensation and job performance.

A study conducted by Chen, Fan, and Shen (2015) on the relationship between employees and executives' compensation on organizational performance among the firms in China where data was collected using questionnaires and analysed using multiple linear regression model. The results revealed that compensation of executives and employees are both positively associated with the performance of enterprises, which indicates the two kinds of compensation incentive have a positive effect on the growth of enterprise performance.

The study also revealed that the pay-performance sensitivity of executives is significantly higher than that of employees. Moreover, the stronger the synchronization between the compensation of employees and that of executive is, the bigger the encouraging effect on future performance is.

Steven et.al (2011) investigated the relationship between the use of performance measures in executive compensation and firm strategy. Their study analysis showed that there is an increased emphasis on sales in the determination of executive compensation for firms pursuing a cost leadership strategy in order to attain competitive advantage through low price and high volume while there is a decreased emphasis on accounting measures in firms pursuing a differentiation strategy, which require investments in brand recognition and innovative products, investments that are subject to unfavorable accounting treatment. These results indicate that executive rewards are linked to firm strategy by compensation committees.

Obasan (2012) conducted a study on the effect of Compensation Strategy on Corporate Performance among the Nigerian Firms. Using the cross-sectional data analysis, the study found that compensation strategy has the potential beneficial effects of enhancing workers' productivity and by extension improving the overall organizational performance. Therefore, the study concluded that the significance of compensation cannot be overemphasized in an organization and is in fact a veritable option for attracting, retaining, and motivating employees for improved organizational productivity.

The findings of this study further enriched the literature supporting that a higher pay guarantees a higher productivity and vice-versa. Many studies have pointed out the existence of a positive relationship between executive compensation and organization's performance, a positive relationship between executive compensation and organization's total sales has been repeatedly revealed, (Haid & Yurtoglu, 2006; Lazarides *et al.,* 2008; Nourayi & Mintz, 2008; Jeppson *et al.,* 2009)

### 2.3.4 Risk Management and Firm Performance

Ariffin and Kassim (2009) examine credit risk and bank's performance in Egypt and Lebanon banks by using data for banks from the two countries over the period 1993-1999, the study estimates a fixed effects model of bank return with varying intercepts and coefficients. The findings of the study show that liquidity variable is insignificant across all banks and have no impact on profitability while credit variable is positively related to profitability. The study also finds a strong link between capital adequacy and commercial bank return, with high capitalization being the hindrance to return. The study concludes that the capital is a sunk cost with large banks realizing high profits in absolute but not in percentage terms.

Bruner (2010) offers another dimension on taking excessive risk to boost performance. Bruner (2010) observed that there are credit expansions in a ferocious search for yield among investors as a result of reduction in real risk-free rates of interest to historically low levels. Hence, inordinate ambition (to make hefty returns for the owners) by decision makers and the board thereby taking excess risk to boost stock prices led to major financial crisis around the world . The 2007 economic crisis and the 2009 financial crisis in the Nigerian banking industry are examples.

Adeusi, Akeke, Adebisi and Oladunjoye (2013) in their study which focuses on the relationship between risk management practices and bank financial performance in Nigeria. They found an inverse relationship between financial performance of banks and doubt loans after using a panel of secondary data for 10 banks and for four years reported. The result showed capital asset ratio positive and significant. Similarly the study suggests that higher management of funds by banks leads to higher performance.

The study concludes that there is a significant relationship between risk management and banks performance. Hence, there is need for commercial banks to embrace and exercise prudent risk management practises so as to protect the interests of stakeholders and investors.

Taiwo, et al. (2017) conducted an empirical investigation into the quantitative effect of credit risk management on the performance of Nigeria's Deposit Money Banks (DMBs) and Bank lending growth over the period of 17 years (1998-2014). Secondary data was obtained from Central Bank of Nigeria Statistical bulletin 2014 and World Bank 2015. The time series data was analysed using multiple linear regression model.

The result from the analysis indicated that investors and savers confidence in banks can be boosted by sound credit management strategies and this in turn leads to a growth in funds for credit/ loans and advances which leads to increased bank profitability. The findings reveal an insignificant impact of credit risk management on the growth of total loans and advances by Deposit money banks in Nigeria. This study recommended that Deposit Money Banks in Nigeria should strictly adhere to credit appraisal policies that only allow credit worthy borrowers to have access to loanable funds. Banks are to ensure that only borrowers with decent to high credit ratings are allocated funds.

An empirical investigation done by Ebrahim, Khalil, Mohamed and Xiangpei (2016) in Yemen on the credit risk determinants and its implication on bank performance from 1998-2013 by using panel data. The findings of the study indicate that non-performing loans have a negative effect on profitability. The result also indicated that Credit risk management and its impact on Banks performance is similar across banks in Yemen.

Another study by Ahmed and Ariff (2007) to find out the key determinants of banks performance and credit risk management, the result shows that defaulting as a credit risk was higher in the emerging developing economies than that of developed economies, the study therefore concluding that statutory prudential requirement and regulation are significant to the banking system that provides various services and products. Therefore, in the case of loan dominated banks in emerging markets and developing economies prudent credit risk management is critical.

Muhammad and Fong (2015) did a study on the impact of Enterprise Risk Management towards the company's performance measured through Economic Value Added factors. The research design employed descriptive and cross-sectional analysis. 120 public listed companies in Bursa Malaysia provided data through questionnaires survey. The empirical analysis results indicate that Risk Managent implementation by Enterprises has significant positive impact on firm performance. Therefore this results support the hypothesis that implementation of enterprise risk management by the firms enhances their performance as validated through the perceived measurement of Economic Value Added factors.

Olayinka et al. (2018) Investigates the impact of risk governance on the performance of money deposit banks in Nigeria where 11 banks were sampled out of 15 listed banks in Nigeria for the period between 2012 to 2016. The risk governance variables were proxy by presence of Chief risk Officer (CRO), Chief Risk Officer Centrality (CRO), Board Risk Committee Independence (BRC), Board Risk Committee Activism (BRC), Board of Director Independence (BOD independence), and Enterprise Risk Management Score (ERM-score) while the study controlled for other variables such as audit committee

independence, firm size, cost to income ratio, board size and loan. Return on assets (ROA) was used to measure Bank performance. The study utilized a correlational research design and multiple regressions in data analysis. The revelation of the empirical finding was that except CRO centrality all other explanatory variables have a positive and significant impact on the performance of listed banks in Nigeria.

The study recommends that concerning risk governance framework, the regulatory authorities (Central Bank of Nigeria, Securities and Exchange Commission and Financial Reporting Council of Nigeria should continue to ensure strict compliance. Also, more importance should be placed on the remuneration of CRO by regulatory authorities in order to further strengthen risk management practices in Nigerian banks (Olayinka et al., 2018).

A study by Songling and Muhammad (2018) in Pakistan examines the mediating role of competitive advantage between enterprise risk management practices and SME performance and the mediating role of financial literacy between enterprise risk management practices and competitive advantage. Data was collected using a structured questionnaire from 304 SMEs operating in the emerging market. The hypotheses of the proposed study are tested through Structural Equation Modeling (SEM) in Analysis of a Moment Structures. The results of this study show that enterprise risk management practises significantly influence competitive advantage and SME performance.

The study by Mumbi and Omagwa (2017) sought to determine the impact of credit risk management on financial performance of selected commercial banks in Kenya. The study employed descriptive research design while probability method of sampling was used to obtain a sample of forty two (42) respondents from five banks. Data was collected using

questionnaires, Empirical evidence from this study indicated that the effect of credit risk management is positive on commercial banks financial performance in Kenya.

The study also found that debt recovery process does not significantly effect on bank performance whereas lending requirements, loan appraisal process, and credit policies were discovered to have a significant effect on bank performance, correlational research design and multiple regression were used to determine analysis results. The study concluded that to maximize a bank's risk adjusted rate of return, the banks need to maintain credit risk exposure within acceptable parameters.

### 2.3.6 Corporate Governance, Strategic Leadership and Firm Performance

According to Ireland and Hitt (2002), there is a definite relationship among the organization's strategies, leadership's characteristics, and its performance. When the leadership and the board of directors in the organization are involved in shaping the institution's direction, the institution generally improves its critical element of strategic leadership and organizational performance, therefore strategic leadership is the ability of leadership to manage and utilize the organization's resource portfolio. This includes creating capabilities by integrating resources and leveraging those capabilities through strategies to build high performance and competitive advantages.

The study by Bader (2016) 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 but not on 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.

James, Grace, Patrick and Oluwatobilola (2015) conducted a study on the effects of strategic leadership using organizational direction as a proxy of strategic leadership on the performance of manufacturing industries in Nigeria. Five large-scale quoted manufacturing firms located in Lagos metropolis were selected. The study relied on primary data which were obtained using structured questionnaire administered to 50 purposively selected respondents of the selected firms.

The data collected were analysed using Analysis of Variance (ANOVA) and correlation analysis as well as descriptive analysis in pursuance of the stated specific objective of the study. The result showed that offering organizational direction by the Board of directors had positive relationship with the level of competition of the firms; also strategic leadership had significant effects on the profitability and operational performance of the selected manufacturing firms. This study concluded that strategic leadership practice is *sine qua non* in lifting organization performance in the manufacturing industries in Nigeria.

Aremu (2014) conducted a study on the significant relationship between strategy formulation and organizational performance and also to assess the difficulties associated with implementing the strategic plans which hinders effective organizational performance. Five banks were randomly selected and one hundred questionnaires were administered. The hypothesis was tested using T-test and Multiple Regression Analysis with the aid of Statistical Package for Social Science (SPSS). The findings of the study

revealed that the strategy formulation affected organizational performance. The research work also showed that no matter how well-structured and organized a plan may be, if not implemented business failure is inevitable.

A study by Nthini (2013) that aimed at establishing the effect of strategic leadership on performance of commercial and financial State Corporations in Kenya where Descriptive survey design was used and The target population consisted of all the 48 commercial and financial SCs in Kenya. The Correlation analysis provided the relationship of strategic leadership practices and organizational performance showing that, there was a positively strong relationship between corporate strategic direction and high customer satisfaction. Balanced organizational controls showed a positive strong relationship with annual employee turnover.

A study by Serfontein (2010) in South Africa on the influence of strategic leadership using customer focus as a proxy of strategic leadership on firm performance where empirical cross-sectional telephone surveys were conducted. The sample of the study was top 200 listed organizations for 2008, which were published in the Financial Mail.

The chief executive officer (CEO) or a member of the executive team was the key respondent. The sample consisted of 200 organizations out of which 118 valid responses were received with a response rate of 59 percent. Data collected were analysed using descriptive and inferential statistics. The findings of the study showed that customer focus is directly and positively associated with firm operational strategy and organizational performance. It is also positively associated with strategy orientation as well as operational excellence of business organizations in South Africa.

## 2.4 Summary of Literature and Research Gap

The review revealed that a lot of studies have been conducted in the area of corporate governance and firm performance around the world; a majority of these studies have been done outside Africa ; Ashraf et al. (2015) in Saudi Arabia, Ajanthan, Balaputhiran, and Nimalathashan (2013) in Sri-lanka, Amarjit and Neil (2011) in Canada, Bahreini and Zain (2013) in Malaysia, Al- Manaseer *et al.* (2012) in Jordan and Songling and Muhammad (2018) in Pakistan, with a few studies being conducted in Ghana, Nigeria and South Africa in Africa : Adeusi (2011) and Puni (2015) in Ghana; Adeusi, Akeke, Adebisi and Oladunjoye (2013) in Nigeria , Taiwo, et al. (2017) in Nigeria and Serfontein (2010) in South Africa . Table 2.2 gives the summary of literature.

**Table 2.2: Summary of Empirical Literature**

| Study (Year) | Dimensions | Performance criteria | Sample | Analytical approaches | Major findings |
|---|---|---|---|---|---|
| Al- Manaseer *et al.* (2012) | Board Independence, Board Size, CEO Stat | Return on equity (ROA) | 15 banks in Jordan listed on Amman Stock Exchange | OLS and pooled data estimation method with panel data methodology | A significant negative relationship was revealed between board size and banks performance |

| | | | | | |
|---|---|---|---|---|---|
| Obasan (2012) | Compensation Strategy | Employee productivity | Nigerian firms | cross-sectional data analysis | Compensation leads to high employee retention, motivation and productivity. |
| Amarjit and Neil (2011) | Board Size, CEO duality, and corporate liquidity | profitability of Canadian service firms | 75 Canadian service companies | multiple regression analysis | Corporate Liquidity and CEO duality impact positively on the profitability of service companies in Canada |
| Nuray and Moazzam (2016) | Compensation scheme | Employee performance | 261 respondents readymade garment firms | quantitative analysis | A strong and positive relationship between compensation and job performance. |
| Adeusi (2011) | Board Structure | ROE and cost income ratio | A sample size of 17 out of 26 universal banks in Ghana | Pooled OLS Regression | The Size of A bank's Board of Directors' decreases with its incr in profitability. |
| Ghabayen (2012) | audit committee composition | Overall Firm performance | 102 non-financial listed companies in Saudi Arabia | Multiple Regression analysis | Audit committee composition do not impact firm performance |
| Muganda and Umulkher (2015) | Board Gender Diversity, Audit Committee Size And Board Size | Profitability | 42 banks in Kenya in the period 2014 | multiple regression analysis | Board gender diversity, audit committee size and bank capital had no significant impact on profitability of banks in the selected sample |

A number of gaps have been revealed through the review of empirical literature. A study by Ajanthan, Balaputhiran, and Nimalathashan (2013) carried out in Sri Lanka on Banking Performance and Corporate Governance used Board Size, Outside Directors Percentage and Board Diversity as proxies of Corporate Governance, all these are variables of board composition and limits the findings of the study to just one variable, however, to bridge the literature gap in this area, the current study incorporated Board committees, compensation system and risk management as proxies of corporate governance while strategic leadership was used as a moderating variable.

A study by Adeusi, Akeke, Adebisi and Oladunjoye (2013) in Nigeria focused on the relationship between risk management practices and bank financial performance where they found an inverse relationship between financial performance of banks and doubt loans after using a panel of secondary data for 10 banks and for four years reported.

This study only utilized risk management as the independent variable and did not give attention to other variables within Corporate Governance mechanism thereby creating a gap in knowledge with regard to other variables within corporate governance mechanisms, to bridge this gap therefore, the current study used Board composition, board committees and compensation system in addition to risk management as independent variables.

In the local context, a study by Muganda and Umulkher (2015) on corporate Governance Mechanisms and Commercial Banks Performance in Kenya examines the impact of board gender diversity, audit committee size and board size on the profitability of these commercial banks, this study only utilizes two sets of variables ; independent and dependent variables while ignored other variables that could have been critical in shaping

the performance of these banks, the study also adopts a narrow way of looking at bank performance since it only focuses on the financial metrics, to bridge this gap, the current study incorporates strategic leadership as a moderating variable to the relationship between corporate governance practices and commercial banks performance in Kenya, the study in addition focuses on a wider performance perspective borrowing from the balanced score card Model.

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 interactions or factors that could be influential to the performance of these institutions as well as their governance framework. To bridge this gap, this study considered the relationship between corporate governance practices and commercial banks performance in Kenya while incorporating strategic leadership as a moderating variable to this relationship. This study therefore uses board composition, board committees, compensation system and risk management as proxies of corporate governance practices which is the independent variable and strategic leadership as a moderating variable thereby bridging the research gap that exists in this area.

## 2.5 Conceptual Framework

The model for conceptual framework was developed based on the reviewed literature and mirrors a similar study by Fillip et al. (2013) and it highlights the methodology that was adopted in this study. The main assumption of this framework is that commercial banks' performance in Kenya is affected by these corporate governance aspects: board composition, board committees, compensation system, and risk management moderated by strategic leadership. Figure 2.6 illustrates the conceptual framework.

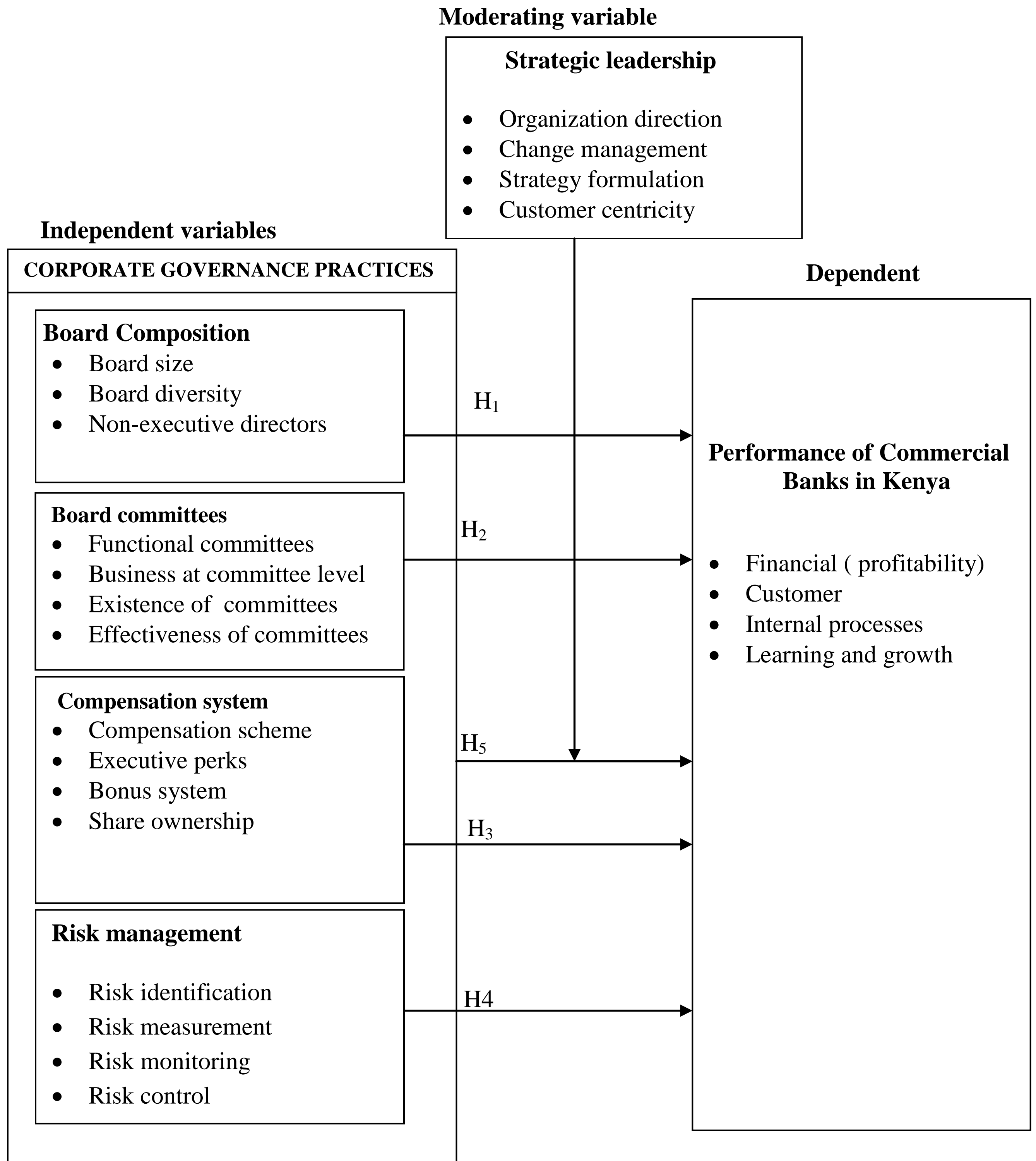


**Figure 2.6: Conceptual Framework**

**Source:** Adopted from Fillip et al. (2013)

## 2.6 Explanation of the Variables

### Board Composition

It is putting together a group of Board of Directors for an organization in terms of Board size, Board diversity and the number of non-executive Directors (Pearce & Robinson, 2007). Board composition is a critical variable that affects the performance of firms as revealed by empirical literature (Ashraf et al., 2015). The different variables of board composition like board size, ethnic diversity, gender diversity and non-executive directors exert different levels of influence on organizational performance.

### Board committees

These are sub-board groups established by the board to help in its oversight roles and responsibilities in specific areas of operation within the organization. Such sub-committees in the banking sector include Audit committee, Credit committee, Compensation committee, Human resource committee etc (Anand, 2007). This study sought to establish the existence of functional committees within the Boards of the banks, conducting of the board business at committee level and the effectiveness of these committees. Board Committees affect the functioning of the whole board and ultimately the performance of the entire firm.

### Compensation system

It is a reward system put in place for the senior members of management to compensate and motivate them in order to enhance organizational performance. They include cash payments, optional grants, bonuses payments, executive perks, share ownership etc. (Dessler, 2011). Putting in place a good compensation system especially for the top

management enhances organizational performance since managers are motivated to work in the best interest of the organization.

**Risk Management**

It is the identification, assessment and prioritization of risks followed by coordinated and economical application of resources to monitor, minimize and control the probability or impact of unfortunate events within the organization (Njogo, 2012). It entails Risk identification, Risk measurement, Risk monitoring and Risk control. Putting in place a robust risk management system enhances organizational performance by identifying, measuring, monitoring and controlling risky transactions that are likely to derail performance within the firm.

**Strategic Leadership**

It 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 (Carter & Greer 2013). Leaders do this by Creation of a vision for the organization**,** management of changes that come with the ever changing business environment**,** formulate Strategies and oversee their implementation and formulate policies that are Client centric. Putting in place a Board of Directors that offers Strategic Leadership for the organization moderates the relationship between Corporate Governance practices and performance of the organization.

**Performance of Banks**

It is a set of non-financial and financial indicators that give information on the extent of achievement of organizational objectives and results (Lebans & Euske, 2006). In the banking sector it is measured by bank profitability, Market share, Customer portfolio and

employee motivation. Commercial banks Performance in Kenya is affected by corporate governance practices that the Board of Directors employ while handling the day to day operations within the organization.

# CHAPTER THREE

# RESEARCH METHODOLOGY

## 3.1 Introduction

This chapter provides the methodology that was adopted for this study; it describes the research design, research philosophy, target population of the study, sampling design, data collection instruments and procedure and data analysis mechanisms that were used for this study.

## 3.2 Research Design

Orodho (2003) describes research design as a scheme plan or outline that is employed to provide answers to fronted research questions. Research design is a general plan or strategy used for conducting research in order to examine specific research questions that are of interest and are testable (Lavrakas, 2008). This research employed correlational research design. This type of design is basically concerned with evaluating the relationships between and among study variables. It is anchored on the ground that using the information available on the independent variables, it is possible to predict the dependent variable and whether a relationship exists between the two variables that is statistically significant.

Kothari (2004) asserts that a correlational research design is utilized to explore the effect of one variable on another and this is consistent with the current study which focused on establishing the relationship between corporate governance practices, strategic leadership and commercial banks' performance. The basic empirical investigation here was to determine whether there exists a relationship between corporate governance variables and performance of commercial banks and whether this relationship is moderated by strategic

leadership. This design has been used by other researchers among them Asaolu and Ogunmuyiwa (2010) and Muganda and Umulkher (2015) who successfully used the design to analyze the relationship between stock prices and different macroeconomic variables and impact of corporate governance mechanisms on the profitability of Kenyan commercial banks.

### 3.3 Research Philosophy

Research philosophy entails the underlying intellectual structure and assumptions that form the basis upon which research in a field of inquiry is based (Sobh & Perry, 2006).

This study adopts positivist paradigm since the approach allows findings to be reported as obtained in the field, the new knowledge discovered explained and assurance of the independence of the researcher. Another reason for anchoring this study on a positivist research philosophy is because it is basically based on existing body of knowledge. The study reviewed literature from previous related studies, a conceptual framework developed and scientific process followed in hypothesizing fundamental laws from which observations are deduced so as to verify or falsify the stated hypotheses.

The study propositions are verified through empirical tests. One feature of positivist approach is that it seeks to identify measure and evaluate any phenomena and to provide rational explanation for it. This explanation attempts to establish causal links and relationships between the different elements (or variables) of the subject and relate them to a particular theory or practice (Collis & Hussey, 2003)

## 3.4 Target Population

Borg and Gall (2007) defines a target population as all members of a real or hypothetical set of people, objects or events from which a researcher wishes to generalize the findings of their research.

The target population for this study was the boards of directors of all the thirty nine (39) operating commercial banks in Kenya; these Boards of directors are each comprised of one Chief Executive Officer (CEO) who is accountable to the Board of Directors, Executive directors and non-executive directors who are accountable to the shareholders (Pandya, 2013). According to the central bank of Kenya, (CBK website) the average number of directors in the boards of directors of banks in Kenya is seven (7) putting the target population of this study at 273 Directors of the Boards of all the 39 operating Kenyan commercial banks; a survey study was carried out on all the 39 commercial banks operating in Kenya and licensed as at April 2019 (See Appendix iii).

## 3.5 Sampling Design

This study adopted purposive sampling where all the thirty nine (39) Chief executive officers (CEOs), one from each bank were the respondents and thirty (39) non-executive directors, one from each bank were also involved in giving responses to the questionnaires thereby giving a sample size of seventy eight (78). This is because chief executive officers of the respective banks are better placed to give accurate answers concerning the performance of their banks and non executive directors are in a better position to provide objective answers concerning the independence of the boards and bank performance (Bernard 2002, Lewis & Sheppard 2006).

In view of this, all the chief executive officers (CEOs) and the non-executive directors (one from each bank) were purposively sampled to provide answers to the research questions on their respective banks. Therefore the unit of analysis was Directors of the Banks. Table 3.1 gives the population sampling.

**Table 3.1: Population sampling**

| Category | population | Sample | Percentage |
|---|---|---|---|
| Chief executive officers | 39 | 39 | 100% |
| Non-executive directors | 117 | 39 | 33.3% |
| Executive Directors | 117 | 0 | 0% |
| **TOTAL** | **273** | **78** | **-** |

### 3.6 Data Collection Instruments and Procedure

Primary data was collected from the respondents using questionnaires (Appendix i) which are structured into two main parts: part I and part II, where part I generated data that provided background information about the respondent, while part II is arranged systematically according to the study objectives to generate data that gave information that was used to test the research hypotheses. The questionnaire comprises of both open-ended and Likert scale questions. Preference is given to structured questions because they take less time to code and transcribe, minimize response variation, and they lead to high response rate (See appendix 1).

The questionnaires were administered to members of the Board of Directors of the banks specifically to the all chief executive officers and non-executive directors (alteast one

respondent from each bank was required), this resonates with the Basel Committee on Banking and Supervision's recommendation that Corporate governance structures should be constituted with Senior Management and Board of Directors (Al-Manaseer *et al.* 2012). The researcher hand dropped the questionnaires to the respondents and collected them on a later agreed date.

### 3.7 Operationalization of variables

Table 3.1 shows how the study variables were operationalized. Board Composition was measured by board size, board diversity and the number of non-executive directors in the Board while Board Committees variable was measured using the existence of functional committees, conducting Board business at committee level and effectiveness of the committees. Compensation system on the other hand was measured using the existence of a compensation scheme for the top management, payment of executive perks, bonus system and share ownership of the company by the top management. Risk management as an independent variable was measured using risk identification, risk measurement, risk monitoring and risk control.

**Table 3.2: Operationalization of variables**

| **Variable** | **Indicator** | **Measurement** | **Questionnaire Item** |
|---|---|---|---|
| **Board composition (Independent)** | • Board size | • Was determined by the no. of members of the board | Question 6 |
| | • Board diversity | • Was determined by | |

| | | | |
|---|---|---|---|
| | | level of education, gender composition, career diversity and ethnic background | Question 8 (i-v) |
| | • Board independence | • was determined by the no. of non-executive directors | |
| **Board committees ( Independent variable)** | • Functional committees<br>• Business at committee level<br>• existence of committees<br>• Effectiveness of committees | • Whether the committees exist<br>• Functionality of the committees<br>• Use of Likert scale type of questions | Question 9 (i-iv) |
| **Compensation system (Independent variable)** | • Compensation scheme | • Comparison of the scheme across the industry | Question 10 (i-iv) |
| | • Executive perks | • Number of perks offered. | |
| | • Bonus system | • Competitiveness of the system | |
| | • Share ownership | • Percent of share ownership (Use of Likert scale type of questions) | |
| | • Risk identification | • Existence of a risk | |

| | | | |
|---|---|---|---|
| **Risk management (Independent variable)** | • Risk measurement<br>• Risk monitoring<br>• Risk control | management policy<br>• Risk incidents for the last three years<br>• No. of non-performing loans<br>(Use of Likert scale type of questions) | Question 11 (i-vii) |
| **Strategic leadership (Moderating variable)** | • organization direction<br>• Change management<br>• Strategy formulation<br>• Customer centricity | • Organization direction e.g. vision, mission, strategic goals.<br>• Adaptation to the changing environment<br>• Strategic plans<br>• Customer service charter<br>• (Use of Likert scale type of questions) | Question 12 (i-vi) |
| **Bank performance (Dependent variable)** | • Financial<br>• Customer<br>• Internal process<br>• Learning and growth | • Profitability<br>• Market share<br>• Efficiency in service delivery<br>• Employee skills | Question 13 (i-iv) |

### 3.8 Reliability and Validity of the Study

The research instrument was subjected to a reliability and validity test. Golafshani (2003) asserts that validity of the tool indicates how truthful the research results are or indicates

whether the tool truly measures that which was intended to be measured While reliability tests show whether the result obtained by the tool is replicable (Kothari, 2004).

### 3.8.1: Reliability

Cronbach's alpha was used to evaluate the reliability of the questionnaire. The ranges of Cronbach's alpha coefficient values are between 0-1. It therefore measures the questionnaire's internal consistency. The interpretation of Field (2005) gives a meaning of a Cronbach's α greater than or equal to 0.7 as implying the instrument provides a good measurement tool hence reliable.

The Alpha Cronbach's formula is as given:

$$\alpha = \frac{n}{n-1}(1 - \frac{\sum V_t}{V_{test}})$$

Where α - Cronbach's Alpha.

n – Number of items to be tested.

VI - Variance of observed total test scores.

Vtest –Total variance of overall scores on the entire test (not % scores)

A higher level of reliability is depicted by Alpha values of higher numbers. Coopers and Schindler (2008) clarifies that an acceptable reliability coefficient begins from a measurement with an alpha value of 0.7 or above.

### 3.8.2 Validity

A pilot study was conducted for face validity testing of the instrument of the study. Before the main study was carried out, a pilot study was carried out on a bank that was randomly sampled and collected data from the executive director on whom the

questionnaire was administered, the executive director involved in the pilot study was however excluded from the main study. The rule of sampling of 1% of the total respondents in the study for a pilot study was applied as recommended by Nachmias & Nachmias, (2008). During pilot study, the questionnaire content was discussed thoroughly together with the respondent with a view to identify and correct any instrument weaknesses. All raised issues concerning the instrument were addressed and the instrument adjusted accordingly before the main survey was carried out.

### 3.9 Data Analysis

Data analysis entails application of reasoning to the data that has been collected with the view of understanding and determining consistent patterns and summarizing the relevant details revealed in the investigation (Zikmund, Babin, Carr & Griffin. 2010). The objectives of the study guided Data analysis and the measurement of the data collected to determine the patterns revealed in the data collected regarding the selected variables. The Data collected was sorted and input into statistical package for social sciences (SPSS) as well as R for production of tables with necessary coefficients for inferential statistics and descriptive statistics. A pre-testing of data was carried out to test for multicollinearity using Principal component analysis (PCA) technique.

The response variable in this study is the performance of the bank which is measured on a five-point Likert scale and is 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. The explanatory variables are classified broadly into five groups. Taking into account the fact that these variables are 25 excluding background information) which is

large, and there is a very high possibility of multi-collinearity among the variables, therefore there was need to reduce the number of these variables by grouping related variables into one set and having each set represented by the strongest variable. This was achieved using the technique of Principal Component Analysis (PCA).

This technique groups related variables into clusters by having variables with strong correlation and therefore probably measuring similar characteristics, into one cluster. However, the related variables have different weights called loadings which show the relative strength within the cluster. The variable with the highest loading was selected from each cluster. The new and reduced number of variables therefore corresponds to the number of clusters.

The response variable denoted by Y is bank performance.

**Definition of explanatory variables used in the analysis**

Background Information

$X_1$ - Gender (*male*, female)

$X_2$ - Education level (certificate, diploma, bachelors, masters, PhD)

$X_3$ - No of board members

$X_4$ - Position in board

The remaining factors were measured as ordinal (V. large, large, moderate, less, not at all) and coded using a five point Likert scale as (5, 4, 3, 2, 1)

Board composition

$X_5$ - Different professional backgrounds

$X_6$ - Different ethnic backgrounds

$X_7$ - Non-executive directors exceed a third

$X_8$ - Adequate female representation

$X_9$ - Adequate board size

Board committees

$X_{10}$ - Different functional committees

$X_{11}$ - Business at committee level

$X_{12}$ - Board has 4 committees

$X_{13}$ - Effective committees

Compensation system

$X_{14}$ - Compensation scheme

$X_{15}$ - Best perks by executive

$X_{16}$ - Performance based bonus

$X_{17}$ - Share ownership by executive

Risk management

$X_{18}$ - Risk management policy

$X_{19}$ - Identification of risky transactions

$X_{20}$ - Monitoring of risky transactions

$X_{21}$ - Control risky transactions

$X_{22}$ - Encountered past risky transactions

$X_{23}$ - Reduced non-performing loans

Strategic leadership

$X_{24}$ - Organization/strategic direction

$X_{25}$ - Commitment to innovation

$X_{26}$ - New products

$X_{27}$ - IT systems stakeholder friendly

$X_{28}$ - Customer service charter

$X_{29}$ - Adaptability to change

Bank performance – response variables (**large, moderate, less**)

$\mathbf{Y_1}$ - Profitability

**Y2 -** Market share

**Y3 -** Service Delivery

**Y4 -** Employees skills and competency

**Ordinal Logistic Regression Technique**

The response variable in this study is the performance of the bank which was measured on a five-point Likert scale and 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 (Zikmund, Babin, Carr & Griffin. 2010).

Bank performance was the response variable and denoted by Y. It was measured on a five-point Likert scale as Very Large, Large, Moderate, less and not at all. This

measurement was converted and categorized into three hierarchical levels of performance- large, moderate and less where Very large and large was consolidated as Large, Moderate maintained as Moderate while less and not at all measurements categorized as less. Therefore the model was fed with the three level performance measurement data namely; large, moderate and less consolidated from the five-point Likert scale of measurement. Based on the ranks, the three levels of Y are 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 are fitted simultaneously on to the data.

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

$$= exp\,(\beta_{01} + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \ldots + \beta_k X_k)$$

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

$$= exp\,(\beta_{02} + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \ldots + \beta_k X_k)$$

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:

$$OR = exp\ (\hat{\beta}_i)$$

**Assumptions in the ordinal logistic regression model**

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.

**Interpretation and Inference**

**(a) Interpretation of the Regression Co-efficient and Odds Ratio**

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 $Y_i$.

**(b) Inference on the Regression Co-efficient**

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

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

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 $\beta_i$ 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 response variable $Y$.

### 3.10 Ethical Considerations

Privacy and confidentiality of the respondents were guaranteed by allowing them to use anonymity when answering questionnaires. The respondents were not coerced into participating in filling the questionnaires and therefore they had the freedom to choose whether to participate or not. Consent was sought from the respondents and time management adhered to in connection to respecting the tight schedules of top bank management. Permission was sought to carry out the research from the National Commission for Science, Technology and Innovation (NACOSTI).

# CHAPTER FOUR

# RESEARCH RESULTS AND FINDINGS DISCUSSION

## 4.1 Introduction

The sections of this chapter gives data analysis results and findings discussion on the relationship between Governance Practices, Strategic Leadership and commercial banks performance in Kenya using techniques and variables stated in the preceding chapter. Data analysis was conducted according to the specific research objectives and the analysis findings thereof drawn.

The study undertook three statistical tests; Descriptive statistical analysis, Correlation and Regression Analysis. Descriptive statistics is used to describe study variables particularly the sample profile, Principal component analysis was used to analyze the correlation among the variables thereafter decomposed the large number of variables into a set of core underlying factors. Regression analysis was used to test the research hypotheses, determine the existence of a significant relationship between the variables under the study and ascertain the predictive power of corporate governance practices on bank performance and also ascertain the same power when strategic leadership is introduced into the relationship.

## 4.2 Response Rate

Through questionnaire administration, a survey was carried out on the 39 operating commercial banks in Kenya. 78 questionnaires were given out to the respondents out of which 75 questionnaires were obtained back representing 96% response rate. 4 % of the respondents failed to cooperate with the researcher because of various reasons leading to the exclusion of these questionnaires from the analysis. According to Mugenda and

Mugenda, (2003), 50% response rate is adequate, rate 60% is good and 70% and above rate is very good. In view of these recommendations, 96% rate is very good. Therefore the collected data was adequate enough leading to satisfactory conclusions about the study. Table 4.1 shows the response rate.

**Table 4.1: Response Rate**

| Category | Sample | Response | Percentage |
|---|---|---|---|
| Chief executive officers | 39 | 39 | 50 |
| Non-executive directors | 39 | 36 | 46 |
| **TOTAL** | **78** | **75** | **96 %** |

### 4.3 Reliability Test

Reliability test was conducted on the questionnaire responses where Cronbach's alpha was used to evaluate the reliability of the questionnaire. The range of Cronbach's alpha coefficient values is between 0-1. It therefore measures the internal consistency of the study questionnaire. The interpretation of Field (2005) gives a meaning of a Cronbach's α greater than or equal to 0.7 as implying the instrument provides a good measurement tool hence reliable. **0.835** was reported for this study as the overall Cronbach's alpha value, with Cronbach's alpha values for the independent variables being 0.865, 0.814, 0.836, 0.845 and 0.814, for Board Composition, Board Committees, Compensation System, Risk Management and strategic leadership respectively. All the values are above the threshold of 0.70 recommended by Field (2005) hence the data collected attained a

relatively high level of consistency making the target population well represented and was therefore suitable for more analysis. Table 4.2 presents the reliability test results.

**Table 4.2: Reliability Test**

| Variables of C.G | Cronbach's alpha coefficients | Remarks |
|---|---|---|
| Board composition | 0.865 | Accepted |
| Board committees | 0.814 | Accepted |
| Compensation system | 0.836 | Accepted |
| Risk management | 0.845 | Accepted |
| Strategic leadership | 0.814 | Accepted |
| **Overall** | **0.835** | **Accepted** |

## 4.4 Descriptive Statistics

### Board Composition and Performance of Commercial Banks

Figure 4.1 shows a summary of the responses received from the questionnaire On Board Composition, on the question whether the respective boards of directors are composed of people from different professional backgrounds, 88% of the respondents indicates this is true to a large extent, 8% of the respondents agree to a very large extent while 4% of the respondents indicated this is true to a moderate extent. These results imply that a majority of the boards of directors in the banking sector in Kenya are constituted taking into account different professions of its members.

On the question whether the boards are composed of people from different ethnic backgrounds, 60% of the respondents indicated this is true to a large extent, 21.3% of the

respondents agreed to a very large extent, 17.3% of the respondents agreed to a moderate extent while 1.4% of the respondents agreed to a less extent. These figures imply that most banks in Kenya constitute their boards with members from different ethnic backgrounds; therefore banks should leverage these different cultural experiences within their boards.

When asked whether more than 1/3 of the board members are non-executive directors, 56% of the respondents agreed to a large extent, 26% of the respondents to a moderate extent, and 17.3% agreed to a very large extent. These responses imply that a majority of the bank boards in Kenya have more than a 1/3 of their members being non-executive directors; these members should be utilized to offer independent opinions on the different areas of bank operations.

The question on whether female members of the board are representative enough for decision making, 33.3% of the respondents agreed to a moderate extent, 28% of the respondents to a less extent, 26.7% of the respondents to a large extent, 6.7% of the respondents to a very large extent and 5.3 % of the respondents said not at all. These figures imply that a majority of the banks in Kenya have less female representation compared to their male counter parts.

The respondents were asked to state whether their respective boards have enough members such that no one feels overworked, 46.7% of the respondents agreed to a large extent, 44% of the respondents agreed to a moderate extent, 8% of the respondents agreed to a very large extent and 1.3% of the respondents to a less extent. These figures imply that a majority of the boards in the Kenyan banking sector do not have enough numbers

to effectively serve the banks; it could mean members of the boards are overworked in one way or the other. The responses on board composition are presented in figure 4.1.

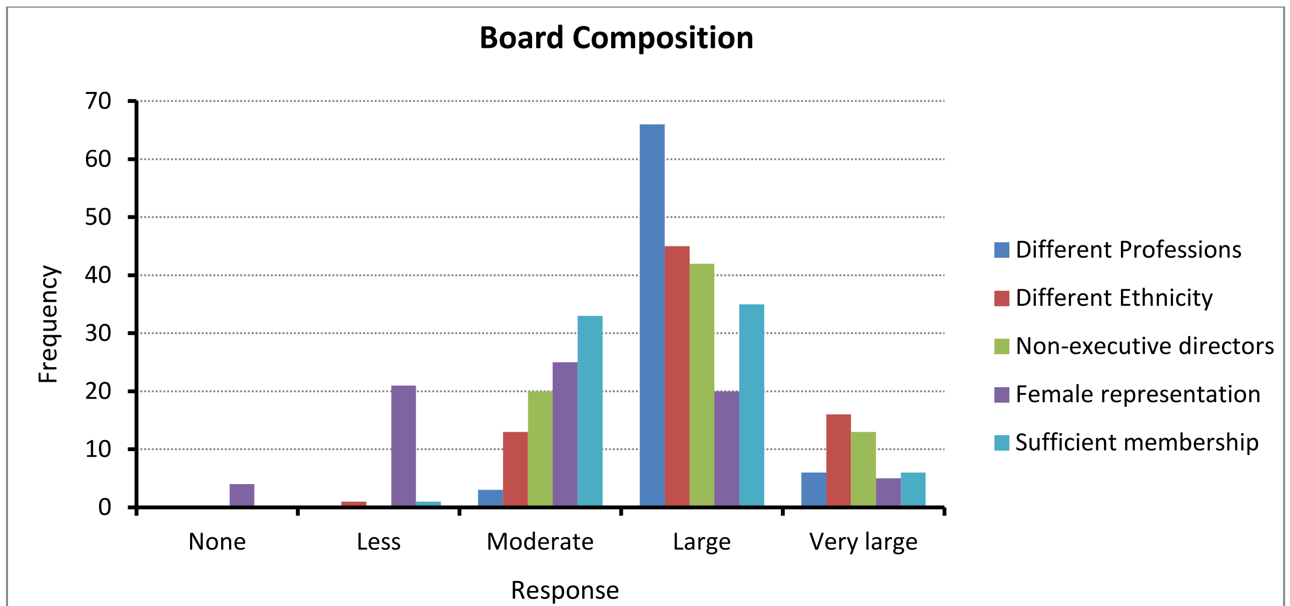


**Figure 4.1: Reponses on board composition**

**Board Committees and Performance of Commercial Banks**

Figure 4.2 shows a summary of the responses received from the questionnaire on board committees; on the question whether the respective boards are divided into different functional committees, 72% of the respondents indicated this is true to a large extent, 21.3% of the respondents agreed to a very large extent while 6.7% of the respondents indicated this is true to a moderate extent. These figures imply that almost all boards in the Kenyan banking sector divide their work into different committees on key areas of operation.

On the question whether a majority of board business is conducted at committee level, 72% of the respondents indicated this is true to a large extent, 14.7% of the respondents

agreed to a moderate extent while 13.3% of the respondents agreed to a very large extent. This clearly implies efficiency in the boards operations since work is already divided among the board members.

When asked whether at least the boards have put in place committees such as Audit, credit, compensation and HR committees, 52% of the respondents agreed to a large extent, 32% of the respondents to a very large extent, and 16% of the respondents agreed to a moderate extent. These figures imply that almost all boards in the banking sector in Kenya have put in place committees to deal with critical areas of bank operations; this should bring accountability since critical areas are closely monitored.

On the question whether the respective committees are effective in doing their work, 60% of the respondents agreed to a large extent, 21.3% of the respondents to a very large extent and 18.7% of the respondents to a moderate extent. This implies that a majority of the committees are effective in doing their work and therefore should enhance bank performance. The responses on board committees are presented using bar charts in figure 4.2

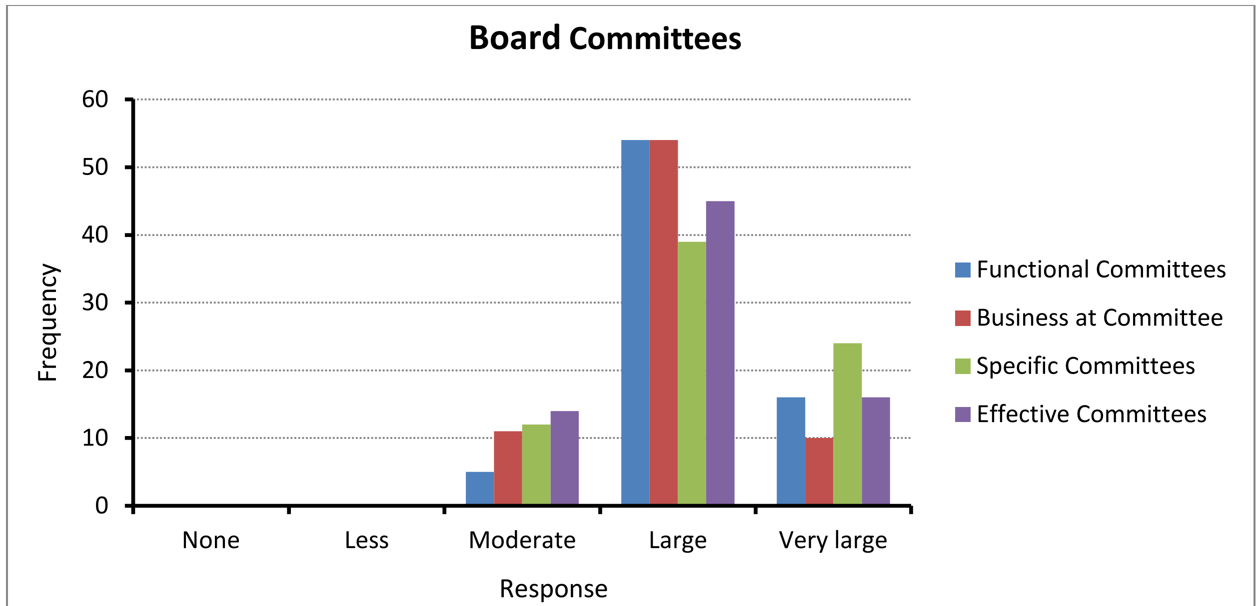


**Figure 4.2: Responses on board committees**

**Compensation System and Performance of Commercial Banks**

Figure 4.3 shows a summary of the responses received from the questionnaire on compensation system; on the question whether the respective board of directors have put in place a compensation scheme for the bank top management, 84% of the respondents indicated this is true to a large extent, 9.3% of the respondents agreed to a very large extent while 6.7% of the respondents indicated this is the case to a moderate extent. This implies that a majority of the boards have a special compensation scheme for the top management.

On the question whether apart from monthly salary the bank top management enjoy some of the best perks in the industry, 52% of the respondents indicated this is true to a large extent, 38.7% of the respondents agreed to a moderate extent and 9.3% of the respondents agreed to a very large extent. This implies that not all boards have allowed

their top management to enjoy special perks a part from their monthly salaries, something that could be slowing performance especially from those managers who are not intrinsically motivated.

When asked whether the board has put in place a competitive bonus system that is paid to the top management based on performance , 50.7% of the respondents agreed to a large extent, 38.7% of the respondents to a moderate extent, and 10.6% of the respondents agreed to a very large extent. This implies that a majority of the boards have put in place a competitive bonus system that is paid to the top management based on performance.

On the question whether members of the executive are allowed share ownership of the banks , 54.7% of the respondents agreed to a moderate extent, 37.3% of the respondents to a large extent, 6.7% of the respondents agreed to a very large extent and 1.3% of the respondent agreed to a less extent. This implies that a good number of the boards do not allow their top management to own shares of these banks; this could be making the management pursue other interests while still serving in these banks thereby derailing performance. The responses on compensation system are presented using bar charts in figure 4.3.

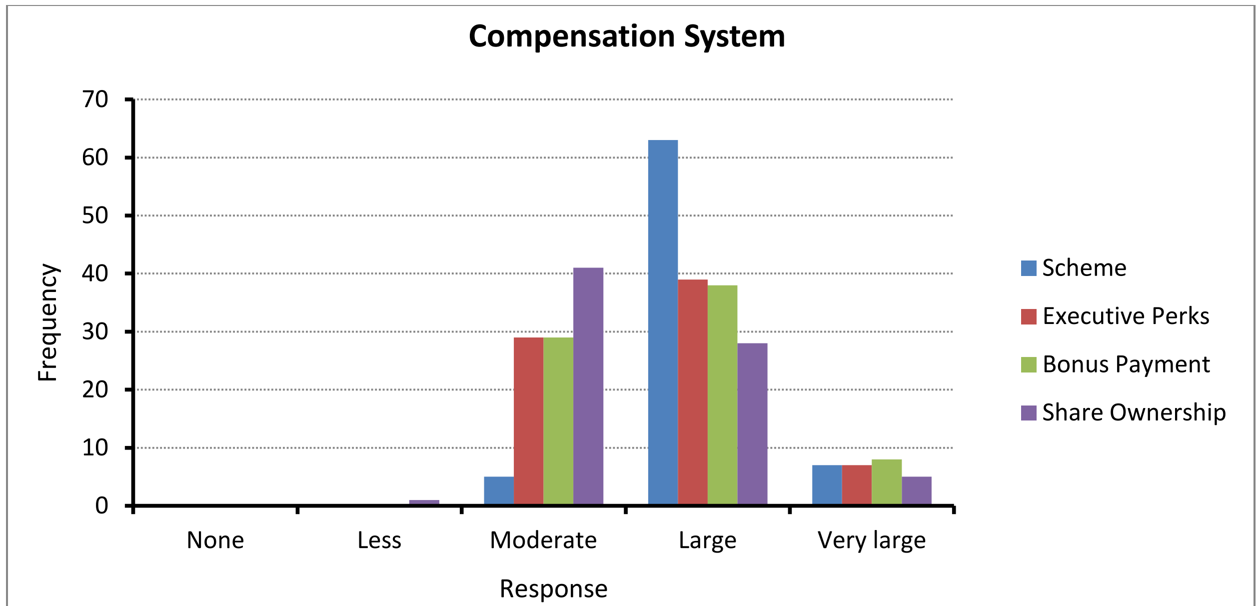


**Figure 4.3: Responses on Compensation system**

**Risk Management and Performance of Commercial Banks**

Figure 4.4 shows a summary of the responses received from the questionnaire on risk management, on the question whether the respective Boards of Directors have put in place a risk management policy for the banks, 77% of the respondents indicated this is true to a large extent, 16% of the respondents agreed to a very large extent while 6.7% of the respondents indicated this is the case to a moderate extent. This implies that boards of commercial banks in Kenya take the issue of risk management seriously given that banking is a highly risky business.

On the question whether the board has put in place mechanisms to be able to identify risky transactions within the bank, 68% of the respondents indicated this is true to a large extent, 26.7% of the respondents agreed to a moderate extent while 5.3% of the respondents agreed to a very large extent. This implies that a majority of the boards have

put in place mechanisms for their staff to be able to identify risky transactions, this helps reduce losses associated with such risky transactions.

When asked whether the board has put in place mechanisms that are good enough to enable monitoring of all risky transactions, 66.7% of the respondents agreed to a large extent, 20% of the respondents to a moderate extent, 12% of the respondents agreed to a very large extent and 1.3% of the respondents agreed to a less extent. This implies a majority of the boards are serious about monitoring risky transactions which could be very detrimental once allowed to hit the bank.

On the question whether the bank is able to identify, measure, monitor and control all forms of risks in its dealings, 77.3% of the respondents agreed to a large extent, 13.4% of the respondents to a very large extent and 9.3% of the respondents agreed to a moderate extent. This means that the various boards of the commercial banks have put in place mechanisms for their staff to be able to identify measure, monitor and control risks in their daily dealings and this should significantly reduce executing risky transactions that might hit the bank.

The respondents are asked to state whether their respective banks have encountered many risky transactions in the last one year, 61.4% of the respondents agreed to a large extent, 21.3% of the respondents agreed to a very large extent and 17.3% of the respondents to a moderate extent. This in essence means that almost all banks have experienced risky transactions in the last one year implying that banking is a highly risky business that should be guarded seriously and commercial banks should strongly adhere to the prudential guidelines issued by the central bank from time to time if they are to enhance their performance.

When asked whether the number of non-performing loans have reduced significantly for the last three years, 52% of the respondents agreed to a moderate extent, 21.3% of the respondents to a large extent, 16% of the respondents agreed to a less extent and 10.7% of the respondents to a very large extent. This implies that a majority of the commercial banks are still grappling with the issue of non-performing loans, a sign that credit risk management is a challenge to most banks and this could be derailing performance. The responses on risk management are presented using bar charts in figure 4.4.

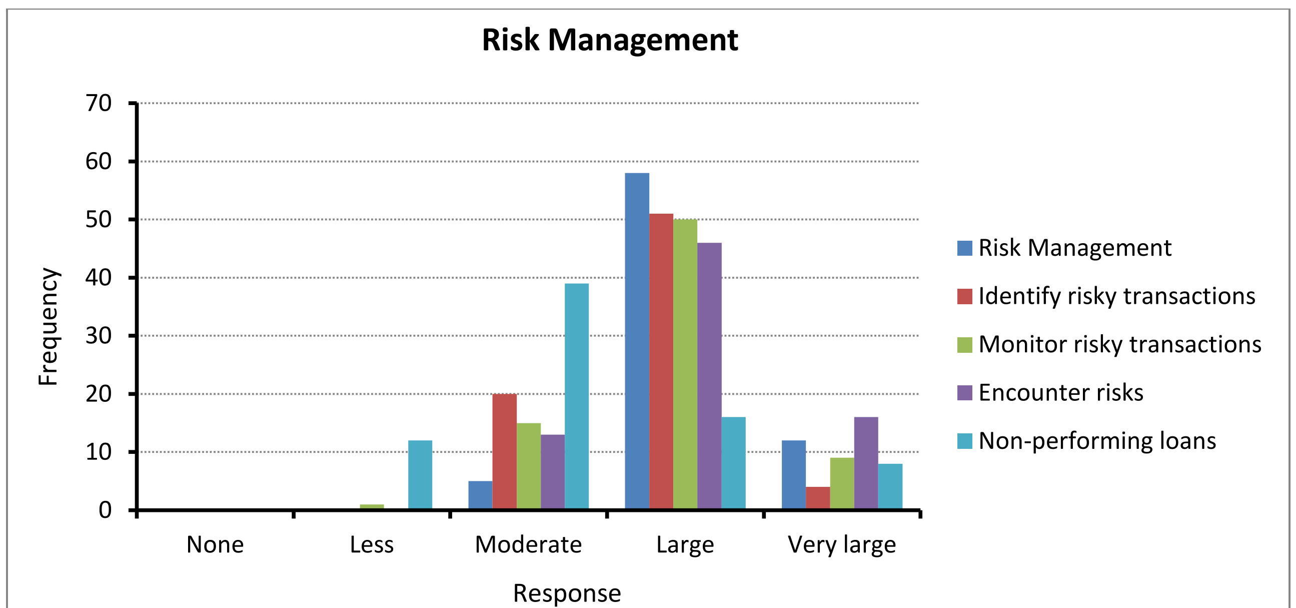


Figure 4.4: Responses on Risk management

### 4.5: Correlation Analysis

The problem of multi-collinearity was solved by computing the correlation matrix for each set of variables in the same group in terms of a single objective. Further the technique of principal component analysis (PCA) 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.

**Board Composition**

The correlation matrix computes the correlation coefficients between different variables and therefore assist in identifying explanatory variables which are related i.e. multi-collinearity , in this research it complements the rotated component matrix in which related variables are grouped together to form a cluster / component. Table 4.3 shows that sufficient membership is related to different ethnicity (r=0.537) and sufficient membership is also related to female representation (r = 0.533) also non-executive directors and different professions are related although the relationship is weak (r = 0.135).

**Table 4.3: 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 |
| sufficient membership | 0.010 | 0.537 | -0.147 | 0.533 | 1.000 |

The technique of principal component analysis (PCA) is 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 is selected to represent the cluster. Table 4.4 shows that sufficient membership and non-executive directors being >1/3 has the highest loading factors in their respective clusters and therefore picked to represent the board composition Variable.

**Table 4.4: Board composition Rotated Component Matrix[a]**

| | Component | |
|---|---|---|
| | 1 | 2 |
| **Sufficient membership** | 0.868 | -0.165 |
| Female representation | 0.785 | 0.007 |
| Different Ethnicity | 0.778 | 0.239 |
| **Non-executive dir > 1/3** | -0.052 | 0.797 |
| Different Professions | 0.079 | 0.684 |

Extraction Method: Principal Component Analysis.

rotation Method: Varimax with Kaiser Normalization.[a]

a. Rotation converged in 3 iterations.

The reduced model therefore becomes

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

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

$X_1$ - Sufficient membership

$X_2$ - Non-executive Directors > 1/3

Evaluating the model based on the Nagelkerke's co-efficient of determination $R^2$, the research notes that the two explanatory variables in the model: Sufficient membership and Non-executive directors > 1/3, contribute 41.5% of the total variation in the response variable bank performance. This means that the extraneous variables which are not in the model also contribute 58.5% in determining the value of the bank performance. Considering the explained variation of 41.5% vis-à-vis the unexplained variation of 58.5%, it means the model is a good fit for the data. Tables 4.5 and 4.5.1 indicates model fit test

**Table 4.5: Board composition Model fit-test**

**Model Fitting Information**

| Model | -2 Log Likelihood | Chi-Square | df | Sig. |
|---|---|---|---|---|
| Intercept Only | 28.890<br>25.241 | 3.649 | 5 | 0.601 |

Link function: Logit.

**Table 4.5.1: Model fit-test**

**Pseudo R-Square**

| | |
|---|---|
| Cox and Snell | 0.235 |
| Nagelkerke | 0.415 |
| McFadden | 0.170 |

Link function: Logit

**Board Committees**

The correlation coefficients matrix in table 4.6 shows the correlation among the different variables of board committees; the results indicate that conducting board business at the committee level is related to the effectiveness of the committee (r = 0.320) and conducting board business at the committee level is related to the board having different functional committees (r = 0.255) while having specific committees in the board is found to have no relationship with any of the variables ( no multicollinearity) .

**Table 4.6 Board Committees Correlation Matrix**

| | Diff. Functional committees | Business at committee level | Specific committees in board | Committee effectiveness |
|---|---|---|---|---|
| Diff. Functional committees | 1.000 | 0.255 | 0.126 | 0.154 |
| Business at committee level | 0.255 | 1.000 | 0.006 | 0.320 |
| Specific committees in board | 0.126 | 0.006 | 1.000 | 0.053 |
| Committee effectiveness | 0.154 | 0.320 | 0.053 | 1.000 |

The technique of principal component analysis is 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 committees variable. Within a cluster the strongest variable which has the highest value (loading) in the rotated component matrix is selected to represent the cluster. Table 4.7 shows conducting of the board business at the committee level and putting in place specific committees have the highest loading factor and therefore are picked to represent the board committees Variable.

**Table 4.7 : Board committees Rotated Component Matrix[a]**

| | Component | |
|---|---|---|
| | 1 | 2 |
| **Business at committee level** | 0.806 | -0.027 |
| Committee effectiveness | 0.729 | -0.002 |
| Diff. Functional committees | 0.526 | 0.446 |
| **Specific committees in board** | -0.066 | 0.933 |

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.[a]

a. Rotation converged in 3 iterations.

The reduced model therefore becomes

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

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

$X_1$ - Business at committee level

$X_2$ - Specific committees in board

Evaluating the model based on the Nagelkerke's co-efficient of determination $R^2$, the research notes that the two explanatory variables in the model: Business at committee level and Specific committees in board, contribute 48.5% of the total variation in the response variable bank performance. This means that the extraneous variables which are not in this model also contribute 51.5% in determining the value of the bank performance. Considering the explained variation of 48.5% vis-à-vis the unexplained variation of 51.5%, it means that the model is a good fit for the data. Tables 4.8 and 4.8.1 indicate model fit test.

**Table 4.8: Board Committees model fit-test**

**Goodness-of-Fit**

| | Chi-Square | df | Sig. |
|---|---|---|---|
| Pearson | 3.424 | 10 | 0.970 |
| Deviance | 4.628 | 10 | 0.915 |

Link function: Logit.

**Table 4.8.1: Model fit-test**

**Pseudo R-Square**

| | |
|---|---|
| Cox and Snell | 0.230 |
| Nagelkerke | 0.485 |
| McFadden | 0.165 |

Link function: Logit.

**Compensation System**

The correlation coefficients matrix in table 4.9 shows the correlation among the different variables of the executive compensation system; the results indicate that allowing share ownership for the executive is related to having special perks for the bank executive in place (r = 0.493) and putting in place a compensation scheme for the bank management is weakly related to payment of bonus (r = 0.081).

**Table 4.9: Compensation System Correlation Matrix**

| | Compensation scheme - mngt | Perks for Executive | Bonus payment | Share ownership by executive |
|---|---|---|---|---|
| Compensation scheme - mngt | 1.000 | 0.084 | 0.081 | 0.053 |
| Perks for Executive | 0.084 | 1.000 | 0.193 | 0.493 |
| Bonus payment | 0.081 | 0.193 | 1.000 | 0.109 |
| Share ownership by executive | 0.053 | 0.493 | 0.109 | 1.000 |

The technique of principal component analysis is 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 Compensation variable. Within a cluster the strongest variable which has the highest value (loading) in the rotated component matrix was selected to represent the cluster. Table 4.10 shows allowing share ownership of the company by top management and putting in place a compensation scheme for the top management has the highest loading factors within their respective clusters and therefore picked to represent the Compensation system Variable.

**Table 4.10: compensation system Rotated Component Matrix[a]**

| | Component | |
|---|---|---|
| | 1 | 2 |
| **Share ownership by executive** | 0.851 | 0.021 |
| Perks for Executive | 0.843 | 0.150 |
| **Compensation scheme (top mngt)** | -0.089 | 0.877 |
| Bonus payment | 0.262 | 0.544 |

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.[a]

a. Rotation converged in 3 iterations.

The reduced model therefore becomes:

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

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

$X_1$ - Share ownership by executive

$X_2$ - Compensation scheme for top management

Evaluating the model based on the Nagelkerke's co-efficient of determination $R^2$, the research notes that the two explanatory variables in the model: Share ownership by executive and Compensation scheme for top management, account for 34% of the total variation in the response variable bank performance. This means that the extraneous variables which are not in this model also account for 66% in determining the value of the bank performance. Considering the explained variation of 34% vis-à-vis the unexplained variation of 66%, it means that the model is a good fit for the data. Tables 4.11 and 4.11.1 indicate the model fit test.

**Table 4.11: Compensation System model fit test**

**Goodness-of-Fit**

| | Chi-Square | df | Sig. |
|---|---|---|---|
| Pearson | 14.033 | 9 | 0.121 |
| Deviance | 9.278 | 9 | 0.412 |

Link function: Logit

**Table 4.11.1: Model fit-test**

**Pseudo R-Square**

| | |
|---|---|
| Cox and Snell | 0.18 |
| Nagelkerke | 0.34 |
| McFadden | 0.13 |

Link function: Logit.

**Risk Management**

The correlation coefficients matrix in table 4.12 shows the correlation among the different variables of Risk management; the results indicate that having risk management policy in place is related to being able to identify risky transactions (r = 0.463) and non performing loans is related to being able to monitor risky transactions (r = 0.341) while being able to control risks in bank dealings is found not related to any variable (no multicollinearity).

**Table 4.12: Risk Management Correlation Matrix**

| | Risk management policy | Identify risky transactions | Monitor risky transactions | Control risks in dealings | counter risky transactions | non-performing loans reduced |
|---|---|---|---|---|---|---|
| Risk management policy | 1.000 | 0.463 | 0.083 | 0.104 | 0.263 | -0.096 |
| Identify risky transactions | 0.463 | 1.000 | 0.266 | 0.142 | 0.190 | 0.276 |
| Monitor risky transactions | 0.083 | 0.266 | 1.000 | 0.295 | 0.047 | 0.341 |
| Control risks in dealings | 0.104 | 0.142 | 0.295 | 1.000 | 0.085 | 0.171 |
| Encounter risky transactions | 0.263 | 0.190 | 0.047 | 0.085 | 1.000 | -0.045 |
| Non-performing loans reduced | -0.096 | 0.276 | 0.341 | 0.171 | -0.045 | 1.000 |

The technique of principal component analysis is 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 risk management variable. Within a cluster the strongest variable which has the highest value (loading) in the rotated component matrix is selected to represent the cluster. Table 4.13 shows having risk management policy in place, being able to reduce non-performing loans, control of risks in dealings and encountering risky

transactions have the highest loading factors within their respective clusters and therefore are picked to represent risk management variable

**Table 4.13 :Risk management Rotated Component Matrix[a]**

| | Component | | | |
|---|---|---|---|---|
| | 1 | 2 | 3 | 4 |
| **Risk management policy** | 0.882 | -0.193 | 0.107 | 0.133 |
| Identify risky transactions | 0.796 | 0.401 | 0.004 | 0.075 |
| **Non-performing loans reduced** | -0.016 | 0.904 | 0.011 | -0.031 |
| Monitor risky transactions | 0.139 | 0.603 | 0.461 | 0.019 |
| **Control risks in dealings** | 0.049 | 0.083 | 0.944 | 0.039 |
| **Encounter risky transactions** | 0.146 | -0.013 | 0.041 | 0.988 |

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.

a. Rotation converged in 5 iterations.

The reduced model therefore becomes

$$\left[\frac{P(Y = less)}{P(Y = moderate,\ large)}\right] = exp\ (\beta_{01} + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4)$$

$$\left[\frac{P(Y = less,\ moderate)}{P(Y = large)}\right] = exp\ (\beta_{02} + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4)$$

$X_1$ - Risky management policy

$X_2$ - Non-performing loans reduced

$X_3$ - Control risks in dealings

$X_4$ - Encounter risky transactions

Evaluating the model based on the Nagelkerke's co-efficient of determination $R^2$, the research notes that the four explanatory variables in the model: Risky management policy, Non-performing loans reduced, Control risks in dealings and Encounter risky transactions, all account for 40.5% of the total variation in the response variable bank performance. This means that the extraneous variables which are not in this model also account for 59.5% in determining the value of the bank performance. Considering the explained variation of 40.5% vis-à-vis the unexplained variation of 59.5%, it means that the model is a good fit for the data. Tables 4.14 and 4.14.1 show model fit test

**Table 4.14: Risk management model fit test**

**Goodness-of-Fit**

| | Chi-Square | df | Sig |
|---|---|---|---|
| Pearson | 40.619 | 45 | 0.658 |
| Deviance | 37.543 | 45 | 0.777 |

Link function: Logit.

**Table 4.14.1: Model fit-test**

**Pseudo R-Square**

| | |
|---|---|
| Cox and Snell | 0.163 |
| Nagelkerke | 0.405 |
| McFadden | 0.126 |

Link function: Logit.

**Strategic Leadership**

The correlation coefficients matrix in table 4.15 shows the correlation among the different variables of strategic leadership; the results indicate that offering strategic direction is related to having a friendly IT system (r = 0.498) and having a customer service charter(r = 0.437) and also being able to adapt to change is related to introducing new products to the market (r = 0.419), however, being innovative is found not related to any of the variables (no multicollinearity).

**Table 4.15: Strategic leadership Correlation Matrix**

| | Strategic direction | Commitment to innovation | New products | IT system friendly | Service charter | Adaptability |
|---|---|---|---|---|---|---|
| Strategic direction | 1.000 | 0.235 | 0.269 | 0.498 | 0.437 | 0.000 |
| Commitment to innovation | 0.235 | 1.000 | 0.229 | 0.182 | 0.178 | 0.226 |
| New products | 0.269 | 0.229 | 1.000 | 0.185 | 0.216 | 0.419 |
| IT system friendly | 0.498 | 0.182 | 0.185 | 1.000 | 0.370 | 0.189 |
| Service charter | 0.437 | 0.178 | 0.216 | 0.370 | 1.000 | 0.094 |
| Adaptability | 0.000 | 0.226 | 0.419 | 0.189 | 0.094 | 1.000 |

The technique of principal component analysis is 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 strategic leadership variable. Within a cluster the strongest variable which has the highest value (loading) in the rotated component matrix is selected to represent the cluster. Table 4.16 shows offering strategic direction by the board, being able to adapt the organization to environmental changes and commitment to innovation have the highest loading factors within their clusters and therefore are picked to represent the strategic leadership variable.

**Table 4.16: Strategic leadership Rotated Component Matrix[a]**

| | Component | | |
|---|---|---|---|
| | 1 | 2 | 3 |
| **Strategic direction** | 0.829 | -0.003 | 0.170 |
| IT system friendly | 0.759 | 0.168 | 0.027 |
| Service charter | 0.744 | 0.093 | 0.044 |
| **Adaptability** | -0.026 | 0.812 | 0.103 |
| New products | 0.245 | 0.774 | 0.084 |
| **Innovation** | 0.135 | 0.153 | 0.776 |
| | | | |

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.

a. Rotation converged in 4 iterations.

$X_1$ - Strategic direction

$X_2$ - Adaptability

$X_3$ - Innovation

The variable strategic direction was selected as a moderating variable and used as an interaction with the other variables.

Evaluating the model based on the Nagelkerke's co-efficient of determination $R^2$, the research notes that the three explanatory variables in the model: Strategic direction, Adaptability and Innovation, all account for 35.0% of the total variation in the response variable bank performance. This means that the extraneous variables which are not in this model also account for 65.0% in determining the value of the bank performance. Considering the explained variation of 35.0% vis-à-vis the unexplained variation of 65.0%, it means that the model is a good fit for the data. Tables 4.17 and 4.17.1 show model fit test.

**Table4:17: Strategic leadership model fit test**

**Goodness-of-Fit**

| | Chi-Square | df | Sig. |
|---|---|---|---|
| Pearson | 18.305 | 23 | 0.741 |
| Deviance | 19.652 | 23 | 0.663 |

Link function: Logit

**Table 4.17.1: Model fit-test**

**Pseudo R-Square**

| | |
|---|---|
| Cox and Snell | 0.265 |
| Nagelkerke | 0.350 |
| McFadden | 0.190 |

Link function: Logit

## 4.6 Regression Analysis

Models are 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 is assigned a regression co-efficient $\beta_i$ and interpreted separately.

### 4.6.1 Board Composition and Performance of Commercial Banks

Table 4.18 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.

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.

**Table 4.18: Board Composition Regression Analysis**

| Coefficients | Estimate | | | | | Odds Ratio | |
|---|---|---|---|---|---|---|---|
| | | | | | | $exp\left(\hat{\beta}_i\right)$ | |
| | Value $\beta_i$ | Std. Error | t-value | 95% C.I for OR Lower | Upper | 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% |
| NonExec3 | -0.92 | 0.81 | -1.10 | -0.03 | -1.83 | 0.41 | 41.0% |
| NonExec4 | 3.21 | 1.61 | 1.23 | 1.23 | 5.18 | 2.471 | 247.1% |
| SuffMemb3 | 3.66 | 2.78 | 0.03 | 3.59 | 3.74 | 3.894 | 389.4% |
| SuffMemb4 | 1.67 | 7.82 | 0.13 | 0.63 | 2.71 | 5.31 | 531.0% |
| StratDirect3 | 15.30 | 63.48 | 0.11 | 9.20 | 21.39 | 4.384 | 438.4% |
| StratDirect4 | 16.65 | 146.75 | 0.12 | 0.00 | 33.3 | 1.7008 | 1700.8% |
| NonExec4:StratDirect3 | 12.83 | 111.09 | 0.12 | 7.55 | 10.11 | 3.719 | 371.9% |
| NonExec4:StratDirect4 | -3.96 | 2.70 | -1.46 | -0.02 | 7.91 | 0.012 | 1.2% |
| SuffMemb3:StratDirect3 | 9.96 | 263.46 | 0.076 | 9.47 | 10.45 | 2.108 | 210.8% |
| SuffMemb4:StratDirect3 | 12.11 | 108.25 | 0.26 | 9.97 | 14.25 | 1.817 | 181.7% |
| SuffMemb3:StratDirect4 | 10.66 | 146.72 | 0.073 | 10.32 | 11.004 | 4.268 | 426.8 % |

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

$$\left[\frac{P(Y = less)}{P(Y = moderate,\ large)}\right] = exp\,(-0.56 - 0.92X_1 + 3.21X_2 + 3.67X_3 + 1.67X_4$$

$$+15.30X_5 + 16.65X_6 + 12.83X_7 - 3.96X_8 + 9.96X_9 + 12.11X_{10} + 10.66X_{11})$$

$$\left[\frac{P(Y = less,\ \ moderate)}{P(Y = large)}\right] = exp\,(3.65 - 0.92X_1 + 3.21X_2 + 3.67X_3 + 1.67X_4$$

$$+15.30X_5 + 16.65X_6 + 12.83X_7 - 3.96X_8$$

$$+9.96X_9 + 12.11X_{10} + 10.66X_{11})$$

Non-executive directors: Moderate $\beta_i$ = -0.92, therefore $exp\left(\hat{\beta}_i\right)$ = 0.41

Therefore a bank whose board has non-executive directors to a moderate extent is 0.4 less likely to increase performance 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 co-efficient βi gives interval [-0.03, -1.83] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance which implies that the number of non-executive directors is a statistically significant factor in influencing the performance of the bank.

Non-executive directors: large $\beta_i$ = 3.21, therefore $exp\left(\hat{\beta}_i\right)$ = 2.471

Therefore a bank whose board has non-executive directors to a large extent is 2.5 times more likely to increase performance from one level to the next compared to a bank whose board has non-executive directors to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [1.23, 5.18] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Sufficient membership: moderate $\beta_i$ = 3.66, therefore $exp\left(\hat{\beta}_i\right)$ = 3.894

Therefore a bank whose board has sufficient number of members to a moderate extent is 3.9 times more likely to increase performance from one level to the next compared to a bank whose board has sufficient number of members to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [3.59, 3.74] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Sufficient membership: large $\beta_i$ = 1.67, therefore $exp\left(\hat{\beta}_i\right)$ = 5.31

Therefore a bank whose board has sufficient number of members to a large extent is 5.3 times more likely to increase performance from one level to the next compared to a bank whose board has sufficient number of members to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [0.63, 2.71] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Strategic direction: moderate $\beta_i$ = 15.3, therefore $exp\left(\hat{\beta}_i\right)$ = 4.384

Therefore a bank whose board offers strategic direction to a moderate extent is 4.4 times more likely to increase performance from one level to the next compared to a bank whose board offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [9.20, 21.39] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance

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

Therefore a bank whose board offers strategic direction to a large extent is 1.7 times more likely to increase performance from one level to the next compared to a bank whose board offers strategic direction to a less extent. Testing the null hypothesis at 95%

confidence interval for co-efficient βi gives interval [0.00, 33.3] which includes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance.

Non-executive directors: large and strategic direction: moderate

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

Therefore a bank whose board has non-executive directors to a large extent and offers strategic direction to a moderate extent is about 3.7 times more likely to increase performance from one level to the next compared to a bank whose board has non-executive directors to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [7.55, 10.11] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance

Non-executive directors: large and strategic direction: large

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

Therefore a bank whose board has non-executive directors to a large extent and offers strategic direction to a large extent is 0.01 less likely to increase performance from one level to the next compared to a bank whose board has non-executive directors to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-0.02, 7.91] which includes 0. Therefore the research rejects the null hypothesis at the 5% level of significance

Sufficient membership: moderate and strategic direction: moderate

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

Therefore a bank whose board has sufficient number of members to a moderate extent and offers strategic direction to a moderate extent is 2.1 times more likely to increase

performance from one level to the next compared to a bank whose board has sufficient number of members to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [9.47, 10.45] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance

Sufficient membership: large and strategic direction: moderate

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

Therefore a bank whose board has sufficient number of members to a large extent and offers strategic direction to a moderate extent is 1.8 times more likely to increase performance from one level to the next compared to a bank whose board has sufficient number of members to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [9.97, 14.25] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance

Sufficient membership: moderate and strategic direction: large

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

Therefore a bank whose board has sufficient number of members to a moderate extent and offers strategic direction to a large extent is 4.3 times more likely to increase performance 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 βi gives interval [10.32, 11.004] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance. This implies that having a sufficient number of members in the

board of directors and strategic direction offered by the board is a factor that is a statistically significant factor in influencing the performance of the bank.

**Hypothesis 1: There is no significant relationship between Board of directors' composition and commercial banks performance in Kenya**

From the regression analysis results (Table 4.18) it is revealed that a bank whose board has non-executive directors to a large extent is 2.5 times more likely to increase performance from one level to the next compared to a bank whose board has non-executive directors to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi 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 of Directors is a statistically significant factor that affects the performance of commercial banks in Kenya.

This invariably means that the more the number of non-executive directors in the board the higher the performance of commercial banks in Kenya in terms of profitability, increase in market share, efficiency in service delivery and employee satisfaction. The findings above agree with those of Ashraf et al. (2015) on the relationship between performance and corporate governance variables of all listed banks in Saudi Arabia, which showed a significant positive relationship between board independence and performance of banks where board independence was measured by the number of non executive directors.

These findings further agree with the perspective of the resource dependence theory whose concern is more on resources access for the organization, like capital and expertise. The 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 offer, as well as increased networking with the external environment and a generally better reputation for the organization (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; thus Non-Executive Directors enhance and improve resources access which simply put enables easier and cheaper access to inputs and thus affect the performance of the firm positively (Nicholson & Kiel, 2003).

Board size is another parameter that is used to measure Board Composition. Results from table 4.17 indicate that a bank whose board has sufficient number of members to a large extent is 5.3 times more likely to increase performance from one level to the next compared to a bank whose board has sufficient number of members 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 concluded 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 commercial banks performance 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; many number of directors 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.

According to the Stewardship theory, Boards which are dominated by executive directors should be favored because these executives have the ability to easily access information that is current on organizational operations, technical expertise, depth of knowledge and their commitment to the daily company operations which potentially impacts performance positively (Letting" *et al.* 2012). Boards which are small in size promote social cohesion and increased participation unlike larger sized boards which often hinders the ability of the boards to reach agreements on decisions which are important (Vallejo, 2009).

Given that the relationship between Board of Directors' Composition and banks performance is significant in Kenya, the research hence rejects the null hypothesis that there is no significant relationship between Board Composition and commercial banks performance and fails to reject the alternative hypothesis that there is a significant relationship between Board Composition and commercial banks performance and concludes that Board Composition is a factor that significantly influences commercial banks performance in Kenya in terms of financial, market share, service delivery and employee skills and competency .

### 4.6.2 Board Committees and Performance of Commercial Banks

Table 4.18 shows the coefficients resulting from the regression analysis among the representing variables of board committees, the moderating variable (offering of strategic direction by the board) and bank performance. Regression analysis was used to test the research hypothesis, determine the existence of a significant relationship between the variables under the study and to ascertain the predictive power of Board committees on bank performance and also ascertain the same power when strategic leadership is introduced into the relationship. Table 4.19 shows regression coefficients for board committees.

**Table 4.19: Board Committees Regression Analysis**

| Coefficients | Estimate | | | | | Odds Ratio $exp\,(\hat{\beta}_i)$ | |
|---|---|---|---|---|---|---|---|
| | Value $\beta_i$ | Std. Error | t-value | 95% C.I for OR Lower | Upper | Absolute | Percentage |
| Model 1: 2\|3 | 3.78 | 6.98 | 7.66 | | | 4.381 | 438.1% |
| Model 2: 3\|4 | 2.80 | 17.97 | 7.67 | | | 1.643 | 164.3% |
| BusLevel3 | 1.10 | 3.57 | 2.81 | -8.9 | 11.14 | 3.004 | 300.4% |
| BusLevel4 | -2.35 | 1.59 | -0.48 | -1.58 | 3.12 | 0.095 | 9.5% |
| SpecComm3 | 1.81 | 2.10 | 0.40 | 0.99 | 2.63 | 6.092 | 609.2% |
| SpecComm4 | 1.78 | 0.95 | 2.68 | -0.77 | 4.33 | 5.929 | 592.9% |
| StratDirect3 | 2.03 | 1.24 | 1.04 | 0.74 | 3.31 | 7.579 | 757.9% |
| StratDirect4 | 2.20 | 1.98 | 0.77 | 0.69 | 3.72 | 9.061 | 906.1% |
| BusLevel3:StratDirect4 | 1.19 | 2.10 | 1.22 | -1.39 | 3.76 | 3.277 | 327.7% |
| BusLevel4:StratDirect3 | -2.15 | 1.24 | -0.79 | -1.18 | -3.12 | 0.117 | 11.7% |
| BusLevel4:StratDirect4 | 0.76 | 1.62 | 1.51 | -1.69 | 3.22 | 2.147 | 214.7% |
| SpecComm3:StratDirect3 | 2.16 | 2.15 | 0.001 | 2.15 | 2.16 | 8.626 | 862.6% |
| SpecComm4:StratDirect3 | 1.58 | 1.04 | 0.76 | 0.78 | 2.38 | 4.845 | 484.5% |
| SpecComm3:StratDirect4 | 1.30 | 2.07 | 0.51 | 0.24 | 2.36 | 3.669 | 366.9% |
| SpecComm4:StratDirect4 | 1.38 | 2.97 | 0.77 | -0.89 | 3.65 | 3.967 | 396.7% |

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

$$\left[\frac{P(Y = less)}{P(Y = moderate,\ large)}\right] = exp\,(3.78 + 1.10X_1 - 2.35X_2 + 1.81X_3 + 1.78X_4 + 2.03X_5 + 2.20X_6 + 1.19X_7 - 2.15X_8 + 0.76X_9 + 2.16X_{10} + 1.58X_{11} + 1.30X_{12} + 1.38X_{13})$$

$$\left[\frac{P(Y = less,\ moderate)}{P(Y = large)}\right] = exp\,(2.80 + 1.10X_1 - 2.35X_2 + 1.81X_3 + 1.78X_4 + 2.03X_5 + 2.20X_6 + 1.19X_7 - 2.15X_8 + 0.76X_9 + 2.16X_{10} + 1.58X_{11} + 1.30X_{12} + 1.38X_{13})$$

Business at committee level: Moderate $\beta_i = 1.10$, therefore $exp\left(\hat{\beta}_i\right) = 3.004$

Therefore a bank whose board conducts business at committee level to a moderate extent is 3 times more likely to increase performance from one level to the next compared to a bank whose board conducts business at committee level to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-8.94, 11.14] which includes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance.

This therefore implies that conducting Board business at committee level is a factor that is not statistically significant in influencing the performance of commercial banks.

Business at committee level: large $\beta_i = -2.35$, therefore $exp\left(\hat{\beta}_i\right) = 0.095$

Therefore a bank whose board conducts business at committee level to a large extent is 0.1 less likely to increase performance from one level to the next compared to a bank whose board conducts business at committee level to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-1.58, 3.12] which includes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance

Specific committees: Moderate $\beta_i = 1.81$, therefore $exp\left(\hat{\beta}_i\right) = 6.092$

Therefore a bank whose board has put in place certain specific committees to a moderate extent is 6 times more likely to increase performance from one level to the next compared to a bank whose board has put in place the specific committees to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [0.99, 2.63] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

This therefore implies that having certain specified committees within the board is a factor that is statistically significant in influencing the performance of the bank.

Specific committees: large $\beta_i = 1.78$, therefore $exp\left(\hat{\beta}_i\right) = 5.93$

Therefore a bank whose board has put in place certain specific committees to a large extent is 6 times more likely to increase performance from one level to the next compared to a bank whose board has put in place the specific committees to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-0.77, 4.33] which includes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance.

Strategic direction: moderate, $\beta_i = 2.03$ therefore $exp\left(\hat{\beta}_i\right) = 7.58$

Therefore a bank whose board offers strategic direction to a moderate extent is 7.6 times more likely to increase performance from one level to the next compared to a bank whose board offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [0.74, 3.31] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Strategic direction: large $\beta_i = 2.20$ therefore $exp\left(\hat{\beta}_i\right) = 9.06$

Therefore a bank whose board offers strategic direction to a large extent is 9 times more likely to increase profits from one level to the next compared to a bank whose board offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [0.69, 3.72] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Business at committee level: moderate and strategic direction: large

$\beta_i = 1.19$, therefore $exp\left(\hat{\beta}_i\right) = 3.277$

Therefore a bank whose board conducts business at committee level to a moderate extent and offers strategic direction to a large extent is 3.3 times more likely to increase performance from one level to the next compared to a bank whose board conducts business at committee level to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-1.39, 3.76] which includes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance.

Business at committee level: large and strategic direction: moderate

$\beta_i$ = -2.15, therefore $exp\left(\hat{\beta}_i\right)$ = 0.117

Therefore a bank whose board conducts business at committee level to a large extent and offers strategic direction to a moderate extent is 0.12 less likely to increase performance from one level to the next compared to a bank whose board conducts business at committee level to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-1.18, -3.12] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Business at committee level: large and strategic direction: large

$\beta_i$ = 0.76, therefore $exp\left(\hat{\beta}_i\right)$ = 2.147

Therefore a bank whose board conducts business at committee level to a large extent and offers strategic direction to a large extent is 2 times more likely to increase performance from one level to the next compared to a bank whose board conducts business at committee level to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-1.69, 3.22] which includes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance.

This therefore implies that combining conducting board business at committee level and offering strategic direction by the board is a factor that is or not statistically significant in influencing the performance of the bank at different levels.

Specific committees: moderate and strategic direction: moderate

$\beta_i$ = 2.16, therefore $exp\left(\hat{\beta}_i\right)$ = 8.626

Therefore a bank whose board has put in place certain specific committees to a moderate extent while strategic direction being offered by the board to a moderate extent is 8.6 times more likely to increase performance from one level to the next compared to a bank whose board has put in place the specific committees to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [2.15, 2.16] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Specific committees: large and strategic direction: moderate

$\beta_i = 1.58$, therefore $exp\left(\hat{\beta}_i\right) = 4.845$

Therefore a bank whose board has put in place certain specific committees to a large extent and offers strategic direction to a moderate extent is 4.8 times more likely to increase performance from one level to the next compared to a bank whose board has put in place the specific committees to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [0.78, 2.38] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Specific committees: moderate and strategic direction: large

$\beta_i = 1.30$, therefore $exp\left(\hat{\beta}_i\right) = 3.669$

Therefore a bank whose board has put in place certain specific committees to a moderate extent and offers strategic direction to a large extent is 3.7 times more likely to increase profits from one level to the next compared to a bank whose board has put in place the specific committees to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [0.24,

2.36] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Specific committees: large and strategic direction: large

$\beta_i = 1.38$, therefore $exp\left(\hat{\beta}_i\right) = 3.967$

Therefore a bank whose board has put in place certain specific committees to a large extent and offers strategic direction to a large extent is 4 times more likely to increase profits from one level to the next compared to a bank whose board has put in place the specific committees to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-0.89, 3.65] which includes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance.

This therefore implies that combining certain specified committees and offering strategic direction by the board is a factor that, for most levels, is statistically significant in influencing the performance of the bank

**Hypothesis 2: There is no significant relationship between establishment of Board Committees and commercial banks performance in Kenya**

The results from the regression analysis (Table 4.19) indicate that a bank whose board conducts business at committee level to a moderate extent is 3 times more likely to increase performance from one level to the next compared to a bank whose board conducts business at committee level to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives

[-8.94, 11.14] which includes 0 value. Therefore the research fails to reject the null hypothesis at the 5% level of significance and concludes that conducting business at committee level is a factor that is not statistically significant in influencing the performance of commercial banks in Kenya.

The existence of key board committees within the banks is another variable that was used to measure board committees relationship with bank performance. The findings from analysis indicate that a bank whose board has put in place certain specific board committees to a large extent is 6 times more likely to increase performance from one level to the next compared to a bank whose board has put in place the specific committees to a less extent.

Testing the null hypothesis at 95% confidence interval for co-efficient $\beta i$ gives interval [-0.77, 4.33] which includes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance and concludes that establishment of specific board committees is not a statistically significant factor that influences commercial banks performance in Kenya.

when strategic direction as a moderating variable is introduced to the relationship, it shows that a bank whose board conducts business at committee level to a moderate extent and offers strategic direction to a large extent is 3.3 times more likely to increase performance from one level to the next compared to a bank whose board conducts business at committee level to a less extent and offers strategic direction to a less extent.

Testing the null hypothesis at 95% confidence interval for co-efficient $\beta i$ gives interval [-1.39, 3.76] which includes 0 value. Therefore the research fails to reject the null hypothesis at the 5% level of significance and concludes that establishment of specific

board committees and also offering strategic direction by the board is not a statistically significant factor that influences commercial banks performance in Kenya.

The findings of this analysis are in line with what Puni (2015) found out when he examined the effect of board committees on corporate financial performance among companies listed on the Ghana Stock Exchange (GSE). The study adopted quantitative research approach to study the prognostic influence of board committee on corporate financial performance for companies listed on the Ghana Stock Exchange from 2006-2010. Data collection was from annual reports of listed companies and a static panel regression model was utilized to analyze the presence and effect of various committees on corporate financial performance. The findings from the analysis indicated that board committees had no statistical significant effect on the corporate financial performance of the listed companies.

Given that the relationship between establishment of board committees and commercial banks performance in Kenya is not significant, the research therefore fails to reject the null hypothesis which states that there is no significant relationship between establishment of board committees and commercial banks performance and rejects the alternative hypothesis that there is a significant relationship between board committees and commercial banks performance and concludes that establishment of board committees is not a statistically significant factor that influences commercial banks performance in Kenya in terms of financial, market share, service efficiency and employee skills and competency.

### 4.6.3 Compensation System and Performance of Commercial Banks

Table 4.20 shows the coefficients resulting from the regression analysis among the representing variables of compensation system, the moderating variable (offering of strategic direction by the board) and bank performance (profitability)

Regression analysis was used to test the research hypothesis, determine the existence of a significant relationship between the variables under the study and to ascertain the predictive power of Compensation system on bank performance and also ascertain the same power when strategic leadership is introduced into the relationship. Table 4.20 shows the compensation system regression analysis.

**Table 4.20: Compensation System Regression Analysis**

| Coefficients: | Estimate | | | | | Odds Ratio $exp\left(\hat{\boldsymbol{\beta}}_i\right)$ | |
|---|---|---|---|---|---|---|---|
| | Value $\beta_i$ | Std. Error | t-value | 95% C.I for OR Lower | Upper | Absolute | Percentage |
| Model 1: 2\|3 | 5.89 | 1.84 | 0.67 | | | 3.633 | 363.3% |
| Model 2: 3\|4 | -2.49 | 1.26 | 0.81 | | | 0.082 | 8.2% |
| CompSchem3 | -1.10 | 1.49 | -0.74 | -0.019 | -2.20 | 0.333 | 33.3% |
| CompSchem4 | -3.36 | 2.13 | 1.80 | 0.19 | 0.47 | 0.035 | 3.5% |
| ShareOwn3 | -0.30 | 5.01 | -0.01 | -0.27 | -0.33 | 0.742 | 74.2% |
| ShareOwn4 | -9.02 | 4.87 | 1.29 | -15.30 | -2.73 | 0.0001 | 0.0% |
| StratDirect3 | 2.14 | 3.09 | 0.20 | 1.52 | 2.76 | 8.499 | 849.9% |
| StratDirect4 | 2.48 | 0.69 | 2.40 | 0.82 | 4.14 | 1.197 | 119.7% |
| CompSchem4:StratDirect3 | 3.58 | 3.86 | 1.47 | -2.078 | 9.25 | 3.602 | 360.2% |
| CompSchem4:StratDirect4 | 3.87 | 0.69 | 2.40 | 2.21 | 5.52 | 4.770 | 477.0% |
| ShareOwn3:StratDirect3 | 3.47 | 7.81 | -0.19 | 4.95 | 9.95 | 3.214 | 321.4% |
| ShareOwn3:StratDirect4 | 4.16 | 5.57 | 0.37 | 2.09 | 6.23 | 6.407 | 640.7% |
| ShareOwn4:StratDirect4 | 5.28 | 4.60 | 1.60 | 2.07 | 12.63 | 1.972 | 197.2% |

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

$$\left[\frac{P(Y = less)}{P(Y = moderate,\ large)}\right] = exp\,(5.89 - 1.10X_1 - 3.36X_2 - 0.30X_3$$

$$-9.02X_4 + 2.14X_5 + 2.48X_6 + 3.58X_7 + 3.87X_8$$

$$+3.47X_9 + 4.16X_{10} + 5.28X_{11})$$

$$\left[\frac{P(Y = less,\ \ moderate)}{P(Y = large)}\right] \ = \ exp\,(-2.49 - 1.10X_1 - 3.36X_2 - 0.30X_3$$

$$-9.02X_4 + 2.14X_5 + 2.48X_6 + 3.58X_7 + 3.87X_8$$

$$+3.47X_9 + 4.16X_{10} + 5.28X_{11})$$

Compensation scheme: Moderate $\beta_i$ = -1.10, therefore $exp\left(\hat{\beta}_i\right)$ = 0.333

Therefore a bank which to a moderate extent has put in place a compensation scheme for top management is 0.3 less likely to increase performance compared to a bank which to a less extent has put in place a compensation scheme for its top management. . Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-0.02, -2.20] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Compensation scheme: large $\beta_i$ = -3.36, therefore $exp\left(\hat{\beta}_i\right)$ = 0.035

Therefore a bank which to a large extent has put in place a compensation scheme for top management is 0.04 less likely to increase performance compared to a bank which to less extent has put in place a compensation scheme for top management. . Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [0.20, 0.47] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

This therefore implies that putting in place a compensation scheme for top management is a factor that is statistically significant in influencing the performance of the banks.

Share ownership: moderate $\beta_i$ = -0.30, therefore $exp\,(\hat{\beta}_i)$ = 0.742

Therefore a bank which to a moderate extent has allowed members of the executive share ownership is 25.84% less likely to increase performance compared to a bank which to less extent has allowed members of the executive share ownership. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-0.27, -0.33] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Share ownership: large $\beta_i$ = -9.02, therefore $exp\,(\hat{\beta}_i)$ = 0.0001

Therefore a bank which to a large extent has allowed members of the executive share ownership is 99.9% less likely to increase performance compared to a bank which to less extent has allowed members of the executive share ownership. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-15.30, -2.73] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

This therefore implies that allowing share ownership to top executive by the board is a factor that is statistically significant in influencing the performance of the commercial banks.

Compensation scheme: large and strategic direction: moderate

$\beta_i$ = 3. 58, therefore $exp\,(\hat{\beta}_i)$ = 3.60

Therefore a bank whose board has put in place a compensation scheme for top management to a large extent and offers strategic direction to a moderate extent is 3.6 times more likely to increase performance from one level to the next compared to a bank whose board has put in place compensation scheme for top management to a less extent

and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [2.08, 9.25] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Compensation scheme: large and strategic direction: large

$\beta_i = 3.87$, therefore $exp(\hat{\beta}_i) = 4.77$

Therefore a bank whose board has put in place a compensation scheme for top management to a large extent and offers strategic direction to a large extent is 4.8 times more likely to increase performance from one level to the next compared to a bank whose board has put in place compensation scheme to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [2.21, 5.52] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Share ownership: moderate and strategic direction: moderate

$\beta_i = 3.47$, therefore $exp(\hat{\beta}_i) = 3.214$

Therefore a bank whose board has allowed members of the executive share ownership to a moderate extent and offers strategic direction to a moderate extent is 3.2 times more likely to increase profits from one level to the next compared to a bank whose board has allowed members of the executive share ownership to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [4.95, 9.95] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Share ownership: moderate and strategic direction: large

$\beta_i = 4.16$, therefore $exp(\hat{\beta}_i) = 6.41$

Therefore a bank whose board has allowed members of the executive share ownership to a moderate extent and offers strategic direction to a large extent is 6.4 times more likely to increase performance from one level to the next compared to a bank whose board has allowed members of the executive share ownership to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [2.09, 6.23] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Share ownership: large and strategic direction: large

$$\beta_i = 5.28, \quad \text{therefore} \quad exp\left(\hat{\beta}_i\right) = 1.972$$

Therefore a bank whose board has allowed members of the executive share ownership to a large extent and offers strategic direction to a large extent is 2 times more likely to increase performance from one level to the next compared to a bank whose board has allowed members of the executive share ownership to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [2.07, 12.63] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

The research therefore concludes that allowing members of the executive share ownership combined with the board offering strategic direction is a factor that is statistically significant in influencing the performance of the bank.

**Hypothesis 3: There is no significant relationship between compensation system and commercial banks performance in Kenya**

The results from the regression analysis (Table 4.20 ) indicate that a bank which to a moderate extent has put in place a compensation scheme for top management is 0.3 less

likely to increase performance from one level to another compared to a bank which to less extent has put in place a compensation scheme for top management. Testing the null hypothesis at 95% confidence interval gives βi co-efficient interval [-0.019, -2.201] which excludes 0 value.

Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that putting in place a compensation scheme for top management is a statistically significant factor that influences commercial banks performance in Kenya. This result is in line with that of Mehul and Surenderrao (2016) that examined the relationship between executive compensation and firm performance among Indian firms where the findings of the study concluded that executive compensation significantly affects firm performance measured by accounting, as well as market-based measures.

Allowing Share ownership by top management is another variable that was used to measure compensation system and the regression results from table 4.19 indicate that a bank which to a moderate extent has allowed members of the executive share ownership of the company is 0.7 more likely to increase profits from one level to another compared to a bank which to less extent has allowed members of the executive share ownership. Testing of the null hypothesis at 95% confidence interval for co-efficient βi gives [-15.30, -2.73] which excludes 0 value. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that allowing share ownership of the company by the bank top management is a statistically significant factor that influences commercial banks' performance in Kenya.

Introducing strategic leadership into the relationship as a moderating variable indicate that a bank whose board has put in place a compensation scheme for top management to a large extent and offers strategic direction to a large extent is 4.8 times more likely to increase performance from one level to the next compared to a bank whose board has put in place a compensation scheme for top management to a less extent and offers strategic direction to a less extent.

The testing of the null hypothesis at 95% confidence interval for co-efficient $\beta i$ gives [2.21, 5.52] which excludes 0 value. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that putting in place a compensation system for top management while offering strategic direction by the board is a statistically significant factor that influences commercial banks performance in Kenya. These findings agree with the study by Mehul and Surenderrao (2016) which examined the relationship between executive compensation and firm performance among Indian firms, based on the empirical findings the study concluded that executive compensation is a factor that significantly affects firm performance.

These findings further agree with the agency theory where according to 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 (managers). 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). This governance structure according to Anderson and Reeb, (2004) involves for instance, creating procedures for reporting, additional management, or a Board of Directors. 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). Compensation plan incentive and pay is a good example of this type of structural mechanism, where the agent's pay is as an incentive for high organizational performance (Chrisman et al., 2007). With this arrangement, the risk is therefore moved or transferred to the agent and this creates the motivation for the agent to align his actions and behaviour with the principal's interest (Chrisman et al., 2007).

According to Stewardship theory managers protect and maximize shareholder wealth through firm performance and therefore, the theory sees a strong relationship between success of the firm and the managers. Corbetta and Salvato (2004) asserts that Successful performance improvement by a steward satisfies most stakeholder groups in an organization, when these groups have interests that are well served by increasing organizational wealth. The power to determine strategy and the fate of the organization is the responsibility of a single person when the position of the chairman and the CEO is held by a single person in an organization, thus rather than control and monitor the focus of stewardship theory is on structures that empower and facilitate the workings of the managers including giving them good compensation (Corbetta & Salvato, 2004).

Given that the relationship between compensation system for top management and commercial banks performance is significant, the study hence rejects the null hypothesis that there is no significant relationship between compensation system and commercial banks performance and fails to reject the alternative hypothesis that there is a significant relationship between compensation system and commercial banks performance and therefore concludes that putting in place a compensation mechanism for the top bank

management is a factor that significantly influences performance of commercial banks in terms of financial, market share, service delivery and employee skills and competency.

### 4.6.4 Risk Management and Performance of Commercial Banks

Table 4.21 shows the coefficients resulting from the regression analysis among the representing variables of risk management, the moderating variable (offering of strategic direction by the board) and bank performance.

Regression analysis was used to test the research hypothesis, determine the existence of a significant relationship between the variables under the study and to ascertain the predictive power of Risk Management on bank performance and also ascertain the same power when strategic leadership is introduced into the relationship. Table 4.21 shows risk management regression analysis.

**Table 4.21: Risk Management Regression Analysis**

| Coefficients: | Estimate | | | | | Odds Ratio $exp\left(\hat{\beta}_i\right)$ | |
|---|---|---|---|---|---|---|---|
| | Value $\beta_i$ | Std. Error | t-value | 95% C.I for OR Lower | Upper | Absolute | Percentage |
| Model 1: 2\|3 | 2.94 | 8.49 | 3.47 | | | 1.898 | 189.8% |
| Model 2: 3\|4 | 4.64 | 8.50 | 3.46 | | | 1.039 | 103.9% |
| RiskMngnt3 | 5.96 | 3.09 | 2.84 | 2.82 | 14.73 | 3.868 | 386.8% |
| RiskMngnt4 | -3.64 | 6.73 | 1.22 | -11.86 | 4.58 | 0.026 | 2.6% |
| ContrRisks | -2.59 | 7.42 | 0.74 | -8.07 | 2.87 | 0.074 | 7.4% |
| EncterRisks | 4.07 | 0.49 | 2.17 | 3.00 | 5.13 | 5.826 | 582.6% |
| NonPerfgLoans | 1.67 | 3.12 | -0.28 | -2.54 | -0.80 | 0.188 | 18.8% |
| StratDirect3 | 3.19 | 2.14 | 0.72 | 1.65 | 4.7 | 2.434 | 243.4% |
| StratDirect4 | 4.69 | 8.46 | 3.48 | -24.75 | 34.13 | 1.093 | 109.3% |
| StratDirect5 | 4.96 | 3.38 | 4.56 | -10.45 | 20.37 | 1.429 | 142.9% |
| RiskMngnt3:StratDirect3 | 4.58 | 2.09 | 1.81 | 0.78 | 8.38 | 9.749 | 974.9% |
| RiskMngnt4:StratDirect3 | 2.96 | 2.30 | 2.70 | 3.26 | 9.18 | 1.934 | 193.4% |
| RiskMngnt4:StratDirect4 | 4.73 | 3.73 | 1.26 | 0.019 | 9.44 | 1.129 | 112.9% |
| ContrRisks:StratDirect4 | 5.11 | 2.42 | 0.72 | 3.35 | 6.87 | 1.66 | 166% |
| EncterRisks:StratDirect3 | 6.19 | 5.83 | 0.34 | 4.23 | 8.17 | 4.917 | 491.7% |
| NonPerfgLoans:StratDirect4 | 4.24 | 3.12 | 0.29 | 3.31 | 5.16 | 6.919 | 692% |

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

$$\left[\frac{P(Y = less)}{P(Y = moderate,\ large)}\right] = exp\,(2.94 + 5.96X_1 - 3.64X_2 - 2.59X_3 + 4.07X_4 + 1.67X_5 + 3.19X_6 + 4.69X_7 + 4.96X_8 + 4.58X_9 + 2.96X_{10} + 4.73X_{11} + 5.11X_{12} + 6.19X_{13} + 4.24X_{14})$$

$$\left[\frac{P(Y = less,\ moderate)}{P(Y = large)}\right] = exp\,(4.64 + 5.96X_1 - 3.64X_2 - 2.59X_3 + 4.07X_4 + 1.67X_5 + 3.19X_6 + 4.69X_7 + 4.96X_8 + 4.58X_9 + 2.96X_{10} + 4.73X_{11} + 5.11X_{12} + 6.19X_{13} + 4.24X_{14})$$

Risk management policy: moderate $\beta_i = 5.96$, therefore $exp\left(\hat{\beta}_i\right) = 3.87$

Therefore a bank which has put in place risk management policy to a moderate extent is 3.9 times more likely to increase performance from one level to the next compared to a bank which has put in place risk management policy to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [2.82, 14.73] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Risk management policy: large $\beta_i = -3.64$, therefore $exp\left(\hat{\beta}_i\right) = 0.0262$

Therefore a bank whose board has put in place risk management policy to a large extent is 0.02 less likely to increase performance from one level to the next compared to a bank whose board has put in place risk management policy to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-11.86, 4.58] which includes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance.

Control risks in dealings: $\beta_i$ = -2.59, therefore $exp\left(\hat{\beta}_i\right)$ = 0.0744

Therefore a bank which has put in place control of risks in dealings to a moderate or large extent is 0.07 less likely to increase performance from one level to the next compared to a bank which has put in place control of risks in dealings to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-8.07, 2.87] which includes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance.

Encountered risky transactions: $\beta_i$ = 4.07, therefore $exp\left(\hat{\beta}_i\right)$ = 5.83

Therefore a bank which has encountered risky transactions in the last one year to a moderate or large extent is about 5.8 times more likely to increase performance from one level to the next compared to a bank which has encountered risky transactions in the last one year to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [3.01, 5.13] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Non-performing loans reduced: $\beta_i$ = 1.67, therefore $exp\left(\hat{\beta}_i\right)$ = 0.1882

Therefore a bank which has managed to reduce non-performing loans to a moderate or large extent is 0.2 more likely to increase performance from one level to the next compared to a bank which has managed to reduce non-performing loans to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [-2.54, -0.80] which excludes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance.

Risk management: moderate and strategic direction: moderate

$$\beta_i = 4.58, \quad \text{therefore} \quad exp\left(\hat{\beta}_i\right) = 9.749$$

Therefore a bank whose board has put in place risk management policy to a moderate extent and also offers strategic direction to a moderate extent is 9.7 times more likely to increase performance from one level to the next compared to a bank whose board has put in place risk management policy to a less extent and also offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [0.78, 8.38] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Risk management: large and strategic direction: moderate

$$\beta_i = 2.96, \quad \text{therefore} \quad exp\left(\hat{\beta}_i\right) = 1.934$$

Therefore a bank whose board has put in place risk management policy to a large extent and also offers strategic direction to a moderate extent is 1.9 times more likely to increase performance from one level to the next compared to a bank whose board has put in place risk management policy to a less extent and also offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [3.26, 9.18] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Risk management: large and strategic direction: large

$$\beta_i = 4.73, \quad \text{therefore} \quad exp\left(\hat{\beta}_i\right) = 1.129$$

Therefore a bank whose board has put in place risk management policy to a large extent and also offers strategic direction to a large extent is 1.1 times more likely to increase performance from one level to the next compared to a bank whose board has put in place risk management policy to a less extent and also offers strategic direction to a less extent.

Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [0.02, 9.44] which excludes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance.

Control risks in dealings: and strategic direction: large

$\beta_i$ = 5.11, therefore $exp\left(\hat{\beta}_i\right)$ = 1.660

Therefore a bank which has put in place control of risks in dealings to a moderate or large extent and also offers strategic direction to a large extent is 1.7 times more likely to increase performance from one level to the next compared to a bank which has put in place control of risks in dealings to a less extent and also offers strategic direction to a less extent. . Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [3.35, 6.87] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance

This implies that putting in place control of risks in dealings and also offering of strategic direction by the board is a factor that is statistically significant in influencing the performance of the banks.

Encountered risky transactions: and strategic direction: moderate

$\beta_i$ = 6.198, therefore $exp\left(\hat{\beta}_i\right)$ = 4.92

Therefore a bank which has encountered risky transactions in the last one year to a moderate or large extent and also offers strategic direction to a moderate extent is 4.9 times more likely to increase performance from one level to the next compared to a bank which has encountered risky transactions in the last one year to a less extent and also offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence

interval for co-efficient βi gives interval [4.23, 8.17] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

Non-performing loans reduced: and strategic direction: large

$\beta_i = 4.237$, therefore $exp\left(\hat{\beta}_i\right) = 6.91$

Therefore a bank which has reduced non-performing loans in the last three years to a moderate or large extent and also offers strategic direction to a large extent is 6.9 times more likely to increase performance from one level to the next compared to a bank which has reduced non-performing loans in the last three years to a less extent and also offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [3.31, 5.16] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

The research therefore concludes that reduction of non-performing loans in the last three years and also offering of strategic direction by the board is a factor that is statistically significant in influencing the performance of the banks.

**Hypothesis 4: There is no significant relationship between risk management and commercial banks performance in Kenya**

Results from regression (Table 4.21) reveals that a bank whose board has put in place risk management policy to a moderate extent is 3.9 times more likely to increase performance from one level to the next compared to a bank whose board has put in place risk management policy to a less extent. Testing the null hypothesis under this parameter at 95% confidence interval for co-efficient βi is [2.81, 14.73] which excludes 0 value. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that having risk management policy in place by the board is a statistically

significant factor that influences commercial banks performance in Kenya in terms of financial, market share, service delivery and employee skills and competency.

When offering of strategic direction as a moderating variable is introduced into the relationship, the results show that a bank whose board has put in place risk management policy to a large extent and also offers strategic direction to a large extent is 1.1 times more likely to increase performance from one level to the next compared to a bank whose board has put in place risk management policy to a less extent and also offers strategic direction to a less extent. Testing of the null hypothesis at 95% confidence interval for co-efficient $\beta i$ gives [0.018, 9.43] which excludes 0 value. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that putting in place a risk management policy while offering strategic leadership at the same time is a statistically significant factor that influences the performance of commercial banks in Kenya in terms of financial, market share, service delivery and employee skills and competency.

Reduction of non-performing loans is another parameter that is used to measure risk management. Results from table 4.21 indicate that a bank which has managed to reduce non-performing loans to a moderate or large extent is 0.2 more likely to increase performance from one level to the next compared to a bank which has managed to reduce non-performing loans to a less extent. Testing of the null hypothesis at 95% confidence interval for co-efficient $\beta i$ gives [-2.54, -0.80] which excludes 0 value. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that putting mechanisms in place to deal with risky transactions such as non-performing loans is a statistically significant factor that influences the performance of commercial banks in

Kenya. These findings agree with those of the study by Mumbi and Omagwa (2017) which looked at the impact of credit risk management on financial performance of selected commercial banks in Kenya. The study employed descriptive research design while probability method of sampling was used to obtain a sample of forty two (42) respondents from five banks. Data was collected using questionnaires. Empirical evidence from this study indicated that the effect of credit risk management on financial performance of commercial banks in Kenya is positive. The study also found that debt recovery process does not have significant effect on bank performance whereas lending requirements, loan appraisal process, and credit policies were discovered to have a significant effect on bank performance. The study concluded that to maximize a bank's risk adjusted rate of return, the banks need to maintain credit risk exposure within acceptable parameters.

Another study by Olayinka et al. (2018) investigated the impact of risk governance on the performance of money deposit banks in Nigeria where 11 banks were sampled out of 15 listed banks in Nigeria for the period between 2012 to 2016. The risk governance variables were proxied by presence of Chief risk Officer (CRO), Chief Risk Officer Centrality (CRO), Board Risk Committee Independence (BRC), Board Risk Committee Activism (BRC), Board of Director Independence (BOD independence), and Enterprise Risk Management Score (ERM-score) while the study controlled for other variables such as audit committee independence, firm size, cost to income ratio, board size and loan. Return on assets (ROA) was used to measure Bank performance. The revelation of the empirical finding was that except CRO centrality all other explanatory variables have a positive and significant impact on the performance of listed banks in Nigeria.

From the findings that the relationship between risk management and commercial banks performance is significant, the study rejects the null hypothesis that there is no significant relationship between risk management and commercial banks performance and fails to reject the alternative hypothesis that there is a significant relationship between risk management and commercial banks performance and further concludes that risk management is a factor that significantly influences commercial banks performance in terms of financial, market share, service delivery, employee skills and competency.

**Hypothesis 5: Strategic leadership has no significant moderating effect on the relationship between corporate governance practices and commercial banks performance in Kenya.**

Strategic leadership measured by giving of strategic direction by the board is used as a moderating or interaction variable in the relationship between the various Corporate Governance practices variables and performance of commercial banks which is the response variable. Table 4.18 shows 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 performance from one level to the next compared to a bank whose board 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 Board of Directors' composition combined

with offering strategic leadership by the board is a statistically significant factor that affects the performance of commercial banks in Kenya.

The results from table 4.19 combining board committees and strategic direction indicate that a bank whose board combines conducting business at committee level to a moderate extent and offers strategic direction to a large extent is 3.3 times more likely to increase performance from one level to the next compared to a bank whose board conducts business at committee level to a less extent and has put in place strategic direction to a less extent.

Testing of the null hypothesis at 95% confidence interval for co-efficient βi gives [-1.39, 3.76] which includes 0 value. Therefore the research fails to reject the null hypothesis at the 5% level of significance and concludes that combining conducting business at committee level and offering strategic direction by the board is a factor that is not statistically significant in influencing the performance of the banks.

When combining Compensation system and offering strategic leadership, table 4.20 indicate that a bank whose board has put in place a compensation scheme for top management to a large extent and offers strategic direction to a large extent is 4.8 times more likely to increase profits from one level to the next compared to a bank whose board has put in place compensation scheme to a less extent and offers strategic direction to a less extent.

Testing of the null hypothesis at 95% confidence interval for co-efficient βi gives [2.21, 5.52] which excludes 0 value. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that putting in place a compensation scheme for top

management of the bank and offering strategic direction by the board is a factor that is statistically significant in influencing the performance of commercial banks in Kenya.

The results from table 4.21 combining risk management and strategic direction indicate that a bank whose board has put in place risk management policy to a large extent and also offers strategic direction to a large extent is 1.1 times more likely to increase performance from one level to the next compared to a bank whose board has put in place risk management policy to a less extent and also offers strategic direction to a less extent.

Testing of the null hypothesis at 95% confidence interval for co-efficient $\beta i$ gives [0.0187, 9.435] which excludes 0 value. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that putting in place risk management mechanisms and offering strategic leadership by the board is a factor that is statistically significant in influencing the performance of commercial banks in Kenya.

Generally, combining strategic leadership with the four independent variables leads to the rejection of null hypotheses except for board committees where the research fails to reject the null hypothesis. We therefore conclude that strategic leadership moderates the relationship between corporate governance practices 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 corporate governance practices and performance of commercial banks in Kenya.

These findings 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. Although there are some studies within economic, finance and management literature that show that board composition, compensation system and risk management have no significant relationship with performance of the organization, empirical findings from this study indicate a contrary opinion from the previous studies. This study reveals that these variables have a significant relationship with commercial banks performance in Kenya and this is an indicator that governance variables are not static, they change with time as the environment keep on changing.

# CHAPTER FIVE

# SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

## 5.1 Introduction

This chapter presents a summary of the findings, conclusions and makes recommendations out of the analysis results given in the preceding chapter. Results summary is given in relation to the theoretical and empirical literature. The conclusions are made directly from the study objectives while on the other hand recommendations are derived from the conclusions and findings discussion.

## 5.2 Summary of Findings

The main study objective was to examine the relationship between corporate governance practices, strategic leadership and commercial banks performance in Kenya. Principal component analysis was used in the study to deal with the issue of multicollinearity where the numbers of measuring variables were reduced to fewer constructs that can clearly explain the influence of each variable on bank performance. The corporate governance practices variables are board composition, board committees, compensation system and risk management. Bank performance indicators are profitability, market share, service delivery and employee skills and competency, while strategic leadership is the moderating variable. Ordinal logistic regression analysis using R technique and SPSS software were used to analyze data as contextualized in the previous chapter.

Empirical findings from this study are mixed with More results indicating a significant relationship between Corporate Governance Practices and Bank Performance whereas a few results show no significant relationship between corporate governance practices and

bank performance, so is the case when the moderating variable is introduced into the relationship.

### 5.2.1 Relationship between Board of Directors' Composition and Commercial Banks Performance in Kenya

Board of directors' composition is found to have a statistically significant relationship with the performance of commercial banks and so is found to be the case when strategic leadership by the board is introduced in the relationship. The empirical findings of this study for example show that having more than 1/3 of the board members as non-executive directors give the coefficients;

Non-executive directors: large $\beta_i = 3.21$, therefore $exp\left(\hat{\beta}_i\right) = 2.47$

This shows that a bank whose board has non-executive directors to a large extent is 2.5 times more likely to increase performance from one level to the next compared to a bank which has non-executive directors to a less extent.Testing this null hypothesis at 95% confidence interval for co-efficient βi gave interval [1.23, 5.18] which excludes 0. 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 influences the performance of commercial banks in Kenya.

### 5.2.2 Relationship between Establishment of Board Committees and Performance of Commercial Banks in Kenya

The relationship between establishment of board committees and performance of Banks in Kenya is generally found not being significant. Introducing strategic leadership into the relationship still shows no amount of significance in terms of influencing the

performance of commercial banks. This findings could be attributed to the fact that as long as the board is effective at its own level then the various committees only serve to duplicate the work of the entire board and also some board sizes are too small to guarantee enough members to be able to effectively serve in the various committees needed by the commercial banks.

The empirical findings of this study for example show that conducting board business at committees' level gives the coefficients;

Business at committee level: Moderate $\beta_i$ = 1.100, therefore $exp\left(\hat{\beta}_i\right)$ = 3.004

This shows that a bank whose board conducts business at committee level to a moderate extent is 3 times more likely to increase performance from one level to the next compared to a bank whose board conducts business at committee level to a less extent. Testing this null hypothesis at 95% confidence interval for co-efficient βi gives interval [-8.94, 11.14] which includes 0. Therefore the research fails to reject the null hypothesis at the 5% level of significance and concludes that conducting business at committee level by the board is a factor that is not statistically significant in influencing the performance of commercial banks in Kenya.

### 5.2.3 Relationship between Compensation System and Commercial Banks Performance in Kenya

The relationship between establishment of compensation system for the top bank management and performance of commercial Banks is found to be significant and so is the case when strategic leadership is introduced into the relationship. These findings agree with both empirical and theoretical related literature. This could be attributed to the

fact that good remuneration serves as a motivator for the top executive and allowing them share ownership of the organization makes them align their interests to that of the other shareholders thereby reducing agency problems and consequently leading to high performance. The empirical findings of this study for example show that allowing the top bank management share ownership of the bank gives the coefficients;

Share ownership: moderate $\beta_i$ = -0.30, therefore $exp\left(\hat{\beta}_i\right)$ = 0.74

This shows that a bank which to a moderate extent has allowed members of the executive share ownership is 0.7 less likely to increase performance from one level to the next compared to a bank which to less extent has allowed members of the executive share ownership. Testing this null hypothesis at 95% confidence interval for co-efficient βi gives interval [-0.27, -0.33] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that allowing members of the top management share ownership of the bank is a factor that is statistically significant in influencing the performance of commercial banks in Kenya.

### 5.2.4 Relationship between Risk Management and Commercial Banks Performance in Kenya.

The relationship between Risk management and commercial banks performance in Kenya is also found to be significant; putting in place risk management policy and being able to detect and control risky transactions has a significant impact in the commercial banks performance in Kenya. These findings agree with the existing literature about risk management and organizational performance. A majority of the respondents indicated that banks have managed to reduce the level of non-performing loans only to a moderate extent thereby indicating that the level of credit risk is still high in the banking industry

which could be derailing performance. The empirical findings of this study for example show that putting in place a risk management policy for the bank by the board gives the coefficients:

Risk management policy: Moderate $\beta_i = 5.96$, therefore $exp\left(\hat{\beta}_i\right) = 3.87$

This indicates that a bank which has put in place risk management policy to a moderate extent is 3.9 times more likely to increase performance from one level to the next compared to a bank which has put in place risk management policy to a less extent. Testing this null hypothesis at 95% confidence interval for co-efficient βi gives interval [2.818, 14.733] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that risk management is a factor that is statistically significant in influencing the performance of commercial banks in Kenya.

### 5.2.5 Moderating Effect on the Relationship between Corporate Governance Practices and Commercial Banks Performance in Kenya

Strategic leadership is found to have a statistically significant moderating effect on the relationship between corporate governance practices and commercial banks performance in Kenya. Except for the establishment of board committees, the rest of the variables show a statistically significant moderated effect by strategic leadership. The empirical findings of this study for example show that introducing strategic leadership as an interaction variable between board composition and bank performance gives the coefficients;

Non-executive directors: large and strategic direction: moderate

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

This shows that a bank whose board is composed of non-executive directors to a large extent and the board offers strategic direction to a moderate extent is 3.7 times more likely to increase performance from one level to the next compared to a bank which has non-executive directors to a less extent and offers strategic direction to a less extent. Testing this null hypothesis at 95% confidence interval for co-efficient βi gives interval [7.55, 10.11] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance and concludes that having a sizeable number of non-executive directors in the board and strategic direction offered by the board is a factor that is a statistically significant in influencing the performance of the bank.

The regression coefficients for Board committees are:

Business at committee level: large and strategic direction: large

$\beta_i = 0.76$, therefore $exp\left(\hat{\beta}_i\right) = 2.147$

This indicates that a bank which combines conducting business at committee level to a large extent with strategic direction being offered by the board to a large extent is 2 times more likely to increase performance from one level to the next compared to a bank which conducts business at committee level to a less extent and offers strategic direction to a less extent.

Testing this null hypothesis at 95% confidence interval for co-efficient βi gives interval [-1.688, 3.216] which includes 0.Therefore the research fails to reject the null hypothesis at the 5% level of significance and concludes that conducting business at committee level and offering strategic direction by the board is a factor not statistically significant in influencing commercial banks performance in Kenya.

The regression coefficients for compensation system are:

Share ownership: large and strategic direction: large

$$\beta_i = 5.28, \quad \text{therefore} \quad exp\left(\hat{\beta}_i\right) = 1.972$$

This shows that a bank whose board has allowed members of the executive share ownership to a large extent and offers strategic direction to a large extent is 2 times more likely to increase performance from one level to the next compared to a bank whose board has allowed members of the executive share ownership to a less extent and offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [2.07, 12.63] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

The research therefore concludes that allowing members of the executive share ownership combined with the board offering strategic direction is a factor that is statistically significant in influencing the performance of the bank.

The regression coefficients for risk management are:

Non-performing loans reduced: and strategic direction: large

$$\beta_i = 4.237, \quad \text{therefore} \quad exp\left(\hat{\beta}_i\right) = 6.91$$

This indicates that a bank which has reduced non-performing loans in the last three years to a moderate or large extent and also offers strategic direction to a large extent is 6.9 times more likely to increase performance from one level to the next compared to a bank which has reduced non-performing loans in the last three years to a less extent and also offers strategic direction to a less extent. Testing the null hypothesis at 95% confidence interval for co-efficient βi gives interval [3.31, 5.16] which excludes 0. Therefore the research rejects the null hypothesis at the 5% level of significance.

The research therefore concludes that reduction of non-performing loans in the last three years and also offering of strategic direction by the board is a factor that is statistically significant in influencing commercial banks performance in Kenya. Table 5.1 highlights the summary of hypotheses test findings.

**Table 5.1: Summary of Research Objectives, Hypotheses and Test Results**

| Research objectives | Null Hypotheses | Hypotheses test results |
|---|---|---|
| **Objective 1**<br>To establish the relationship between board of directors' composition and performance of commercial banks in Kenya. | **Hypothesis 1**<br>There is no significant relationship between Board of directors' composition and Commercial Banks performance in Kenya | **False**<br>**( Rejected)** |
| **Objective 2**<br>To determine the relationship between establishment of board committees and commercial banks performance in Kenya | **Hypothesis 2**<br>There is no significant relationship between establishment of board committees and commercial banks performance in Kenya | **True**<br>**( Failed To Reject)** |

| Objective | Hypothesis | Result |
| --- | --- | --- |
| **Objective 3**<br>To determine the relationship between compensation system and commercial banks performance in Kenya | **Hypothesis 3**<br>There is no significant relationship between compensation system and commercial banks performance in Kenya | **False ( Rejected)** |
| **Objectives 4**<br>To establish the relationship between risk management and commercial banks performance in Kenya | **Hypothesis 4**<br>There is no significant relationship between risk management and commercial banks performance in Keny. | **False ( Rejected)** |
| **Objective 5**<br>To examine the moderating effect of strategic leadership on the relationship between corporate Governance practices and commercial banks performance in Kenya. | **Hypothesis 5**<br>Strategic leadership has no significant moderating effect on the relationship between Corporate Governance Practices and performance of commercial banks in Kenya. | **False (Rejected)** |

### 5.3 Conclusion

The examination of the relationship between corporate governance practices, strategic leadership and commercial banks performance in Kenya was the main objective of this study. Given the empirical findings, this study therefore concludes there is a statistically significant relationship between corporate governance practices and commercial banks performance in Kenya.

The study concludes there is a statistically significant relationship between board of director's composition and commercial banks performance in Kenya. Board of Directors' composition variables like board size, gender, professional qualifications of the board members, ethnic diversity of board members , number of non-executive directors are all critical factors that significantly influence the performance of the boards and ultimately performance of the banks.

The study further concludes that there is a significant relationship between establishment of a compensation system for top management and commercial banks performance in Kenya. Compensation system variables like Compensation scheme for top bank management, allowing top management share ownership of the banks. Payment of executive perks and Bonus system that is performance based significantly affect commercial banks performance in Kenya. There is a statistically significant relationship between risk management and commercial banks performance in Kenya. Risk management variables like risk identification, risk measurement, risk monitoring and risk control are all critical factors that significantly influence commercial banks performance in Kenya. This study however concludes that there is no statistically significant relationship between establishment of board committees and commercial banks

performance in Kenya. Board committees' variables like conducting a majority of the board business at the committee level and putting in place various specific board committees are not critical factors that significantly affect commercial banks performance in Kenya. Therefore commercial banks in Kenya should focus their efforts in other factors away from board committees if they are to improve their performance.

The study further concludes that offering strategic leadership by the board of directors is a statistically significant factor that moderates the relationship between governance practices and commercial banks performance 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 governance practices and commercial banks performance in Kenya.

## 5.4 Recommendations

This study presents two sets of recommendations based on the findings namely:

Recommendations on policy and further research areas.

### 5.4.1 Policy Recommendation

Regarding the findings that board composition has a statistically significant relationship with commercial banks performance in Kenya, Banks should constitute boards whose sizes are relative to the size of the banks; first tier banks should have more board members compared to second and third tier banks to enable them cover all the key areas of their operations. These boards should reflect diversity in terms of professional

background, gender, ethnicity and a substantial portion of their members should be non-executive directors.

Given the findings that the relationship between establishment of compensation system for top management and commercial banks performance in Kenya is significant, Board of Directors should establish a system of compensation for top management that is performance based and top executive should be allowed share ownership of these banks, this will induce the top management to align their interests to the interest of other shareholders and subsequently work to improve the performance of these banks.

In view of the findings that risk management has a significant relationship with commercial banks performance in Kenya, Commercial banks should invest in risk management systems that are able to monitor, detect and control risky transactions as opposed to the generic methods of know your customers (KYC), that way they will significantly reduce risky transactions like non-performing loans. Since the findings of this study reveal that there is significant moderating effect of strategic leadership on the relationship between corporate governance practices and commercial banks performance in Kenya, Boards of Directors should offer strategic management leadership, they should draw strategic plans detailing clear strategic objectives on key areas of operation like finance, human resource, credit and customer. The same should clearly be disseminated to all bank employees with the view to having them buy in and direct their efforts to productive areas. 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.

### 5.4.2 Areas for Further Research

Since this study recognized that some variables outside corporate Governance like economic, social, corruption, bureaucracy, and political disruptions could also be instrumental in determining performance within the Kenyan banks. This study therefore recommends further research to be conducted to explore how the said factors could be influencing performance in the Kenyan banking sector.

There exist many variables of corporate governance whose underlying effects on organizational performance should be understood. These variables are: audit committees, board of directors, insider ownership, ordinary and executive director compensation, corporate by-laws, progressive practices and director characteristics among others. Because this study is only limited to four variables, further studies should be carried out using other variables so as to holistically bring out the relationship between corporate governance practices and commercial banks performance.

Since the scope of this study is limited to the banking industry in Kenya, further studies should be carried out in other sectors of the economy in order to holistically bring out the relationship between corporate governance practices and firm performance.

## 5.5 Contribution to Knowledge

This study contributes to understanding the link between corporate governance practices and firm performance, while at the same time confirms the findings of previous studies that have found a significant link between corporate governance practices and firm performance, for example a study by Ashraf et al. (2015) on the relationship between performance and corporate governance variables of all listed banks in Saudi Arabia

where 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. The results of this study show a significant positive relationship between governance variables and performance of banks, this study however focused on two variables only hence the findings could be inconclusive.

The current study considered the relationship between corporate governance practices and commercial banks performance in Kenya while incorporating strategic leadership as a moderating variable to this relationship. This study therefore brings out an increased understanding that the combination effect of the study variables is greater than the individual effects and enriches literature in this area.

Previous studies have also taken a narrow view when it comes to examining performance of organizations since they concentrate on the financial performance aspect only at the expense of other organizational performance metrics; this study however embraced the Balanced Score Card model approach and looked at the bank performance from the four perspectives namely: Financial, customer, internal processes, learning and growth. This approach therefore brings out an increased understanding on organizational performance and helps enrich literature in this area.

This study adopted ordinal logistic regression model in data analysis methodology thereby bringing out and enriching literature in research methodology since none of the literature reviewed has adopted the use of this model. This therefore contributes to scholarly work on research methodology and broadening the thinking around data analysis by providing an alternative view as far as analysis of ordinal data is conc

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# APPENDICES

## Appendix i: Survey Questionnaire

My name is Daniel Barante. I am a PhD student at Machakos University, kindly answer the various questions on the questionnaire provided. Questionnaires collected from respondents will be treated with utmost confidentiality. This study is a university requirement before the award of the degree in business administration. *The purpose of this study is to investigate the relationship between corporate Governance practices, strategic leadership and the performance of commercial banks in Kenya***.**

### PART I: Background Information

**Kindly answer all the questions either by ticking (√) in the Boxes or writing in the spaces provided.**

1) Name of the Bank (**optional**) ________________________

2) Name of the respondent (**optional**) ________________________

3) Gender: Male ☐ Female ☐

4) Number of years served in the bank board

1-3 Years ☐ 4-6 Years ☐ 7-10 Years ☐ more than 10 Years ☐

5) What is your highest level of education?

Certificate ☐ Diploma ☐ Degree ☐ Masters ☐ PhD ☐

6) How many members does your board have?

___________________________________

7) What position do you hold in your board? _________________________________

**PART II: Variable questions**

Kindly indicate by ticking (√) the extent to which you agree or disagree with the following statements on corporate governance practices, strategic leadership and bank performance

Use the scale:

1= Not at all (NAA)   2 = Less extent (LE)   3 = Moderate extent (ME)   4 = Large extent (LE)   5 = Very large extent (VLE

**SECTION ONE: Board composition**

**8)** Please respond to the following statements by ticking in the appropriate box corresponding to each statement

| **S N** | **Board composition** | **Very large extent** | **Large extent** | **Moderate extent** | **Less extent** | **Not at all** |
|---|---|---|---|---|---|---|
| **i** | Our board is comprised of people from different professional backgrounds | | | | | |
| **ii** | Our board is comprised of people from different ethnic background | | | | | |
| **iii** | More than 1/3 of the board members are non-executive directors | | | | | |
| **iv** | The number of female members on our board is representative enough for decision making | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| **v** | The number of members on our board is sufficient such that no one feels overworked | | | | | |
| **vi** | Board composition is something that affects the performance of the bank | | | | | |

**SECTION TWO: Board Committees**

**9)** Please respond to the following statements by ticking in the appropriate box corresponding to each statement

| **SN** | **Board committees** | **Very large extent** | **Large extent** | **Moderate extent** | **Less extent** | **Not at all** |
|---|---|---|---|---|---|---|
| **i** | Our Board is divided into different functional committees | | | | | |
| **ii** | Majority of the board business is conducted at the committees level | | | | | |
| **iii** | At least our board has the following committees in place: Audit, credit, compensation & HR committees | | | | | |
| **iv** | The various committees of our board are effective in doing their work | | | | | |
| **v** | Dividing the work of the board into various committees is something | | | | | |

| | that affects the performance of the bank | | | | | |
|---|---|---|---|---|---|---|

## SECTION THREE: Compensation System

10) Please respond to the following statements by ticking in the appropriate box corresponding to each statement

| SN | Compensation system | Very large extent | Large extent | Moderate extent | Less extent | Not at all |
|---|---|---|---|---|---|---|
| **i** | Our Board has put in place a compensation scheme for top management | | | | | |
| **ii** | Apart from monthly salary our bank executive enjoy some of the best perks in the industry | | | | | |
| **iii** | Our board has put in place a competitive bonus system that is paid to its members and the executive based on performance | | | | | |
| **iv** | members of the executive are allowed share ownership of the bank | | | | | |
| **v** | Having executive compensation system in place is something that affects the overall performance of the bank | | | | | |

**SECTION FOUR: Risk Management**

11) Please respond to the following statements by ticking in the appropriate box corresponding to each statement

| SN | Risk management | Very large extent | Large extent | Moderate extent | Less extent | Not at all |
|---|---|---|---|---|---|---|
| **i** | Our board has put in place a risk management policy for the bank | | | | | |
| **ii** | Our board has put in place mechanisms to be able to identify risk transactions | | | | | |
| **iii** | The mechanisms we have in place are able to help bank employees measure the level of risk in any transaction | | | | | |
| **iv** | We have put in place mechanisms that are good enough to enable us monitor all risky transactions | | | | | |
| **v** | As a bank we are able to identify,measure,monitor and control all forms of risks in our dealings | | | | | |
| **vi** | Our bank has encountered so many risky transactions in the last one year | | | | | |
| **vii** | The number of non-performing loans has reduced significantly for the last three years | | | | | |
| **viii** | Having a risk management policy in | | | | | |

| | place is something that affects the overall bank performance. | | | | | |
|---|---|---|---|---|---|---|

**SECTION FIVE: Strategic Leadership**

12) Please respond to the following statements by ticking in the appropriate box corresponding to each statement

| SN | Strategic leadership | Very large extent | Large extent | Moderate extent | Less extent | Not at all |
|---|---|---|---|---|---|---|
| **i** | As a board we always offer strategic direction for the bank by developing a vision, mission and strategic objectives | | | | | |
| **ii** | As a board we are committed to innovation in terms of products and services | | | | | |
| **iii** | Our bank has pioneered and introduced new products in the industry for the last three years | | | | | |
| **iv** | Our IT systems and internal operation processes are stakeholder friendly in terms of turnaround time | | | | | |
| **v** | As a board we put the customer at the centre of whatever we do and we have a customer service charter in place. | | | | | |
| **vi** | As a board we are always flexible | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| | and ready to adapt the bank to the changing business environment. | | | | | |
| **vii** | Having a leadership that is strategic is something that affects our governance and the overall bank performance | | | | | |

**SECTION SIX: Bank Performance**

13) Please respond to the following statements by ticking in the appropriate box corresponding to each statement**.**

| **SN** | **Bank performance** | **Very large extent** | **Large extent** | **Moderate extent** | **Less extent** | **Not at all** |
|---|---|---|---|---|---|---|
| **i** | Our bank profitability has continued to increase for the last three years | | | | | |
| **ii** | We have enhanced the employment and working conditions for our employees for the last three years | | | | | |
| **iv** | Our market share has increased significantly for the last three years | | | | | |
| **v** | Our systems are easy to use and offer quick customer solutions | | | | | |

**Thank you for your time and cooperation.**

Appendix ii**: Questionnaire Responses**

**1. Board Composition**

i. Our board is comprised of people from different professional backgrounds

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 6 | 8 |
| Large extent | 66 | 88 |
| Moderate extent | 3 | 4 |
| Less extent | 0 | 0 |

ii. Our board is comprised of people from different ethnic background

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 16 | 21.3 |
| Large extent | 45 | 60.0 |
| Moderate extent | 13 | 17.3 |
| Less extent | 1 | 1.4 |

iii. More than 1/3 of the board members are non-executive directors

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 13 | 17.3 |
| Large extent | 42 | 56.0 |
| Moderate extent | 20 | 26.7 |
| Less extent | 0 | 0.0 |

iv. The number of female members on our board is representative enough for decision making

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 5 | 6.7 |
| Large extent | 20 | 26.7 |
| Moderate extent | 25 | 33.3 |
| Less extent | 21 | 28.0 |
| Not at all | 4 | 5.3 |

v. The number of members on our board is sufficient such that no one feels overworked

| Choice | frequency | percentage |
| --- | --- | --- |
| Very large extent | 6 | 8.0 |
| Large extent | 35 | 46.7 |
| Moderate extent | 33 | 44.0 |
| Less extent | 1 | 1.3 |
| Not at all | 0 | 0.0 |

**2. Board Committees**

**i.** Our Board is divided into different functional committees

| Choice | frequency | percentage |
| --- | --- | --- |
| Very large extent | 16 | 21.3 |
| Large extent | 54 | 72.0 |
| Moderate extent | 5 | 6.7 |
| Less extent | 0 | 0.0 |
| Not at all | 0 | 0.0 |

ii. Majority of the board business is conducted at the committees level

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 10 | 13.3 |
| Large extent | 54 | 72.0 |
| Moderate extent | 11 | 14.7 |
| Less extent | 0 | 0.0 |
| Not at all | 0 | 0.0 |

iii. At least our board has the following committees in place: Audit, credit, compensation & HR committees

iv.

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 24 | 32 |
| Large extent | 39 | 52 |
| Moderate extent | 12 | 16 |
| Less extent | 0 | 0 |
| Not at all | 0 | 0 |

v. The various committees of our board are effective in doing their work

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 16 | 21.3 |
| Large extent | 45 | 60.0 |
| Moderate extent | 14 | 18.7 |
| Less extent | 0 | 0.0 |
| Not at all | 0 | 0.0 |

**3. Compensation System**

**i.** Our Board has put in place a competitive compensation scheme for top management.

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 7 | 9.3 |
| Large extent | 63 | 84.0 |
| Moderate extent | 5 | 6.7 |
| Less extent | 0 | 0.0 |
| Not at all | 0 | 0.0 |

ii. Apart from monthly salary our bank executive enjoy some of the best perks in the industry

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 7 | 9.3 |
| Large extent | 39 | 52.0 |
| Moderate extent | 29 | 38.7 |
| Less extent | 0 | 0.0 |
| Not at all | 0 | 0.0 |

iii. Our board has put in place a competitive bonus system that is paid to its members and the executive based on performance

| **Choice** | **frequency** | **percentage** |
|---|---|---|
| Very large extent | 8 | 10.6 |
| Large extent | 38 | 50.7 |
| Moderate extent | 29 | 38.7 |
| Less extent | 0 | 0.0 |
| Not at all | 0 | 0.0 |

iv. Members of the executive are allowed share ownership of the bank

| **Choice** | **frequency** | **percentage** |
|---|---|---|
| Very large extent | 5 | 6.7 |
| Large extent | 28 | 37.3 |
| Moderate extent | 41 | 54.7 |
| Less extent | 1 | 1.3 |

**4. Risk Management**

**i.** Our board has put in place a risk management policy for the bank

| **Choice** | **frequency** | **percentage** |
|---|---|---|
| Very large extent | 12 | 16.0 |
| Large extent | 58 | 77.3 |
| Moderate extent | 5 | 6.7 |
| Less extent | 0 | 0.0 |
| Not at all | 0 | 0.0 |

ii. Our board has put in place mechanisms to be able to identify risk transactions

| **Choice** | **frequency** | **percentage** |
|---|---|---|
| Very large extent | 4 | 5.3 |
| Large extent | 51 | 68.0 |
| Moderate extent | 20 | 26.7 |
| Less extent | 0 | 0.0 |
| Not at all | 0 | 0.0 |

iii. We have put in place mechanisms that are good enough to enable us monitor all risky transactions

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 9 | 12.0 |
| Large extent | 50 | 66.7 |
| Moderate extent | 15 | 20.0 |
| Less extent | 1 | 1.3 |

iv. As a bank we are able to identify, measure, monitor and control all forms risks in our dealings

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 10 | 13.4 |
| Large extent | 58 | 77.3 |
| Moderate extent | 7 | 9.3 |
| Less extent | 0 | 0.0 |

v. Our bank has encountered so many risky transactions in the last one year

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 16 | 21.3 |
| Large extent | 46 | 61.4 |
| Moderate extent | 13 | 17.3 |
| Less extent | 0 | 0.0 |

vi. The number of non-performing loans has reduced significantly for the last three years

| Choice | frequency | percentage |
|---|---|---|
| Very large extent | 8 | 10.7 |
| Large extent | 16 | 21.3 |
| Moderate extent | 39 | 52.0 |
| Less extent | 12 | 16.0 |

**Appendix iii**: List of Commercial Banks in Kenya

| | |
|---|---|
| **1** | ABC Bank (Kenya) |
| **2** | Bank of Africa |
| **3** | Bank of Baroda |
| **4** | Bank of India |
| **5** | Barclays Bank (Kenya) |
| **6** | Citibank NA |
| **7** | Commercial Bank of Africa |
| **8** | Consolidated Bank of Kenya |
| **9** | Co-operative Bank of Kenya |
| **10** | Credit Bank |
| **11** | Development Bank of Kenya |
| **12** | DIB Bank (Kenya) Limited |
| **13** | Diamond Trust Bank |
| **14** | Ecobank |
| **15** | Equity Bank |
| **16** | Family Bank |
| **17** | First Community Bank |
| **18** | Guardian Bank |
| **19** | Guaranty Trust Bank (K) Ltd |
| **20** | Gulf African Bank |
| **21** | Habib Bank AG Zurich |

| | |
|---|---|
| **22** | I&M Bank |
| **23** | Jamii Bora Bank |
| **24** | Kenya Commercial Bank |
| **25** | Middle East Bank Kenya |
| **26** | Mayfair Bank |
| **27** | M-Oriental Bank Limited |
| **28** | National Bank of Kenya |
| **29** | NIC Bank |
| **30** | Paramount Universal Bank |
| **31** | Prime Bank (Kenya) |
| **32** | SBM Bank Kenya limited |
| **33** | Sidian bank limited |
| **34** | Standard Chartered Kenya |
| **35** | Stanbic bank |
| **36** | Spire Bank |
| **37** | Trans National Bank Kenya |
| **38** | United Bank for Africa Kenya Ltd |
| **39** | Victoria Commercial Bank |

**(Source: CBK 2018)**

**Appendix iv: Banking Sector Profitability (December 2016 and December 2017)**

| # | Bank Name | Year 2016 | | | Year 2017 | | |
|---|---|---|---|---|---|---|---|
| | | Profit/loss Before tax | Total Assets | ROA %(1/2) | Profit/loss Before tax | Total Assets | ROA %(1/2) |
| | | Kshs. M | Kshs. M | | | Kshs. M | |
| **1** | ABC Bank (Kenya) | 222 | 22,422 | 0.99% | 203 | 24,804 | 0.82% |
| **2** | Bank of Africa | (16) | 55,996 | -0.03% | 35 | 54191 | 0.06% |
| **3** | Bank of Baroda | 3,876 | 82,907 | 4.67% | 5,053 | 96,132 | 5.26% |
| **4** | Bank of India | 2,185 | 47,815 | 4.57% | 2,675 | 56,631 | 4.72% |
| **5** | Barclays Bank (Kenya) | 10,440 | 259,498 | 4.02% | 10,006 | 271,682 | 3.68% |
| **6** | Citibank NA | 6,033 | 103,324 | 5.84% | 6,373 | 98,232 | 6.49% |
| **7** | Commercial Bank of Africa | 7,593 | 210,878 | 3.60% | 7,189 | 229,525 | 3.13% |
| **8** | Consolidated Bank of Kenya | (277) | 13,918 | -1.99% | (439) | 13,456 | -3.26% |
| **9** | Co-operative Bank of Kenya | 18,024 | 349,998 | 5.15% | 16,502 | 382,830 | 4.31% |
| **10** | Credit Bank | 158 | 12,202 | 1.30% | 179 | 14,465 | 1.24% |
| **11** | Development Bank of Kenya | 95 | 16,418 | 0.58% | 58 | 16,320 | 0.35% |
| **12** | DIB Bank (Kenya) Limited | | | | (839) | 2,610 | -32.15% |
| **13** | Diamond Trust Bank | 8,876 | 244,124 | 3.64% | 8,228 | 270,082 | 3.05% |
| **14** | Ecobank | (2,889) | 47,124 | -6.13% | (1,434) | 53,456 | -2.68% |
| **15** | Equity Bank | 22,778 | 379,749 | 6.00% | 23,086 | 406,402 | 5.68% |
| **16** | Family Bank | 633 | 69,432 | 0.91% | (1,371) | 69,051 | -1.99% |
| **17** | First Community Bank | (41) | 14,962 | -0.28% | 216 | 17,360 | 1.25% |
| **18** | Guardian Bank | 302 | 14,705 | 2.05% | 228 | 15,803 | 1.44% |
| **19** | Guaranty Trust Bank (K) Ltd | 659 | 29,619 | 2.23% | 241 | 27,628 | 0.87% |
| **20** | Gulf African Bank | 754 | 27,156 | 2.78% | 254 | 31,316 | 0.81% |
| **21** | Habib Bank AG Zurich | 622 | 17,033 | 3.65% | 409 | 18,708 | 2.19% |
| **22** | Habib Bank Limited | 493 | 12,508 | 3.94% | | | |
| **23** | I&M Bank | 8,651 | 164,116 | 5.27% | 7,516 | 183,953 | 4.09% |
| **24** | Jamii Bora Bank | (490) | 15,724 | -3.12% | (762) | 12,851 | -5.93% |
| **25** | Kenya Commercial | 28,482 | 504,778 | 5.64% | 27,472 | 555,630 | 4.94% |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | Bank | | | | | | |
| **26** | Middle East Bank Kenya | (101) | 5,234 | -1.93% | (41) | 5,121 | -0.81% |
| **27** | Mayfair bank | | | | (297) | 3,548 | -8.38% |
| **28** | M-Oriental Bank Limited | 36 | 9,920 | 0.36% | 116 | 10,577 | 1.10% |
| **29** | National Bank of Kenya | 162 | 115,114 | 0.14% | 740 | 109,942 | 0.67% |
| **30** | NIC Bank | 5,926 | 161,847 | 3.66% | 5,676 | 192,817 | 2.94% |
| **31** | Paramount Universal Bank | 105 | 9,427 | 1.11% | 96 | 9,541 | 1.01% |
| **32** | Prime Bank (Kenya) | 2,336 | 65,338 | 3.57% | 1,977 | 76,438 | 2.59% |
| **33** | SBM Bank Kenya limited | | | | (361) | 11,745 | -3.07% |
| **34** | Sidian bank limited | 62 | 20,875 | 0.30% | (633) | 19,302 | -3.28% |
| **35** | Standard Chartered Kenya | 12,764 | 250,274 | 5.10% | 9,510 | 285,125 | 3.34% |
| **36** | Stanbic bank | 6,910 | 204,895 | 3.37% | 5,599 | 239,408 | 2.34% |
| **37** | Spire Bank | (968) | 13,802 | -7.01% | (1,576) | 11,148 | -14.14% |
| **38** | Trans National Bank Kenya | 160 | 10, 465 | 1.53% | 54 | 10,295 | 0.52% |
| **39** | United Bank for Africa Kenya Ltd | 50 | 5,601 | 0.89% | 14 | 6,505 | 0.21% |
| **40** | Victoria Commercial Bank | 796 | 22,403 | 3.55% | 849 | 25,985 | 3.27% |

**Appendix v: Banking Sector Market share (December 2016 and December 2017)**

| # | Bank Name | Year 2016 | | | Year 2017 | | |
|---|---|---|---|---|---|---|---|
| | | **Market Size index** | **Total Net Assets Kshs M** | **% of the market** | **Market Size index** | **Total Net Assets** | **% of the market** |
| | **Weighting** | | **0.33** | | | | |
| | **Large peer group >5%** | | | | | | |
| **1** | Kenya Commercial Bank | 14.10% | 504,778 | 13.70% | 14.14% | 555,630 | 13.9% |
| **2** | Equity Bank | 10.00% | 379,749 | 10.30% | 9.85% | 382,830 | 9.6% |
| **3** | Co-operative Bank of Kenya | 9.90% | 349,998 | 9.50% | 9.93% | 406,402 | 10.2% |
| **4** | Barclays Bank (Kenya) | 7.00% | 259,498 | 7.00% | 6.57% | 271,682 | 6.8% |
| **5** | Standard Chartered Kenya | 7.00% | 250,274 | 6.80% | 7.11% | 285,125 | 7.1% |
| **6** | Diamond Trust Bank | 6.40% | 244,124 | 6.60% | 6.72% | 270,082 | 6.7% |
| **7** | Commercial Bank of Africa | 5.90% | 210,878 | 5.70% | 6.05% | 229,525 | 5.7% |
| **8** | Stanbic bank | 5.10% | 204,895 | 5.50% | 5.62% | 239,408 | 6.0% |
| | **Sub Total** | | **2,404,193** | **65.10%** | **65.99%** | **2,640,684** | **66.0%** |
| | **Medium Peer Group (1-5%)** | | | | | | |
| **9** | NIC Bank | 4.50% | 161,847 | 4.40% | 4.62% | 192,817 | 4.8% |
| **10** | I&M Bank | 4.20% | 164,116 | 4.40% | 4.78% | 183,953 | 4.6% |
| **11** | National Bank of Kenya | 2.90% | 115,114 | 3.10% | 2.37% | 109,942 | 2.7% |
| **12** | Citibank NA | 2.80% | 103,324 | 2.80% | 2.56% | 98,232 | 2.5% |
| **13** | Bank of Baroda | 2.40% | 82,907 | 2.20% | 2.56% | 96,132 | 2.4% |
| **14** | Family Bank | 1.90% | 69,432 | 1.90% | 1.71% | 69,051 | 1.7% |
| **15** | HFC Ltd | 1.60% | 68,084 | 1.80% | 1.43% | 62,127 | 1.6% |
| **16** | Prime Bank (Kenya) | 1.80% | 65,338 | 1.80% | 2.01% | 76,438 | 1.9% |
| **17** | Bank of Africa | 1.40% | 55,996 | 1.50% | 1.25% | 54191 | 1.4% |
| **18** | Bank of India | 1.30% | 47,815 | 1.30% | 1.55% | 56,631 | 1.4% |
| **19** | Ecobank | 1.20% | 47,124 | 1.30% | 1.27% | 53,456 | 1.3% |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Sub Total** | | **981,098** | **26.5%** | **26.10%** | **1,052,969** | **26.31%** |
| | **Small peer group (<1%)** | | | | | | |
| **20** | Guaranty Trust Bank (K) Ltd | 0.90% | 29,619 | 0.80% | 0.85% | 27,628 | 0.7% |
| **21** | Gulf African Bank | 0.80% | 27,156 | 0.70% | 0.77% | 31,316 | 0.8% |
| **22** | ABC Bank (Kenya) | 0.60% | 22,422 | 0.60% | 0.59% | 24,804 | 0.6% |
| **23** | Victoria Commercial Bank | 0.70% | 22,403 | 0.60% | 0.71% | 25,985 | 0.6% |
| **24** | Sidian bank limited | 0.60% | 20,875 | 0.60% | 0.49% | 19,302 | 0.5% |
| **25** | Habib Bank AG Zurich | 0.50% | 17,033 | 0.50% | 0.45% | 18,708 | 0.5% |
| **26** | Giro Commercial Bank Ltd | 0.50% | 16,254. | 0.40% | 0.25% | 11,745 | 0.3% |
| **27** | Development Bank of Kenya | 0.40% | 16,418 | 0.40% | 0.37% | 16,320 | 0.4% |
| **28** | Jamii Bora Bank | 0.40% | 15,724 | 0.40% | 0.35% | 12,851 | 0.3% |
| **29** | First Community Bank | 0.40% | 14,962 | 0.40% | 0.39% | 17,360 | 0.4% |
| **30** | Guardian Bank | 0.40% | 14,705 | 0.40% | 0.40% | 15,803 | 0.4% |
| **31** | Consolidated Bank of Kenya | 0.30% | 13,918 | 0.40% | 0.26% | 13,456 | 0.3% |
| **32** | Spire Bank | 0.30% | 13,802 | 0.40% | 0.23% | 11,148 | 0.3% |
| **33** | Habib Bank Limited | 0.40% | 12,508 | 0.30% | 0.11% | | |
| **34** | Credit Bank | 0.40% | 12,202 | 0.30% | 0.38% | 14,465 | 0.4% |
| **35** | Trans National Bank Kenya | 0.30% | 10,465 | 0.30% | 0.28% | 10,295 | 0.3% |
| **36** | M-Oriental Bank Limited | 0.30% | 9,920 | 0.30% | 0.32% | 10,577 | 0.3% |
| **37** | Paramount Universal Bank | 0.30% | 9,427 | 0.30% | 0.25% | 9,541 | 0.2% |
| **38** | United Bank for Africa Kenya Ltd | 0.20% | 5,601 | 0.20% | 0.21% | 6,505 | 0.2% |
| **39** | Middle East Bank Kenya | 0.20% | 5,234 | 0.10% | 0.14% | 5,121 | 0.1% |
| | **Sub Total** | | **310,650.62** | **8.40%** | **7.91%** | 309,088 | **7.72%** |
| | **Grand Total** | | **3,695,943** | **100.00%** | **100.0%** | **4,002,741** | **100%** |

**Source**: CBK

Appendix vi: **Research permit**

**NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY AND INNOVATION**

Telephone:+254-20-2213471,
2241349,3310571,2219420
Fax:+254-20-318245,318249
Email: dg@nacosti.go.ke
Website : www.nacosti.go.ke
When replying please quote

NACOSTI, Upper Kabete
Off Waiyaki Way
P.O. Box 30623-00100
NAIROBI-KENYA

Ref: No. **NACOSTI/P/19/3819/29001**

Date **3rd April 2019**

Daniel masaga Barante

Machakos University

P.O Box 136-90100,

**MACHAKOS**

**RE: RESEARCH AUTHORIZATION**

Following your application for authority to carry out research on ***"corporate governance practices, strategic leadership and performance of commercial banks in Kenya.''*** I am pleased to inform you that you have been authorized to undertake research in **Nairobi County** for the period ending 1st April, 2020.

You are advised to report to the **County Commissioner and the County Director of Education**, **Nairobi County,** before embarking on the research project.

Kindly note that as an applicant who has been licensed under the science, technology and innovation Act 2013, to conduct research in Kenya. You shall deposit **a copy** of the final research report to the commission within **one year** of completion. The soft copy of the same should be submitted through the online research innovation system.

**BONIFACE WANYAMA**
**FOR: DIRECTOR-GENERAL/CEO**

Copy to:

The County Commissioner
Nairobi County.

The County Director of Education
Nairobi County.