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CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF PUBLIC LISTED BANKS IN KENYA

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ABSTRACT

Corporate governance is a key tool used to balance and ensure interests of all company's stakeholders are met. These stake orders majorly consist of shareholders, suppliers, customers, government, community and financiers. The purpose of the study was to examine the impact of the corporate governance on financial performance of listed banks in Kenya. A purposive sampling method integrating qualitative and quantitative design methods was employed in this study. The target and sample population was all the eleven public listed banks in Kenya. For the eleven listed banks, the company secretaries and other two executive top management members were each subjected to the study through the administration of questionnaires, hence three respondents per public listed bank.

The published annual reports of the eleven listed banks for the years 2015 – 2017 were used to collect secondary data. SPSS research analysis tool was used emphasizing on the Multiple Regression Analysis and the Spearman Correlation Coefficient among others to assess the magnitude and relationship and thus come up with a finding of the relationship of the independent and dependant variables. The research found that corporate governance practices affects the financial performance of the eleven listed banks in Kenya.

KEYWORDS:

Corporate governance, financial performance, Governance and Listed banks.

1.INTRODUCTION

Corporate governance is all about the use of power in organizations (Erken, Hung, & Motos, 2010). It is primarily concerned with the leaders who are the people who govern, that is, direct and control organizations. Corporate governance seeks to ensure that leaders act in the best interest of the organization. Corporate governance also targets the members of organizations. These are primarily shareholders in companies; whether public or private, listed or unlisted. Members are the owners or part owners of the organizations. They are often the people whose money is invested in the organizations (Fama, 1980). They are thus the ultimate beneficiaries of well-run organizations and the ultimate losers of badly-run organizations. For this reason they are the ones with authority to demand and enforce good governance of their organizations.

Good corporate governance seeks to ensure that the power of organizations are used in a manner that ensures effectiveness, efficiency, probity, fairness, transparency, discipline, accountability, responsibility, independence and good social responsibility (La Croix, 2014). Adherence to good corporate governance practices does aim at ensuring that organizations are sustainable in the long run (Barako, Hancock, & Izan, 2006)

2.LITERATURE REVIEW

2.1 EMPHIRICAL LITERATURE REVIEW

Considerable research has focused on the composition of board of directors and particularly the importance of outside directors. Outside directors are expected to represent the interests of shareholders by mitigating agency problems between management and shareholders (Fama, 1980). This careful thought may lead one to assert that firms perform better when they are being monitored by a board dominated by independent outside directors. Contrary to this proposition, (Liang & Li, 1999) carrying out a research on Singapore firms, which looked at whether boards dominated by independent outside directors performed financially better, plays down the importance of boards dominated by independent outside directors rather stressing the importance of business experience and entrepreneurship to influence the better financial performance. According to them, firms managed by dynamic CEO's tend to perform financially better than other categories of firms on the assumption that foreign firms are managed by more experienced CEOs.

A large boardroom size may also be inimical to the decision-making pattern of a firm (Yermack, 1996) hence less performance. Yermack posits in a study carried out in Turkey that the smaller the board size the better the financial performance and proposes an optimal board size of 10 or fewer. This study looked at the board size and its effect on firm's financial performance for banks in Turkey. The findings by Tanko and Oladale (2008), in a similar study in Nigeria on the board size and its effect on firm's financial performance, supports the negative relationship between the board size and bank's financial performance. Following their work, it was suggested that on an average 10-15 board members for a firm is large. I totally agree with these findings as smaller boards are more cohesive and can be better controlled and managed.

During the 2007-2008 economic crisis period, a study to establish whether firms with more independent board and higher institutional ownership perform was carried out by Erken, Hung, and Motos (2006) using a sample of 296 financial firms from 30 countries in Europe and the Americas, it was established that firms with more independent boards and higher institutional ownership experienced worse stock returns as a result of taking more risk which led to loss of many shareholders (Erken, Hung, & Motos, 2010). However, Bekaert and Harvey (2002) argue that firms with more independent boards raised more equity capital during the crisis, which led to a wealth transfer from existing shareholders to debt holders. This research was carried out in the USA which aimed at establishing the financial performance of firms with more independent boards and higher institutional ownership.

Although the value of the firm increases with foreign ownership, firm performance decreases with state ownership (Hung & Chen, 2009). This study was conducted in China to establish the influence of firm performance when the firm ownership structure is foreign owned or state owned. The study noted that state owned majority firms have directors with less keen interest in the firm and hence are more likely to make decisions affecting the firm that are not well thought out.

2.2 THEORETICAL LITERATURE REVIEW

2.2.1 Agency Theory

Agency theory is defined as the relationship between the principals, such as shareholders and agents such as the company management (Clark, 2004). In this theory, shareholders who are the owners or principals of the company, hires the agents to perform work. Principals delegate the running of business to the directors or managers, who are the shareholder's agents (Clark, 2004). In agency theory, the agent may be driven by self-interest which may bring about a conflict of interest between the aspirations of the principal and the agent's pursuits.

The separation of ownership of an organization from its management has generated a lot of discussion on how to effectively align the interests of the managers, directors and the owners. Adam Smith raised this question as early as 1776 when he suggested that the separation of ownership and control resulted in poor incentives for managers and directors to efficiently manage the affairs of the firm (Ansari, 2014). The theoretical underpinnings for most of the current framework of corporate governance has come from the classic work of Berle and Means (1932) according to Ansari (2014) which described the agency problem, in modern firms, as one arising from the separation of ownership and control.The essence of the agency problem is the separation of management and finance, or, as has been defined in more standard terminology, the separation of ownership and control. In a business organization, an entrepreneur, or a manager, raises funds from investors to put them to productive use and, while the investors need the manager's specialized human capital to generate returns on their funds, the manager needs the investor's funds since he does not have enough capital of his own to invest. The investors' dilemma is how to ensure that, once they have put in their funds in the venture, they would not be left holding a worthless piece of paper issued by the manager. Viewed in this context, the agency problem refers to the difficulties that investors face in ensuring that the funds, which they place at the disposal of the manager, are not expropriated or wasted on unviable projects (Ansari, 2014).

The agency theory has been criticized as it identifies shareholders as the only interest group of an organization. This has led to the development of the stakeholder theory (Cuevas-Rodriguez, Gomez-Mejia, & Wiseman, 2012)..

2.2.2 Stakeholder Theory

The essence of the stakeholder theory has been well captured in two key questions (Freeman, 1994). The first question was what is the purpose of the firm? This question encouraged the managers of the firm to articulate the shared sense of the value that they created and which brought the key stakeholders together and propelled the firm forward, allowing it to generate superior performance in terms of its business goals and marketplace financial metrics. Secondly, the stakeholder theory asked the question; what is the responsibility of the management of the firm to its stakeholders? This question pushed managers to define how they wanted to do business—specifically, what kinds of relationships they wanted (and needed) to create with their stakeholders to deliver on their business purpose (Ansari, 2014).

Even though, in the legal framework (under which a company operates), the directors of a company are responsible and accountable only to the shareholders of the company, such legal accountability exists only in a strict and narrow sense. Today, with mounting public pressure arising from corporate governance scandals and environmental concerns – the concept of the responsibility of companies is changing and broader corporate governance guidelines are gradually emerging. Consequently, the earlier view, based on a narrow, legal interpretation, which held that the directors, in an organization, were solely responsible to their shareholders, is now rapidly giving way to a broader interpretation of their role and responsibilities (Ansari, 2014).

1.RESEARCH METHODOLOGY AND MODEL SPECIFICATION

This study integrated both qualitative and quantitative design methods. For the purposes of this study, The target population of the study was also the eleven (11) purposively selected publicly listed banks. The research study was carried out at the various head offices since this is where the company secretary and other senior executive management, the target respondents in the listed banks are based.

Structured questionnaires were used to collect data and were administered to the company secretaries and top executive management staff. The study also utilized secondary data that was obtained from the 2015 to 2017 annual reports of the public listed banks.

2.PRESENTATION AND DISCUSSION OF RESULTS

4.1 Descriptive Statistics

Table 1 : Source Financial Reports (2015-2017)

	N	Minimum	Maximum	Mean	Standard Deviation
Measure of financial performance (ROE)	11	.10	.27	.2127	.05503
Valid N (list wise)	11				

The data analysis revealed that the lowest earner public listed bank returned 10 cents for every one shilling of shareholders equity while the highest earner returned 27 cents for every shilling of shareholder's investment. The mean was 21 cents with a standard deviation of 0.055. The data was analysed from the ROE of the years 2015 through to 2015. The interpretation of the data revealed that public listed banks ROE over the three years varied, hence the need to carry out the study to reveal how corporate governance practices impacted on this variance.

4.2 Correlations

Table 2 : Correlations matrix between the dependent variable and the independent variables

		Mean ROE	SRR	CGPR	CGPO	DPP
Mean_ROE	Pearson Correlation	1	0.753**	0.404	0.614*	0.668*
	Sig. (2-tailed)		0.007	0.217	0.045	0.025
	N	11	11	11	11	11
SRR	Pearson Correlation	0.753**	1	0.009	0.420	0.646*
	Sig. (2-tailed)	0.007		0.978	0.198	0.032
	N	11	11	11	11	11
CGPR	Pearson Correlation	0.404	0.009	1	0.002	0.529
	Sig. (2-tailed)	0.217	0.978		0.995	0.094
	N	11	11	11	11	11
CGPO	Pearson Correlation	0.614*	0.420	0.002	1	0.209
	Sig. (2-tailed)	0.045	0.198	0.995		0.536
	N	11	11	11	11	11
DPP	Pearson Correlation	0.668*	0.646*	0.529	0.209	1
	Sig. (2-tailed)	0.025	0.032	0.094	0.536	
	N	11	11	11	11	11

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

With N being the number of financial data collected from the eleven public listed banks, the matrix above gives the correlation of the financial performance against the four corporate governance indices.

The matrix indicates that there was a significant correlation between the return on equity and shareholder's rights and responsibilities, corporate governance policies and disclosure policies and practices. There was also a correlation between return on equity and corporate governance practices though it was not to a statistically significant level. The correlations indicate that as the response value increased from strongly disagreed to strongly agreed, the return on equity also increased. Shareholder's rights and responsibilities showed a particularly strong correlation of 0.753 significant at the 0.01 level as was the finding by Miseda (2012).

Corporate governance policies recorded a correlation value of 0.614 with P value of 0.045 which is statistically significant at the 5% level. This indicates that there is a statistically significant correlation between corporate governance policies and the bank's profitability. As the responses increased from strongly disagreed to strongly agreed, the mean return on equity value also increased.

Disclosure policies and practices recorded a Pearson's correlation value 0.668 with a P value of 0.025 which is statistically significant at the 5% level. This also shows that as the responses on disclosure policies and practices increased from strongly disagree to strongly agree, the mean return on equity also increased and this correlation was statistically significant as was the finding by Miseda (2012).

Corporate governance practices recorded a Pearson's correlation value of 0.404 which means that as the responses grew from strongly disagreed to strongly agreed, the mean return on equity also increased but it had a P value of 0.217 which infers that it was not statistically significant at the 5% level.

4.3 Regression Analysis

The statistics above were made clearer with the regression model below:

ROE= $ß_0 + ß_1$ CGPR + $ß_2$ SRR + $ß_3$ CGPO + $ß_4$ DPP + u

Where;

ROE: Return on equity

$ß_i$ = coefficient estimators of the predictor variables

u = error

CGPR: Corporate governance practices

SRR: Shareholders rights and responsibilities

CGPO: Corporate governance policies

DPP: Disclosure policies and practices

Table 3: Regression model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.913[a]	.833	.722	.02902

a. Predictors: (Constant), SRR, CGPR, CGPO, DPP

The R Square in the model summary indicates how much of the variance in the response is explained by the predictors. The R square 0.833 shows a relationship between the observed and predicted values of the dependent variable. In conclusion it can be authoritatively said that the CGPP, CGPO, DPP and SRR account for about 83.3% of the variance observed in the mean return on equity. Therefore this informs the fact that corporate governance practices play a big role in the financial performance of public listed Banks in Kenya.

Table 4: ANOVA: Analysis of Variance

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	.025	4	.006	7.488	.016[b]
Residual	.005	6	.001		
Total	.030	10			

a. Dependent Variable: ROE

b. Predictors: (Constant), SRR, CGPR, CGPO, DPP

Table 5: Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	1.612	.463		3.485	.000		
CGPO	.053	.027	.361	1.948	.039	.811	1.233
CGPR	.300	.170	.406	1.766	.128	.527	1.896
DPP	-.004	.085	-.014	.048	.002	.305	3.281
SRR	.771	.348	.607	2.216	.000	.371	2.698

The table 5 above shows the B column which are the beta values and they give the coefficient estimates of the predictor variables for the regression model. The table shows that three of the variables namely corporate governance policies, disclosure practices and policies and shareholders rights and responsibilities have P values which were significant at the 5% level (0.05).

Interpreting the values of the beta coefficients, it shows that holding all other factors constant, every positive unit change in corporate governance policies will increase the mean return on equity by 0.053 while still holding all factors constant, a unit change in shareholders rights and responsibilities will increase the mean return on equity by 0.771 units. However, a unit increase in disclosure policies and practices will bring about a negative change by 0.04.

Collinerarity statistics is used to check for correlation between the predictor variables. For each predictor variable, the tolerance level is more than 0.1 and the VIF value is less than 10, it shows that there is no correlation between the predictor variables.

4.4 SUMMARY OF FINDINGS

Corporate governance policies recorded a correlation value of 0.614 to the mean return on equity showing that similarly, as the responses under this category rose from strongly disagree to strongly agree, the mean return on equity increased and as the responses decreased, the mean return on equity increased. This correlation value was significant at the 0.05 level as it had a significant F value of 0.045.

Corporate governance practices showed a correlation of 0.404 to the mean return on equity but it had an F value of 0.217 which is not significant at the 0.05 level. In the regression matrix, corporate governance practices also recorded an F value of 0.128 which is not significant at the 0.05 level.

From table 3 which gives a summary of the regression model, it was found that the four group indices analyzed (the independent variables), the independent factors accounted for 83.3% of the variance in the rate of change from the Mean of the ROE. Of the four indices, three factors namely corporate governance policies, disclosure policies and practices and shareholder's rights and responsibilities were the most significant with shareholders rights showing high significance.

Though corporate governance showed strong correlation, it did not show any statistical significance as it had a p value of 0.128 which is greater than 0.05. In table 2, a collinearity test performed to test if there was any correlation between one independent variable and another showed that there was no correlation indeed between one predictor variable and another. This was ascertained since all the tolerance levels were greater than 0.1 and the TIF values were all less than 10. This is a strong indication that the regression model was valid.

CONCLUSIONS AND RECOMMENDATIONS

The study concluded that corporate governance practices cannot be down played as they indeed do play a very vital role on the financial performance of public listed banks in Kenya. From the regression results, it is important to note that the extent of the firm's performance is dependent on the predicators examined.

Corporate governance is very important to the listed banks as it involves the way the listed bank's business and affairs are managed by the board and the top management, thus affecting how the listed bank's objectives are arrived at, plans and policies.

The core of the study proves that good corporate governance structures are very important to the financial performance of public listed banks. The further upshot of this study is that it does not only aim at ensuring that public listed banks observe sound corporate governance practices, but equally important is to emphasize the need to ensure that the collapse of public listed banks as a result of unsound corporate governance practices is nipped at the bud.

The study recommended that public listed banks should also ensure that shareholders and other stakeholders are timely provided with relevant information regarding the financial performance of the bank and also the management analysis as shareholders rights and responsibilities showed a significant correlation with the financial output of the listed banks.

The study also recommended that the CBK, NSE and CMA should further monitor compliance with the corporate governance codes and guidelines by them as this will ensure that public listed Banks are well aligned in observing good corporate governance practices, which shall correlate in good performance of the public listed Banks. The ICPSK should ensure that all company secretaries of public listed banks in Kenya are registered certified public secretaries, so that they can ensure that good corporate governance practices as they are the custodians of good corporate governance practices.

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