EFFECT OF CORPORATE GOVERNANCE PRACTICES ON PROFITABILITY OF COMMERCIAL BANKS IN KENYA

BY

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A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF SCIENCE IN FINANCE

SCHOOL OF BUSINESS AND ECONOMICS

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DECLARATION

I declare that this project is my original work and has not been presented for a degree in any other University.

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Declaration by Supervisor

This project has been presented for examination with our approval as the supervisors appointed by the University Senate.

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ACKNOWLEDGEMENT

I am heartily thankful to my supervisor Dr. Benjamin Ombok whose encouragement, guidance and support from the initial to the final level enabled me to develop an understanding of the subject. My deepest gratitude to my siblings Ascensio, Bonventure and Aurelia for their continuous love and support every single minute. Words are not enough to describe my indebtedness to my parents who sacrificed so much and have helped me become who I am now and placed me on the path where I am today. To all my classmates from whom I received valuable comments, I say thank you all and may God bless you mightily. Above all, I thank the Almighty God for the gift of life, opportunity and ability granted for me to witness the successful completion of this research project.

DEDICATION

To my dad Mr. Bantaleo Muhindi, your teachings and ceaseless support is always cherished. To my mother Mrs. Anne Muhindi, for being a role model in my life's struggle for success. To my siblings Ascensio Bonventure and Aurelia Muhindi, for the continuous encouragement and support that has enabled me achieve my goals. This project would not have been successfully completed without your enormous support, love and patience.

ABSTRACT

Corporate Governance is important to all financial institutions for its contribution to firm performance. Despite being critical to the world economic stability, the banking industry has experienced severe financial challenges since the 2007 global financial crisis, which negatively affected economic performance of most countries. Whereas the Kenyan banking sector remained stable in profit during 2015; from Kshs. 3.2 trillion in 2014 to Kshs. 3.5 trillion in 2015, the period 2012 to 2016 registered declining trends despite the slowdown in global economic growth to 3.1% in 2015 from 3.4% in 2014. Studies relating to Corporate Governance and profitability of Commercial Banks have also given mixed results; where some scholars argue that it improves Commercial Banks profitability while others observe the contrary. Consequently, this study sought to analyze the effect of Corporate Governance practices on profitability of Commercial Banks in Kenya. The specific objectives of this study were to establish the association between qualification of Board of Directors and profitability of Commercial Banks in Kisumu, to determine the relationship between role definition and profitability of Commercial Banks in Kisumu, to assess the relationship between operational and ethical controls and profitability of Commercial Banks in Kisumu, to analyze the relationship between board performance and compensation and profitability of Commercial Banks in Kisumu and to determine the relationship between risk management and profitability of commercial banks in Kisumu. The study was anchored on Stewardship theory and Stakeholder theory. The study used Correlation research design. Primary quantitative data was collected through semi-structured questionnaires while Secondary data was collected from Bank Supervision Reports and Commercial Banks' websites. Validity of the questionnaire was ensured through finance expert review and opinion, a Cronbach's Alpha technique was adopted to ensure reliability of the questionnaire. A survey was conducted on 13 Commercial Banks in Kisumu County. The target population was 75 top Managers of Commercial banks in Kisumu County. The collected data was analyzed using SPSS Version 20.0. Multiple regression analysis was used to determine the effect of Corporate Governance practices on profitability. The research findings were presented in tables for clarity. The findings revealed that there is a positive significant correlation between board of directors and profitability of commercial banks (r=.270, p=.023), role definition among commercial banks and bank profitability (r=.373, p=.001), operational ethical control and bank profitability (r=.623, p=.000), board performance& compensation and bank profitability (r=.335, p=.004) and risk management and bank profitability (r=.561, p=.000). Finally, the Regression results indicated that corporate governance practices accounted for 63.7% adjusted to 60.9% change in bank profitability; with Board performance, qualification, ethical control and risk management yielding significantly positive contribution to profitability. The study concluded that corporate governance has an effect on bank profitability. It was recommended that all the corporate governance selected dimensions be improved to ensure maximum bank profitability. This study may help banking policy makers understand the need to streamline Corporate Governance implementation requirements. It will contribute to the existing body of knowledge on Corporate Governance.

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ACRONYMS AND ABBREVIATIONS

CBK Central Bank of Kenya

CEO Chief Executive Officer

CG Corporate Governance

CGPs Corporate Governance Practices

EPS Earning Per Share

NIM Net Interest Margin

NSE Nairobi Securities Exchange

OECD Organization for Economic Cooperation and Development

OLS Ordinary Least Square

P/E Price to Earnings Ratio

PM Profit Margin

ROA Return on Asset

ROE Return on Equity

SR Stock Return

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Performance is the reflection of the way in which the resources of a company (bank) are used in the form which enables it to achieve its objectives (Namisi, 2002). Financial performance refers to the act of carrying out financial activity; which in broader sense, is the degree to which financial objectives are being or have been accomplished (Trivedi, 2010). According to Heremans (2007), it is the employment of financial indicators to measure the extent of objective achievement and its contribution to making available financial resources and support of the bank with investment opportunities. He asserts that an understanding of the organization's overall financial situation and enterprise relationships requires three key financial documents; which are Balance Sheet, Income Statement and Cash Flow Statement.

Metcalf and Titard (1976) state that financial performance is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. Financial analysts often assess firm's profitability performance, productivity performance, liquidity performance, working capital performance, fixed assets performance, fund flow performance and social performance as aggregate sum (Meigs, 1978). Whereas there are many different ways of measuring financial performance, all measures should be taken in totality as they drive to a firm's profitability. Line items such as revenue from operations, operating income or cash flow from operations can also be used, as well as total unit sales (Jayawardhera and Foley, 2000). Gordon (2007) and Pye, (2002) state that using financial performance measures, a company can develop an assessment of its current financial position. A key indicator of financial performance is profit, which is measured through Return on Assets, Return on Equity, Net Interest Margin, among others.

According to Pandey (2002), profitability means ability of a firm to make profit from all its business activities; showing how efficiently the management can make profit by using all the resources available in the market. However, Harward & Upton (1961) states that "profitability is the ability of a given investment to earn a return from its use." Dumbrava (2010) subsequently defines profitability as the contribution of various resources to the increase of efficiency. Therefore profitability is an aggregated capacity of a firm to employ firm based resources and environmental opportunities to generate optimum benefit or profit. Profitability analysis therefore focuses on the relationship between revenues and expenses and on the level of profits relative to the size of investment in the business. Repayment capacity as a measure of financial performance is the ability to repay debt from both firm and non-firm income. It evaluates the capacity of the business to service additional debt or to invest in additional capital after meeting all other cash commitments (Brunnermeier and Pedersen, 2008).

Financial efficiency measures the degree of efficiency in using labor, management and capital. Efficiency analysis deals with the relationships between inputs and outputs. Because inputs can be measured in both physical and financial terms, a large number of efficiency measures in addition to financial measures are usually possible. Profitability incorporates measures that are used to accurately predict the firm performance by various decision makers. Delen, Kuzey and Uyar (2013), analyze firm profitability through financial ratios (i.e. Return on Assets, Return on Equity, Net Interest margin among others), as predictive measures of performance. Stierwald (2009), while examining determinants of profitability; through effect of productivity and its persistence asserts that productivity is a function of firm level variables; which include firm size, growth estimates, fixed asset levels and firm working capital. This view is also held by Al-Jafari and Al-Samman (2015); whom on investigating the Determinants of Profitability of listed industrial companies in Muscat Security Market Oman, identify the firm size variables as critical determinants of profitability. UK - Cadbury Report, (1992) states that Corporate Governance is the system by which companies are directed and controlled. It therefore comprises a set of rules that define the relationship between stakeholders, management, and board of directors of a company; and influences how that company is operating. This implies that it deals with issues that result from the separation of ownership and control; providing the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined. According to Youssef (2007), Corporate Governance is the process carried out by the board of directors, and its related committees, on behalf of and for the benefit of the company's shareholders and the other stakeholders, to provide direction, authority, and oversights to management; inferring how to make the balance between the board members and their benefits and the benefits of the shareholders and the other stakeholders. Research and experience reveal that key Corporate

Governance arrangements are important and critical to economic growth, enhanced welfare, increased investment, capital market efficiency and company performance; all of which are proxies of firm level environment, which determine profitability.

Rostamia, Rostamib and Kohansal (2015), in examining association between qualification of Board of Directors and Profitability in Companies Listed in Tehran Stock Exchange; using Return on Assets and Net Interest Margin, and employing generalized Least Square method established that there is a significant positive relationship between Qualification of Board of Directors and Return on assets (ROA). Dabor, Isaivwe, Ajagbe and Oke (2015), on Impact of Corporate governance on Firm performance; examining Board structure as a variable for measuring corporate governance, revealed that there is significant negative relationship between Board qualification and firm ROA and Return on Equity (ROE). Ijeh, Adesanmi, and Njogo (2014), on a study of Impact of corporate governance on commercial bank performance in Nigeria; making use of cross sectional data for 10-years collated from Central Bank of Nigeria between 2003-2012, revealed a significant positive effect of corporate governance practices on ROA. Mwega (2010) from his research work relating to improvements in corporate governance in Kenyan banking institutions to better profitability found that there is a positive correlation between Qualification of Board of directors and profitability in Kenyan Banks. Kilonzo (2008) researching on the effect of the global financial crisis in Kenya, argued that good corporate governance in Kenyan Banks is required to restore market confidence, attract foreign direct investment or private capital inflows and investments that will propel the ROA. From the foregoing information, it is evident that studies on qualification of Board of Directors and profitability across various sectors including commercial banks reveal conflicting results. This requires further examination of the variable of Corporate Governance and its contribution to profitability of not only other sectors but also to the critical financial sector as predictor of their sustainable growth and profitability.

Dehaene, Vuyst and Oogodhe (2001) in an examination of Corporate Performance and role definition in Belgian Companies unveiled that defining roles has a positive correlation on return on equity (ROE) among Belgian companies. This finding is supported by Byrdet al. (2010) in studying the impact of corporate governance practices on firm profitability, as he pointed out a significant positive effect of role definition on firm profitability. Ramdani and Witteloostuijn (2009) claimed that role definition only have an effect on firms' ROE if the firms have average performance; firms with below average performance are not affected. Beineret (2004) analyzed the relationship between role definition and Return on Equity of Swiss firms, and revealed a negative relationship between the two variables. Wangari (2014) after conducting a study on the effect of chairman duality on the profitability of Commercial Banks in Kenya found a positive relationship between role definition and ROE. Musa (2006) examined the impact of corporate governance on the performance and value of banks in Nigeria and found that CEO duality has a significant impact on the performance of banks in Nigeria, as measured by ROE. Al-Manaseer (2012) found an insignificant negative relation between Corporate Governance Practices and Return on Equity after researching on Effects of Corporate Governance on profitability of a firm. Mang'unyi (2011) on his study to explore the ownership structure and Corporate Governance and its effects on performance of Kenyan banks, revealed that there was significant difference between role definition and ROE of banks. The study recommended that management of corporate entities should clearly define their roles to send positive signals to potential investors and those regulatory agencies including the government should promote and socialize Corporate Governance and its relationship to firm performance across firms. Miring'u and Muoria (2011) analyzed the effects of Corporate Governance on performance of commercial banks in Kenya and found a positive relationship between Return on Equity (ROE) and role definition of Commercial Bank staff. From the above findings, it is clear that research on Role definition and profitability in various commercial banks reveal conflicting results. This shows more examination has to be conducted on the relationship between role definition and profitability of Commercial Banks.

Woidtke (2002) on a study of the role of ethical controls in Foreign Direct Investment Decisions (FDID) established a positive relationship between ethical controls and Net Interest Margin (NIM) in a firm. Htay and Shahid (2012) in a bi-variate study found a negative relationship between operational and ethical controls and Return on Assets, Return on Equity and Net Interest Margin. However, Enobakhare (2010) found no relationship between ethical values and banks profitability after conducting a research on Corporate Governance (CG) and Bank Performance in Nigeria. Al-Manaseer, Al- Hindawi, Al-Dahiyat and Sartawi (2012) on their study of effect of corporate governance on bank performance found a significant negative relation between ethical controls and NIM. Angbazo (1997) in analyzing determinants of bank interest margins indicated that ethical controls, a corporate governance practice, is positively associated with bank interest margin in US banks. Carbo and Rodriguez (2007) in their study on determinants of bank margins in European Banking reveal that operational and ethical controls are positively related with return on equity and return on assets. Masibo, (2005) while studying ethical controls and Net Interest Margin of selected Commercial Banks and listed organizations got a positive direct and indirect link between the two. According to Matengo (2008), systematic failures of such banks as Trust and Euro in Kenya and other African countries in the 1990s were attributed to moral hazards. The preceding review presents a framework of conflicting study results, ranging from negative and positive relations for some, while for others there was no relation; a situation which subsequently require further examination.

Wen (2010), who investigated the impact of managing risk on profitability of companies in general found no obvious correlation between the two, although he stated that state-owned Commercial banks might present a quadratic relationship. A study conducted by Muriithi (2011) on Effect of Board compensation on firm profitability in Kenya reveals that there is a relationship between the two variables. He states that poor compensation and failure to review performance leads to a drop in company profitability. Nguyen et al. (2014) on Impact of employee compensation on Bank Profitability – An Empirical Test in Vietnamese Banks, found a positive correlation of the two variables. Kiruri (2013) studied the effects of reviewing employee performance on bank profitability in Kenya. The result showed that the Board performance review is negatively correlated with bank profitability. From the preceding literature, it is evident that further studies have to be conducted on the relationship between Board performance and compensation and profitability of Commercial Banks in Kenya.

Forbes and Milliken (1999) in their study of profitability and risk management argued that risk management is not a demographic attitude, thus it is unlikely to affect ROA. Eisenberg (1998) conducted a study on risk management and decreasing firm value and found positive correlation when using sample of small and medium Finnish firms. The result is consistent with study on corporate governance of family firms in Norway (Mishra et al., 2001). Khatab, Masood, Zaman, Saleem and Saeed (2011), on determining the relationship between risk management and profitability, revealed that managing risk has a positive relationship with Tobin’s Q, which confirms a significant effect in measuring profitability of the firm. Al-Shurfa’a (2008) investigated the relationship between profitability and risk management in firms listed at Amman Stock Exchange. The results of findings revealed that there is negative relationship between the two variables. Matama (2005) in the study of Board performance and compensation and profitability on selected commercial banks in Kenya, obtained no relationship between reviewing performance and compensation of employees and bank profitability. From the available literature, it is clear that there exists a relation between risk management and profitability of commercial banks but many studies present contradictory information in terms of the direction and effect power of the relationship of risk management on profitability of firms in general and Commercial Banks in particular. This study employed three variables for bank profitability relevant to return on shareholder's investment. These are Return on Assets (ROA), Return on Equity (ROE) and Net Interest Margin (NIM).

1.1.1 Return on Assets

Return on Asset is a measure computed from the bank's financial statement data. It shows ability of the company to utilize assets in an efficient way to generate profits (Mohamad, Saleh and Fares, 2011).

$$ROA = \frac{\text{Profit before tax}}{\text{Total assets}}$$

1.1.2 Return on Equity

Return on Equity (ROE) is financial ratio for analyzing stocks which measures rate of return on ownership interest of common stock owners (Vintila &Gherghina, 2012). It indicates effectiveness of the management team in converting reinvested money into profits.

$$ROE = \frac{\text{Profit after tax}}{\text{Shareholders' equity}}$$

1.1.3 Net Interest Margin

NIM is a measure of the difference between the interest income generated by banks and the amount of interest paid out to their lenders relative to the amount of their assets, and is usually expressed as a percentage of what the financial institution earns on loans in a specific time period and other assets minus the interest paid on borrowed funds divided by the average amount of the assets on which it earned income in that time period (the average earning assets). The NIM variable is defined as the net interest income divided by total earnings assets (Gul and Faiza, 2011). Net interest margin measures the gap between the interest income the bank receives on loans and securities and interest cost of its borrowed funds.

$$NIM = \frac{(\text{Investment Returns} - \text{Interest Expenses})}{\text{Average Earning Assets}}$$

1.2 Statement of the Problem

Corporate Governance practices are vital to the profitability of the banking sector because commercial banks are the heart of a country's economic activities and therefore, poor bank performance minimizes the economic welfare in a country. Good corporate governance practices need to be considered for the stability of commercial banks because decline in profitability creates loss of relationship between banks with their clients and particular knowledge of management and risk preferences necessary to improve performance. In spite of strong regulatory and legal framework imposed by Central Bank, banking system in Kenya has experienced banking problems since 1986, leading to the downfall of more than 40 commercial banks. Listed Commercial Banks in Kenya recorded anemic Earnings Per Share growth in 2016, coming in at 4.4%, compared to 2.8% in 2015, and a 5 year average of 13.9%. The poor performance which is in terms of Return on Assets, Return on Equity and Net Interest Margin was on the back of weak Corporate Governance Practices. Recorded also were gross loans and advances growth of 8.1% to Kshs 1.9 trillion in December 2016 from Kshs 1.8 trillion in December 2015, slowing down from the 5 year average growth rate of 14 .6%, while deposits grew 6.7% to Kshs 2.1 trillion in December 2016 from Kshs 2.0 trillion in December 2015, also slower than the 5 year average of 14.6%. Available information on the relationship between Corporate Governance Practices and profitability measures (Return on Assets, Return on Equity and Net Interest Margin) present contradictory information in terms of the direction and effect power of the relationship of Corporate Governance Practices on profitability of firms in general and Commercial Banks in particular. It is on this basis that this study sought to analyze the effect of corporate governance practices on profitability of commercial banks in Kenya.

1.3 Objectives of Study

1.3.1 General objective

The general objective of the study was to analyze the Effect of Corporate Governance Practices on Profitability of Commercial Banks in Kenya.

1.3.2 Specific Objective

This study also seeks to achieve the following objectives:

a) Qualification of Board of Directors has no significant relationship with Profitability of Commercial Banks in Kisumu County.

b) To determine the relationship between Role Definition and Profitability of Commercial Banks in Kisumu County.

c) To assess the relationship between Operational and Ethical Controls and Profitability of Commercial Banks in Kisumu County.

d) To analyze the relationship between Board Performance and Compensation and Profitability of Commercial Banks in Kisumu County.

e) To determine the relationship between Risk management and profitability of commercial banks in Kisumu county

1.3.3 Research Hypothesis

To proffer useful answers to the research questions and realize the study objectives, the following hypotheses stated in their null forms was tested;

H_{01} There is no significant relationship between Qualification of Board of Directors and Profitability of Commercial Banks in Kisumu County.

H_{02} There is no significant relationship between Role Definition and Profitability of Commercial Banks in Kisumu County.

H_{03} There is no significant relationship between Operational and Ethical Controls and Profitability of Commercial Banks in Kisumu County.

H_{04} There is no significant relationship between Board Performance and Compensation and Profitability of Commercial Banks in Kisumu County.

H_{05} There is no significant relationship between Risk management and profitability of commercial banks in Kisumu County.

1.4 Scope of the Study

The study sought to establish the relationship between Corporate Governance and profitability of Commercial Banks in Kisumu County. The main variables under study were Corporate Governance and profitability of Commercial Banks. The study adopted correlation research design. Primary quantitative data was collected through semi-structured questionnaires while secondary data was collected through bank supervisory report and official websites of commercial banks. Multiple regression analysis was used to determine the relationship between Corporate Governance and profitability of commercial banks. The researcher aims to collect the data in two months and complete this study by August 2017.

1.5 Significance of the Study

The findings of the study aim at understanding and improving the relationship between Corporate Governance practices and profitability of commercial banks in Kenya. Commercial Banks in Kenya found the study very valuable to their operations and more so a benchmark to decisions to improve on Corporate Governance in the banking industry. It further provides an insight into understanding the degree to which the banks that are reporting on their Corporate Governance have been compliant with different sections of the codes of best practice and where they are experiencing difficulties. Boards of Directors found the information of value in benchmarking the performance of their banks, against that of their peers. The results of this study also serve as a data base for further researchers in this field of research. This study gave insight to the government and the policy makers especially in the areas of human resource and planning on the need to streamline the Corporate Governance implementation requirements so as not to shift the focus of the management on achieving the intended Corporate Governance targets, while neglecting their main objective of steering the society towards prosperity. Corporate Governance should be meant to help organizations achieve their objectives by practicing good governance. To the academicians, the study will contribute to the existing body of knowledge of Corporate Governance in Kenya. It will also stimulate prospective researchers to replicate the study in other sectors of the economy.

1.6 Justification of the study

Generally, banks occupy an important position in the economic equation of any country such that its profitability affects the economy of the country. Kisumu County has a number of businesses such as Jua Kali industry, Fishing industry, sugarcane industry, airport, breweries, among others. With these kind of industries in place, it is therefore believed that banks have a strong customer base and business for their profitability. In 2012, the profitability of the banks in Kisumu combined was Kshs.3.6 billion. In 2013 it was Kshs. 3.0 billion, Kshs. 3.4 billion in 2014, Ksh. 3.1billion in 2015 and in 2016 profitability was recorded at Kshs 3.0 billion. This is very much below the threshold of the other similar towns like Nakuru which reported Kshs. 3.8 billion in 2012, Kshs. 3.5 billion in 2013, Kshs. 3.6 billion in 2014, Kshs. 3.2 billion in 2015 and Kshs. 3.1 billion. It is on this note that the study seeks to establish the effect of Corporate Governance Practices on profitability of Commercial Banks in Kisumu County, Kenya.

1.7 Conceptual Framework

The conceptual framework is developed from the literature discussed and presented in a diagram (figure 1.1). It shows the relationship between the dependent (ROA, ROE, NIM) and independent (Qualification of BOD, Role Definition, Operational and Ethical controls, Board Performance and Compensation, Risk management) variables.

Independent Variables **Dependent Variables**

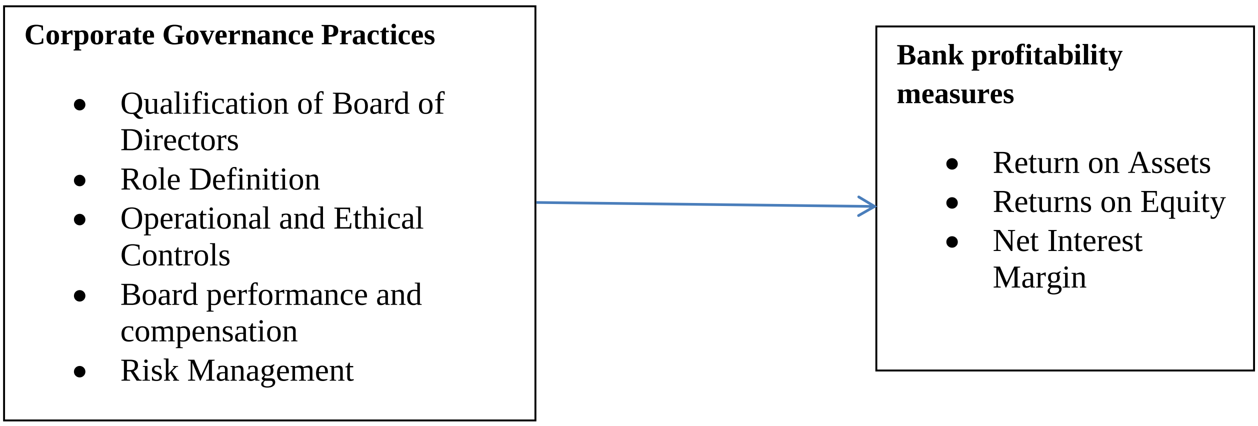

Fig. 1.1 Self Conceptualization (2017)

Independent variables are those related to agency theory and Corporate Governance as presented in the conceptual framework (figure 1.1) defined as follows; Qualification of

Board of Directors - Boards should be comprised of Directors who are knowledgeable and have expertise relevant to the business and are qualified and competent; Role Definition - Establish clear lines of accountability among the Board, Chair, CEO, Executive Officers and management; Operational and Ethical controls -Not only must Directors declare conflicts of interest and refrain from voting on matters in which they have an interest, but a general culture of integrity in business dealing and of respect and compliance with laws and policies without fear of recrimination is critical. Board performance and compensation - The Board should set Directors' fees that will attract suitable candidates, but won't create an appearance of conflict in a Director's independence or discharge of her duties. Risk Management - Companies should regularly identify and assess the risks they face, including financial, operational, reputational, environmental, industry-related, and legal risks. Bank performance measures will be measured as follows: Return on asset was measured by the ratio of profit before tax to total assets of the bank; Return on Equity was measured by the ratio of net income (profit after tax) to shareholders equity of the bank; Net Interest Margin was measured by the ratio of net interest income to total earnings assets.

CHAPTER TWO

LITERATURE REVIEW

2.1 Theoretical Review

Corporate Governance issues arise in an organization whenever two conditions are present. Oliver (1995) attributes first condition to the fact that there is an agency problem, or conflict of interest, involving members of the organization, as owners, managers, workers or consumers; while the second condition explains the fact that transaction costs are such that this agency problem cannot be dealt with through a contract. This implies that Corporate Governance is an issue even in a small (closely-held) firm. However, it is usually thought to be more significant issue in large public companies. This study covered two theories on the effect of Corporate Governance on profitability.

2.1.1 Stewardship Theory

It is a requirement in Kenyan Company Law (Cap 486) that Directors show a fiduciary duty towards the shareholders of the company. Inherent in the role of Directors having a fiduciary duty is that they can be trusted and acted as stewards over the resources of the company (Tricker, 1984). A steward is a person who essentially wants to do a good job, to be a good manager or official of the corporate assets (Donaldson and Davis, 1991). A steward protects and maximizes shareholders wealth through firm profitability because by so doing, the steward's utility functions are maximized (Schoorman, 1997). Schoorman and Donaldson (1997) defined stewardship theory as "a steward protects and maximizes shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximized". According to Pastoriza and Arino (2008), Stewardship theory is a new perspective to understand the existing relationships between ownership and management of the company. Stewardship theory is a model of management where managers are considered good stewards who will act in the best interest of the owners and that when left on their own, they will indeed act as responsible stewards of the assets they control (Fernando, 2009). Stakeholders can be instrumental to corporate success and have moral and legal rights (Cullen, Kirwan and Brennan, 2006). When stakeholders get what they want from a firm, they return to the firm for more (Freeman, 1984; Freaman and McVea, 2001). Therefore, corporate leaders have to consider the claims of stakeholders when making decisions and conduct business responsibly towards the stakeholders.

Participation of stakeholders in corporate decision-making can enhance efficiency and reduce conflicts (Rothman and Friedman, 2001). According to Kaptein and Van Tulder (2003), corporations adopt reactive or proactive approaches when integrating stakeholders' concerns in decision making. A corporation adopts a reactive approach when it does not integrate stakeholders into its corporate decision making processes. This results into a misalignment of organizational goals and stakeholder demands (Mackenzie, 2007). A proactive approach is used by corporations that integrate stakeholders' concerns into their decision-making processes and that establish necessary governance structures (de Wit et al, 2006). Stewardship theory suggests role definition so as to improve profitability of a firm and to have greater role as stewards in the organization. It was empirically found that the returns on assets (ROA) of a company improved by having this theory in place (Donaldson and Davis, 1991). Stewardship theory places a greater value on goal convergence among the parties involved in corporate governance than on the agent's self-interest (Van Slyke, 2006). Board of Directors and its CEO, acting as stewards, are more motivated to centralize on profitability of the firm rather than for their own selfish interests because over time, senior executives tend to view a firm as an extension of themselves (Clarke, 2004). Therefore, the stewardship theory argues that a firm's top management cares more about the firm's long term success (Mallin, 2004). To achieve research objectives, this study examined Stewardship theory because according Letting' (2012), it further argues that: executive-dominated Boards should be favored by organizations because of their depth of knowledge, ability to access current operating information and their technical expertise and commitment to the firm that potentially impacts on profitability positively.

Figure 2.1 below explains the stewardship theory relationship.

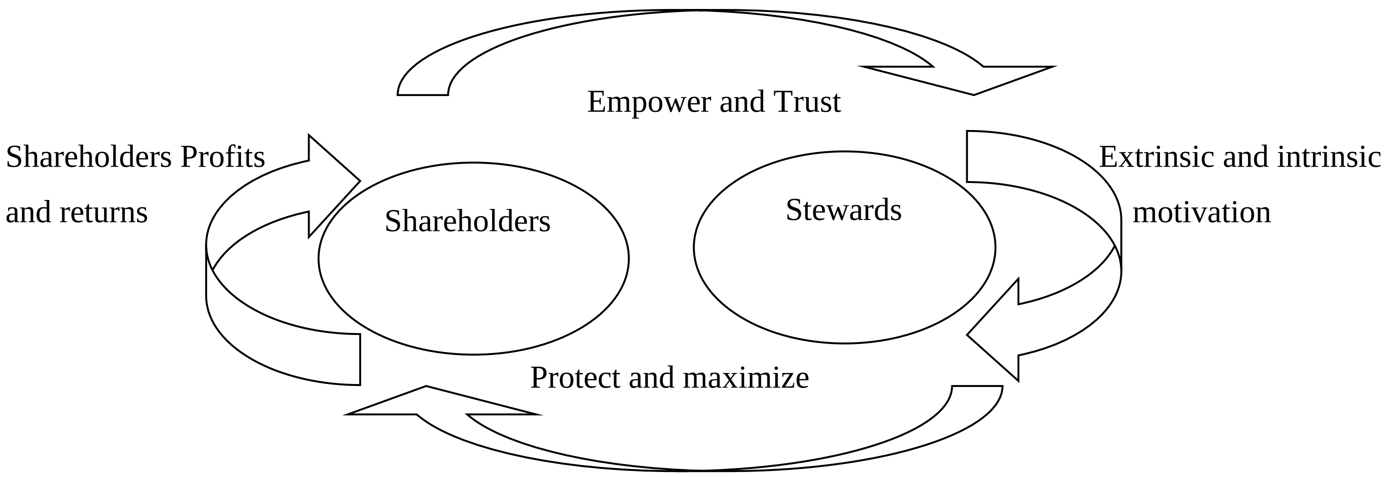

Fig. 2.1 Stewardship Theory: Abdullah (2009)

2.1.2 Stakeholder Theory

Stakeholder theory was embedded in the management discipline in 1970 and gradually developed by Freeman (1984) incorporating corporate accountability to a broad range of stakeholders (Abdullah, 2009). Stakeholder theory can be defined as "any group or individual who can affect or is affected by the achievement of the organization's objectives - profit" (Freeman, 1999). This theory stipulates that a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction (Abrams, 1951). Stakeholder theory explains the role of Corporate Governance by highlighting different constituents of a firm (Coleman, 2008). Stakeholder theorists suggest that managers in organizations have a network of relationships to serve – this include the suppliers, employees and business partners (Freeman, 1999). According to the stakeholder model, Corporate Governance is primarily concerned with how effective different governance practices are in promoting firm profitability and commitment amongst the various stakeholders (Williamson, 1985). Kester (1992), for instance, states that the central problem of governance is to devise specialized systems of incentives, safeguards, and dispute resolution processes that will promote the continuity of business relationships that are efficient in the presence of self-interested opportunism. Blair (1995) also defines corporate governance in this broader context and argues that corporate governance should be regarded as the set of institutional arrangements for governing the relationships among all of the stakeholders that contribute firm specific assets. Therefore, it is in the interest of the shareholders to take account of other stakeholders, and to promote the development of long term relations, trust, and commitment amongst various stakeholders (Mayer, 1996). This study will adopt stakeholder theory because it basically aims at striking a balance between the company's profitability, corporate governance and stakeholder satisfaction, hence trying to identify the purpose of the firms (bank). This therefore becomes the driving force underlying the firm's activities. By highlighting the firms' responsibility to its stakeholders, it pushes management to design and employ appropriate methodologies to determine the nature of relationship between Corporate Governance Practices and profitability of the firm.

2.2 Empirical Literature Review

This section reviews literature from previous studies in almost the same area of study. This was done as per the objectives of the study as in the subsequent sections.

2.2.1 Qualification of Board of Directors

Boards should be comprised of Directors who are knowledgeable, have expertise relevant to the business, are qualified and competent and have diverse backgrounds and skill sets, and sufficient time to commit to their duties (Uadiale, 2010; Lawal, 2012,). Qualification of BOD is considered an important factor in the performance of Board roles. In Kenya, Qualification of BOD is prescribed under Section 11(3) and 12of the Capital Markets Authority Act, (CMA Act, 2000) that empowers the Capital Markets Authority to make rules and regulations to govern capital markets in Kenya. Epstein, Jones and Roy (2002) conducted a study on the effect of Corporate Governance Practices on profitability of firms. Qualification of Board of Directors was one of the variables used to represent Corporate Governance Practices, whereas return on assets and return on equity were used as measures of profitability. They concluded that from either an internal long-term profitability or external shareholder perspective, there is an indication that good Boards may be able to add value to the organization. Rowe (2004) after analyzing the impact of qualified Board of Directors on performance of a bank asserted that the impact of qualified Board of Directors on profitability is not at all clear. Bhagat and Black, (2005) examined the effect of qualified Board of Directors on long-term stock market and accounting performance and they do not find any relationship between Board composition and profitability. Ademba (2006) examined the influence of the educational qualifications of board members, on the financial performance of Kenyan banks. He used Return on Assets (ROA) and Tobin‘s Q to measure profitability and regression analyses performed on the management board and CEO. The findings indicated that the return on assets or Tobin‘s Q is influenced by educational qualifications of board members and CEO especially. The findings indicated that CEOs holding degrees from prestigious universities perform better than those without the qualifications. Naibo (2006) investigated the impact of corporate board characteristics on the financial performance of Kenyan quoted banks. By using the random-effects and fixed-effects Generalised Least Squares (GLS) regression, the study found that board education and experience was negatively linked to firm profitability Board of Directors and profitability and therefore, this study seeks to establish the association between qualification of Board of Directors and profitability of Commercial Banks in Kenya.

2.2.2 Role Definition

According to Mahaffy (2015), clear lines of accountability among the Board Chair, CEO and management should be established. He stated that there should be separation of the roles of the Board Chair and the CEO: the Chair leads the Board and ensures it’s acting in the company’s long-term best interests; the CEO leads management, develops and implements business strategy and reports to the Board. Role definition will lead to avoidance of CEO entrenchment, increase of Board monitoring effectiveness, availability of Board chairman to advise the CEO and establishment of independence between Board of Directors and corporate management (Baysinger and Hoskisson, 1990). Cannella and Lubatkin (1993) carried out a study on the relationship between CEO duality and firm profitability. They used return on assets and return on equity as measures of profitability. They reported a positive link between the two variables. Brickley, Coles, and Jarrell (1997) on investigating the effect of role definition on financial performance of a firm, adopted net interest margin, return on assets and return on equity as measures of performance and found a negative market reaction upon the announcement of splitting roles. Dedman and Lin (2002) analyzed the impact of role definition on bank performance and found no evidence of significant abnormal returns upon the announcement of splitting roles. Simpson and Gleason (1999) carried out a study on the relationship between CEO/Chairman duality and firm profitability and reported that companies that combine the roles of the CEO and chairman are less likely to be financially distressed. Muriithi (2004) who studied the relationship between corporate governance practices and performance of Kenyan banks quoted on the Nairobi Securities Exchange used net interest margin and return on equity as the performance measure. He concluded that defining roles is positively correlated with bank performance. Available information on the relationship between role definition and profitability of firms reveal conflicting results. This means more examination has to be conducted on the relationship between role definition and profitability of Commercial Banks in Kenya.

2.2.3 Operational and Ethical Controls

Not only must Directors declare conflicts of interest and refrain from voting on matters in which they have an interest, but a general culture of ethics in business dealing and of respect and compliance with laws and policies without fear of recrimination is critical (Langford, 2014). Ethical and operational controls are important and highly valued morals, not only in banking but also in business generally (Fakunyama, 1995). Steinberg (1994) argued that ethics in the world of organization's business involve "ordinary decency" which encompasses such areas as integrity, honesty and fairness. Behaving in an ethical manner is seen as part of the social responsibility of organization, which itself depends on the philosophy that organizations ought to impact the society in ways that go beyond the usual profit maximization objective (Adenubi, 2000). Mathenge (2013) reports that the Kenya financial sectors continue to witness several unreported cases of unethical conducts, with bank workers having the focus to raise money for themselves instead of offering products and services affecting bank profitability. Kehinde (2010) on a bivariate study finds no relationship between the operational and ethical controls and bank profitability. Uwuigbe (2011) examined the relationships between corporate governance and profitability in the Nigerian consolidated banks, using Pearson Correlation and the regression analysis; and established a negative but significant relationship between ethical controls and profitability of these banks. Kelifa and Yodit (2013) examined impact of corporate governance practices on profitability of commercial banks through assessment of ethics as a corporate governance practice and Return on Assets and Return on Equity as dependent profitability measures. Findings of the study indicated that ethical and operational controls had statistically significant positive effect on bank profitability. Nyarige (2012) analyzed effect of corporate governance on profitability of commercial banks in Kenya. Obtaining data from nine commercial banks listed on Nairobi Securities Exchange; setting ethical bahaviour as one of the independent variables and Tobin q ratio as proxy for profitability being the dependent variable, the findings of the study indicated that ethics has no effect on banks' profitability. Kiruri (2013) on a research of effects of ethical controls on bank profitability in Kenya, adopted Commercial banks' profitability measures as a dependent variable, while ethical controls as independent variables, found that there is lack of ethical rules in Kenyan banks which leads to lower profitability. These studies raise issues of contradictions through variations of their findings which has potential to creating inconsistency in information. This requires further assess the relationship between Operational and Ethical Controls and Profitability of Commercial Banks in Kenya.

2.2.4 Board Performance and Compensation

Firms should establish measurable performance targets for executive officers (including the CEO), regularly assess and evaluate their performance against them and tie compensation to performance (National State Auditors Association, 2004). The link between Director's pay and firm profitability provides an important incentive through which the Board of Directors can be used to tackle the agency problem. However, increasing levels of Director's compensation over the past two decades has elevated attention and concern among shareholders making it an agency problem as opposed to being a solution to the agency problem (Yatim, 2010). Rouf (2012) examined the relationship between corporate governance and Value of the Firm in Developing from Bangladesh. Results provided evidence of a positive significant relationship between ROA and monitoring board performance. Khatab, Massod, Zaman, Saleem and Saeed, (2011) investigated the relationship between corporate governance and firm's profitability of twenty firms listed at Karachi Stock Exchange. Profitability of the firms was measured by return on assets (ROA) and monitoring board performance and compensation was used as an independent variable. The result showed that tying performance to compensation has a positive impact on ROA. Kigera (2012) studied impact of board compensation on return on assets of commercial banks in Kenya. The study relied on the provisions of the prudential guidelines on corporate governance as well as the requirements of the CMA for the listed banks in Kenya. Results concluded that there is no relationship between board compensation and ROA of banks as some have declining ROA over the period despite compliance to the corporate governance requirements. Different researchers have come up with different conflicting conclusions presenting a structure of conflicting study results, where some pose no relation, and others there was negative and positive relations; hence further examination needed on the relationship between Board performance and compensation and profitability of Commercial Banks in Kenya.

2.2.5 Risk Management

Companies should regularly identify and assess the risks they face, including financial, operational, reputational, environmental, industry-related, and legal risks (Epstein and Rejc, 2005). The management of the risks occurring in the banking sector becomes important for reducing the losses of the banking industry as profitability and risk are positively related in commercial banks (Aloglu, 2005). Stone (1974), Booth and Officer (1985) and Flannery and James (1984) applied a Two-Index Model in banking and found a positive correlation between the yield on bank shares and changes in stock and bond indices (reflecting risks). In a competitive business environment where symmetrical information between the bank and its borrowers prevails, positive relationship between profitability and risk management is expected (Saunders, 1990; Shrieves and Dahl, 1992). Angeela (2010), in a bivariate study, found no relationship between the credit risk management and the profits figures for Kenyan banks within the financial statements. Low profits of banks were found even within the period when the credit facilities of the banks were also very low. In contrary, Aduda and Gitonga (2011) by using the regression model found a reasonable level relationship between the risk management and the Kenyan banks profitability level. Leila (2013) conducted a research on the relationship between corporate governance and profitability of the companies in Tehran Stock Exchange adopting Return on Equity (ROE) and Return on Assets (ROA) as the dependent variables whereas risk management, qualification of board of directors and role definition were used as independent variables. The study concluded that there is no significant relationship between the corporate risk management and Return on Equity. Azeez (2015) examined corporate governance and firm profitability in Sri Lanka. Risk management was used as a corporate governance variable and Earnings per Share (EPS), Return on Assets (ROA), and Return on Equity (ROE) as measures of profitability. Regression results indicated that risk management is negatively associated with firm ROE. Kimosop (2011) studied the relationship between corporate governance practices and profitability on all the 42 listed commercial banks in Kenya. He found out that there is significant influence of managing risk on the profitability of commercial banks. Otieno (2012) examined the Corporate Governance practices and Financial Performance of Commercial banks in Kenya with the aim of establishing the effects of corporate governance practices and policies on financial performance of commercial banks. ROE, ROA and Tobin's q ratio were used as dependent variables while risk management, was used among the independent variables. He found out that risk management plays an important role on bank stability and profitability. From the findings, he concluded that there is a significant relationship between managing risk and ROE of commercial banks. From the available literature, it is clear that there exists a relation between risk management and profitability of Commercial Banks but studies present contradictory information in terms of the relationship of the two. It is on this note that this study will determine the relationship between risk management and profitability of commercial banks in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

This section discusses the methods and procedures that were employed in carrying out the research. It discusses the research design, study population, research instruments, data collection procedure, pilot testing, data analysis and presentation

3.1 Research Design

This study applied a Correlational Research Design. According to Kothari (2014), Correlational research design examines the relationship of two or more variables without any attempt to influence them and also tests the hypotheses of causal relationships between variables.

3.2 Study Area

The study was conducted in Kisumu County. The county is situated in Western part of Kenya. It boarders Siaya County to the West, Vihiga County to the North, Nandi County to the North East and Kericho County to the East. Its neighbor to the South is Nyamira County and Homa Bay County is to the South West. Kisumu County is one of the 47 Counties in Kenya lying within longitudes 33° 20’E and 35° 20’E and latitudes 0° 20’ South and 0° 50’ South.

3.3 Target Population

Sanders et al (2003) further defines population as the full set of cases from which a sample was taken. Target population in statistics is the specific population about which information is desired. The target of this study was 85 branch managers from 13 Commercial Banks in Kisumu County.

3.4 Sample Size

Census study was carried out on all the population. According to Kothari (2006) Census is the best method when a population of the study is small. In this case, the target population was bank managers who are 85 in Kisumu County.

3.5 Data Collection Methods

The study used both primary and secondary data. According to Shodhganga (2012), primary data are information collected by a researcher specifically for a research assignment. i.e. information which a company must gather and is yet to be compiled and published in a forum accessible to the public. According to Shodhganga (2012), secondary data on the other hand are the data collected by a party not related to the research study but collected these data for some other purpose and at different time in the past.

3.6 Data Collection Instruments

Semi-structured questionnaires was used as a primary data collection instrument by administering them to the sampled commercial banks. Questionnaires are data collection instruments which consist of a series of questions and other prompts for the purpose of gathering information from respondents (Karim, 2013).

3.7.1 Validity tests

According to Kothari (2004), validity is the extent to which differences found with a measuring instrument reflect true differences among those being tested. The study adopted content validity as a measure of the degree to which data was obtained from the research instrument. Content validity of the questionnaire was ensured by giving it to the research experts in the field of finance to review and consequently corrected accordingly.

3.7.2 Reliability Tests

The Cronbach's Alpha technique was used to test the reliability of the research instrument, a sample of 10 branch managers were randomly selected. These were pretested before the actual data collection in order to check the reliability of the research instruments. A total of 8 items were therefore pretested with a threshold Cronbach's Alpha value of 0.7 in order to pass the reliability test. Instruments with reliability value more than 0.7 would be deemed to be reliable while those with reliability value less than 0.7 would be corrected and the instrument pretested again. Table 3.1 presents the reliability results for the 8 items tested.

Table 3.1 Reliability Test using Cronbach's Alpha Coefficient

Items (n=5 items)	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted
Qualification of Board of Directors	.320	.775
Role Definition	.562	.730
Operational and Ethical Controls	.612	.723
Board performance and compensation	.278	.785
Risk Management	.485	.753
Overall Cronbanch's Alpha		0.772

Source: Research Data 2017

From the Table 3.1 the reliability test results of Cronbach's Alpha test reveal coefficients of 0.775 for qualification of board of directors, 0.730 for role definition, 0.723 for operational and ethical controls, 0.785 for board performance and compensation and 0.753 for risk management. An overall reliability value of 0.772 for all the items was obtained. All these coefficients are more than 0.700; acceptable range according to Huysamen (2006). The tools can therefore be applied in collecting the requisite data for the study; due to the determined high level of overall consistency

3.8 Data analysis

Data was analyzed using descriptive, correlational and regression analysis techniques. Descriptive analysis deals with describing what exists and tries to pave the ground for finding new facts (Walliman, 2011). This study used descriptive analysis because according to Lans and Van (2002), it has a high degree of objectivity, is more expansive and it gives a broader picture of an event. Correlation analysis was used to measure the association between variables and quantitate the strength of their relationship. Godfrey (1985) asserts that some advantages of correlation analysis are that it is not influenced by the units of measure, it yields insight into relationships between variables and reveals effects. Regression analysis was adopted to determine the effect of independent variables on a dependent variable and to predict the value of one variable based on the value of one or more other variables. Euro Surveillance (2002) states that it provides a more reliable approach to forecast and hence, this study used regression analysis.

3.9 Model Specification and Variable Definition

The broad objective of this research was to analyze the Effect of Corporate Governance Practices on Profitability of Commercial Banks in Kenya. The data used for the purpose of this study was obtained from annual reports of 13 Commercial Banks in Kisumu County and Primary data collected. A period of 5 years was considered. To test the hypothesis, the relationship between corporate governance practices and profitability was considered. The model used for the purpose of the study is:

$$P=\beta_0+\beta_1 QB+\beta_2 RD+\beta_3 OE+\beta_4 BP+\beta_5 RM+\ldots u$$

Where: P= Profitability measured by Net Interest Margin, Return on Equity and Return on Assets

β_0 = Regression Coefficients

QB = Qualification of Board of Directors

RD = Role Definition

OE =Operational and Ethical Controls

BP = Board Performance and Compensation

RM = Risk Management

u = Stochastic error term

CHAPTER FOUR

RESULTS AND DISCUSSIONS

4.0 Introduction

This chapter presents the findings and discussions of the study as per the objectives. The aim of the study was to analyze the effect of corporate governance practices on profitability of commercial banks in Kenya. The analysis was based on data that was gathered exclusively from the structured questionnaires and Bank Supervision reports alongside Commercial Banks' official websites. The findings of the study are presented using means, standard deviations for descriptive statistics and Pearson's correlation coefficient and regression coefficients for inferential statistics. A brief presentation of demographic characteristics and response return rate are preliminarily presented.

4.1 Response Return Rate

The total number of questionnaires that were administered to the respondents was 75 questionnaires. The caliber of the respondents from the target population was top managers in commercial banks in Kisumu County, Kenya. Out of a total of 75 targeted bank managers in various banks sections, 71 questionnaires were returned with adequate data. This transformed to percentage yields 94.67% return rate. Table 4.1 gives information on the number of bank managers from each bank.

Table 4.1: Response from each of the Banks.

	Frequency	Percent
Bank of Africa	6	8.5
Barclays Bank	6	8.5
Cfc Stanbic Bank	6	8.5
Cooperative Bank	5	7.0
Diamond Trust Bank	5	7.0
Standard Chartered Bank	6	8.5
Equity Bank	11	15.5
I&M Bank	5	7.0
Bank of India	6	8.5
Kenya Commercial Bank	10	14.1
National Bank of Kenya	5	7.0
Total	71	100.0

Source: Research Data 2017

The results in table 4.1 shows sample banks and the number of managers that participated in the study. It is clear from the findings that Equity bank had the highest number of managers 11(15.5%) responding to the study questionnaire followed by KCB bank with 10(14.1%) respondents, Bank of Africa, Barclays bank, Standard Chartered Bank, CFC Stanbic bank, all with 6(8.5%) each and finally the least were co-operative bank, Diamond Trust bank, I & M bank and National Bank of Kenya with each having 5(7.0%) respondents.

4.2 Demographic Characteristics of the Banks and Respondents

The study also sought bank characteristics and demographic characteristics of the bank managers. For the banks, the study was interested in current number of employees, number of members serving in the board, composition of the board and number of times the board meets in a year. For the manager's characteristics, the study was interested in the gender of the respondents only. The findings for some of the traits are presented as shown in table 4.2 below.

Table 4.2. Bank Characteristics and Respondents demographic information

Characteristics	Board Category	f	%
Current number of employees	More than 1000	71	100
Number of Bank Managers	5-9 members	28	39.4
	10-14 members	38	53.5
	15-20 members	5	7.0
Composition of board	Mix of executive and non-executive/independent	71	100.0
Number of times the board meets in a year	Once in a year	71	100.0
Gender of Respondents	Male	43	60.6
	Female	28	39.4

Source: Research Data 2017

Table 4.2 presents frequency results for all the banks that participated in the study. The total respondents consisted of current number of employees was more than 1000 and the board composition was a mix of executive, non-executive and independent as indicated by 100% response in both cases. The results indicate that the respondents consisted of 28 managers from Banks with Board membership of between 5 – 9, while 38 managers were from Banks with Board membership of between 10 – 14, and 5 managers from Banks with Board membership of between 25 – 20. This constituted 39.4%, 53.5% and 7% respectively. The commercial Bank Board membership constitutes a mix of executive with management responsibilities and non-executive/independent without management responsibilities. Of the 71 managers, 43 were male while 28 were female; responding to a 60.6% to male and 39.4% to female respectively.

4.3 Qualification of Board of Directors and Profitability of Commercial Banks

The first objective of the study was to establish the association between qualification of board of directors and profitability of commercial banks. To achieve this objective, two steps were carried out; that is approximating the average level of respondents' agreement on qualification of board of directors, on the basis of a five point Likert scale questionnaire whose findings are presented as shown on table 4.3 using means and standard deviations. Subsequently, correlation and regression analyses were carried out to determine the level and magnitude of association and effect power of the independent variables on the dependent variables.

Table 4.3 Level of Qualification of Board Members

Statements	M	SD
1. Directors are knowledgeable, have expertise relevant to the business, qualified and competent.	3.07	0.74
2. BOD has an appropriate structure in terms of diversity.	3.54	0.65
3. Company sets the criteria which defines the required expert and professional knowledge and experience, as well as other requirements to be met so as to be appointed a director	3.45	0.65
4. Your bank has training programs for management committees	3.41	0.73
5. The size and composition of the board of directors is reviewed periodically with intent to render the board more effective and efficient	3.55	0.63
6. Members of the board have undergone training in directorship prior to appointment	3.61	0.49
7. Board is able to provide a balanced and understandable assessment of the organization's position	3.61	0.75
8. The Board consists of the executive and non-executive members on a fairly balanced proportion	3.38	1.01
9. The selection process considers present skills and requirements in the Board of directors	3.46	1.03
10. A succession plan is in place for the Board's chairperson, Board members, the CEO and the senior management	3.77	0.68
Overall mean and standard deviation	3.46	0.24

KEY: SD-Standard Deviation; M-Mean

Source: Research Data 2017

The findings in table 4.3 indicate the level of agreement among the respondents on qualification of board of directors. Respondent's response on the fact that directors are knowledgeable, have expertise relevant to the business, qualified and competent was neutral (M=3.07, SD=0.74). It also emerged from the responses that BOD has an appropriate structure in terms of diversity as agreed (M=3.54, SD=0.65). Furthermore, respondents agreed that, the companies sets the criteria which defines the required expert and professional knowledge and experience, as well as other requirements to be met so as to be appointed a director (M=3.45, SD=0.65). The same trend of agreement was echoed on the questions that bank have training programs for management committees (M=3.41, SD=0.73), **S**ize and composition of the board of directors is reviewed periodically with intent to render the board more effective and efficient (M=3.55, SD=0.63), members of the board have undergone training in directorship prior to appointment (M=3.41, SD=0.73) and that board is able to provide a balanced and understandable assessment of the organization's position (M=3.61, SD=0.49). The findings also reveals that board consists of the executive and non-executive members on a fairly balanced proportion with agreement (M=3.38, SD=1.01), the selection process considers present skills and requirements in the Board of directors (M=3.46, SD=1.03), and a succession plan is in place for the Board's chairperson, Board members, the CEO and the senior management (M=3.77, SD=0.68) from respondents agreement and finally, an overall mean on the level of agreement (M=3.46, SD=0.24) implies that respondents agreed that board of directors were qualified.

4.4 Role Definition among Commercial Banks

The study sought level of role definition among commercial banks using various statements. The findings were measured on a five point likert scale and presented using means and standard deviations. The aim of establishing level of agreement among the respondents was to come up with appropriate means to correlate with profitability and obtain an association between the two. The findings on respondent's level of agreement on role definition are presented as shown in table 4.4 below.

Table 4.4 Level of Role Definition among Commercial Banks

Statements	M	SD
1. There is separation of the post and roles of the Board Chair and the CEO (No CEO/Chairman Duality)	2.99	0.57
2 The Company's act clearly defines the authorizations and responsibilities of the executive directors	3.51	0.65
3. Employees are allowed to be in a material business relationship (e.g. as a supplier or customer) with the Company or other group member	3.21	0.58
4. A better understanding of the role and function of the Chairperson and the Chief Executive Officer is laid down in the company's code	3.54	0.63
5. The Board has formally constituted and recorded committees with clearly defined terms of reference, composition and reporting mandates	3.61	0.62
6. Board defines and communicates to management their powers, roles and responsibilities	3.62	0.62
7. Board consults technocrats on professional matters	3.54	0.84
8. Board has got an operating plan that defines its functions, activities and its objectives	3.48	0.63
9. Board conducts its activities in a free and democratic atmosphere	3.62	0.49
10. The Board is involved in the selection of the directors	3.62	0.49
Overall mean and standard Deviation	3.47	0.28

KEY: SD-Standard Deviation; M-Mean

Source: Research Data 2017

The findings in Table 4.4 shows that there is neutral response on separation of the post and roles of the Board Chair and the CEO (No CEO/Chairman Duality) as indicated by mean and standard deviation (M=2.99, SD=0.57). The findings however indicate an agreement on the fact that the company's act clearly defines the authorizations and responsibilities of the executive directors (M=3.51, SD=0.65), and also employees are allowed to be in a material business relationship (e.g. as a supplier or customer) with the Company or other group member (M=3.21, SD=0.58). It was also clearly agreed that a better understanding of the role and function of the Chairperson and the Chief Executive Officer is laid down in the company's code (M=3.54, SD=0.63). Respondents further show an agreement that board has formally constituted and recorded committees with clearly defined terms of reference, composition and reporting mandates (M=3.61, SD=0.62) and board defines and communicates to management their powers, roles and responsibilities (M=3.62, SD=0.62). It emerged that board consults technocrats on professional matters as indicated by mean agreement, (M=3.54, SD=0.84). Further findings indicates that board has got an operating plan that defines its functions, activities and its objectives (M=3.48, SD=0.63), the board conducts its activities in a free and democratic atmosphere (M=3.62, SD=0.49) and finally, the board is involved in the selection of the directors (M=3.62, SD=0.49). An overall mean of 3.47 and a standard deviation of 0.28 confirmed that respondents agreed that there were clearly defined roles among commercial banks.

4.5 Operational and Ethical Control's association with Bank Profitability

The third objective of the study entailed fining association between operational & ethical controls and bank profitability. The study therefore used statements that are theoretically aligned to define operational and ethical controls to establish their level on a five point Likert scale. The findings are presented as shown in Table 4.5 using means and standard deviations.

Table 4.5 Level of Operational and Ethical Controls

Statements	M	SD
1. Trust and integrity are important and highly valued morals among the bank employees.	3.30	0.62
2. Bank Managers are challenged and have met the obligation on bank operation and society at large, to support and assist the society to imbibe the ethical culture in which there is the interest of everyone.	3.75	0.60
3. Management has established an ethical tone at the top by setting a good example of ethical conduct, providing positive and open communication, and supporting ethical conduct	3.44	0.65
4. There are resources adequate for the organization's ethics program	3.83	0.38
5. Ethics is a focus during regular top management meetings	3.83	0.38
6. There is a designated ethics officer or ethics contact	3.52	0.50
7. Ethics is a focus during hiring and employee training process	3.39	0.75
8. Your bank has a written ethics code	3.39	0.62
9. Importance of ethics is communicated to all employees on a regular basis via formats such as organization newsletter articles and posters	3.77	0.42
10. Your organization has an ethics hotline	3.83	0.38
11. An ethical culture has been ingrained in the organization's brochures, materials, and website	3.48	0.75
12. Staff treat each other with respect and dignity	3.46	0.50
13. Where the conduct of any director becomes questionable, he or she is asked to leave the Board	3.54	0.65
14. Interest and conflicts between Board members are declared and resolved amicably	3.75	0.71
Overall mean and standard Deviation	3.59	0.28

KEY: SD-Standard Deviation; M-Mean

Source: Research Data, 2017

The findings in table 4.5 indicates that trust and integrity are important and highly valued morals among the bank employees as agreed among the respondents, (M=3.30, SD=0.62), and bank managers are challenged and have met the obligation on bank operation and society at large, to support and assist the society to imbibe the ethical culture in which there is the interest of everyone (M=3.75, SD=0.60), Management has established an ethical tone at the top by setting a good example of ethical conduct, providing positive and open communication, and supporting ethical conduct as agreed by respondents, (M=3.44, SD=0.65),]. The findings also indicate that respondents agreed on the fact that there are resources adequate for the organization's ethics program (M=3.83, SD=0.38), and ethics is a focus during regular top management meetings, (M=3.83, SD=0.36) and hiring and employee training process (M=3.39, SD=0.75). Besides, there is a designated ethics officer or ethics contact as well from the respondents agreement on the statement, (M=3.52, SD=0.50). The findings also indicates that banks have a written ethics code (M=3.39, SD=0.62) and importance of ethics is communicated to all employees on a regular basis via formats such as organization newsletter articles and posters (M=3.77, SD=0.42). From the findings, it further emerged from respondents agreement that there is an ethics hotline (M=3.83, SD=0.38) and ethical culture has been ingrained in the organization's brochures, materials, and website (M=3.48, SD=0.75). Staff treat each other with respect and dignity from strong agreement, (M=3.46, SD=0.50) and in case the conduct of any director becomes questionable, he or she is asked to leave the Board (M=3.54, SD=0.65). There was also an agreement on the fact that interest and conflicts between Board members are declared and resolved amicably (M=3.75, SD=0.71). The overall mean and standard deviation indicated that there are high operational and ethical controls.

4.6 Board Performance and Compensation and Bank Profitability

The fourth objective of the study aimed at analyzing the relationship between Board Performance and Compensation and Profitability of Commercial Banks in Kisumu County. The first step was to establish the level of agreement on board performance and compensation through computed respondents views on the items on the dimension. Various items were used on the same and measured on a five point Likert scale. The findings are presented as shown in table 4.6 using means and standard deviations.

Table 4.6 Board performance and compensation

Statements	M	SD
1. Performance of staff is regularly assessed and evaluated	3.23	0.59
2. The company ties compensation to performance	3.24	0.80
3. There is a written remuneration policy	3.63	0.62
4. The firm adopts a transparent and publicly available remuneration policy for the Board of Directors members	3.20	0.71
5. Remuneration paid to the company's commission members is included in the remunerations policy for the Company's Commission members, i.e. determined within the framework defined by the Company's assembly	3.62	0.49
6. Remuneration paid depends on their contribution to attaining corporate financial and non-financial results and business goals	3.14	0.66
7. Specific committee (i.e executive compensation, audit or personnel) has a responsibility for evaluation of the CEO’s performance and compensation	3.86	0.35
8. A set of performance standards of criteria that allow for periodic evaluation of a Council director‘s performance has been established	3.62	0.62
9. The board takes collective responsibility for the performance of the organization.	3.72	0.59
10. The board has a good understanding of the performance of the organization relative to other bodies, where appropriate.	3.76	0.43
11. Management provides a thorough analysis of performance against budget, targets and key outcomes, and discusses any necessary remedial action	3.23	0.59
13. The board gets early-warning signals of problems ahead that will adversely affect key outcomes, targets or financial performance	3.24	0.80
Overall mean and standard deviation	3.51	0.25

KEY: SD-Standard Deviation; M-Mean

Source: Research Data, 2017

Table 4.6 presents the findings on the level of board performance and compensation. Respondents agreed that performance of staff is regularly assessed and evaluated as indicated by a mean of 3.23 and standard deviation of 0.59 which shows no deviation from the mean. The companies, which are the banks, ties compensation to performance as indicated by agreement among the respondents with a mean of 3.24, which is above neutral and standard deviation of 0.80, which is below 1 indicating small deviations or movement away from the mean. Furthermore, the findings indicates that there is a written remuneration policy as agreed among the respondents with means and standard deviations of (M=3.63, SD=0.62) respectively. The banks adopts a transparent and publicly available remuneration policy for the Board of directors as shown by means and standard deviation of (M=3.20, SD=0.71) and remuneration paid to the company's commission members is included in the remunerations policy for the Company's Commission members, i.e. determined within the framework defined by the Company's assembly as shown by means and standard deviation of (M=3.62, SD=0.49). Remuneration paid depends on their contribution to attaining corporate financial and non-financial results and business goals

(M=3.14, SD=0.66) from respondents agreement, and in addition, specific committee (i.e executive compensation, audit or personnel) has a responsibility for evaluation of the CEO's performance and compensation from respondents agreement of (M=3.86, SD=0.35). The findings further reveal that a set of performance standards of criteria that allow for periodic evaluation of a Council director‘s performance has been established (M=3.62, M=0.62) according to respondents agreement on the scale. The board also takes collective responsibility for the performance of the organization based on the agreement of the respondents (M=3.72, SD=0.59) and also, the board has a good understanding of the performance of the organization relative to other bodies from respondents means of (M=3.76, SD=0.43). Clear agreement among respondents indicated that management provides a thorough analysis of performance against budget, targets and key outcomes, and discusses any necessary remedial action (M=3.23, SD=0.59) and the board gets early-warning signals of problems ahead that will adversely affect key outcomes, targets or financial performance as indicated by means and standard deviations of 3.24, and 0.80 respectively.

4.7 Risk Management and Bank Profitability

In this objective, the study sought to establish whether banks could increase their profits by taking more risks. This is through establishing an association between the two variables. With regard to this, the independent variable, which is risk management, was there measured using means and standard deviations from the respondents answer on the items related to risk management. The findings were presented in table 4.10 using means and standard deviations.

Table 4.7 Level of Risk Management

Statement	M	SD
1. Risks faced are regularly identified and assessed	3.24	0.43
2. The Board accepts it their responsibility for strategic leadership in establishing the company's risk tolerance and developing a framework and clear accountabilities for managing risk.	3.44	0.50
3. The board has a sound process for identifying and regularly reviewing its principal risks, and makes the necessary amendments in the light of changes in the internal and external environment		
4. The board takes full account of risk in its decisions , for example, in relation to proposed major projects and programs	3.69	0.47
5. The board receives reliable projections of future cash flows for the medium as well as the short term, and is confident that the available funding will enable the organization to develop and operate as planned	3.54	0.50
6. The board is satisfied there have been no problems with regulatory and similar requirements, and that sound health and safety, employment and other practices are implemented to protect the organization against unnecessary litigation and reputation risk	3.62	0.49
7. The board is aware of changing demand patterns and is confident that these can be met from the resources available and within the organization's statutory remit	3.93	0.26
8. The board monitors the political environment for potential changes to its remit and assesses the impact these will have on the strategy	3.69	0.47
9. The board is aware of the organization's information needs. Any exceptions to best practice over data acquisition, usage, storage and destruction are reported	3.85	0.36
10. No substantial, unexpected problems have emerged which the board should have been aware of earlier	3.83	0.38
Overall mean and standard deviation	3.51	0.25

KEY: SD-Standard Deviation; M-Mean

Source: Research Data, 2017

Table 4.7 presents the findings on risk management level among commercial banks. It was agreed among respondents that risks faced are regularly identified and assessed (M=3.24, SD=0.43) and furthermore, the board accepts it as their responsibility for strategic leadership in establishing the company's risk tolerance and developing a framework and clear accountabilities for managing risk (M=3.44, SD=0.50). The board has a sound process for identifying and regularly reviewing its principal risks, and making the necessary amendments in the light of changes in the internal and external environment as indicated by respondents agreement (M=3.69, SD=0.47). The respondents further agreed that the board receives reliable projections of future cash flows for the medium as well as the short term, and is confident that the available funding will enable the organization to develop and operate as planned (M=3.54, SD=0.50). In addition, the findings indicates an agreement that the board is satisfied there have been no problems with regulatory and similar requirements, and that sound health and safety, employment and other practices are implemented to protect the organization against unnecessary litigation and reputation risk (M=3.62, SD=0.49). In addition, the board is aware of changing demand patterns and is confident that these can be met from the resources available and within the organization's statutory remit (M=3.93, SD=0.26) and also monitors the political environment for potential changes to its remit and assesses the impact these will have on the strategy from respondents agreement (M=3.69, SD=0.47). The board is aware of the organization's information needs. Any exceptions to best practice over data acquisition, usage, storage and destruction are reported as agreed y respondents (M=3.85, SD=0.36), and no substantial, unexpected problems have emerged which the board should have been aware of earlier (M=3.83, SD=0.38). The overall mean (3.59) and standard deviation (0.28) implies that there is an agreement that the board has good risk management among the banks, a factor that could be associated with bank profitability

4.8 Correlation Analysis

Table 4.8 Correlation Results for all the variables

Correlations							
		board performance and compensation	**board qualifications**	**operational and ethical controls**	**risk management**	**role definition**	**profitability**
board performance and compensation	Pearson Correlation	1	.406**	.019	.413**	.263*	.335**
	Sig. (2-tailed)		.000	.876	.000	.027	.004
	N	71	71	71	71	71	71
board qualifications	Pearson Correlation	.406**	1	.170	.231	-.191	.270*
	Sig. (2-tailed)	.000		.156	.053	.111	.023
	N	71	71	71	71	71	71
operational and ethical controls	Pearson Correlation	.019	.170	1	.619**	.545**	.623**
	Sig. (2-tailed)	.876	.156		.000	.000	.000
	N	71	71	71	71	71	71
risk management	Pearson Correlation	.413**	-.231	.619**	1	.316**	.561**
	Sig. (2-tailed)	.000	.053	.000		.007	.000
	N	71	71	71	71	71	71
role definition	Pearson Correlation	.263*	-.191	.545**	.316**	1	.373**
	Sig. (2-tailed)	.027	.111	.000	.007		.001
	N	71	71	71	71	71	71
profitability	Pearson Correlation	.335**	.270*	.623**	.561**	.373**	1
	Sig. (2-tailed)	.004	.023	.000	.000	.001	
	N	71	71	71	71	71	71

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

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

Source: Research Data, 2017

4.8.1 Association between Qualification of Board of Directors and Profitability of Commercial Banks in Kisumu County

The main aim of the first objective was to establish association between qualification of board of directors and profitability of commercial banks in Kisumu County. The study employed Pearson product moment correlation since the variables of the study were ratio scale. This was also because apart from establishing mere association, both strength and direction of the association could be ascertained. Therefore means on qualification of board of directors as obtained in Table 4.8 were correlated with those of profitability of commercial banks. The findings show that there is a positive significant correlation between board of directors and profitability of commercial banks (r=.270, p=.023). This implies that there is an association between board of directors and profitability and secondly, the association is positive and significant. From these findings, more information can be obtained upon keenly examining the correlation coefficient. The coefficient value (0.270) can be squared to obtain a value of 0.073, a value that if multiplied by 100% gives rise to percentage change in profitability as a result of board qualification. This is in fact a variation of 7.3% which can be interpreted as the variance in profitability when only board qualification is considered without shared variance among other variables. This could be a significant variance, although this can be ascertained through regression model analysis. Based on these study findings, it can thus be concluded that bank profitability is associated with board qualifications such that the better the board qualification, the more the bank's profitability. In this case, banks could be recommended to employ managers that are well qualified and during selection of board members, the panelists should ensure that the board members selected are of high qualifications.

From the review of the existing literature, these findings agree with those of Ademba (2006) who examined the influence of the educational qualifications of board members, on the financial performance of Kenyan bank using Return on Assets (ROA) and Tobin's Q to measure profitability and regression analyses performed on the management board and CEO. He found a positive relationship between the two The slight difference in these findings results from the fact that Ademba (2006) used regression analysis on ROA only as the dependent variable. The present study combines multiple dimensions of bank profitability including return on assets among others that are return on equity and net interest margin, which makes it better placed when measuring bank profitability. However, Bhagat and Black, (2005) examined the effect of qualified Board of Directors on long-term stock market and accounting performance and did not find any relationship between Board composition and profitability. It can however be concluded that there is a relationship between board performance and bank profitability due to a combination of the dimensions used to measure bank performance and the strength from the previous literature.

4.8.2 Association between Role Definition and Bank Profitability

To establish the association between role definition and bank profitability as defined in the objective of the study, Pearson product moment correlation was carried out. The study hypothesis stated that "There is no significant relationship between Role Definition and Profitability of Commercial Banks in Kisumu County". Therefore the means on bank profitability and role definition were correlated and the results presented as shown in table 4.8 above. The findings show a positive significant correlation between role definition among commercial banks and bank profitability (r=.373, p=.001). This implies that there is a positive association between role definition and bank profitability such that the better the roles are defined, the more the banks realize profit. Since the two variables are significantly related, we reject the null hypothesis and adopt an alternative hypothesis indicating that there is a significant relationship between the two variables. These findings have other more implications apart from the strength and direction of the nature of association. For instance, if the correlation coefficient value is squared, we obtain the shared variance between bank profitability and role definition, which could as well be treated as the coefficient of determination. This gives the overall variance in bank profitability accounted for by role definition when no other variables are included in the correlation model.

The findings of this study agree with those of other studies on an almost same study topic. For instance, Cannella and Lubatkin (1993) carried out a study on the relationship between CEO duality and firm profitability. They used return on assets and return on equity as measures of profitability. They reported a positive link between the two variables. However, Cannella and Lubatkin (1993) findings did not incorporate net interest margin as in the case of the present study. Brickley, Coles, and Jarrell (1997) on investigating the effect of role definition on financial performance of a firm, adopted net interest margin, return on assets and return on equity as measures of performance and found a negative market reaction upon the announcement of splitting roles. Their findings draws missed reactions and could be declined for generalizability on the basis of the negative relationship, especially due to an improvement in the market knowledge for the current banks of the study. The findings also differ with those of Dedman and Lin (2002) who analyzed the impact of role definition on bank performance and found no evidence of significant abnormal returns upon the announcement of splitting roles. Simpson and Gleason (1999) carried out a study on the relationship between CEO/Chairman duality and firm profitability and reported that companies that combine the roles of the CEO and chairman are less likely to be financially distressed. Despite these few contradicting findings, the banks under study are completed modernized and with high level roles. These findings and others therefore confirm that role definition is strongly associated with bank profitability and has an effect on bank profitability.

4.8.3 Correlation between Operational & Ethical Control and Bank Profitability

Pearson Product moment correlation was used to establish whether there is an association between operational ethics and bank profitability. The means for the two variables were obtained and correlated. The findings are presented as shown in table 4.8 using (r) values. The findings show a moderate positive significant correlation between operational ethical control and bank profitability (r=.623, p=.000). This is an indication that as the banks improve on their operation and ethics, there is a consequent improvement in profitability. As compared with the other defining variables such as board qualification and role definition, operational and ethical control emerges to have moderate relationship. This variable also gives the highest (38.81%) variance that accounts for bank profitability, which is obtained by squaring the coefficient. This means bank profitability is associated with operational and ethical control and accounts for a significant variance in bank profitability.

A review of literature indicates that Kelifa and Yodit (2013) examined impact of corporate governance practices on profitability of commercial banks through assessment of ethics as a corporate governance practice and Return on Assets and Return on Equity as dependent profitability measures. Findings of the study indicated that ethical and operational controls had statistically significant positive effect on bank profitability hence similar to the present study findings. However, there are differences for other studies such as Nyarige (2012) who analyzed effect of corporate governance on profitability of commercial banks in Kenya. Obtaining data from nine commercial banks listed on Nairobi Securities Exchange and setting ethical bahaviour as one of the independent variables and Tobin q ratio as proxy for profitability being the dependent variable, the findings of the study indicated that ethics has no effect on banks' profitability. Kiruri (2013) on a research of effects of ethical controls on bank profitability in Kenya, adopted Commercial banks' profitability measures as a dependent variable, while ethical controls as independent variables, found that there is lack of ethical rules in Kenyan banks which leads to lower profitability. However, it can be concluded that operational and ethical controls have an effect on bank profitability and are associated.

4.8.4 Correlation between Board performance & compensation and Bank Profitability

The study sought an association between Board performance & compensation and Bank Profitability using Pearson product moment correlation. This was to test the null hypothesis which stated that **“**There is no significant relationship between Board Performance and Compensation and Profitability of Commercial Banks in Kisumu County”. This was achieved by taking the means of the two variables and correlating them. The findings are presented in table 4.8 using correlation coefficients. The findings indicate a positive significant correlation between board performance& compensation and bank profitability (r=.335, p=.004). This implies that the two variables are associated positively such that as board performance and compensation improves, there is occurrence of improvement in bank profitability as well. This means that bank profitability depends on board performance and compensation. From the findings, keen analysis also reveals that board performance explains 11.2% variation in the bank profitability. This value is obtained after squaring the correlation coefficient value and thereafter multiplying it by 100%. Therefore, the null hypothesis of the study can be rejected and an alternative hypothesis adopted, which indicates a significant relationship between the two variables.

These findings are almost similar to those of Rouf (2012) who examined the relationship between corporate governance and Value of the Firm in Developing from Bangladesh. Results provided evidence of a positive significant relationship between ROA and monitoring board performance. In addition, the findings agree with those of Khatab, Massod, Zaman, Saleem and Saeed, (2011) who investigated the relationship between corporate governance and firm’s profitability of twenty firms listed at Karachi Stock Exchange. However, these findings are different from those of Kigera (2012) who studied impact of board compensation on return on assets of commercial banks in Kenya. The study relied on the provisions of the prudential guidelines on corporate governance as well as the requirements of the CMA for the listed banks in Kenya. Results concluded that there is no relationship between board compensation and ROA of banks as some have declining ROA over the period despite compliance to the corporate governance requirements. Hover, due to the advancing technology in the study area, and the nature of commercial banks under the area of study, it can be concluded that there is a significant relationship between board performance and compensation and bank profitability. This means that banks that practice good compensation mechanisms with ensuring better performance will end up with more profit.

4.8.5 Correlation between Risk Management and Bank Profitability

The final objective of the study sought to establish the association between bank profitability and risk management. From the literature reviewed, it was hypothesized that risk management could in some way affect bank profitability. Pearson product moment correlation was therefore used to establish if risk management was associated with bank profitability using correlation coefficients as indicated in table 4.8. The findings in table 4.8 indicate that there is a moderate positive significant correlation between risk management and bank profitability ($r=.561$, $p=.000$). This means that when banks take more risk management, there is higher profit income as compared to when no risk management is taken. The value of 0.561 was squared to obtain the shared variance of .3147 between the two variables. This means that risk management accounts for 31.47% change in bank profitability when no other variable is included in the model. Therefore, high risk management is associated with high bank profitability among banks.

The findings are supported by Aloglu (2005) who states that the management of the risks occurring in the banking sector becomes important for reducing the losses of the banking industry as profitability and risk are positively related in commercial banks. Furthermore, Stone (1974), Booth and Officer (1985) and Flannery and James (1984) applied a Two-Index Model in banking and found a positive correlation between the yield on bank shares and changes in stock and bond indices (reflecting risks). These findings and others coupled with the current study findings leads to the conclusion that risk management has an influence on bank profitability among commercial banks in Kisumu County, Kenya.

4.9 Summary Effect of Corporate Governance Practices on Profitability of Commercial Banks in Kenya.

In order to capture the overall effect of corporate governance practices on profitability of commercial banks in Kenya, a standard multiple regression models was carried out. The independent variables composing corporate governance practices were role definition, board qualification, board performance and compensation, operational and ethical controls and risk management. Therefore bank profitability, which was a combination of return on assets, return on equity and net interest margin was regressed on corporate governance practices. The summary model results are presented as shown in table 4.9 below.

Table 4.9 Summary Model Results on Effect of Corporate Governance on Bank Profitability.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.798[a]	.637	.609	.10339	.637	22.836	5	65	.000

a. Predictors: (Constant), Role definition, Board qualifications, Risk management, Board performance and compensation, Operational and ethical controls

Source: Research Data, 2017

The findings in table 4.9 show that there is a positive relationship between corporate governance and bank profitability as indicated by R value of 0.798 in the overall model. This means that the two variables are associated. The findings further show an R square value of 0.637, which is the proportion of variance in the bank profitability accounted for by corporate governance. This value can as well be expressed as a percentage when multiplied by 100% so that a value of 63.7% becomes the overall percentage change in bank profitability accounted for by corporate governance. An adjusted R square value of 0.609 was obtained after shrinkage so as to get the true population value when errors in the estimation were controlled for. Thus it is clear that corporate governance explained 60.9% change in bank profitability. An F value of 22.836 confirms that the findings are not by chance but as a result of fitting the model and therefore the model is significant, $F(5, 65)=22.836$, $P=.000$. These findings imply that in overall, corporate governance significantly accounts for over half of change of commercial bank profitability based on the selected variables.

4.9.1 Coefficients on the Contribution of each Corporate Governance Dimensions on Bank Profitability

In this sub-section, the study presented the findings on the contribution of each dimension of corporate governance on bank profitability. Standardized coefficient values are therefore used since they indicate the unique contributions of each dimension after an overall comparison on the same scale through standardization process. The findings are presented as shown in table 4.12 that follows.

Table 4.10 Model Coefficients on the Contribution of Each Corporate Governance Dimension.

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.148	.477		.309	.758
	board performance and compensation	.231	.060	.362	3.844	.000
	board qualifications	.211	.043	.458	4.960	.000
	operational and ethical controls	.166	.078	.291	2.132	.037
	risk management	.373	.151	.302	2.480	.016
	role definition	.065	.059	.112	1.098	.276

a. Dependent Variable: y-profitability

Source: Research Data, 2017

Therefore, on the basis of the analysis model;

Profitability = 0.148(Constant)+0.231(BP)+0.211(QB)+0.166(OE)+0.373(RM)+0.65(RD); all significant at P=0.05 except to role definition which was insignificant. The results imply that for every unit change in profitability, Board performance contributes 0.231significant while at P=0.000, Board qualification contributes 0.211 while at P=0.000, operational and ethical controls contributes 0.166 while at P=0.037, risk management contributes 0.373 while at 0.016 and role definition contributes 0.065 while at P=0.276. From the findings presented in table 4.12, there would be a change in corporate governance by a value of 0.148 (constant value), without an introduction of any independent variable in the model. However, based on the selected variables, the findings indicates that board qualification as a dimension of corporate governance has the most unique significant contribution to bank profitability (β=.458, p=.000) followed by board performance risk management (β=.302, p=.016) and finally compensation (β=.362, p=.000), operational and ethical control (β=.291, p=.037). However, it emerged that role definition did not have a significant effect on bank profitability. These findings imply that whenever any of the mentioned dimensions are increase, there are significant improvements in bank profitability, leading to realization of maximum profit among commercial banks.

According to the review of existing literature, Uadiale, (2010); Lawal, (2012,) note that qualification of BOD is considered an important factor in the performance of Board roles. Ademba (2006) also finds this qualification to have an influence on bank performance. Cannella and Lubatkin (1993) on the other hand carried out a study on the relationship between CEO duality and firm profitability. They used return on assets and return on equity as measures of profitability and reported a positive link between the two variables. In support to the findings, ethical and operational controls are important and highly valued morals, not only in banking but also in business generally (Fakunyama, 1995). For the case of board performance and compensation, National State Auditors Association, (2004) revealed that the link between Director's pay and firm profitability provides an important incentive through which the Board of Directors can be used to tackle the agency problem, which supports a positive link in the current study. Furthermore, Angeela (2010), in a bivariate study, found no relationship between the credit risk management and the profits figures for Kenyan banks within the financial statements. It can thus be concluded that corporate governance dimensions have an influence on bank profitability among commercial banks in Kenya.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter presents the summary of findings, conclusions and recommendations. These are presented based on the study objectives as in the subsequent sections.

5.1 Summary of Findings

The first objective of the study sought to establish the association between qualification of board of directors and profitability of commercial banks in Kisumu County. The study hypothesis stated that “There is no significant relationship between Qualification of Board of Directors and Profitability of Commercial Banks in Kisumu County” The finding indicated that there is a positive significant correlation between board of directors and profitability of commercial banks and that board qualifications have an effect on bank profitability.

The second objective of the study sought to determine the relationship between Role Definition and Profitability of Commercial Banks in Kisumu County. In this case, the study hypothesis stated that “There is no significant relationship between Role Definition and Profitability of Commercial Banks in Kisumu County.” However, the findings revealed that there was a positive significant correlation between role definition among commercial banks and bank profitability. The null hypothesis was therefore rejected an alternative hypothesis adopted indicating presence of association.

The third objective of the study sought to assess the relationship between Operational and Ethical Controls and Profitability of Commercial Banks in Kisumu County. Its hypothesis stated that “There is no significant relationship between Operational and Ethical Controls and Profitability of Commercial Banks in Kisumu County” The study however found a moderate positive significant correlation between operational ethical control and bank profitability which implies an association between the two variables.

The fourth objective of the study analyzed the relationship between Board Performance and Compensation and Profitability of Commercial Banks in Kisumu County. The study hypothesis stated that “There is no significant relationship between Board Performance and Compensation and Profitability of Commercial Banks in Kisumu County”. However, the study found a positive significant correlation between board performance& compensation and bank profitability implying that there was an association between the two variables.

Finally, the study sought to determine the relationship between Risk management and profitability of commercial banks in Kisumu County. The hypothesis in this case was “There is no significant relationship between Risk management and profitability of commercial banks in Kisumu County.” The study however found that that there is a moderate positive significant correlation between risk management and bank profitability implying that there is an association between the two variables.

5.2 Conclusions

From the study findings on the five objectives, various conclusions were made as follows.

First, there is a relationship between Qualification of Board of Directors and Profitability of Commercial Banks in Kisumu County. This finding also lead s to a conclusion that bank profitability is partly a result of board of director qualifications. Hence, board director qualifications have an effect on bank profitability. Secondly, it can be clearly concluded that there is a relationship between Role Definition and Profitability of Commercial Banks in Kisumu County. There is therefore an association between Role Definition and Profitability of Commercial Banks, however, role definition is not the best predictor of bank profitability among commercial banks. The third conclusion drawn from the third objective is that a relationship exists between Operational and Ethical Controls and Profitability of Commercial Banks in Kisumu County. This means that Operational and Ethical Controls have an effect on bank profitability.

The findings also conclude that there is a relationship between Board Performance and Compensation and Profitability of Commercial Banks in Kisumu County. This is also same as to having bank profitability associated with Board Performance and Compensation. Therefore this leads to a conclusion that Board Performance and Compensation has an effect on bank profitability of commercial banks. Finally, the study concludes that Risk management and profitability of commercial banks in Kisumu County are associated such that good risk management leads to higher profitability and therefore Risk management has an effect on bank profitability.

5.3 Recommendations

From the first objective of the study, it can be recommended that the recruited or appointed board members should be qualified to serve in that capacity. Banks should as improve on their qualification through trainings in order to improve their profitability.

The findings on the second objectives lead to a recommendation that role definition should be improved among commercial banks. This should be done on all employees to avoid conflicts of the roles played and ensure proper demarcation of the duties to enhance effectiveness and improvement in performance.

It can also be recommended that bank management be fully equipped with the knowledge on operational & ethical controls so as to improve bank performance among commercial banks in Kenya.

From objective four of the study, the study recommends that banks should ensure good Board Performance and improvement on Compensation so as to enhance bank Profitability.

Finally, the study recommends that banks should engage into risk taking ventures after through layout of high caliber risk management strategies. This could avoid losses among the banks while improving on their profits.

5.4 Suggestions for Further Studies

Due to the fact that the current study could not zip every gap, the study suggests additional studies on the same.

i. A study to be carried out on the moderating role of board qualification on the relationship between their competency and bank performance
ii. A study can also be carried out on the relationship between compensation and service quality among commercial banks in Kisumu
iii. Finally. A study can be carried out on the effect of risk management strategies on expansion of commercial banks in Kenya.

5.5 Limitations of the Study

The current study had a few limitations which were consequently dealt with.

The small number of respondents was countered by carrying out census study on all brank managers. Secondly, the study instruments were well drafted to ensure high level truthfulness of the responses. Finally, the study compared responses from different banks before making conclusions due to the caliber of the respondents.

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APPENDICES

Appendix 1: Letter of Introduction

Consolata Muhindi,

Maseno University,

School of Business and Economics.

To: All Respondents

Dear Sir/Madam,

REF: REQUEST FOR RESEARCH DATA

I am a Master of Science in Finance student at Maseno University. In partial fulfillment of the requirements of MSc. Finance, I am conducting an academic research on ***Effect of Corporate Governance Practices on Profitability of Commercial Banks in Kenya.*** To achieve this, you and your organization are one of those selected for the study. I kindly request you to fill the attached questionnaire to generate data required for this study. This information will be used purely for academic purpose and your name or the name of your organization will not be mentioned in the report. Findings of the study, shall upon request, be availed to you.

Your assistance and cooperation will be highly appreciated.

Thank you in advance.

Consolata Muhindi,

Reg. No. MSC/BE/00043/2015

MSc. Finance Student – Researcher

Maseno University.

Appendix II: Questionnaire

This questionnaire seeks your opinion on the application of corporate governance within the organization and asks you the staff member to evaluate your organizations. The following questions are facts about your bank that you are required to clarify to the respondents in the survey on the relationship between corporate governance practices and profitability of commercial banks in Kenya. The information you will provide will be held in confidence, will specifically be used for academic purposes and will not be disclosed to another party without your prior permission. Please respond as accurately and honestly as possible and respond to the statement by a tick (√) where appropriate except where instructions are given to the contrary. Thank you.

1-Strongly Agree

2-Agree

3-Neither agree nor disagree

4-Disagree

5-Strongly disagree

1. General information

i. Name of your Bank ……………………………………………..………………...

ii. Current number of employees (tick as appropriate)

Less than 500 [ ]

Between 501 -1000 [ ]

More than 1000 [ ]

iii. Number of Bank Managers

iv. What is the composition of the Board?

Executive directors only [ ]

Non-executive directors only [ ]

Independent directors only [ ]

Mix of the above mentioned [ ]

v. The number of times the Board meets in a year

Once a year [ ]

Twice a year [ ]

Once in a quarter [ ]

Once a month [ ]

As need arises [ ]

vi. I am

Male [ ]

Female [ ]

2. Board Effectiveness

The following questions are concerned with your knowledge and understanding of corporate governance in terms of board effectiveness

Statement	**1**	**2**	**3**	**4**	**5**
i. Corporate governance in your company is better compared with other banks					
ii. Your firm's current corporate governance practices is better compared to those of five years ago					
iii. Your firm has adopted its own Code of Corporate Governance					
iv. The company publishes adopted decisions and minutes of the meetings, immediately, i.e. within prescribed deadlines, after the meeting					
v. The mission statement and corporate objectives are periodically reviewed to determine strategic direction of the institution.					
vi. Board understands and accepts its responsibility for reviewing the appropriateness of long-range planning and corporate strategy					
vii. Board regularly refers to approved goals, objective, and plans to guide its decision making process.					

viii.	There an understanding and acceptance that the organization is managed and led by the CEO, who serves at the pleasure of the Council.					
ix.	There are many potential conflicts of interest between the company and the BOD					
x.	Your firm provides equal access to information for Shareholders and investment analysts					
xi.	There is adequate time given during the annual shareholders' meeting for shareholders to ask questions					
xii.	Minorities' are well protected					
xiii.	Shareholders are aware of their rights and responsibilities					
xiv.	Shareholders have a freehand in the election, appointment and removable of directors					

3. Qualification of Board of Directors

How do you describe the Qualification of Board of Directors of the bank based on the following statements?

Statements		**1**	**2**	**3**	**4**	**5**
i.	Directors are knowledgeable, have expertise relevant to the business, qualified and competent.					
ii.	BOD has an appropriate structure in terms of diversity.					
iii.	Company sets the criteria which defines the required expert and professional knowledge and experience, as well as other requirements to be met so as to be appointed a director					
iv.	Your bank has training programs for management committees					

v. The size and composition of the board of directors is reviewed periodically with intent to render the board more effective and efficient					
vi. Members of the board have undergone training in directorship prior to appointment					
vii. Board is able to provide a balanced and understandable assessment of the organization's position					
viii. The Board consists of the executive and non-executive members on a fairly balanced proportion					
ix. The selection process considers present skills and requirements in the Board of directors					
x. A succession plan is in place for the Board's chairperson, Board members, the CEO and the senior management					

4. Role Definition

Are the roles of top management well defined and clear lines of accountability among the Board, Chair, CEO, Executive Officers and management been established in the following ways?

Statements	**1**	**2**	**3**	**4**	**5**
i. There is separation of the post and roles of the Board Chair and the CEO (No CEO/Chairman Duality)					
ii. The Company's act clearly defines the authorizations and responsibilities of the executive directors					
iii. Employees are allowed to be in a material business relationship (e.g. as a supplier or customer) with the Company or other group					

	member					
iv.	A better understanding of the role and function of the Chairperson and the Chief Executive Officer is laid down in the company's code					
v.	The Board has formally constituted and recorded committees with clearly defined terms of reference, composition and reporting mandates					
vi.	Board defines and communicates to management their powers, roles and responsibilities					
vii.	Board consults technocrats on professional matters					
viii.	Board has got an operating plan that defines its functions, activities and its objectives					
ix.	Board conducts its activities in a free and democratic atmosphere					
x.	The Board is involved in the selection of the directors					

5. Operational and Ethical Controls

Is there a general culture of integrity and ethics in business dealing and of respect and compliance with laws and policies?

Statements		**1**	**2**	**3**	**4**	**5**
i.	Trust and integrity are important and highly valued morals among the bank employees.					
ii.	Bank Managers are challenged and have met the obligation on bank operation and society at large, to support and assist the society to imbibe the ethical culture in which there is the interest of everyone.					
iii.	Management has established an ethical tone					

	at the top by setting a good example of ethical conduct, providing positive and open communication, and supporting ethical conduct					
iv.	There are resources adequate for the organization’s ethics program					
v.	Ethics is a focus during regular top management meetings					
vi.	There is a designated ethics officer or ethics contact					
vii.	Ethics is a focus during hiring and employee training process					
viii.	Your bank has a written ethics code					
ix.	Importance of ethics is communicated to all employees on a regular basis via formats such as organization newsletter articles and posters					
x.	Your organization has an ethics hotline					
xi.	An ethical culture has been ingrained in the organization’s brochures, materials, and website					
xii.	Staff treat each other with respect and dignity					
xiii.	Where the conduct of any director becomes questionable, he or she is asked to leave the Board					
xiv.	Interest and conflicts between Board members are declared and resolved amicably					

6. **Board performance and compensation**

To what extent do you agree with the following corporate governance practices in relation to Board performance and compensation?

Statements		1	2	3	4	5
i.	Performance of staff is regularly assessed and evaluated					
ii.	The company ties compensation to performance					
iii.	There is a written remuneration policy					
iv.	The firm adopts a transparent and publicly available remuneration policy for the Board of Directors members					
v.	Remuneration paid to the company's commission members is included in the remunerations policy for the Company's Commission members, i.e. determined within the framework defined by the Company's assembly					
vi.	Remuneration paid depends on their contribution to attaining corporate financial and non-financial results and business goals					
vii.	Specific committee (i.e executive compensation, audit or personnel) has a responsibility for evaluation of the CEO's performance and compensation					
viii.	A set of performance standards of criteria that allow for periodic evaluation of a Council director‘s performance has been established					
ix.	The board takes collective responsibility for the performance of the organization.					
x.	The board has a good understanding of the performance of the organization relative to other bodies, where appropriate.					

xi.	Management provides a thorough analysis of performance against budget, targets and key outcomes, and discusses any necessary remedial action					
xii.	The board gets early-warning signals of problems ahead that will adversely affect key outcomes, targets or financial performance					

7. **Risk Management**

State the extent to which risk management is taken into consideration in the bank operation, with respect to the following statements

Statement		**1**	**2**	**3**	**4**	**5**
i.	Risks faced are regularly identified and assessed					
ii.	The Board accepts it their responsibility for strategic leadership in establishing the company's risk tolerance and developing a framework and clear accountabilities for managing risk.					
iii.	The board has a sound process for identifying and regularly reviewing its principal risks, and makes the necessary amendments in the light of changes in the internal and external environment					
iv.	The board takes full account of risk in its decisions , for example, in relation to proposed major projects and programs					
v.	The board receives reliable projections of future cash flows for the medium as well as the short term, and is confident that the available funding will enable the organization to develop and operate as planned					
vi.	The board is satisfied there have been no					

	problems with regulatory and similar requirements, and that sound health and safety, employment and other practices are implemented to protect the organization against unnecessary litigation and reputation risk					
vii.	The board is aware of changing demand patterns and is confident that these can be met from the resources available and within the organization's statutory remit					
viii.	The board monitors the political environment for potential changes to its remit and assesses the impact these will have on the strategy					
ix.	The board is aware of the organization's information needs. Any exceptions to best practice over data acquisition, usage, storage and destruction are reported					
x.	No substantial, unexpected problems have emerged which the board should have been aware of earlier					

Appendix III: List of Licensed Commercial Banks in Kenya

1. African Banking Corporation Limited
2. Bank of Africa Kenya Limited
3. Bank of Baroda (K) Limited
4. Bank of India
5. Barclays Bank of Kenya Limited
6. CFCStanbic Bank Limited
7. Charterhouse Bank Limited
8. Chase Bank (K) Limited
9. Citibank N.A. Limited
10. Commercial Bank of Africa Limited
11. Consolidated Bank of Kenya Limited
12. Co-operative Bank of Kenya Limited
13. Credit Bank Limited
14. Development Bank of Kenya Limited
15. Diamond Trust Bank of Kenya Limited
16. Ecobank Kenya Limited
17. Spire Bank Limited
18. Equity Bank Kenya Limited
19. Family Bank Limited
20. Fidelity Commercial Bank Limited
21. First Community Bank Limited
22. Guarantee Trust Bank (K) Limited

23. Giro Commercial Bank Limited
24. Guardian Bank Limited
25. Gulf African Bank Limited
26. Habib Bank A.G Zurich
27. Habib Bank Limited
28. Imperial Bank Limited
29. I & M Bank Limited
30. Jamii Bora Bank Limited
31. KCB Bank Kenya Limited
32. Middle East Bank (K) Limited
33. National Bank of Kenya Limited
34. NIC Bank Limited
35. M-Oriental Bank Limited
36. Paramount Bank Limited
37. Prime Bank Limited
38. Sidian Bank Limited
39. Standard Chartered Bank Kenya Limited
40. Trans-National Bank Limited
41. UBA Kenya Bank Limited
42. Victoria Commercial Bank Limited

(Source: CBK 2017)