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THE INFLUENCE OF BOARD STRUCTURE ON THE FINANCIAL PERFORMANCE OF TIER THREE COMMERCIAL BANKS IN NAKURU COUNTY, KENYA

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Abstract

The banking sector pre-tax profits declined by 14.7 per cent in the year to June 2017, largely reflecting an 18.5 per cent fall in earnings on advances, which constituted 54.4 per cent of total income. The Return on Assets and Return on Equity decreased from 3.5 per cent and 33.8 per cent, respectively in June 2016 to 2.8 per cent and 22.3 per cent by June 2017(CMA,2018). The deterioration is attributed to the significant decline in the sector's profitability. Consequently, this study focuses on determining the role of board structure on the financial performance of tier three commercial banks. This study focus seeks to investigate the relationship that exists in tier three commercial banks which the study did not cover. This study sought to examine the influence of board structure on the financial performance of tier three commercial banks in Nakuru County, Kenya. The study used descriptive survey research design. The target population was 22 Finance Managers of the 22 tier three commercial banks in Nakuru County, Kenya. The study employed census technique to include all the 22 respondents since the population was relatively small. These populations are chosen due to their availability of finance managers in these institutions and also accessibility. Secondary data on return on asset and return on equity was also gathered from the financial statements and annual reports of the companies. The secondary data was obtained from annual reports of the tier three commercial banks and financial statements of the 22 tier three commercial banks. From the correlation results the study showed a strong positive significant relationship that led to the rejection of the null hypothesis and subsequently the adoption of the view that board structure was instrumental in ensuring effective financial performance of tier three commercial banks in Nakuru County, Kenya. The study recommended that the there is need of maintaining CEO duality as it positively influences the financial performance of the Tier three commercial bank. In addition, large boards should be maintained as it enhances financial performance. However, the boards should be dominated by non-executive directors, as this it enhances firm value.

Keywords: Board Structure, Financial Performance, Tier Three Commercial Banks

I.INTRODUCTION

The banking sector pre-tax profits declined by 14.7 per cent in the year to June 2017, largely reflecting an 18.5 per cent fall in earnings on advances, which constituted 54.4 per cent of total income. The Return on Assets and Return on Equity decreased from 3.5 per cent and 33.8 per cent, respectively in June 2016 to 2.8 per cent and 22.3 per cent by June 2017(CMA,2017). The deterioration is attributed to the significant decline in the sector's profitability (Demsetz & Lehn, 2018). Consequently, this study focuses on determining the role of board composition on the financial performance of tier three commercial banks. The results of previous researches that are conducted to research on the link between board composition and financial performance are mixed and inconclusive especially on the performance of tier three commercial banks.(Manini & Abdillahi, 2015), in relationship between board composition and Financial performance of parastatals in Kenya, concluded that large boards enhanced corporate performance and that when such boards were dominated by non-executive directors, it enhanced firm value. This study focus seeks to investigate the relationship that exists in tier three commercial banks which the study did not cover. The lack of internal controls, weak company governance practices, weaknesses in restrictive and superior systems, business executive loaning and conflict of interest are factors behind the history of poor governance system within the banking system during which has resulted to the closure of the many financial establishments with others sinking receivership like was seen with chase bank and Imperial bank LTD Ongore, (2011). Despite the measures put in place by financial regulators of Republic of Kenya, Capital Markets Authority and Centre for company Governance to campaign permanently company governance, the matter of company governance is nonetheless to be solved. The gap these studies left is that this research sought to fill is that none of them provides a comprehensive examination of the influence of corporate governance on the financial performance of banks in Kenya, consequently, it is required that this topic should be tackled to determine the influence of Corporate Governance on financial performance of tier three commercial banks in Nakuru county, Kenya. This study is based on the question: What is the influence of Corporate Governance on the financial performance of tier three commercial banks in Nakuru County, Kenya.

II.RESEARCH OBJECTIVE

To determine the influence of board composition structure on the financial performance of tier three commercial banks in Nakuru County, Kenya

III.RESEARCH QUESTION

What is the influence of board composition on the financial performance of tier three commercial banks in Nakuru County, Kenya?

IV. LITERATURE REVIEW

The board should be structured and composed in such a way that it was act to monitor itself. A study by (Adeusi, Akeke, Adebisi, & Oladunjoye, 2014) states that "corporate governance literature debated within two extreme streams of board practices examining whether the board composition in the form of representation of outside independent directors and structural dependence of the board influence the firm financial performance. The available literature on the relationship between the board composition and firm financial performance reflects mixed results. The idea of endogenous relationship between board composition and corporate performance was advanced by(Ab Razak & Palahuddin, 2014), that is, board composition and corporate performance jointly influence each other rather the board composition influencing corporate performance or corporate performance influencing board composition. A study by Wanjama, (2015) note that board composition and financial performance influence each other but the effect is not immediate.(Murage, 2014), in relationship between Corporate Governance and Financial performance of parastatals in Kenya, concluded that large boards enhanced corporate performance and that when such boards were dominated by non-executive directors, it enhanced firm value. While the CEO duality did not significantly impact on financial performance measure of ROA, in his study, it had a positive relationship with financial performance in conflict with other studies.

A study done by (Omer, 2017) in their study "an empirical test of competing corporate governance theories on the performance of firms listed at the Nairobi securities found that the overall regression models for firm performance for both the Return on Assets (RAO) and Tobin Q ratio are significant, which means that the independent variables of board size, outside directors, inside directors, and CEO duality are important predictors of firm performance. According to (Kumari & Pattanayak, 2015) investigated the relationship between board characteristics and financial performance of US firms with initial public offerings from 2000 to 2002. By using Tobin‘s Q financial performance of the firms was measured and findings showed that board quality (board expertise and educational background) positively related to firm performance. This evidence supports the view of Ab Razak et al., (2015) whose study found that the number of board members with At least a degree qualification impacted positively on firm performance in Nigerian quoted firms. The return on assets or Tobin‘s Q is influenced by educational qualifications of board members and CEO especially.

A study by Ab Razak et al., (2015) investigated the impact of corporate board characteristics on the financial performance of Nigerian quoted firms. By using the random-effects and fixed-effects Generalized Least Squares (GLS) regression the study found that board size, CEO duality and gender diversity were negatively linked with firm performance, whereas board nationality, board ethnicity and the number of board members with at least a degree qualification were found to impact positively on firm performance. However, the findings indicated that using the same board characteristics for 160 small firms showed that board duality was positively linked to firm performance, while at least a degree qualification was negatively linked to firm performance. This evidence supports the view of Wanjama, (2015)whose study showed that board quality (board expertise and educational background) positively related to firm performance. According to (Abrar & Javaid, 2016), the return on assets or Tobin‘s Q is influenced by educational qualifications of board members and CEO especially.

V.RESEARCH METHODOLOGY

The study used descriptive survey research design. The target population was 22 Finance Managers of the 22 tier three commercial banks in Nakuru County, Kenya. The study employed census technique to include all the 22 respondents since the population was relatively small. These populations are chosen due to their availability of finance managers in these institutions and also accessibility. Secondary data on return on asset (ROA) and return on equity (ROE) was also gathered from the financial statements and annual reports of the companies. The secondary data was obtained from annual reports of the tier three commercial banks and financial statements of the 22 tier three commercial banks. The secondary data collected was in panel form. The secondary data was extracted from the financial statements and annual reports of the firms. Descriptive analysis was done using means and standard deviations to describe the basic characteristics of the population. Inferential statistics involved the use of Pearson’s Product Moment correlation and multiple regression models to determine the nature of the relationship between the variables.

VI.RESEARCH FINDINGS AND DISCUSSIONS

Descriptive Analysis

The first objective of the study was to determine the influence of board composition structure on the financial performance of tier three commercial banks in Nakuru County, Kenya. This objective was achieved by posing several statements related to the extent to which board composition influenced financial performance. Table 1 shows the statistical results in details.

Table 1: Descriptive Statistics for Board Composition and Financial Performance

Statement	SA Freq (%)	A Freq (%)	N Freq (%)	D Freq (%)	SD Freq (%)	Mean	Std. Dev
The firm considers representation of outside independent directors to enhance financial performance	2(9)	11(69)	2(10)	2(9)	1(3)	3.88	0.629
The firm considers the structural independence of the board to enhance financial performance	2(11)	9(53)	1(6)	4(19)	2(11)	3.6	0.576
CEO duality positively influences the financial performance of the commercial bank	4(23)	8(43)	3(14)	2(11)	1(9)	3.38	0.774
Large boards enhance financial performance	3(17)	11(62)	1(8)	2(11)	1(2)	3.81	0.835
When boards are dominated by non-executive directors, it enhanced firm value	4(20)	7(38)	5(33)	1(6)	1(3)	3.66	0.946
Board members with at least a degree qualifications impacted positively on firm financial performance	3(17)	9(57)	4(20)	1(4)	1(2)	3.83	0.838
Aggregate Score						**3.645**	**0.796**

The results in Table 4.3 suggest that the Tier three commercial banks considers representation of outside independent directors to enhance financial performance (Mean = 3.88; Std. Dev = 0.629). The Tier banks considers the structural independence of the board to enhance financial performance (Mean = 3.6; Std. dev =0.576). The findings also indicate that CEO duality positively influenced the financial performance of the commercial bank (mean = 3.38; Std. Dev =0.774). Large boards enhance financial performance (Mean = 3.81; Std. dev =0.835). The findings, however, suggest that when boards are dominated by non-executive directors, it enhanced firm value (Mean = 3.66; Std. Dev =0.946) also board members with at least a degree qualifications impacted positively on firm financial performance (Mean = 3.83; Std. dev =0.838). These findings particularly the one on Large boards enhance financial performance are consistent with those of (Murage, 2014), in relationship between Corporate Governance and Financial performance of parastatals in Kenya, concluded that large boards enhanced corporate performance and that when such boards were dominated by non-executive directors, it enhanced firm value.

Correlational Analysis

This section outlines the results of correlation analysis between Board Composition and Financial Performance of Tier Three Commercial Banks (Table 3). The findings were interpreted and discussed accordingly.

Table 3: Correlation between Board Composition and Financial Performance of Tier Three Commercial Banks in Nakuru County, Kenya

		Financial Performance
Board Composition	Pearson Correlation	.528**
	Sig. (2-tailed)	.000
	N	18

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

The first correlation analysis was carried out to determine whether board composition have any significant influence on financial performance of tier three commercial banks in Nakuru County, Kenya. The correlation results showed that a strong positive significant relationship existed ($r = 0.528$; $p < 0.05$).

VII.CONCLUSION OF THE STUDY

From the correlation results the study showed a strong positive significant relationship that led to the rejection of the null hypothesis and subsequently the adoption of the view that board composition was instrumental in ensuring effective financial performance of tier three commercial banks in Nakuru County, Kenya.

VIII.RECOMMENDATIONS OF THE STUDY

The following recommendations are drawn with regard to the study findings; There is need of maintaining CEO duality as it positively influences the financial performance of the Tier three commercial bank. In addition, large boards should be maintained as it enhances financial performance. However, the boards should be dominated by non-executive directors, as this it enhances firm value. Nevertheless, the firms should encourage engagement of board members with at least a degree qualification as this was greatly impact positively on firm financial performance of Tier Three Commercial banks in Nakuru County, Kenya

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