Factors Influencing Corporate Governance Quality in Kenya
A Study on Kenya Commercial Bank

BY

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UNITED STATES INTERNATIONAL UNIVERSITY - AFRICA

SPRING 2016
FACTORS INFLUENCING CORPORATE GOVERNANCE QUALITY IN KENYA
A STUDY ON KENYA COMMERCIAL BANK

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A Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the degree of Masters in Business Administration
(MBA)

UNITED STATES INTERNATIONAL UNIVERSITY AFRICA

SPRING 2016
STUDENT'S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: ____________________________  Date: ____________________________

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This Project Report has been presented for examination with my approval as the appointed supervisor

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ABSTRACT

The purpose of the study was to analyze the factors influencing corporate governance quality in Kenya. With corporations increasingly becoming powerful as well as dominant institutions, governance has emerged as an integral part of them. The study addressed the following research objectives; to assess the influence of bank financial performance on corporate governance, to determine the influence of bank size (Asset Size) on corporate governance and to establish the influence of board characteristics on corporate governance.

The research design was a case study on Kenya Commercial Bank. The population was drawn from 332 staff of Kenya Commercial Bank in Nairobi which formed the basis from which the sample or subjects of the study was drawn. The target population comprised of six departments at KCB namely: Human Resources department with a population of 60 employees, Retail and Consumer Banking department with a population of 116 employees, Finance department with a population of 48 employees, Operations department with a population of 36 employees, Information Communication Technology department with a population of 40 employees and Strategy department with a population of 32 employees. This was our population of interest and from it we were able to further the study.

A sample of 166 respondents which represents 50% of the target population was selected using a random sample. Data collection method was through a structured questionnaire which was used to collect information from the organization under study. A quantitative analysis in regards to the data was done. Descriptive statistics were generated then analysed.

The findings of the study to assess the influence of bank financial performance on corporate governance were that financial performance had the biggest influence on the quality of corporate governance. The findings on the influence of bank size on corporate governance were that the size of an organization influenced the quality of corporate governance. The findings on the board characteristics’ influence were that this was the board characteristics had an influence on the quality of corporate governance.
It emerged from the study that over half of the respondents were of the view that board characteristics had the greatest influence on corporate governance quality. A vast majority of the respondents indicated that the firm’s financial performance had an impact on the quality of corporate governance followed by the organization size. The conclusion drawn was that the research was a success having shown that board characteristics were more influential to corporate governance, followed by financial performance and least influential being the bank size.

Recommendations arising from the study were that banks should pay keen attention to the characteristics of the board as they also focus on their financial performance and bank size since they all have an influence on the quality of corporate governance. Recommendation for a similar study but drawing respondents from the whole banking industry will assist to further this study. Another area that would be important to study would be to check the importance of corporate governance for the stability of the banking industry.
ACKNOWLEDGEMENT

It is with God’s grace that I have this opportunity to be a student at the United States International University. I extend my gratitude to my lecturers in the master’s program at the United States International University. My appreciation to my project supervisor Mr. Kepha Oyaro and project reviewer who patiently guided and encouraged me. I acknowledge my family for their inspiration and prayers and my parents for their support and the value they have given to academic excellence. This has been instrumental towards my pursuit of knowledge.

I thank the members of staff of KCB for their co-operation and valuable feedback.
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CHAPTER 1

1.0 INTRODUCTION

1.1 Background of the Problem

Corporate governance is a term that has been adopted by most corporates. Listed companies regard corporate governance as an integral part of their success. Corporate governance as the system by which companies are directed and controlled. This is according to the Cadbury report of 1992. It encompasses directors of companies and the managers, how they relate and their responsibilities.

The term corporate governance is derived from the Greek word “Kyberman” which means to steer, guide or govern. A more indirect meaning is the process of decision making or the process by which decisions are implemented. Different people/organisations have given different meaning to the term corporate governance (Abu – Tapanjeh, 2008). According to Dimsdale and Prevezer (1994) corporate governance is concerned with the way in which corporations are governed and in particular in the United Kingdom, the relationship between the management of a company and its shareholders.

Various reports especially in the United Kingdom have continued to explore the definition and understanding of corporate governance such as the Higgs report (2003), the Smith report (2003), Turnbull report (1999), Hampel report (1998) and Greenbury report (1995). With the lack of a generally accepted definition of corporate governance, it can be defined as a set of processes and structures for controlling and directing an organization. Bruce Brown in his book “The history of the corporation” explains that the word corporation is derived from the Latin word corpus which means to make corporal or physically embody or a group of people. A corporation is thus a group of people registered and authorized to act in a single entity. They have been instrumental in the growth of economies all over the world. With this growth the need to come up with governance structures became necessary. The collapse of various huge corporations only intensified the need for corporate governance. The loss of trust and value to shareholders was detrimental to economies. With the emergence of globalization, there is greater deterritorialization and less government control which results is a greater need for accountability (Crane and Matten, 2007).
Corporate governance constitutes sets of rules which governs the relationship between management, shareholders and stakeholders (Ching et al, 2006). Owing to the vast influential factors, proposed models of corporate governance can be flawed as each social scientist is forming their own scope and concerns (Olumbe, 2012).

Corporate governance is not restrictive. Though there is ambiguity in use of words such as regulate, control, manage and govern, there are no organizations exempt from governance. Corporations have become a powerful and dominant institution. They have reached to every corner of the globe in various sizes, capabilities and influences. Their governance has influenced economies and various aspects of social landscape. Shareholders are seen to be losing trust and market value has been tremendously affected. Moreover with the emergence of globalization, there is greater deterritorialization and less of governmental control, which results is a greater need for accountability (Crane and Matten, 2007). Hence, corporate governance has become an important factor in managing organizations in the current global and complex environment. One integral feature that has become accepted for modern corporations is the separation of management from owners.

Corporate governance theories have been evolving over time. Companies worldwide have been making efforts to instill governance into their structure. The fundamental theories in corporate governance began with the agency theory, expanded into stewardship theory and stakeholder theory and evolved to resource dependency theory, transaction cost theory, political theory and ethics related theories such as business ethics theory, virtue ethics theory, feminists ethics theory, discourse theory and postmodernism ethics theory (Abdulla and Valentine, 2011).

Agency is the relationship between two parties where one is a principle and the other an agent who represents the principle in third party transactions. Agency relationships in corporations are two fold; one between owners and managers and the other between owners and creditors. Principals delegate the running of the business to the directors or managers who become the shareholders agents (Clarke, 2004). The agency theory was first heard of in the 1970s. Many writers have explored this theory including Alchian and Demsetz (1972) and Jensen and Meckling (1976).
The agency theory explores the problems that exist in this agency relationship. It addresses two problems; conflict in goals and desires of the principal and agent and the difference in risk appetite/tolerance between the principal and agent. The difference in risk attitudes will determine the investment and other decisions that will be made. Shareholders expect the agents to act and make decisions in the interest of the principal. Contrary to this, the agent may not necessarily make decisions that are in the best interest of the principal (Padilla, 2000). In theory, the agency problem is solved if the principal and agent share common interest and goals and desire the same outcome. The other scenario is that the principal is knowledgeable about the consequences of the agent’s activities. The agency theory relies on the assumption of self-interested agents who seek to maximize personal economic wealth (Bruce et al., 2005). Various mechanisms have been suggested to ensure that the interest of the principal and the agent are the same. These include profit sharing, employee stock options and performance measures. This theory has been explored by Adam Smith in the 18th century, Rose (1973) and the problems arising from separation of ownership and control by Davis, Schoorman and Donaldson (1997). Due to the inherent difficulty of objectively observing and judging the CEO or top management’s performance, directors monitor the corporate financial performance of the organization to ensure that the shareholders’ interest are being properly represented (Fama & Jensen, 1983).

Stewardship theory contrasts the agency theory. Stewardship theory says that left on their own, managers will act as responsible stewards of the assets that they control. It is thus a sociological and psychological approach to governance. Under this theory, the executive manager wants to perform a good job. The theory focuses on facilitative structures rather than motivation of the manager. Harmony is created where the Chief executive officer is also the chairman of the board. He exercises complete authority over the company and there are no two centres of power. The company benefits from strong control since power is centred on one a single person. The theory was developed by Donaldson and Davies (1991 & 1993) as they tried to explain the relationship between the stockholders and managers in a corporation. Unlike agency theory, stewardship theory stresses not on the perspective of individualism (Donaldson & Davis, 1991), but rather on the role of top management being as stewards, integrating their goals as part of the organization. Managers are said not to be driven by extrinsic motivators but their loyalty to the
company and their interest in achieving a higher goal. They have the desire to perform excellently. According to Agyris (1973), agency theory looks at employees as economic beings. The proponents of the two theories which are agency and stewardship have tried to put forth reasons why either is superior to the other. The challenge lies in blending the best of both models and furthering conceptual advance (Hambrick, 2005). Stewardship theory does not envisage conflict between owners and managers. Firm managers tend to be benign in their actions (Donaldson, 2008). Their behavior is aligned to that of the owners. More value is placed on goal convergence instead of the manager’s self-interest as does the agency theory. More interest is placed on collective goals rather than individual goals. The success of the company becomes the motivation.

It was previously believed that the role of a corporation was to maximize profit for shareholders. With the recent financial crisis and collapse of companies, this believes has waned with the term managing for stakeholders has gained prominence. The role of management is to create value for stakeholders. The theory which addresses morals and values in managing a corporation or organization was developed by Edward Freeman (1984). The stakeholder theory recognizes stakeholders other than shareholders in an organization such as creditors, employees, customers, financiers, suppliers, regulators, communities and the government. It looks at the relationship between the organization and those in its internal and external environment. Stakeholders are therefore a group of people that can affect or be affected by the organization. Freeman (1984) contends that organizations that manage their stakeholder relationships will survive longer and perform better. Stakeholder theory was derived from a combination of sociological and organizational disciplines (Wheeler et al 2002). However, the nature of what a stakeholder is is highly contested with a multitude of definitions given over the years (Miles, 2011) The stakeholder theory brings in the aspect of morality and ethics in business. Donaldson and Preston (1995) uses the descriptive approach to explain the characteristics behavior of firms. Their instrumental approach identifies the connections that exists between the management of stakeholders and achievement of corporate goals. Phillips (2003) distinguishes between normatively legitimate stakeholders and derivatively legitimate stakeholders. Sundaram & Inkpen (2004) argue that the theory addresses the group of stakeholders deserving management attention.
Various other theories that developed in the 1970s continue to exercise influence today even as some of the questions asked by theorists change (Davies, 2005). The resource dependency theory can be attributed to the works of Pfeffer and Salancik (1978). It has become an influential theory in strategic management and organization theory. The resource dependency theory categorizes an organization as one dependent on contingencies in the external environment (Pfeffer and Salancik, 1978). They talked about what they referred to as the ecology of an organization. A key aspect of the theory is the analysis of where power and dependence comes from and how managers use their power and manage their dependence. Managers act to reduce the influence and dependence of external factors on the organization through power to control vital resources (Ulrich & Barney, 1984). Resource dependency theory concentrates on the role of directors in the provision of essential resources to an organization through linkages to external environment (Hillman, Canella & Paetzold, 2000). As part of the increased focus on the dynamic nature of boards, literature has expanded into organization behaviour theory including those concentrating on identity and social identity. Scholars focus on identification with not only the focal organization but also with other contingencies both within and outside the organization. (Harris & Goel 2010). According to Hillman, Canella and Paetzold (2000), that directors bring resources to the firm, such as information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy.

The transactional cost theory is widely accepted in various management disciplines including vertical integration decisions, acquisitions and networks. It is a core theory in the field of strategy as it tries to explain why firms exist, how firms define their boundaries and how they govern their operations. The theory can be traced back to the works of Cyert and March (1963). Transactional cost theory is the cost incurred in making an economic exchange. These transactional costs include search and information costs, bargaining costs and policing and enforcement costs. Transactional cost theory adopts a contractual approach and tries to explain why some transactions are performed within an organization rather than in the market. The proponents of this theory classify the costs into two broad categories which are transaction costs and production costs. Firms try to minimize the cost of exchange within the environment as well as minimize the bureaucratic costs of exchange within itself. Transaction cost is incurred each time a
good or service is transferred from one stage to another (Williamson, 1981). Transacting agents at times disclose distorted information, withhold facts and even mislead the other party is a self-seeking opportunistic manner. Transacting parties sometimes behave in an opportunistic manner and take advantage of the other party only transacting in their own interest (Williamson, 1996).

Political theory is associated with ethics and ethical behavior and sets of values for an organization. It is broad in its outlook as it studies topics including liberty and justice, and the enforcement of a legal code. It seeks to explore a firm’s relationship with the society. Politicians and legislators in many countries in the world have instituted quotas that boards of directors must include 33-50 percent of women (Terjesen, Aguilera & Lorenz 2014). A growing body of research on organizational change has emphasized the importance of sociopolitical processes driving the diffusion of organizational practices/ideas (Ansari, Fiss & Zajak, 2010). Despite several recent empirical investigations of board tasks (Minichilli et all 2009, the evidence of factors explaining the extent to which the board undertakes different tasks is still somewhat limited (Daily et all 2003).

Corporate governance took prominence in Kenya in 1998 when a workshop on the role of non-executive directors was held in Nairobi. Kenya's market regulation matches that in developed countries as it has legislation that governs the market, a regulatory agency in the form of the Capital Market Authority which oversees the stock exchange and, like most developing countries, it has adopted a corporate governance code in the form of the Sample Code of Best Practice of Corporate Governance in Kenya 2002, which was developed by the Centre for Corporate Governance (Musikali, 2008), an affiliate of the Commonwealth Association for Corporate Governance (CACG). Leading organisations that have interest in corporate governance include the Nairobi Securities Exchange, Capital Markets Authority, and Institute of Certified Public Accountants among others. Kenya's corporate governance code is enforced by the Capital Markets Authority through the CMA Guidelines, which are the result of a combination of ideas from corporate governance codes from different jurisdictions.
1.2 Statement of the Problem

During the last decade, corporate governance of listed companies has come under the scrutiny of institutional investors, regulatory authorities and the financial press. Several financial scandals as well as the increased risk of investors' spoliation have urged regulatory agencies of several countries to institute special task forces with a mission to make recommendations or to establish "codes for best practices" for corporate governance of listed companies (Broshko and Li, 2006).

Banks represent a significant and influential sector of business worldwide that plays a crucial role in the global economy. Since banks are complex institutions and may require employees with specialized skills (Philippon & Reshef, 2012), selecting the right executives could give banks a significant competitive edge as well as contribute to the growth of the economy. Commercial banks are financial intermediaries that serve as financial resource mobilization points in the global economy. Kenyan banks have in the recent past experienced a number of corporate failures related to corporate governance structures in place. In 2007, Charter Bank was placed under statutory management amidst suspicions of money laundering and fraud. With these issues in view, it is important to undertake a study on the factors influencing corporate governance in Kenya.

Many studies have dealt with the determinants of corporate governance. Weisbach (1988) and Klein (2002) look into the incentives of insiders and show that there exists a negative correlation between the ownership of managers and the proportion of outside directors on the boards of directors, or on audit committees. Shivdasani and Yermack (1999) claim that CEO exercises major influence on the selection of new directors when the ownership distribution of his firm is dispersed, while it is the controlling shareholder under concentrated ownership structures. Durnev and Kim (2003) show that firms with good investment opportunity, higher sales growth rates and higher dependency on external financing would maintain a better corporate governance not to lose those good investment opportunities. Prior research differentiates between board demographics and structural diversity (Ben-Amar, Francorur, Hafsi & Labelle 2013). Several studies find a strong connection between independent directors and market valuations of firms in some emerging markets (Black, De Carvalho, Khanna, Kim & Yortoglu 2013). The study also contributes to the literature that relates ownership structure to financial strategy such as
choice of leverage (Aslan & Kumar 2014). Given the limited number of studies on the determinants of corporate governance in Kenya, this study sought to establish the determinants of corporate governance in Kenya Commercial Bank.

1.3 General Objective
The general objective of this study was to establish the determinants of corporate governance in Kenya Commercial Bank (KCB).

1.4 Specific Objectives
The objectives of the study were:
1.4.1 To assess the influence of bank financial performance on corporate governance.
1.4.2 To determine the influence of bank size (Asset Size) on corporate governance.
1.4.3 To establish the influence of board characteristics on corporate governance.

1.5 Importance of the Study
The findings and recommendations from this study are of benefit to diverse groups including learning institutions and other organizations. It will provide a foundation for their studies.

1.5.1 Organization under Study
The study aimed at benefiting KCB by making it aware of the determinants of corporate governance in the bank. This will help the bank to understand the factors that may positively or negatively influence their corporate governance quality.

1.5.2 Managers
The study will also be useful for managers who wish to gain an increased understanding of the determinants of corporate governance quality so that they can put up measures to improve the corporate governance quality of their companies.

1.5.3 Researchers
The study will also benefit the other researchers to have practical insight on the factors that influence corporate governance of companies in Kenya and what measures can be
taken to improve the quality of corporate governance. This can help them in furthering this study to different economic sectors or markets.

1.5.4 Regulators and Policy Makers
The banking industry is highly regulated. Corporate Governance is one of the aspects that need to be enhanced to ensure the long term sustainability and growth of this industry. Among the regulators who will benefit from the study are the Central Bank of Kenya and the Capital Markets Authority.

1.5.5 Investors
It is important for potential investors to focus on companies that will be sustainable in the long run. Future growth and prosperity of companies in anchored on Corporate Governance. Their investment decisions should be driven by this.

1.6 Scope of the Study
The research study was based on identifying the determinants of corporate governance in Kenya Commercial Bank (KCB). The study covered three specific objectives in an effort to establish whether financial performance, size, and board characteristics affect corporate governance quality in KCB. The scope of the study covered the headquarters of Kenya Commercial Bank in Nairobi. The target population of the study was composed of 332 staff of Kenya Commercial Bank in Nairobi which formed the basis from which the sample or subjects of the study was drawn. Data was collected over a two week period in the month of June 2014.

1.7 Definition of Terms
1.7.1 Corporate Governance
Corporate governance is the system by which firms are controlled, directed and governed (Cadbury Report, 1992).

1.7.2 Performance
The performance of business organizations is affected by their strategies and operations in the market and non-market environments (Baron, 2000). Performance is defined as a
company’s financial viability or the extent to which a company achieves its economic goals (Price and Mueller, 1986). In this context performance for this study refers to the financial performance of the company in terms of income statements and the balance sheets.

1.7.3 Size
This refers to the size of the company as measured by its total assets growth. Size is calculated as the log of total assets (Collett and Hrasky, 2005).

1.8 Chapter Summary
Chapter one reviewed the background of the problem. It presented the problem statement, the purpose and specific objectives of the study and the importance of the study. The scope of the study and definitions of terms as applied are also presented. The next chapter reviews the literature in line with the specific objectives of this study. Chapter three goes ahead and provides information on the research process followed in the study. This then leads to presentation of findings under chapter four. These research findings are discussed and a summary of key findings and recommendations presented in chapter five.
CHAPTER 2

2.0 LITERATURE REVIEW

2.1 Introduction
This chapter develops a conceptual framework for the study by reviewing literature in line with the general objective of the study. Literature is reviewed as guided by the objectives of the study which were to: establish the influence of bank financial performance on corporate governance of Kenya Commercial Bank; determine the influence of bank size on corporate governance of Kenya Commercial Bank; and establish the influence of board characteristics on corporate governance of Kenya Commercial Bank. The chapter concludes with a summary of the relevant issues discussed.

2.2 The Influence of Financial Performance on Corporate Governance

2.2.1 Financial Disclosure
The accounting literature relates firm financial attributes to the disclosure level in the annual report. Prior accounting research looking to the relation between firm performance and disclosure quality has obtained mixed evidence (Lang and Lundholm, 1993). Managers of firms experiencing good performance have incentives to improve their corporate governance disclosure quality to present the governance system in place.

However, managers of firms having a poor financial performance should increase the quality of Corporate Governance disclosure to convince shareholders and potential investors that the governance system in place is appropriate and should help the company improve its performance in the next few years. Bujaki and McConomy (2002) found an inverse relationship between financial performance, measured as the change in revenues, and the extent of Corporate Governance disclosure. Previous research has tended to find a positive association between firm performance and voluntary disclosure. Managers are motivated to disclose more detailed information to support the continuance of their positions and remuneration and to signal institutional confidence. We find a negative relationship between Share Value Orientation adoption and subsequent firm performance, although this effect is attenuated when accompanied by greater Share Value Orientation alignment among major owners and a firm's visible commitment to an Share Value
Orientation (Bezemer & Zajac, 2013; Bosch & Volberda 2014).

2.2.2 Declining Financial Performance

Financial performance is the overall health of an organisation within a given period of time. It measures the extent to which an organisation has used its assets to generate profit. Different measures are aggregated and used to assess financial performance. Early researcher on companies insisted that the business was only accountable to their shareholders. Some researchers have presented a negative relationship between financial performance and corporate governance (Bromiley & Marcus, 1989) while others have found an inconclusive result (Freedman and Jaggi, 1986). Board composition is thus affected by decline in financial performance since companies react to performance down turns by adding outside directors who will take corrective action (Shivdasani, 2004). The replacement of inside directors with outside directors will better monitor management (Hermalin & Weisbach, 1988). Decline in financial performance will often lead to downsizing measures including plant closures, employee layoffs and sale of assets. This however has been found to be less prevalent in Japanese firms than in the United States. Board composition is associated with future measurements of financial performance. Increased uncertainty of a firm’s environment, diversification and poor past financial performance were associated with large board size and increase in outside directors (Zahra, 1992).

Performance decline results in an organisation adding outsiders so as to provide new ideas and add to knowledge. This also signals to stakeholders that all is well. Board composition has an impact on the quality of deliberations and decisions and impacts their ability to provide strategic direction (Rosenstein, 1987). Powerful and participative boards are more progressive and post better financial performance. In general larger boards are preferred by smaller firms even though there arises disputes over the effect of the size of the board on performance. The threat of lawsuits may result in appointment of outside directors to enhance control over management (Davis & Thompson, 1994). The ability of a board to perform thus is dependent on the composition. Studies have shown that board composition determines the power of the board which impacts on their control and contribution to company performance. There have been studies that reveal that when a firm’s performance declines, board membership reduces. According to Yermack (1996),
the number of outside directors is likely to decrease since these outsiders are more costly to the organisation. Only about 46 percent of outside directors remain following bankruptcy of an organisation (Gibson, 1990). Directors who lack the necessary skills to provide strategic direction and exercise control over the firm are largely responsible for declining financial performance. Various regulators have established guidelines in the selection of board members to safeguard the interest of the various stakeholders. There are also guidelines on the number of committees and who should be in them. There is a push for scrutiny and information on the director’s background and expertise.

2.2.3 Strong Financial Performance

The composition of the board of directors can influence a variety of organisation outcome. More institutions are focused of governance reforms including the separation of the position of the CEO and the board in order to improve their financial performance (Biggs, 1995). Contrary to a situation where a firm is experiencing declining performance, firms with strong performance are better placed to recruit outside directors since they can afford to. This is beneficial to the firms since effective boards will comprise of a greater proportion of outside directors (Lorsch and Maciver, 1989). This preference is grounded on the agency theory which advocates for separation of ownership and control. The choice of outside directors may be driven by their qualification and expertise and their potential to exert influence on outside resource providers such as financial institutions. They are believed to provide higher benefits as a result of their independence from the firm and are positively associated with profitability (Ezzamel and Watson, 1993). Organisations with more outside directors have a higher return on equity (Baysinger and Butler, 1985). Having high status directors can send a signal of a firm’s legitimacy and future success in an initial public offering (Certo, Dailey and Dalton, 2001). The addition of a prominent director on the board of a new firm serves as a seal of approval to address the concerns of dubious investors (Davis and Robbins, 1998). Scholars studying diverse groups have found that decision making improves with diversity. Creativity is higher and a broader set of alternatives is considered, and firms are more innovative with diverse boards (Letedre, 2004; Miller & Triana, 2009; Nielsen & Huse 2010). However, some researchers are of a contrary view that inside directors are associated with higher firm performance and that there is a positive relationship between the proportion of inside directors and returns to investors (Kesner, 1987).
Chief Executive Officers are charged with the responsibility of carrying on their role in the best interest of shareholders. The board of directors on their part are mandated to monitor and ensure that the chief executive officer does so. They align the chief executive officer and the shareholders’ interests (Fama and Jensen, 1983). CEO duality occurs when the same person holds the CEO and board chairperson positions (Rechner and Dalton, 1991). During periods of good financial performance, the position of CEO and the board chairperson are preferred to be separate (Finkelstein and D’Aveni, 1994). However, duality can entrench the CEO on top of the organisation and challenge the board’s authority to monitor and discipline (Mallette and Fowler, 1992). CEO duality becomes less common when an organisation’s performance is high. Combining the two roles is preferred in times of financial distress to enable the CEO make critical decisions required (Harris and Helfat, 1998). This study suggests that, when board members are considering the adoption of new ideas/practices such as Share Value Orientation, they should consider the contextual fitness of the idea/practice with the firm's owners and their interests (Bosch & Volberda 2014). The surprise departure of an independent director result in a worse performance of a company’s stocks, is likely to restate earnings and have negative return events (Fahlenbrach, Low, & Stulz, 2010). Companies with their CEO as a director have positive market reactions. Demirkan and Platt (2009) investigated how and when corporate governance affects managers decisions to use discretionary accruals artificially influencing a company’s financial reporting. Further findings by Platt and Platt (2012) are that non-bankrupt organisations have more CEOs on their board of directors than organisations that have gone bankrupt. The relationship between board composition and external auditors was exemplified by Desender & Aguilera (2013). While board independence and audit service complement each other when ownership is dispersed it is not so when ownership is concentrated (Desender & Aguilera 2013).

Some researchers have argued that duality establishes one centre of command with unambiguous leadership thus clarifying decision making authority which reassures stakeholders. During the crisis years of 2008 and 2009, CEO duality had a positive influence on corporate performance (Dekker, 2013). There is a view that corporate governance stands for the internal system designed to minimize the agency problem and external rules and regulations (Cadbury Committee, 1992). Meanwhile, Harjoto and Jo
(2008) found the opposite result, i.e., that combining the chair and CEO positions had a positive relationship with firm performance. Boyd (1995) explains the discrepancy by arguing that the effect of duality depends on previous firm performance.

The dominant board structure in the United States is the board duality. The structure is common in 80 per cent of the companies (Rhoades et al., 2001). Studies support CEO duality on corporate governance during strong financial performance (Lil, 2005). When a person combines the role of a CEO and chairman of the board, there is faster response to environmental changes due to faster information processing, and flexible decision making. The findings of Elsayed (2007) support Boyd’s (1995) view. In his research on a sample of Egyptian firms, Elsayed discovered that CEO duality had a positive impact on firm performance when examined in the context of firms with low corporate performance. Conversely, when a corporation experiences an improvement in performance, the arguments for combining the CEO and chair positions become moot.

2.2.4 Poor Financial Performance

Poor financial performance impacts stakeholders, management and the board and there is expectancy that some form of action will follow. The decisions may be influenced by the structure of the board. While some studies support a positive impact of CEO duality (Lil, 2005), others support a negative relationship between CEO duality and corporate governance (Rechner and Dalton, 1991). Others have found no correlation between CEO duality and corporate governance (Abdullah, 2004). Stronger boards where there is no duality are more likely to take serious action such as the dismissal of a CEO due to poor financial performance (Bhagat, Carey and Elson, 1999). A contrary view is that when the two positions are combines, the person is see a clear direction and make faster decisions to increase shareholders value and recover from poor financial performance faster. The effects of profitability on corporate governance may be two way. High profitability implies a good capability of management and so monitoring them may not be necessary. On the other hand, high profitability means the company can afford a better governance system. Outside investors may also demand better governance as they have a greater economic stake to lose.

Higher liquidity as measured by the amount of free cash flow would lead to a better
governance mechanism since it can be appropriated by the management for their private benefit. It also allows firms to maintain a costly monitoring system. The growth potential would also be related to better governance since those firms with high growth rates have more to lose from a lack of investment capital, and would try to satisfy outside investors with better governance as Durnev and Kim (2003) have argued.

A higher debt ratio implies a larger amount of interests and principals to be paid periodically, and the management would be under pressure to ensure enough cash flow to cover the debt payment, which can be done through more efficient management (Grossman and Hart (1982)). This is expected to be negatively correlated with the corporate governance mechanism. Among the different types of debt, a bank loan is of particular interest since banks, as larger creditors with a long-term relationship with firms, are supposed have an incentive and capability to monitor their client firms.

With regard to empirical evidence on corporate governance, there have been mixed findings on the direction of causality between firm performance and corporate governance (Bauer et al., 2004). From the point of view of a critic, Brennan (2006) considered that the contradictory evidence between corporate governance and firm performance can be due to an expectation gap between what stakeholders (e.g. investors, regulators, researchers, the media and the public) expect and what boards of directors can reasonably provide. In the opinion of this study, corporate governance disclosure can contribute to reducing or eliminating the expectation gap, which supposes that those companies with higher levels of performance will have incentives to improve the information provided about corporate governance.

2.3 The Influence of Size on Corporate Governance
Since governance mechanisms consume corporate resources, we expect that larger firms would have better corporate governance, and we include asset size as a control variable. Most of the monitoring system such as the board of directors, internal control system, and financial reporting and disclosure system incur financial costs, most of which are of a fixed component and can be borne more efficiently by larger firms. The more complicated business structure of large firms may also require better corporate governance.
Larger firms have sustainability-oriented corporate governance mechanisms which impact the voluntary assurance of corporate sustainability reports. The presence and characteristics of environmental committees on the Board of Directors and a Chief Sustainability Officer (CSO) among the management team impacts the quality of corporate governance. When examining assurance services, we make a distinction between those services performed by professional accountants, consultants, and internal auditors. We find that the presence of a CSO is positively associated with corporate sustainability report assurance services, and this association increases when the CSO has sustainability expertise. Presently, environmental committees with greater expertise appear to prefer the higher-quality assurance services of professional accounting firms. Expert CSOs, on the other hand, prefer assurance services from their peers with sustainability expertise, as evidenced by their choice to employ consultants. Larger firms in the U.S. are significantly less likely to employ assurance, this result decreases over time. Further, the value-relevance of sustainability assurance is increasing with time (Peters and Romi 2015)

2.3.1 Financial Disclosure
Prior research suggests that firm size is a key determinant of the extent of voluntary disclosure (Meek et al., 1995; Ahmed and Courtis, 1999). Larger companies are associated to larger resources to allocate for the preparation of high quality information, and the costs involved are lesser due to the economies of scale. The accounting literature (Chow and Wong-Boren, 1987; Gul and Lang, 2004) has consistently confirmed the existence of a positive relationship between firm size and the extent of voluntary information disclosure. Bujaki and McConomy (2002) also document the existence of a positive relationship between firm size and the extent of information provided by Toronto Stock Exchange listed companies regarding their corporate governance practices in 1997.

Large firms may adopt good Corporate Governance practices in order to mitigate the agency costs of free cash flow. Firms with large free cash flows may not use them in the best interest of all shareholders. Small firms may grow faster than large firms and will need more external financing. Both large and small firms could have incentives to adopt good Corporate Governance practices voluntarily (Klapper and Love, 2004).
Developed by societies to create order, institutions provide the rules of the game and organisations are the players that are bound by these rules (North, 1990). The institutional perspective emphasises the influences of the context surrounding organisations that shape their behaviour (Scott, 1995). It suggests that one cannot understand business strategy if one cannot understand the context (Meyer and Nguyen, 2005). In most markets there exists laws that regulate and govern the disclosure of detailed information in annual reports on matters related to the nomination of directors, the formation and composition of board committees, the organisation of board leadership structure and the remuneration of directors especially in publicly held corporations. These are aimed at protecting the interest of investors.

According to Harrison (1997) for a board of directors, its committee structure symbolises its method of operation which itself is not readily observable. Boards are getting increasingly confronted by the need to generate more openness, transparency and openness. Despite the growing concern on board disclosure, annual reports still present a limited view of board practices. International developments in corporate governance increasingly force exchanges to set forth new corporate governance standards while they fight for a piece of the financial pie (Griffith, 1990). In essence, the principal characteristics of effective corporate governance transparency which entails full disclosure, protection and enforceability of the rights and prerogatives of all shareholders. The board should not be involved in developing or implementing strategy unless it firmly believes that the proposed strategy or its execution is wrong (Zahra, 1990). For disclosure purposes McMullen (1996) indicated that the existence of audit committees is associated with a lower number of shareholder law suits. Companies with unreliable financial reporting and disclosure were less likely to have audit committees than those not confronted with law suits.

This study exploits an exogenous change to audit committee policy in Canada and presents new evidence on how high-quality corporate governance mitigates managerial resource diversion and improves firm values. We first examine why some firms listed on the Toronto Venture Exchange (TSX Venture) voluntarily adopted the more stringent governance policy in 2004 that requires all audit committee members to be independent
and financially literate. We develop a parsimonious analytical model that shows that both compliance costs and financing needs have an impact on firms' adoption decisions. Confirming the model's predictions, we find that TSX Venture firms with low compliance costs and greater future financing needs are more likely to adopt the new policy voluntarily. The analytical model also shows that high-quality audit committees enhance firm values by reducing the likelihood of managerial resource diversion. Consistent with the predictions of our analytical model, we find that the adoption decision has a positive impact on firm value and a negative impact on firms' cost of equity capital for both Toronto Stock Exchange (TSX) and TSX Venture firms. As corroborating evidence of the economic impact of the more stringent governance policy, we also show that both TSX and TSX Venture firms have improved investment efficiency following the adoption decisions (Feng Chen and Yue Li 2013).

Effective monitoring and enhanced internal control following the adoption of high-quality audit committees should mitigate managers’ incentives to make inefficient investments (Huang and Zhang 2012).

2.3.2 Listed Companies
Companies may choose to raise capital through the stock market by listing. When a company goes public, it puts itself under greater public and investor scrutiny. For example, the pay-out to the CEOs may receive negative media and affect the public image of a firm (Bolt, 2004). Kenya is no exception to this. There are reporting and disclosure requirements that will drive the company to invest more in corporate governance. The annual reporting will also require extensive disclosure which may be a notch higher than would be required upon non-listed companies. Aside from investors, regulators also put additional demands to the listed company in form of board characteristics, remuneration, choice of auditors and daily operations.

The agency theory is frequently applied to understand the role of corporate boards to mitigate agency problems. Another leading theory, the resource dependence theory emphasises the resource allocation role of corporate boards. The involvement of directors in the strategic course of the corporation is mainly understood in the stewardship theory. These multiple perspectives of board involvement in decision making yield a better
understanding of the roles of corporate board of directors (Hung, 1998). Pressure from regulators, legislators and investors may stimulate directors to transform the formal organisation of their boards into more independent board structures (Maassen and Van Den Bosch, 1997). Listed companies thus tend to have stronger corporate governance. Societal pressures, regulatory systems, and ownership patterns are considered to act as fundamental influences on the role and organisation of corporate boards (Judge, 1989). Stock exchanges and institutional investors are increasingly playing a dominant role in the discussions of board roles as regards corporate governance and the independence of these boards.

The empirical evidence shows that the size of a firm is an important factor in explaining the variability and extent of the information it discloses, particularly on a voluntary basis (see, among others, Cooke, 1991; Meek et al., 1995; Raffournier, 1995; Depoers, 2000). Big companies have smaller costs associated with the generation of information or the existence of competitive disadvantages arising from its divulgence. For these companies, corporate governance disclosure is essential due to the complexity of its corporate relationships. The dissemination of this information will contribute to reducing the costs of monitoring the outside shareholders and the information asymmetries (Eng and Mak, 2003). Empirical evidence from research into online disclosure (see Craven and Marston, 1999; Pirchegger and Wagenhofer, 1999; Bonsón and Escobar, 2002; Bollen et al., 2006) also suggests a positive and significant relationship between the size of a company and the level of disclosure.

It is advisable to tap into various sources of capital; either debt or equity. The diverse capital sources ends up reducing a firm’s cost of capital. Debt is money borrowed from a lender and is repaid back with some element of interest over a period of time while equity entails selling a portion of the company to an investor. During uncertain economic periods, the credit environment may get tighter which may call for more creative and non-traditional ways of sourcing for capital. In issuing new equity, smaller firms face higher costs. This may explain the reason the smaller firms rely more on internal funds and the finding that financing constraints decrease with firm size (Hooks, 2003). Large firms on their part display higher investment cash flow sensitivities (Vogt, 1994).
In testing the propositions firm’s investment behavior is modeled in a dynamic setting in the presence of adjustment costs, liquidity constraints and imperfect competition, similar to Whited (1992) and Bond and Meghir (1994). Stock exchanges have the unique power to amend listing rules related to the governance structure of listed corporations. The New York Stock Exchange for example started to recommend formation of audit committees in 1939. Many other Exchanges followed the early initiatives in the US and UK. Disclosure and not compliance is at the heart of these self regulatory initiatives (Conner, 1995). Institutional investors are also increasingly putting pressure on corporations to alter the composition and structure of their boards. It is hard to ignore the pressure from institutional investors on corporate governance practices of listed companies (McCarthy, 1996).

2.4 The Influence of Board Characteristics on Corporate Governance

2.4.1 Board Size

From a sociological perspective, it has been argued that a larger board of directors is beneficial and will increase the collection of expertise and resources accessible to a firm (Dalton et al., 1999). Scholars have also illustrated that family owners often have a more traditional long term orientation and often act as “protective stewards” of a firm (Miller, Le Breton-Miller, & Lester, 2013). Yet, Hermalin and Weisbach (2003) argue that the consensus among the economic literature is that a larger board will impair firm performance. For instance, Jensen (1993) argues that as board size increases, boards’ ability to monitor management decreases due to a greater ability to shirk and an increase in decision-making time. A larger board may also be indicative of a firm’s attempt to satisfy independence requirements by diluting the concentration of insiders via appointment of independent directors.

Contrary to these statements, a study by Adams and Mehran (2003) report that banking firms have a larger board of directors in comparison to manufacturing firms and Belkhir (2009) reports that a larger board of directors at banks is positively associated with return on assets and Tobin’s Q which is the ratio between the market value and replacement value of the same physical asset calculated by comparing the market value of a company's stock with its equity book value. This suggests that the performance of banks with a smaller board do not surpass their counterparts with larger boards. Adams and Mehran
(2003) speculate that banks have larger boards due to their complex organizational structure and the requirement to have more committees (e.g., lending and credit risk committees) and thus require more members.

Our second determinant of code compliance is the size of the supervisory board. The decision making process on the supervisory board is likely to be affected by its size for at least two reasons. First, coordination problems are larger on a large board compared to a small board. Jensen (1993) and Lipton and Lorsch (1992) suggest that large boards can be less effective than small boards, presuming that the emphasis on politeness and courtesy in boardrooms is at the expense of truth and frankness. Specifically, when boards become too big, agency problems (e.g., director free-riding) increase and the board becomes more symbolic and neglects its monitoring and control duties. Moreover, large boards may reflect an inadequate perception of the true executive function, particularly in firms with public involvement. Supporting this rather ad-hoc proposition, Yermack (1996) was the first to report empirical evidence for a negative relationship between board size and firm valuation (see also Eisenberg, Sundgren, and Wells (1998); Beiner, Drobetz, Schmid, and Zimmermann (2004)). Second, on a large board it is likely that more conflicting groups of stakeholders, such as representatives of large shareholders, employees, and creditors, are represented than on smaller boards. Third, many companies do have a (and if, at most one) representative of small shareholders. However, the larger the board the less weight this representative has at a ballot.

2.4.2 Board Composition

An outside director is a member of a company’s board of directors who is neither an employee nor a stakeholder of the company. In most instances, they are paid a retainer, share option or other prescribed benefit. They are non-executive directors and are believed to have unbiased opinions. Outside directors bring a certain level of impartiality in evaluating management decisions (Baysinger and Hoskisson, 1990). Firms with lower profitability are more likely to increase the number of outside directors to their boards (Bhagat and Black, 2002). The careers of outside directors are not likely to be affected by the outcome of their decisions and are more objective (Rechner, Sundaramurthy and Dalton, 1993). Many countries worldwide have established the minimum standards for representation for outside directors on the boards of public quoted companies (Dahya and
McConnell, 2002). Fama and Jensen (1983) indicated that outside directors are in a better position to monitor management because of their independence from the firm’s management. They advise management on operations and strategy based on their professional experience while monitoring the firm to ensure that management act in the sole interest of the shareholders. They are therefore likely to act without undue influence from management while providing third party oversight. Shareholders react positively to the appointment of outside directors (Rosenstein and Wyatt, 1990). Proponents of inside directors on the other hand advance the argument that outside directors are less informed about a company and may be less qualified and engaged. They may lack independence since they are co-opted by management and thus may make wrong decisions. Shareholders react negatively to the sudden death of an outside director especially when the director serves in a key role such as board chairperson and when the overall representation by outsiders is low (Nguyen and Nielsen, 2010).

As a result of recent corporate scandals, several rules have focused on the role played by Boards of Directors on the planning and monitoring of corporate codes of ethics. In theory, outside directors are in a better position than insiders to protect and further the interests of all stakeholders because of their experience and their sense of moral and legal obligations. Female directors also tend to be more sensitive to ethics according to several past studies which explain this affirmation by early gender socialization, the fact that women are thought to place a greater emphasis on harmonious relations and the fact that men and women use different ethical frameworks in their judgments Luis Rodriguez-Dominguez, Isabel Gallego-Alvarez & Isabel Maria Garcia-Sanchez (2009). Our findings show that a greater number of female directors does not necessarily lead to more ethical companies. Luis Rodriguez-Dominguez, Isabel Gallego-Alvarez & Isabel Maria Garcia-Sanchez (2009).

The resource dependency theory explains how organisations reduce environmental interdependence and uncertainty. Pfeffer and Salancik (1978) proposed five options that firms can use to minimize environmental dependence which are mergers and vertical integration, joint ventures, board of directors, political action and executive succession. External factors influence organisation behaviour but managers can act to reduce environmental uncertainty and dependence. One such way is the appointment of external
directors to a company’s board. Changes in the membership of a corporate board are a direct response to changes in the environment. Central to these actions is the urge to control power and reduce other people’s power over them. Boards enable firms to gain resources and minimise dependence. Pfeffer (1978) found that board size relates to the firm’s environmental needs and those firms with greater interdependence have a higher number of outside directors. He concluded that board composition and size are rational organisation responses to the conditions of the external environment. Board size are related to an organisation’s environmental dependence (Sanders and Carpenter, 1998). Others advocate that board size and composition are dependent not only on the external environment but also on the firm’s strategy and previous financial performance (Pearce and Zahra, 1992). Boyd (1990) proposed that in some environmental conditions, board size can be a hindrance while board interlocks are a benefit. Utility companies made changes to the composition of their boards to make them more responsive to competitive conditions when the industry underwent deregulation (Hillman, 2002). Firms that are able to attract powerful members of a community to their boards are able to acquire critical environmental resources (Provan, 1980). Organisational characteristics predict board composition including the likelihood of female directors in the board (Hillman, Shropshire and Cannella, 2007).

Studies on the effect of demographic diversity on firm performance in emerging markets on the other hand are very rare and lack statistical significance or focus on single diversity dimensions such as gender or race. (Ben-Amar et al 2013) is one of the few. Consider the evidence that women are more risk averse than men (Sapienza, Zingales, & Maestripieri, 2009). Because of selection, it does not follow that female directors should also be more risk averse than male directors. In fact, in a sample of Swedish directors, Adam and Funk (2012) find that female directors are more risk loving than male directors. Women are not only more ethical but ruminate over decisions more than men (Knippen, 2014). The role played by boards cannot be under emphasised. It is here that ket strategic decisions are made, risks overseen and governance structures set. Women directors attend a higher percentage of board meetings than male directors with male attendance being higher where the board is gender diverse (Adam & Ferreira, 2009). It is imperative that a board comprises of high calibre and diverse individuals in terms of gender, experience and knowledge. In 2010, women made up 12.5% of the membership
of boards of the Financial Times Stock Exchange 100 companies which were up from 9% in 2004 (Abersoch, 2011). Studies have shown that gender diverse boards have fewer conflicts (Nielsen and Huse, 2010). Increasing the number of women in a team increases its collective intelligence. Some countries have established quota systems as a way to facilitate more women in boards. Norway has a mandatory quota system of 40%. Many women brought to the board bring a different set of perspective, experience, angle and viewpoints than their male counterparts (Dhir, 2015).

Organizations such as the National Association of Corporate Directors suggest setting a retirement age and limiting the amount of time served for directors. This is based on the argument that older directors are less likely to take an active monitoring role and that the greater tenure of these directors may hinder independence from top management. Board tenure has been found to be positively associated with the likelihood of financial statement fraud (Beasley, 1996) and negatively associated with earnings quality (Vafeas, 2005). Vafeas (2003) reports that directors with 20 or more years of board service are nearly twice as likely to occupy a “management-affiliated” position compared to directors with less tenure, and that they are also more likely to staff the firm's nominating and compensation committees. Further, senior director membership to the compensation committee is linked with higher pay for the CEO.

Director age may be related to more than one underlying construct considering that the board of directors are responsible in identifying the strategic direction and improving decision making (Hambrick & Mason, 1984). Top management characteristics influence the decisions that they make. This is because demographic characteristics such as age are associated with cognitive bases, values and perceptions that influence the decision making at the top (Marimuthu & Kolandaaisalmy, 2009). Goll and Rashid argued that the demographic characteristics of top management affects the decision making process.

Like old directors, it has been argued that busy directors are expected to be less active monitors relative to directors who sit on fewer boards. The number of busy directors is positively correlated with CEO pay and Beasley (1996) reports that the probability of committing accounting fraud is positively related to the number of directorships held by outside directors. Thus, a high number of directorships results in weak monitoring and
enables the CEO to extract more pay from the firm. Providing more evidence regarding
the weak governance of busy directors, Fich and Shivadasani (2004) find that when a
majority of outside directors serve on three or more boards, firms exhibit lower market-
to-book ratios as well as weaker operating profitability.

Despite the findings, which suggest that busy directors are a form of weak corporate
governance, Ferris et al. (2003) find that serving on multiple boards does not impact the
ability to carry out board member responsibilities. As well, Harris and Shimizu (2004)
find that busy directors are important sources of knowledge and improve acquisition
performance. However, these studies do not negate the finding that busy directors may be
too “busy” to challenge insiders such as the CEO.

Frequency of board meetings is suggested to indicate active monitoring by the board
(Conger et al., 1998). Contrary to this perspective, Vafeas (1999) found that frequency of
board meetings is negatively related to performance, which may be the result of boards
meeting more often subsequent to poor performance. This finding suggests that board
meetings are a reactive measure to performance rather than proactive measure (Jensen,
1993). In periods of financial distress such as the subprime crisis this view purports that
boards would meet more frequently and may have met less frequently prior to the crisis.
As discussed previously, banks are likely to have larger boards which may increase
schedule conflicts and reduce the quantity of meetings. Adams and Mehran (2003)
suggest that since banks have more committees than non-banking organizations it is
necessary that the boards of banks meet more frequently for effective operating purposes.

The board of directors is an important element of the governance system of a listed firm.
According to agency theory, the board should be more effective when composed of a
majority of unrelated directors. Given that independent directors compete in the directors’
labor market (Fama and Jensen, 1983), they have incentives to establish and keep a
reputation of professional experts who effectively monitor managers and who look for the
shareholders’ best interests. Chen and Jaggi (2000) argue that boards with a majority of
external directors should be aware and more responsive to investors’ demands for
informative disclosure and consequently would improve the comprehensiveness and the
quality of firm disclosure. Chen and Jaggi (2000) provide evidence of a positive
association between board independence and the comprehensiveness of financial disclosures in Hong-Kong. Cheng and Courtenay (2006) report also that board independence is positively correlated to the disclosure level for a sample of firms listed on the Singapore stock exchange.

However, Forker (1992) conclude that there is no significant association between corporate governance attributes and share option disclosure quality and Ho and Wong (2001) did not report any significant relation between the proportion of independent directors and the extent of voluntary disclosure for a sample of listed companies in Hong-Kong. Eng and Mak (2003) even find a negative relationship between board independence and level of voluntary disclosure. Their results suggest that board independence acts as a substitute rather than a complement for accounting disclosure.

CEO duality which entails combing the role of CEO with that of the chairman of the board is exemplified by the agency theory (Jensen & Meckling, 1976; Fama & Jensen, 1983), indicating a lack of separation between management and control decisions. It is argued that CEO duality may reduce board independence and its ability to effectively monitor managers including the disclosure of information to external stakeholders. Gul and Leung (2004, p. 356) suuggest that ‘firms with CEO duality are more likely to be associated with lower levels of voluntary disclosures since the board is less likely to be effective in monitoring management and ensuring a higher level of transparency.’

Prior accounting research looking to the relationship between CEO duality and disclosure level has obtained mixed evidence. Gul and Leung (2004) find that CEO duality is associated with a lower level of voluntary disclosure in Hong-Kong whereas Cheng and Courtenay (2006) did not report any significant association between CEO duality and the extent of voluntary disclosure in Singapore.

2.4.3 Executive Compensation and Remuneration

Consistent with prior studies on director compensation (e.g., Core et al. 1999; Archambeault et al. 2008; Engel et al. 2010), a compensation package for each independent director include board meeting fees, annual cash retainer, value of stock awards (the market price of shares awarded to an independent director at the fiscal year-end preceding the proxy date), value of
option grants (the market value of stock options awarded to an independent director at the fiscal year-end preceding the proxy date) and other miscellaneous rewards (e.g., loans to an independent director) Duchin et al. (2010), and Ahern and Dittmar (2012). There has been a lot of studies on CEO and executive compensation more so in the 1990s. The increase in academic papers on CEO and executive compensation more so in the 1990s. The increase in academic papers on this subject seems to have outpaced even the remarkable increase in CEO pay itself (Murphy, 1999). Remuneration of board of directors and executives should reflect the interest and be consistent with the shareholders as well as safeguard a company's interests. Payment of incentives is allowed in certain companies but with clear guidelines. Incentives may include share options and bonus payments. Part of the considerations made in setting the compensation level for member of the board of directors is comparability to other companies, the competencies and experience of board members, scope of work and number of meetings.

A combination of fixed and performance based pay is given to many executive management to attract and retain key employees. Denis and McConnell (2003) investigated the relationship between board composition, executive compensation and other corporate governance aspects. Agency problem can be mitigated by the composition of a board and the existence of a remuneration committee (Pukthuanthong et al., 2004). Studies have shown that it is important for members of the executive management to be employed under executive service contracts with the board of directors setting the terms within the contract framework. A remuneration committee of the board comes up with proposals on the compensation of executive management while ensuring that it is in line with comparable organisations. The proposal is submitted for adoption in a board meeting.

A higher proportion of outside directors provide a stronger monitoring effect inside boards (Hermalin & Weisbach, 2003). Boards of publicly traded companies do not bargain at arm’s length with the executive management thus they wield substantial power over their own remuneration. Outside board members holding multiple directorship in other companies are said to have a greater incentive to monitor corporate decisions due to their reputation (Fama & Jensen, 1983). Remuneration is meant to help solve the agency problem where the managers may use their influence for private interest in a variety of ways (Shleifer & Vishny, 1977). It is also meant to enhance performance thus the reason some companies link incentives to performance. However, some research based on different data sets have found weak or insignificant relationships between pay and performance (Jensen & Murphy, 1990).
Outside directors to a company board are favoured because they are said to be more concerned with the company compensation structure in the interest of shareholders (Pukthuanthong et al., 2004). With the generally agreed role of the board of directors being the monitoring of management on behalf of shareholders and providing resources, effective monitoring can improve firm performance by reducing agency costs. Two studies have however shown no statistical relationship between board incentive to monitor and firm performance (Certo & Roengpitya, 2003). The magnitude of monetary rewards to independent directors was found to be consistent with output Engel et al. (2010).

The quality of board members will positively contribute to management decisions which will then be translated into the firm’s performance (Adams & Ferreira, 2007). Board members thus need management knowledge in marketing, finance, legal issues accounting and other related areas. Education can have a positive impact on the quality of decisions made by a board (Kim & Lim, 2010). The total number of degrees on a particular board has a positive impact on the company performance (Wincent, Anokhin and Ortvist, 2010). However, Daily and Dalton (1994) found that educational background can have no impact on a firm’s value. Advanced education degrees of outside directors have a negative impact on research and development budgets.

2.5 Chapter Summary

This chapter reviewed the relevant literature in relation to the specific objectives of the study. In this regard, the literature was on the influence of performance on corporate governance, company size and corporate governance, and board characteristic influence on corporate governance. Chapter three describes the research methodology that will be used to conduct the study.
3.0 RESEARCH METHODOLOGY

3.1 Introduction

The research process of the study which is the research design, population, sampling design, sample frame, sample technique, sample size, data collection methods, research procedures, data analysis methods is exemplified. The conclusion of the chapter discusses the relevant issues discussed.

3.2 Research Design

The study was carried out using the case of Kenya Commercial Bank. It is a descriptive research. Descriptive studies intend to describe or explain relationships among phenomena, situations, and events as they occur. The major purpose of descriptive research is to provide an overall “picture” of a population or phenomenon by describing situations or events (Rubin & Babbie, 1997). The purpose of a descriptive research is to examine a phenomenon that is occurring at a specific place(s) and time. The research used the descriptive method of correlation to describe what exists at the moment (conditions, practices, processes and structures). The descriptive research method in this study was a survey which made use of questionnaires administered through mail.

Descriptive research is directed at making careful observations and detailed documentation of a phenomenon of interest. These observations must be based on the scientific method (i.e., must be replicable, precise, etc.), and therefore, are more reliable than casual observations by untrained people. Descriptive research involves gathering data that describe events and then organizes, tabulates, depicts, and describes the data collection (Glass & Hopkins, 1984). Observational and survey methods are frequently used to collect descriptive data (Borg & Gall, 1989). Descriptive studies are generally aimed at finding out "what is". Descriptive research is unique in the number of variables employed. Like other types of research, descriptive research can include multiple variables for analysis, yet unlike other methods, it requires only one variable (Borg & Gall, 1989).
This study looked at Corporate Governance in relation to financial performance, company size and board characteristics. From the findings, recommendations are made that will have an impact on the banking sector as a whole. The variables in this study are the bank financial performance, the bank size and the board characteristics which are all dependent variables. Though each item was looked at independently, they are related and all work together towards the overall success or failure of an organisation.

3.3 Population and Sampling Design

3.3.1 Population

A population is the entire group to which a researcher wishes to generalise findings. It is further defined as the total selection of objects about which the researcher makes some inferences (Cooper and Schindler, 2000). The target population of the study was composed of 332 staff of Kenya Commercial Bank in Nairobi which formed the basis from which the sample or subjects of the study was drawn. The target population comprised of six (6) departments at KCB namely: Human Resources department with a population of 60 employees, Retail and Consumer Banking department with a population of 116 employees, Finance department with a population of 48 employees, Operations department with a population of 36 employees, Information Communication Technology department with a population of 40 employees and Strategy department with a population of 32 employees. This was the population of interest which enabled furtherance of the study.

Table 3.1: Population Distribution Table

<table>
<thead>
<tr>
<th>Divisions</th>
<th>Absolute Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human Resources</td>
<td>60</td>
<td>18</td>
</tr>
<tr>
<td>Retail</td>
<td>116</td>
<td>35</td>
</tr>
<tr>
<td>Finance</td>
<td>48</td>
<td>14</td>
</tr>
<tr>
<td>Operations</td>
<td>36</td>
<td>11</td>
</tr>
<tr>
<td>Information Communication Technology</td>
<td>40</td>
<td>12</td>
</tr>
<tr>
<td>Strategy</td>
<td>32</td>
<td>10</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>332</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

KCB Human Resource data base
3.3.2 Sampling Design

Sampling design determines the number of participants in a study, what and how many events to observe and how many records to inspect (Cooper and Schindler, 2000).

3.3.2.1 Sampling Frame

The sample frame constitutes a list of elements from which the sample has similar characteristics to those of the population drawn (Scholz and Tietje, 2002). The sample frame of 332 employees was drawn from the Human Resources office where all employee information is stored. It comprised of a listing of all these employees and their departments. It is from this sampling frame that the study drew a sample from. Information was obtained with regard to all employees in the six departments of the bank namely: Human Resources, Retail and Consumer banking, Finance, Operations, Information technology, and Strategy. This information was obtained from the Human Resource Division at Kenya Commercial Bank.

3.3.2.2 Sampling Technique

The sample design of the study defines the boundary of the study by using the probability sampling such as the stratified random sampling in order to ensure fair representation and generalization of the general population. A stratified random sampling technique was used to select the sample. This was used to achieve the desired representation of the population under study through sampling (Mitchell and Jolley, 2007). This technique involves the division of the target population into strata. A stratum is a subset of the population that shares a common characteristic (Mitchell and Jolley, 2007). In this case the population was divided into six (6) strata based on functional areas/ departments.

3.3.2.3 Sample Size

According to Mitchell and Jolley (2007) a sample is a functional variation in the population parameters under study and the estimation of the precision needed by the research. A sample is a group of respondents, cases/ records comprising part of the entire study population that is empirically selected to represent the population of the study (Shuttleworth, 2008). It is thus a subset of a population that provides statistical information about a population. The sample size of 166 employees was divided into sub-
stratums and from each stratum a random sample of respondents was carried out. The sample was made up of employees of Kenya Commercial Bank in Nairobi.

The sample of 166 respondents represents 50% of the target population. A sample size should be at least 10% of the entire population (Mugenda & Mugenda, 2003). Thus, a sample of 50% is considered appropriate for the study. In research, the minimum number required for a study is 30. This sample size was proportionally picked from the employees in each department. This sampling technique guaranteed reduction in sampling errors.

**Table 3.2: Sample Size Distribution**

<table>
<thead>
<tr>
<th>Strata</th>
<th>Population</th>
<th>Percentage</th>
<th>Sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human Resources</td>
<td>60</td>
<td>50%</td>
<td>30</td>
</tr>
<tr>
<td>Retail &amp; Consumer Banking</td>
<td>116</td>
<td>50%</td>
<td>58</td>
</tr>
<tr>
<td>Finance</td>
<td>48</td>
<td>50%</td>
<td>24</td>
</tr>
<tr>
<td>Operations</td>
<td>36</td>
<td>50%</td>
<td>18</td>
</tr>
<tr>
<td>Information Communication Technology</td>
<td>40</td>
<td>50%</td>
<td>20</td>
</tr>
<tr>
<td>Strategy</td>
<td>32</td>
<td>50%</td>
<td>16</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>332</strong></td>
<td><strong>50%</strong></td>
<td><strong>166</strong></td>
</tr>
</tbody>
</table>

3.4 Data Collection Methods

This study focused on quantitative data which is data in numeric form as opposed to qualitative data. Data collection requires the formulation of an instrument. The instrument used in this study for collection of information was a structured questionnaire. This was appropriate as it captured all relevant aspects of the study and incorporated the objectives of the study and the audit questions. The questionnaire was structured to have four parts named A, B, C and D. Part A contained items/questions on demographic information. This included gender, age group, level in the organisation and education level. Part B, C, and D gathered questions relevant to the study objectives. Part B focused on the influence of financial performance on corporate governance, Part C looked at the influence of size on corporate governance while the focus for part D was on the influence of board characteristics on corporate governance. This implies that part B was concerned with capturing aspects of financial performance; part C captured aspects of company size.
while part D was concerned with board composition in relation to corporate governance. The questions were close ended and the respondent was requested to tick the appropriate box. The likert scale used served as a self-coding for any explanation.

3.5 Research Procedures

Permission to administer the questionnaire was obtained from the Human Resource Manager at Kenya Commercial Bank together with the departmental heads. This was to ensure minimal disruption at the work place as well as build acceptance from the teams involved. Their buy-in was important for the success of the study.

A pilot test with sixteen (16) employees who were not part of the sample was carried out. Feedback was received and utilized for questionnaire modification to suit the purpose of the study. This was to ensure that the final run was able to capture the required information and that the questionnaire as a data collection instrument was adequate for the exercise. The respondents for the pilot were not part of the sample picked to ensure objectivity at the final administration of the questionnaire.

The whole questionnaire was made short enough to encourage most people to complete it. The questions were made easy to understand and respond to. To ensure that a significant proportion of the target population had the chance to respond, the questionnaire was physically distributed to the respondents. The respondents were requested to drop the questionnaire in a drop box made available for them in their department’s reception desk on completion. There was need to be careful about obtaining the highest possible response rate otherwise the answers you get may not be representative of the overall population.

3.6 Data Analysis Method

The analysis of data in regards to establishing the factors influencing corporate governance quality was quantitative. All questionnaires collected were coded then keyed into the computer. Descriptive statistics were generated then analysed. Data analysis is the systematic application of statistical technics to describe and evaluate data. The analysis of data entailed compressing the accumulated data to manageable sizes and developing summaries. Various analytic procedures provide a way of drawing inductive
inference from data (Shamoo & Resnik, 2003). The study used both qualitative and quantitative technics. Researchers generally analyse for patterns in observations through the entire data collection phase (Savenye & Robin, 2004). Punch (2009) argued that data presented as figures and tables give a precise picture of the findings. Research findings have to be accurately and appropriately analysed as improper statistical analysis distorts findings and can mislead readers (Shepard, 2002).

3.7 Chapter Summary

The research design, population, sampling design, Sample frame, sample technique, sample size, data collection methods, and research procedures and data analysis methods are exemplified in this chapter. The chapter describes the research methodology used in this study. Based on the specific objectives of the study, the research findings are presented in the next chapter.
CHAPTER 4

4.0 RESULTS AND FINDINGS

4.1 Introduction

The research findings are presented in this chapter. As described in chapter three the data collected from the questionnaire was analysed then output of the results were obtained as tables. The preference to MS Excel figures then meant that some tables were transferred to MS Excel to obtain different charts. The results findings were portrayed in the charts and tables. After the presentations of the results the study then continued with the discussion of the findings.

4.2 Response Rate

Out of the sample of 166 respondents, responses were received from 165 of them. Only one did not respond which meant that the response rate was at 99.4%.

Table 4.1: Response Rate

<table>
<thead>
<tr>
<th>Strata</th>
<th>Sample size</th>
<th>Responses Received</th>
<th>Percentage of responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human Resources</td>
<td>30</td>
<td>30</td>
<td>100%</td>
</tr>
<tr>
<td>Retail &amp; Consumer Banking</td>
<td>58</td>
<td>57</td>
<td>98.2%</td>
</tr>
<tr>
<td>Finance</td>
<td>24</td>
<td>24</td>
<td>100%</td>
</tr>
<tr>
<td>Operations</td>
<td>18</td>
<td>18</td>
<td>100%</td>
</tr>
<tr>
<td>Information Communication Technology</td>
<td>20</td>
<td>20</td>
<td>100%</td>
</tr>
<tr>
<td>Strategy</td>
<td>16</td>
<td>16</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>166</strong></td>
<td><strong>165</strong></td>
<td><strong>99.4%</strong></td>
</tr>
</tbody>
</table>

4.3 Demographics, Knowledge and Access To Information

The study started with showing the representation of the respondents. This was meant to show the profile of the respondents from different demographic angles.
4.3.1 Respondents by Gender
Out of the random sample, 83 respondents were male while 82 were female. This implies that 50% of respondents were male while 49% were female as represented in Figure 4.1 below.

![Figure 4.1: Respondents by Gender](image)

4.3.2 Respondents by Age
After looking at the respondents’ gender the study then looked at the respondents’ representation by age. The findings were that 27% of the respondents had an age of below 25 years, while 52% had an age of between 25-50 and only 20% were over 50 years.

![Figure 4.2; Age of Respondents](image)
4.3.3 Respondent’s by Level in the Organization
After looking at the respondents’ age the study then looked at the respondents’ representation by level they were in KCB. Figure 4.3 shows that 69% of the respondents were managers, while 25% were not in management and only 6% did not respond to this question.

![Figure 4.3; Level in the Organisation](image)

4.3.4 Respondent’s by Level of Academic Qualification
After looking at the respondents’ level in the organization the study then looked at the respondents’ representation by their level of academic qualifications. 90% of the respondents had reached university level, while 4% had reached college level and 3% had reached only secondary school level.

![Figure 4.4; Academic Qualification of Respondents](image)
4.3.5 Respondent’s by Number of Years Worked in the Bank
After looking at the respondents’ level of education the study then looked at the number of years respondents’ had worked for KCB. The findings were that 39% of the respondents had worked below 5 years, while 31% had worked between 5-8 Years, 3% had worked between 9-12 years and 26% had worked for over 12 years.

![Figure 4.5: Number of Years Worked by Respondents.](image)

4.3.6 Respondent’s Knowledge, Access and Attitudes towards Factors Influencing Corporate Governance
After looking at the respondent’s demographics the study looked at the knowledge, access and attitudes of respondents towards factors influencing Corporate Governance. The study first checked on the knowledge and access before checking the attitudes of the respondents.

4.3.7 Respondent’s Knowledge and Access to Information
The study wanted to test the respondents’ knowledge of the composition of the KCB’s board and the size of KCB’s balance sheet. It also checked on the respondents’ accessibility of KCB’s audited financial reports. Figure 4.6 showed that 96% of the respondents knew the composition of KCB Board and had access to the bank’s audited financial reports while 98% knew the size of the bank in terms of the balance sheet.
Figure 4.6; Respondent’s Knowledge and Access to Information about the Factors Influencing Corporate Governance.

4.3.8 Respondents’ Attitudes towards Factors Influencing Corporate Governance

After looking at the respondents’ knowledge and information accessibility the study wanted to find out the respondents’ high level attitudes on factors influencing the quality of corporate governance.

The study checked on the respondents’ attitudes towards the factors that influenced corporate governance the most. The factors checked were the financial performance of the bank, balance sheet size and composition of the board.

Figure 4.7 below showed that 23% (39) and 75% (124) of the respondents felt that financial performance influenced Corporate Governance highly and very highly respectively, while 23% (39) and 74% (123) of the respondents felt that balance sheet size influenced Corporate Governance highly and very highly respectively. On the other hand 26% (43) and 72% (120) of the respondents felt that composition of the board influenced Corporate Governance highly and very highly respectively.
4.3.9 Respondents’ Attitudes at How Key Organizational Factors Influenced the Quality of Corporate Governance

The study then established how the key organization factors influenced the quality of corporate governance. The research looked at the extent of influence of board characteristics, balance sheet size and financial performance. The findings as represented by figure 4.8 showed that 97% of the respondents felt that financial disclosure and size of the bank influenced Corporate Governance to a very large extent; while 98.8% of the respondents felt that board characteristics influenced Corporate Governance to a very large extent.
4.4 Influence of Financial Performance on Corporate Governance

The first core result the study dealt with was the effect of Financial Performance on Corporate Governance. In the area the study looked at how both financial performance and financial performance dynamics influenced the corporate governance.

4.4.1 Financial Disclosure and Performance Position’s Influence on Quality of Corporate Governance

The study looked at the how strongly financial disclosure, declining financial performance, strong financial performance and poor financial performance had on corporate governance. Figure 4.9 showed that 17% (28) and 81% (135) of the respondents felt that financial disclosure had high and very high influence on Corporate Governance respectively, while 22% (37) and 71% (118) of the respondents felt that declining financial performance had high and very high influence on Corporate Governance respectively. On the other hand 27% (45) and 70% (116) of the respondents felt that strong financial performance had high and very high influence on Corporate Governance respectively, while 16% (27) and 77% (128) of the respondents felt that poor financial performance had high and very high influence on Corporate Governance respectively.
4.4.2 Revenue, Cost and Profitability Influence on Quality of Corporate Governance

26% (28) and 71% (135) of the respondents agreed and strongly agreed that Revenues had a strong influence on Corporate Governance respectively, while 27% (37) and 67% (118) of the respondents agreed and strongly agreed that Costs had a strong influence on Corporate Governance respectively. On the other hand 24% (45) and 71% (116) of the respondents agreed and strongly agreed that Total Assets had a strong influence on Corporate Governance respectively, while 25% (27) and 70% (128) of the respondents agreed and strongly agreed that Profitability had a strong influence on Corporate Governance respectively.
Banks are closely monitored by their regulators and have high disclosure requirements. This explains their strong corporate governance structures that are in place. This is the case at KCB as well as other banks in Kenya.

The performance of banks in Kenya with regards to profitability has been on the rise in the recent past. The top tire banks have had strong financial performance which in turn has ensured that they have strong corporate governance.

There is a positive correlation between financial disclosure, financial performance and the quality of corporate governance.

4.5 Influence of Size (Asset Size) on Corporate Governance

The second area the research looked at was the effect balance sheet size had on quality of corporate governance. On the factor the research checked on balance sheet size dynamics’ influence on quality of corporate governance and then looked at the influence of different balance sheet attributes on corporate governance.
4.5.1 Balance Sheet Size Dynamics’ Influence on Quality of Corporate Governance

The study looked at the balance sheet size dynamics’ influence on quality of corporate governance. On that front it checked the following balance sheet dynamics; balance sheet disclosures, listing at the stock market, use of international accounting standards in the preparation of financial statements and use of a leading global firm in preparation of financial account.

Figure 4.11 showed that 20% (34) and 78% (129) of the respondents felt that balance sheet disclosure had high and very high influence on Corporate Governance respectively, while 24% (40) and 71% (118) of the respondents felt that listing at the stock market had high and very high influence on Corporate Governance respectively. On the other hand 25% (42) and 69% (115) of the respondents felt that using international accounting standard in financial reporting had high and very high influence on Corporate Governance respectively, while 22% (36) and 69% (115) of the respondents felt that using a leading global firm in preparation of financial account had high and very high influence on Corporate Governance respectively.

<table>
<thead>
<tr>
<th>Balance Sheet Disclosure</th>
<th>listing at the stock market</th>
<th>using international accounting standards in financial reporting</th>
<th>using a leading global firm in preparation of financial account</th>
</tr>
</thead>
<tbody>
<tr>
<td>No response</td>
<td>1</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Very High Influence</td>
<td>129</td>
<td>118</td>
<td>115</td>
</tr>
<tr>
<td>High Influence</td>
<td>34</td>
<td>40</td>
<td>42</td>
</tr>
<tr>
<td>Low Influence</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>No Influence</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

Figure 4.11; Influence of Balance Sheet Dynamics on Corporate Governance
4.5.2 Influence of Bank Size Attributes on Corporate Governance

The study then went ahead and checked the influence of bank size attributes on corporate governance. The attributes checked were balance sheet size, total deposits and number of employees. Figure 4.12 showed that 19% (31) and 80% (133) of the respondents agreed and strongly agreed that balance sheet size had a strong influence on Corporate Governance respectively, while 16% (27) and 79% (131) of the respondents agreed and strongly agreed that total deposit had a strong influence on Corporate Governance respectively. On the other hand 18% (30) and 75% (124) of the respondents agreed and strongly agreed that number of employees had a strong influence on Corporate Governance respectively.

![Figure 4.12: Influence of Bank Size Attributes on Corporate Governance](image)

Banks in general use leading global firms in the preparation of financial accounts. These global firms do emphasis the application of International Accounting Standards in the financial reports. These two factors influence the quality of corporate governance as was seen in the study alongside the listing of firms in the stock market.
4.6 Influence of Board Composition on Corporate Governance

The third area the research looked at was the effect that board composition had on quality of corporate governance. On the factor the research checked on the board composition dynamics’ influence on quality of corporate governance and then looked at the influence of board composition attributes on corporate governance.

4.6.1 How Board Composition Dynamics Influenced Corporate Governance

The study then went ahead and checked the influence of board composition dynamics influenced on corporate governance. The attributes checked were; size of the board, number of outside directors, age of the board members, length of time served by individual in the board and remuneration and executive compensation.

The study revealed that 17% (29) and 80% (134) of the respondents felt that size of the board had high and very high influence on Corporate Governance respectively, while 23% (38) and 74% (123) of the respondents felt that number of outside directors (non-KCB employees) had high and very high influence on Corporate Governance respectively. On the other hand 19% (31) and 72% (119) of the respondents felt that age of the board members had high and very high influence on Corporate Governance respectively, while 20% (33) and 76% (126) of the respondents felt that length of time served by an individual in the board had high and very high influence on Corporate Governance respectively and 25% (41) and 72% (119) of the respondents felt that remuneration and executive compensation had high and very high influence on Corporate Governance respectively.
Figure 4.13; Influence of Board Composition On Corporate Governance

4.6.2 Influence of Board Composition’s Attributes on Corporate Governance

The study then went ahead and checked the influence of board composition attributes on corporate governance. The attributes checked were; number of board members size, frequency of board meetings, number of bankers in the board and number of institutional members in the board.

Figure 4.14 showed that 23% (38) and 75% (125) of the respondents agreed and strongly agreed that number of board member size had a strong influence on Corporate Governance respectively, while 24% (40) and 70% (117) of the respondents agreed and strongly agreed that frequency of board meetings had a strong influence on Corporate Governance respectively. On the other hand 20% (33) and 71% (123) of the respondents agreed and strongly agreed that number of bankers in the board had a strong influence on
Corporate Governance respectively, while 25% (41) and 70% (118) of the respondents agreed and strongly agreed that number of institutional members in the board had a strong influence on Corporate Governance respectively.

![Figure 4.14; Influence of Board Composition’s Attributes on Corporate Governance](image)

The board plays a critical role in corporate governance. A weak board will generally result to poor corporate governance. The study checked on the various aspects touching on the board. There is a strong push to vet board members before assuming office. The quality of corporate governance for banks is high partly due to the role the regulator plays when it comes to the appointment of the board members as well as in senior bank position appointments.

4.7 Chapter Summary

This focus of this chapter is the analysis of data collected and the findings of the analysis. The analysis and presentation of the findings were in accordance to the study objectives with the use of figures and tables. The result findings were then discussed. The demographics, knowledge and access to information of the respondents are discussed. The research findings are explained in line with the research specific objectives. The
quality of corporate governance can be said to be as a result of a combination of the factors that were considered. The next chapter summarises the key findings, conclusion and makes recommendations.
CHAPTER 5

5.0 DISCUSSION, CONCLUSION AND RECOMMENDATION

5.1 Introduction
This chapter discusses the results and findings of chapter four. The research objectives and the literature review presented in chapter two form the basis of these results and findings. The section that trails discusses the key conclusions of the study. Further, the summary of the study and the recommendations for further research were delved in to.

5.2 Summary
The purpose of the study was to determine factors influencing corporate governance quality in Kenya. The research objectives which guided the study were the following: To assess the influence of bank financial performance on corporate governance; to determine the influence of bank size (Asset Size) on corporate governance; and to establish the influence of board characteristics on corporate governance.

The research design used in the study was the descriptive survey research design. The population consisted of 332 employees who worked at various departments. The departments were Human Resources, Retail and Consumer Banking, Finance, Operations, Information Communication Technology and Strategy. A sample size of 166 respondents was selected randomly from the target population. A self-administered questionnaire was designed and used as the data collection instrument for the study. The study used statistical methods including descriptive statistics to analyze the data. The study results from the analysis were presented and captured as charts and tables with frequency distribution and percentages.

The study found out that the respondents were knowledgeable and had access to information required to give the information on Kenya Commercial Bank’s corporate governance. The conclusion was derived from the fact that; the respondents were from KCB, over 90% were academically equipped having reached university, had access to KCB’s audited financials, knew KCB’s balance sheet size and the composition of the KCB’s Board.
The findings regarding the influence of bank financial performance on corporate governance showed that employees generally agreed that the stronger the financial performance, the higher the quality of corporate governance. Furthermore, in regards to bank size, the researcher found out that respondents are of agreement that the asset size influenced the quality of governance. Finally, findings regarding the board characteristics showed that a large number of employees believed that the board composition had the highest impact on the quality of corporate governance.

The respondents felt that Financial Performance was the biggest influencer of Corporate Governance even though Board Composition had greatest impact on corporate governance. The research found out that the knowledge on corporate governance in the banking industry in Kenya was abundant. One of the key information sources for investors to put management and the board to task over corporate governance was audited financial accounts. Additionally all the three variables that influenced corporate governance in the banking industry were important; however the composition of the board was the most important, followed by financial performance and lastly the bank size. The respondents felt that all factors had great influence on corporate governance to a large extent.

5.3 Discussions

5.3.1 Influence of Bank Financial Performance on Corporate Governance

Bujaki and McConomy (2002) claimed that the managers of firms having a poor financial performance should increase the quality of Corporate Governance disclosure to convince shareholders and potential investors that the governance system in place. They insinuated that financial disclosure were important but more so when a firm was experiencing down time. Today’s company have grown in size and influence affecting the lives of citizens either directly or indirectly. The community around a company are stakeholders as they may be its shareholder, customer, supplier, employee or dealer and even if not in these categories, their life may still be affected by what the company does or fails to do. Corporate governance has thus become a legitimate social concern today. The research affirmed to that as financial disclosure were found to be very important at all times only that respondents felt that
declining result or poor performance would influence the corporate governance more than when the organization was experiencing strong performance. In terms of performance revenues and total assets were the main areas of financial performance where the investors would pay more attention to as opposed to costs when perusing the financial statements. It meant that if those areas declined then the investors would look for methods to strengthen the corporate governance to avert any negative future impact.

The financial disclosure was seen to be very important because it was a way in which the investors would understand from the very basics of how much the firm they invested into what the profits they were making and possibly the dividend they were going to get out of it. As a result, entities such as states and prudential supervisory bodies dominate the banking sector in order to minimize the risk of failure and enhance governance. Special government supervision can enhance banks’ transparency (Flannery 2002). Governments impose strong regulations on the banking system, to avoid the concentration of power and control of banks, thus enhancing disclosure and improving the flow of information thus enhancing market discipline.

Investors would also find out about the trends of the firm they have invested in by checking at whether the profitability of the firm was declining or going strong. If the firm was declining then the investor might decide to offload their shares to make capital gains or to hedge against future losses. Those who were long term investors would wish to then look at the corporate governance issues that needed to be addressed to strengthen the organization. The research affirmed the Bujaki and McConomy (2002) theory that financial disclosure was very important especially during declining result or poor performance. Financial disclosure would influence the corporate governance more during poor or declining financial performance than when the organization was experiencing strong performance. This will entail objective presentation of financial information with full disclosure of all material information accurately and objectively.

Corporate governance does not differ on the basis of the indigenous characteristics of the firms being governed but instead differs on the basis of national boundaries. The corporate governance approach by Anglo-American companies focuses on the interests of maximizing shareholder value, while the Franco-German approach considers the interests
of all stakeholders (Macey and O'Hara, 2003). In terms of performance, revenues and total assets were the main areas of financial performance where the investors would pay more attention to as opposed to costs when perusing the financial statements.

### 5.3.2 Influence of Bank Size on Corporate Governance

Ahmed and Courtis (1999) suggested that firm size was an important aspect of corporate governance. Bolt (2004) also felt that the size was important especially if the firm was listed. They both saw the need for a thorough balance sheet disclosure even if it was on voluntary basis in order to convince investors firms would require to go beyond following international accounting standards or hiring internationally recognized firms to audit them by providing extra information that they deem necessary for the investors. The research findings were not in agreement with the theories as the found that use of internationally recognized audit firms and following the international standards in providing balance sheet disclosure was enough to influence corporate governance decisions and that listing on itself was important without provision of extra information.

The capital structure of banks distinguishes them greatly from other firms. According to Macey and O’hara (2003) banks have little equity relative to other firms. They receive 90% of their funding from debt. The rest is equity from shareholders, bondholders and depositors. Additionally, banks create liquidity in the economy by having liabilities in the form of deposits that they issue to creditors or depositors. A mismatch between deposits and liabilities may result to the failure of a bank as it will be illiquid. This explains why the respondents felt that deposits have an influence on the quality of corporate governance. The bank balance sheet size was more important than the deposit collected and even the number of employees. Even though the findings somewhat confirms Ahmed and Courtis (1999) theories the research went further to distinctly showed that bank balance sheet size was more important than deposit and number of employees while the formers’ theory was general with the term bank size. Investors’ decision making was driven by the balance sheet size because it was an indicator of stability and future capabilities with a flash of information on the present profitability.

Today’s corporations should strive to strike the balance between the demands to become globally competitive with its responsibilities to the society in which they function.
Investment into a company is based on public confidence and the image of a company. Corporate fraud and scandals can shatter the image of corporations in the eyes of the public. Corporate governance is thus the key to a company’s growth, future preservation and public confidence. The research findings were not in agreement with the Ahmed and Courtis (1999) and Bolt (2004) theories that the use of internationally recognized audit firms and following the international standards in providing balance sheet disclosure was in itself enough to influence corporate governance decisions without provision of extra information. Banks in Kenya use the globally recognised audit firms to give the public assurance that their reporting can be trusted. These global firms use the international accounting standards in the reporting since these are widely accepted. The banks go this extra mile since they recognise that stakeholder confidence is critical in their business. Investors require that confidence and trust. The bank balance sheet size was more important than the deposit collected and even the number of employees. The findings confirmed Ahmed and Courtis (1999) theories that bank size was very important measure as far as corporate governance was concerned.

5.3.3 Influence of Board Characteristics on Corporate Governance
Hung (1998) said that the agency theory was frequently applied to understand the role of corporate boards to mitigate agency problems. Another leading theory, the resource dependence theory emphasized the resource allocation role of corporate boards. The involvement of directors in the strategic course of the corporation was mainly understood in the stewardship theory. These multiple perspectives of board involvement in decision making yielded a better understanding of the roles of corporate board of directors.
Maassen and Van Den Bosch (1997) iterated that pressure from regulators, legislators and investors may stimulate directors to transform the formal organization of their boards into more independent board structures. The independence was meant to ensure that decision brought on board would reduce agency problems and ensure the long term strength of the firms.

The research however found that the board size was very important and that the bigger it was the broader for the organization. The research found that the board members on the other hand were not to serve for long as that would have a negative impact on corporate governance. The research also found out that non-executive directors were more trusted
but the remuneration and age of the directors were not very important influencers of corporate governance. Maassen and Van Den Bosch (1997) reiterated that having influential people from big institutions would give the board required strength to tackle complex corporate governance issues. The finding however negated the theory with most respondents feeling that having bankers in the board was more important than having institutional board members. It was important to select members of the board who would understand the operations and regulation of the industry within the organization they would be representing the shareholders. It would help them understand the issues related and help sought problems or read signals that would make them act accordingly. It was therefore imperative for board members for an industry that was sensitive as banking for them to have sufficient knowledge and experience other than institutional board members who may not have relevant experience to assist the firms operating in that industry.

The research confirmed Maassen and Van Den Bosch (1997) theory that the board size was very important and that the bigger it was the better it was for the organization. The research found that the board members on the other hand were not to serve for long as that would have a negative impact on corporate governance. Good Corporate Governance ensures that the company has good systems, which allow sufficient freedom to the board of directors and the executives to take decisions for the progress of the company. According to Jensen (1993), the board of directors is a crucial corporate governance mechanism. Its role is to discipline and to fix the game's rules with the manager. However, Jensen (1993) proposed several basics on the board of directors' composition to better control the manager. First of all, directors must have free access to all relevant information and not only those selected by the manager. Access to information will enhance the quality of decisions that are made by the board of directors for the corporation. Then, the directors have to be competent to better evaluate pertinent information. Thirdly, the administrators must have the suitable incentives to take actions that create value to the company; their role shouldn't be limited to the reduction of agency problems. Fourthly, managers as directors should have important participations in the capital to generate a certain convergence of interest with the shareholders in order to maximize the firm value. Fifthly, the size of the board should be limited to seven or eight members to be more efficient. In the same way, the CEO should be the only internal member sitting at the Board of directors because the presence of other internal members
can support the influence of the manager on them. Finally, the CEO and the chairman of the board haven’t to be the same person. There must have a separation between the two functions, because in the case of duality, the manager holds the major part of decisional rights and this fact exacerbates the conflicts of interests between him and the Board of directors. The research also found out that non-executive directors were more trusted but the remuneration and age of the directors were not very important influencers of corporate governance. The appropriateness of a particular corporate governance model will depend on its fit with the specific technical and political situations in which listed firms reside (Ansari et al., 2010)

5.4 Conclusions
5.4.1 Influence of Bank Financial Performance on Corporate Governance
The first major research objective focused on finding out if a bank’s financial performance influences the quality of corporate governance. The conclusion made towards this research objective is that it was discovered that financial performance had a very strong impact on corporate governance and the strength of the corporate structures in an organization. Respondents generally agreed that if the organization is performing well the quality of corporate governance is high.

5.4.2 Influence of Bank Size on Corporate Governance
The second research objective had its focus on discovering the impact of bank size on corporate governance. The conclusion made towards this research objective is that it was discovered that the asset and balance sheet size influences the degree to which a company adopts strong corporate governance structures. Respondents strongly agreed that the bigger the size of the bank, the higher the quality of corporate governance.

5.3.3 Influence of Board Characteristics on Corporate Governance
The third research objective had its focus on investigating the influence of board characteristics on corporate governance. Conclusion can be made towards this research objective by stating that respondents agreed that board composition influences corporate governance. Most of the respondents were in agreement that the board was the driver of corporate governance thus the composition and characteristics had a high impact on corporate governance.
5.5 Recommendations

5.5.1 Recommendation on Improvement

5.5.1.1 Influence of Bank Financial Performance on Corporate Governance

The research revealed that respondents agree that bank financial performance has an influence on corporate governance. However, Companies should continue to use the international accounting standards and hire highly recognized professional auditors to scrutinize their books and present their position about the financial standing of the organization as it would help in strengthening corporate governance in the banking industry. The liability of auditors should be enhanced to ensure this professionalism in presentation of audited accounts. There have been instances when auditors have presented unqualified reports showing a strong performance only for the company to go into receivership.

5.5.1.2 Influence of Bank Size on Corporate Governance

Findings of the study have shown that the respondents are in agreement that bank size influences corporate governance. Governance mechanisms consume corporate resources thus larger firms would have better corporate governance. It is recommended that companies allocate resources towards improving governance structures irrespective of their size. In the same way resources are allocated to areas such as recruitment, Research and procurement, the same should apply for corporate governance. The sustenance and future of companies is pegged on proper corporate governance and ethical practices. Rarely will we see a company that has been in existence for many years without strong governance.

5.5.1.3 Influence of Board Characteristics on Corporate Governance

The research was able to reveal that board characteristics influences corporate governance. Many employees believe that the board characteristics including the composition and experience are an important aspect of corporate governance. It is therefore recommended that there is need to review the minimum and maximum number of board members. It may be pegged on the size of the bank’s balance sheet and industry complexity. The number of years served should be reviewed to a maximum of 8 years for
each individual board member. The vetting of individuals who constitute the board should be done to ensure that they are of persons of good standing and integrity.

5.5.2 Recommendation On Further Studies

It is with no doubt that corporate governance has become a key component to the success and future sustainability of organisations. One of the study limitations was that the study focused on only one bank KCB as opposed to the whole industry. I would therefore recommend that similar study be conducted with respondents drawn from across the whole banking industry. It would also be worthwhile to find out what are the key influencers of corporate governance in other industry like the hospitality industry, retail chains and manufacturing industry.
REFERENCES


Bujaki, M., & McConomy, J. (2002). Corporate Governance: Factors Influencing Voluntary Disclosure by Publicly Traded Canadian Firms; Canadian Accounting Perspectives.


Terjesen, S., Aguilera, R. & Lorenz, R. (2013). *Legislating a Woman’s Seat on the Board: Institutional Factors Driving Gender Quotas for Boards of Directors*


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Dear Sir/ Madam,

I am a student at United States International University (USIU) in pursuit of a post graduate degree in Business Administration (MBA).

In partial fulfillment of the requirement of this master’s degree, I am conducting a research on Corporate Governance Quality in Kenya.

We request for your participation in this research by answering the questions in the attached questionnaire. Kindly be informed that any information received from you will be held with utmost confidentiality and remain anonymous and will only be used for the sole purpose of this project.

Your feedback will be highly appreciated. We are looking forward to your valued response.

Yours Faithfully,

John Maingi
APPENDIX 2: RESEARCH QUESTIONNAIRE ON CORPORATE GOVERNANCE

PART A: GENERAL INFORMATION

1. Gender  
   Male ☐ Female ☐

2. Age:  
   Below 25 Years ☐ 25 – 50 Years ☐ Above 50 Years ☐

3. Cadre in the organization:  
   Non-Management ☐ Management ☐

4. Furthest Level Of Education:  
   Secondary ☐ College ☐ University ☐

5. Do you have access to the bank’s audited financial reports?  
   Yes ☐ No ☐

6. Do you know the size of the bank in regards to balance sheet size?  
   Yes ☐ No ☐

7. Do you know the composition of the KCB board?  
   Yes ☐ No ☐

PART B: INFLUENCE OF FINANCIAL PERFORMANCE ON CORPORATE GOVERNANCE

8. How do you rank the quality of corporate governance at KCB on the basis of financial performance?  

<table>
<thead>
<tr>
<th>Financial Performance</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Governance Quality</td>
<td>1</td>
</tr>
</tbody>
</table>
9. To what extent do the following aspects influence the quality of corporate governance at KCB?

1. Very High Influence  
2. High Influence  
3. Low Influence  
4. No Influence

<table>
<thead>
<tr>
<th>Aspect</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Level of Financial Disclosure</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B Declining Financial Performance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C Strong Financial Performance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>D Poor Financial Performance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

10. How do you rank the following in influencing the quality of corporate governance at KCB?

1. Strongly Agree  
2. Agree  
3. Uncertain  
4. Disagree  
5. Strongly Disagree

<table>
<thead>
<tr>
<th>Aspect</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Revenues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B Costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C Total Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>D Profitability</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

11. To what extent do you think the performance of the bank has influence on the quality of corporate governance in KCB?

High Extent (    )  
Low Extent (    )  
Very Low Extent (    )  
No Extent (    )

PART C: INFLUENCE OF SIZE (ASSETS) ON CORPORATE GOVERNANCE

12. How do you rank the quality of corporate governance at KCB on the basis of balance sheet size?

1. Very Highly  
2. High  
3. Low  
4. Very Low

<table>
<thead>
<tr>
<th>Balance Sheet Size</th>
<th>Rank</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Governance Quality</td>
<td>1</td>
<td>2</td>
</tr>
</tbody>
</table>
13. To what extent do the following aspects influence the quality of corporate governance at KCB?

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A Level of Financial Disclosure</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>B Listing at the stock market</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>C Use of International Accounting standards in financial reporting</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>D Use of a leading global firm in preparation of financial accounts</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>

14. How do you rank the following in influencing the quality of corporate governance at KCB?

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>A Size of Balance Sheet</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>B Total deposits</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>C Number of employees</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>

15. To what extent do you think the size of the bank has influence on the quality of corporate governance at KCB?

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>High Extent</td>
<td>(       )</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low Extent</td>
<td>(       )</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very Low Extent</td>
<td>(       )</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No Extent</td>
<td>(       )</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
PART D: INFLUENCE OF BOARD CHARACTERISTICS ON CORPORATE GOVERNANCE

16. How do you rank the quality of corporate governance at KCB on the basis of board composition?

<table>
<thead>
<tr>
<th>Board Composition</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Governance Quality</td>
<td>1</td>
</tr>
</tbody>
</table>

17. To what extent do the following aspects influence the quality of corporate governance at KCB?

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Board Size</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>B</td>
<td>Number of outside directors (Non-KCB employees)</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>C</td>
<td>Age of board members</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>D</td>
<td>Length of time served by an individual in the board</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>E</td>
<td>Executive Compensation and Remuneration</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
</tbody>
</table>

18. How do you rank the following in influencing the quality of corporate governance at KCB?

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Number of board members</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>B</td>
<td>Frequency of board meetings</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>C</td>
<td>Number of bankers in the board</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>D</td>
<td>Number of institutional members in the board</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>
19. To what extent do you think the board characteristics have influence on the quality of corporate governance at KCB?

High Extent (       )
Low Extent (       )
Very Low Extent (       )
No Extent (       )

THANK YOU FOR TAKING PART IN THE STUDY