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The Strategic JOURNAL of Business & Change MANAGEMENT
ISSN: 2312-9492 www.strategicjournals.com
Vol. 4, Iss. 4 (20), pp 367 - 384, Oct 10, 2017, www.strategicjournals.com, ©strategic Journals

EFFECT OF CORPORATE GOVERNANCE ON THE FINANCIAL STABILITY OF THE BANKING INDUSTRY IN KENYA

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Accepted: October 8, 2017

ABSTRACT
This study sought to determine the effect of corporate governance on financial stability of Commercial Banks in Kenya. The study applied a descriptive research design. Descriptive research includes surveys and fact finding to ensure that the research problem is effectively addressed. The target population of this study was all the commercial banks in Kenya, looking particularly at their financial reports for a five year period (2011-2015). Due to the population size, census survey was used. The study relied on a five year (2011-2015) secondary data from the CBK bank supervision annual reports and the Kenya Institute for Public Policy Research and Analysis (KIPPRA) – Kenya Economic reports. The data extracted was analysed using descriptive statistics, correlation analysis, and panel multiple regression analysis. The multiple regression analysis was done using Statistical Package for Social Sciences (SPSS). Findings reveal that a majority of the commercial banks surveyed observe various corporate governance practices with respect to the board structure with a view to enhance financial stability in respective firms. It was also found that various measures are in place to ensure that management-shareholder conflict does not negatively affect the financial stability of respective commercial banks. The study further established that the regulatory environment in the country is keen on ensuring that commercial banks operating in the country are financially stable. Findings further revealed that a majority of the commercial banks surveyed observe a formalized organizational structure with respect to flow of command and decision making. In conclusion, with an adjusted R-squared of 0.594, the model shows that board structure, Management-shareholder conflict, Regulatory environment and Organizational structure explain 59.4 percent of the variations in the Performance while 40.6 percent is explained by other factors not part of the mode.

Key Terms: *Corporate Governance, Board Structure, Management-Shareholder Conflict**,** Regulatory Environment**,** Organizational Structure**,** Financial Instability*

INTRODUCTION

Corporate governance in financial institutions, and specifically banks, is a significant issue worldwide. In recent years, the Kenya's banking sector has seen three commercial banks put under receivership. These are Dubai Bank limited in August 2015 (CBK, 2015), Imperial Bank Limited in October 2015 (CBK, 2015) and Chase Bank Limited in April 2016 (CBK, 2016). To a large extent, the crisis in this very crucial industry has been as a result of poor corporate governance. Schjoedt (2010) observed that this poor corporate governance, in turn, was very much attributable to the relationships among the government, banks and large businesses as well as the organizational structure of businesses.

Fears of structural weaknesses in Kenyan banks resurfaced following the placing of a third bank, Chase Bank, under receiver management in less than six months, with opinions pointing to weak supervision and outright fraud by directors (Olingo, 2016). The situation is similar to the speculation that prevailed during the major bank failures caused by systemic weaknesses in 1988, 1993 and 1998 that claimed more than 50 financial institutions. A running thread in the failures of what came to be known as political banks was unsecured lending to directors, politicians and their associated companies; a factor in the closures of Dubai Bank, Imperial Bank and later Chase Bank.

With only 20 per cent of Kenya's population having bank accounts with the commercial banks, there is need for banks to strategize and reach more of the unbanked, which would constitute a big business growth as opposed to regional (Muthoni, 2013; Ngari and Muiruri, 2014). Therefore, corporate governance is vital among commercial banks in the country to the adaptation of the changing business environment and managing the growing competition from the foreign banks.

The study thus sought to investigate effect of corporate governance on financial stability of Commercial Banks in Kenya. More specifically, the study sought to determine the effect of board structure on financial stability of Commercial Banks in Kenya; establish the effect of management-shareholder conflict on financial stability of Commercial Banks in Kenya; establish the effect of organizational structure on the financial stability of Commercial Banks in Kenya; and establish the effect of the regulatory framework on the financial stability of Commercial Banks in Kenya.

Objectives of the Study

The study sought to determine effect of corporate governance on financial stability of Commercial Banks in Kenya. The objectives were:

- To determine the effect of board structure on financial stability of Commercial Banks in Kenya.
- To establish the effect of management-shareholder conflict on financial stability of Commercial Banks in Kenya.
- To determine the effect of regulatory environment on financial stability of Commercial Banks in Kenya.
- To establish the effect of organizational structure on the financial stability of Commercial Banks in Kenya

RESEARCH METHODOLOGY

The study took a descriptive research design. The descriptive research design was thus suitable in the present study because it helped describe the current nature of corporate governance among commercial banks including board structure, management-shareholder conflict, regulatory environment and organizational structure and show the relationship between the financial stability and management performance.

The study population was all the commercial banks in Kenya regulated and supervised by CBK.

Due to the population size, census enquiry was used since the target population is not large. The study used multiple regression analysis to show how the independent variables affect the dependent variable.

Data was organized and interpreted on account of concurrence to objectives using assistance of the computer package, statistical package for social scientists (SPSS) version 24, to communicate research findings. ANOVA was used to test the level of significant of the variables on the dependent variable at 95% level of significance.

Multiple regression analysis was used. The regression equation:

$$Y= \beta0+ \beta1X1+\beta2X2+ \beta3X3+ \beta4X4+ \varepsilon$$

Where Y was the dependent variable (Financial Stability), β0 was the regression constant, β1, β2, β3, and β4 were the coefficients of independent variables, X1 was Board Structure, X2 was Management-Shareholder conflicts, X3 was Regulatory Environment, and X4 was Organizational Structure. After analysis and interpretation of data, a report summarizing the findings and conclusions as well as the research recommendations was presented.

RESEARCH FINDINGS

A pilot study was carried out in order to determine reliability of the questionnaires. Reliability of the questionnaires was then evaluated through Cronbach's Alpha which measures the internal consistency. The Alpha measures internal consistency by establishing if certain item measures the same construct. The study thus found that the analysis was reliable and could be used for further investigation.

Table 1 Reliability Coefficients

Scale	Cronbach's Alpha	Number of Items
Board structure	0.811	10
Management-shareholder conflict	0.778	6
Regulatory environment	0.819	8
Organizational structure	0.833	8
Financial stability	0.792	4

The reliability test results in table 1 above showed that all the scales were significant, having an alpha above the prescribed threshold of 0.7. Organizational structure had the highest reliability (α=0.833) followed by Regulatory environment (α=0.819), then Board structure (α=0.811), while financial stability and management-shareholder conflict had the lowest, albeit significant, at 0.792 and 0.778 respectively. The study thus found that the analysis was reliable and could be used for further investigation.

Study Variables

The study investigated four conceptualized aspects of corporate governance including board structure, management-shareholder conflict, regulatory environment and organizational structure and how the same affect financial stability of Commercial Banks in Kenya. This section presents an analysis of the foregoing conceptualized relationships.

Financial Stability

The study first found it necessary to evaluate the performance of the commercial banks based on their financial leverage as measured by the debt to equity ratio and liquidity as measured by current assets to current liabilities ratio of the individual banks. Their mean, standard deviation, minimum and maximum values were determined as indicated in Table 2.

Table 2: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Financial Leverage	38	-4.486	2.813	0.464	0.082
Liquidity	38	10.154	16.276	13.113	1.504
Valid N (listwise)	38				

Financial Leverage as indicated by the Debt to Equity ratio had a mean of 0.464, minimum value of -4.486 and a maximum of 2.813 with a standard deviation of 0.082. This indicated that, on average, the commercial banks surveyed were highly geared with a significant proportion of their financing coming from deposits and investor financing (shareholders) for listed commercial banks. Liquidity as measured by current assets to current liabilities ratio of the listed company recorded a mean value of 13.113, a minimum of 10.154 and a maximum of 16.276 with a standard deviation of 1.504. The relatively high ratios generally indicated a majority of the commercial banks reached are highly liquid and thus a large margin of safety.

Effect of Board Structure on Financial Stability

The study sought to determine the effect of board structure on financial stability of Commercial Banks in Kenya. This section presented findings to pertinent questions asked with a view to address the objective. Respondents were first asked to indicate the extent to which board structure affects the financial stability of their respective companies. This would indicate whether in respondents' experience, board structure affected the financial stability of commercial banks in Kenya. Figure 1 illustrated the finding.

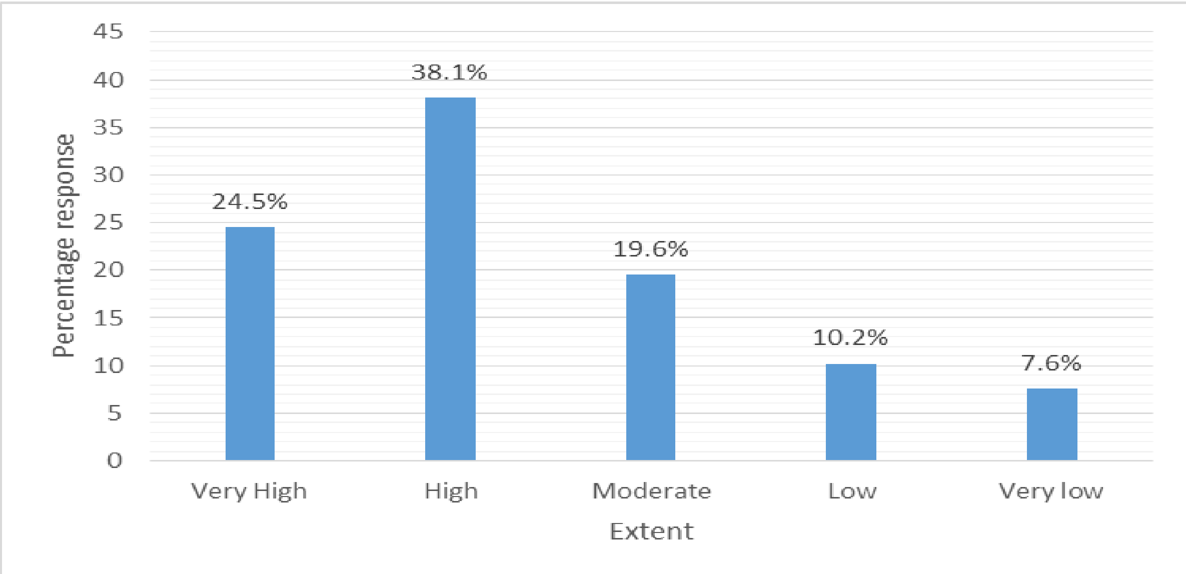

Figure 1: Extent of Board Structure Influence on Financial Stability

As illustrated in figure 1, a majority of respondents (38.1%) affirmed that board structure affected financial stability in their respective firms to a high extent, followed by 24.5% affirming to a very high extent and 19.6% as moderate. Only 10.2% and 7.6% affirmed to low and very low extent respectively. It follows then that board structure was a significant determinant of financial stability among commercial banks in Kenya.

The study first found it necessary to evaluate the board structure among the commercial banks under consideration, that is, board independence (BI), board size (BS), CEO Duality (CEOD) and board tenure (BT). Their mean, standard deviation, minimum and maximum values were determined as indicated in table 3.

Table 3: Board Structure

	Minimum	Maximum	Mean	Std. Deviation
BI	0.00	1.00	0.600	2.48
BS	6.00	13.00	9.5455	1.870
CEOD	0.00	1.00	0.0909	0.294
BT	0.00	1.00	0.8606	0.0904

Board Independence (BI) was used to indicate the presence of Non-Executive Directors (NEDs) sitting in the board where '1' was used if there were NEDs and '0' if that was not the case. Across a majority of the banks, there were NEDs sitting on the board, as the mean was 0.6. The statistic had a standard deviation of 2.48 suggesting a variance of about 2 companies surveyed. It can be noted from the table also that the minimum number of board members was 6 while the maximum number was 13. This means that the board members were within the limits provided for by best corporate governance practice. The average number of board members for the listed companies surveyed was 9.5455 which means that most of the companies had an average of 9 members. The standard deviation was 1.87 suggesting a variance of about 2 people on the companies' board of directors.

CEO duality measured whether the CEO was also the chairman of the board. The study used a dichotomic variable where the value of 1 was fixed in case of duality and the value of 0 if the two functions were separate. Table 4 showed that the minimum was 0 and maximum was 1. The mean was 0.0909 which suggested that most of the companies did not have board structure as a problem, since the CEO did not double up as the board chairman. The standard deviation of 0.29 also suggests very low variance from the mean duality value. Board Tenure (BT) is also a dummy variable, with 0 representing less than 5 year tenures and 1 more than 5 years. With a mean of 0.86, it can be noted that most boards are long serving.

Respondents were further asked to indicate their respective levels of agreements with various statements posed pertinent to elements of board structure that affect financial stability. This was on a 5-point Likert scale (1=Highly disagree, 2=Disagree, 3=Neutral, 4=Agree, 5=Highly Agree). Table 4.5 below presents the findings.

Table 4: Elements of Board Structure

	Mean	**Std. Dev**
Board chairman has the personal stature to withstand the influence of strong personalities in the senior executive ranks	3.713	0.5423
Members of the board have a clear aptitude for exercising independent judgment	3.813	0.0617
The board meetings are held frequently	3.857	0.6834
All the directors are responsible for the institution's financial soundness and prudent approach to risk management	3.791	0.9431

The board comprises at least three independent directors who comprise the majority of its membership	3.852	0.2317
At least annually the board meets with the chief risk officer in the absence of other management	3.313	0.6034

As table 4 presented, a majority of respondents highly agreed that board meetings were held frequently (3.857); the board comprised at least three independent directors who comprised the majority of its membership (3.852); members of the board had a clear aptitude for exercising independent judgment (3.813); all the directors are responsible for the institution's financial soundness and prudent approach to risk management (3.791); and that board chairman has the personal stature to withstand the influence of strong personalities in the senior executive ranks (3.713). A majority of respondents however only moderately agrees that at least annually the board meets with the chief risk officer in the absence of other management (3.313).

It could be deduced from the foregoing finding that a majority of the commercial banks surveyed observed various corporate governance practices with respect to the board structure with a view to enhance financial stability in respective firms. It was particularly notable that in most banks surveyed, board meetings were held frequently; the board comprised at least three independent directors who comprise the majority of its membership; members of the board have a clear aptitude for exercising independent judgment; and that all the directors are responsible for the institution's financial soundness and prudent approach to risk management.

The finding is in agreement with Jensen (2013) who also appears to support Lipton and Lorsch (2013) who recommend a number of board members between seven and eight. However, board structure recommendations tend to be industry-specific, since Adams and Mehran (2013) indicate that bank holding companies have board structure significantly larger than those of manufacturing firms. The findings further corroborate with Munter and Kren (2015) who posit that external board membership ensures proper management supervision and limit managerial opportunism. The finding is however in contrast with Bathala and Rao (2015) and Hutchinson (2012) who found a negative relationship between the proportion of outside directors and the firm's growth rate. In support of the present study however, Hossain (2010) found that the percentage of outside directors is positively related to firms' investment opportunities.

Effect of Management-Shareholder Conflict on Financial Stability

The study also sought to establish the effect of management-shareholder conflict on financial stability of Commercial Banks in Kenya. This section presented the findings to pertinent questions asked with a view to address the objective. Respondents were first asked to indicate the extent to which management-shareholder conflict influences the financial stability in their respective commercial banks. Findings were as presented in figure 2.

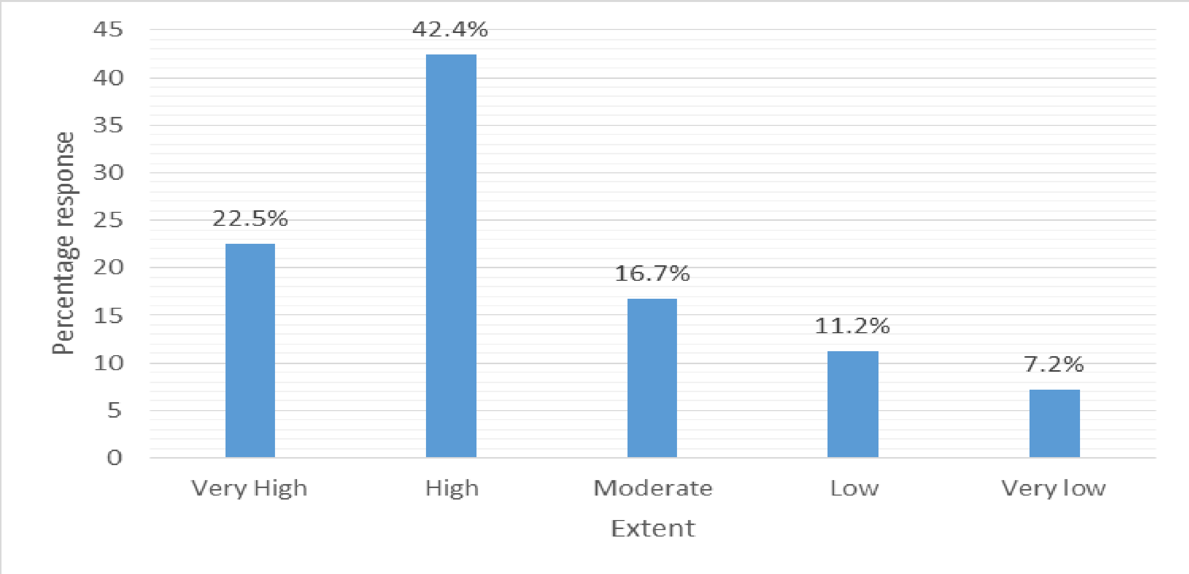

Figure 2: Extent of Management-Shareholder Conflict on Financial Stability

As illustrated in figure 2, a majority of respondents (42.4%) affirmed that management-shareholder conflict affected financial stability in their respective firms to a high extent, followed by 22.5% affirming to a very high extent than 16.7% as moderate. Only 11.2% and 7.2% affirmed to low and very low extent respectively. It follows then that management-shareholder conflict is a significant determinant of financial stability among commercial banks in Kenya.

Respondents were further asked to indicate their levels of agreement to statements posed with a view to determine the extent to which respondents agree with statements pertinent to management-shareholder conflict in relation to financial stability in respective commercial banks. This was also on a Likert scale (1 = Highly disagree; 2 = Disagree; 3 = Neutral; 4 = Agree; 5 = Highly Agree). Table 5 presented the finding.

Table 5: Management-Shareholder Conflict and Financial Stability

	Mean	**Std. Dev**
The executive works to minimize risk exposure by shareholders	4.224	0.5682
Decisions are made without fear at all levels of the organization, for the longer-term interest of the institution.	3.491	0.6134
Compensation models are aligned with long-term firm wide profitability.	3.709	1.0067
There is clear understanding of business goals and shareholder expectations by management.	4.052	0.5225
Self-interested behavior of managers precludes them from structuring a cooperative arrangement.	2.343	0.5360

Results presented in table 5 revealed that a majority of respondents highly agreed that the executive works to minimize risk exposure by shareholders (4.224); there was clear understanding of business goals and shareholder expectations by management (4.052); and that compensation models were aligned with long-term firm wide profitability (3.709). A majority however only moderately agrees that decisions were made without fear at all levels of the organization, for the longer-term interest of the institution (3.491); while a majority disagreed that self-interested behavior of managers precludes them from structuring a cooperative arrangement (2.343).

It could be deduced from the foregoing findings that various measures were in place to ensure that management-shareholder conflict does not negatively affect the financial stability of respective commercial banks. It was particularly notable from the finding that in most of the commercial banks surveyed, the executive works to minimize risk exposure by shareholders; there is clear understanding of business goals and shareholder expectations by management; and that compensation models are aligned with long-term firm wide profitability.

The finding agreed with Clifford (2011) and Brav et al. (2012) who found that activism can create value and be an effective monitoring mechanism of publicly listed companies, reducing agency costs and improving returns. Greenwood and Schor (2013) also found that activist shareholders can induce positive changes in the companies they monitor and increase shareholder value. Accordingly, Boyson and Mooradian (2011) found that governance-related hedge fund activism through management turnover is associated with favorable stock market reactions.

Effect of Regulatory Framework on Financial Stability

The study further sought to determine the effect of regulatory environment on financial stability of Commercial Banks in Kenya. This section presented findings to pertinent questions asked with a view to address the objective. Respondents were first asked to indicate the extent to which regulatory framework influences the financial stability in their respective commercial banks. Findings are as presented in figure 3.

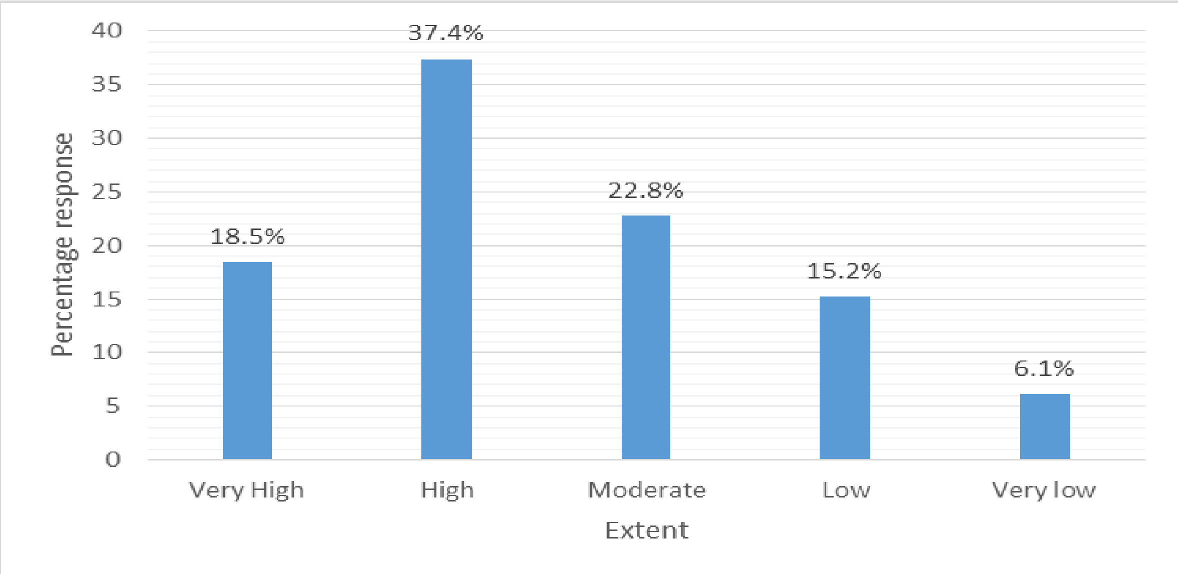

Figure 3: Extent of Regulatory Framework on Financial Stability

As illustrated in figure 3, a majority of respondents (37.4%) affirmed that regulatory environment affected financial stability in their respective firms to a high extent, followed by 22.8% affirming to a moderate extent then 18.5% to very high. Only 15.2% and 6.1% affirmed to low and very low extent respectively. It follows then that regulatory environment was a significant determinant of financial stability among commercial banks in Kenya.

Respondents were then asked to indicate their levels of agreement with pertinent statements with a view to determine how regulatory framework affects financial stability in respective banks. This was also on a 5-point Likert scale (1 = Highly disagree; 2 = Disagree; 3 = Neutral; 4 =

Agree; 5 = Highly Agree). Table 6 presented the finding.

Table 6: Regulatory Framework and Financial Stability

	Mean	Std. Dev
The banking Act has clear guidelines on financial stability	4.339	0.8317
Templates used to report to the regulator are uniform across the banking industry	4.293	0.6315
The classification of products is consistent in all the templates across the banking industry	3.725	1.0092
The templates are revised regularly in line with relevant changes in the industry	3.857	1.3718
Regulatory framework sets out penal actions in cases of misappropriation	3.842	0.6347
Regulatory framework monitors performance in the financial stability	4.283	0.9442
Regulatory framework has set clear financial stability benchmark	4.119	0.0429

A majority of respondents highly agreed that the banking Act had clear guidelines on financial stability (4.339); templates used to report to the regulator were uniform across the banking industry (4.293); regulatory framework monitors performance in the financial stability (4.283); regulatory framework has set clear financial stability benchmark (4.119); the templates were revised regularly in line with relevant changes in the industry (3.857); regulatory framework sets out penal actions in cases of misappropriation (3.842); and that the classification of products was consistent in all the templates across the banking industry (3.725). The finding is of the implication that the regulatory environment in the country was keen on ensuring that commercial banks operating in the country are financially stable. It is notable that in the country, the banking Act has clear guidelines on financial stability; templates used to report to the regulator are uniform across the banking industry; regulatory framework monitors performance in the financial stability; and that regulatory framework has set clear financial stability benchmark.

The finding was in tandem with Pogue (2013) who found that the legal and regulatory frameworks establish the "rules of the game" in a society and govern the way in which the government, enterprises and civil society interact with each other. The rules influence investment decisions, the opportunities and rewards available to economic actors. The finding was also in agreement with Bannock et al. (2012) who argue that when imposed at unrealistic levels and inadequately enforced, regulation divides the economy into formal and informal sectors and erects barriers between the two, which perpetuates the division.

Effect of Organizational Structure on Financial Stability

The study sought to establish the effect of organizational structure on the financial stability of Commercial Banks in Kenya. This section presented findings to pertinent questions asked with a view to address the objective. Respondents were first asked to indicate the extent to which organization structure influences the financial stability in their respective commercial banks.

Findings are as presented in figure 4.

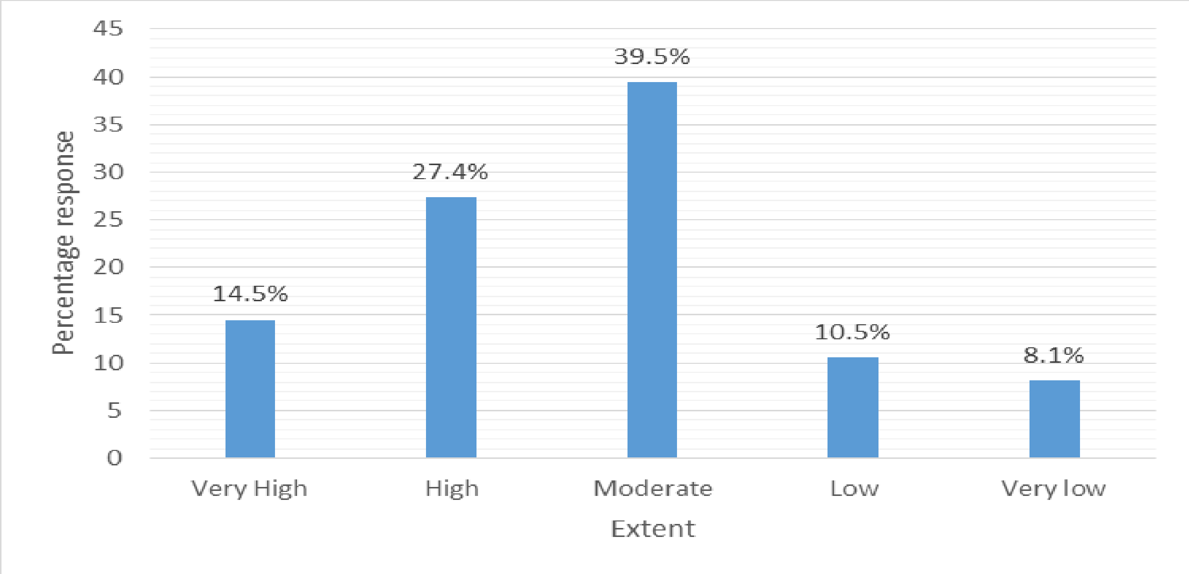

Figure 4: Extent of Organizational Structure on Financial Stability

As illustrated in figure 4, a majority of respondents (39.5%) affirmed that organizational structure affected financial stability in their respective firms to a moderate extent, followed by 27.4% affirming to a high extent then 14.5% to very high. Only 10.5% and 8.1% affirmed to low and very low extent respectively. It follows then that organizational structure was a significant determinant of financial stability among commercial banks in Kenya. Respondents were finally asked to indicate their levels of agreement with statements posed with a view to assess how organizational structure affects financial stability in their respective banks. This was also on a 5-point Likert scale (1 = Highly disagree; 2 = Disagree; 3 = Neutral; 4 = Agree; 5 = Highly Agree). Findings are presented in table 7.

Table 7: Effect of Organizational Structure on Financial Stability

	Mean	**Std. Dev**
All operation activities to be undertaken by the business are approved by the chief executive officer	3.993	0.9025
Sub-ordinate staffs play a part in decision making on matters relating to day to day operations of the corporation.	3.159	0.6315
No or little action can be taken by a staff on any matter without supervisor permission	3.819	0.0092
Staffs are asked to give their input on the adoption of new policies and procedures.	3.624	0.6134
For every corporation mandate, there is an established department/division to deal with it	4.391	0.5682
Written formal communications through established channels must be used on every engagement to be undertaken by the corporation.	3.692	0.7295

There are formal procedures on how to deal with every operational activity/situation and the guidelines are available to staff.	4.350	0.6520

Findings presented in table 7 indicated that a majority of respondents agreed that for every corporation mandate, there is an established department/division to deal with it (4.391); there are formal procedures on how to deal with every operational activity/situation and the guidelines are available to staff (4.350); all operation activities to be undertaken by the business are approved by the chief executive officer (3.993); no or little action can be taken by a staff on any matter without supervisor permission (3.819); written formal communications through established channels must be used on every engagement to be undertaken by the corporation (3.692); and that staffs are asked to give their input on the adoption of new policies and procedures (3.624). A majority however only moderately agrees that sub-ordinate staffs play a part in decision making on matters relating to day to day operations of the corporation (3.159).

It can be deduced from the foregoing finding that a majority of the commercial banks surveyed observed a formalized organizational structure with respect to flow of command and decision making. It was particularly notable that for every corporation mandate, there was an established department/division to deal with it; there were formal procedures on how to deal with every operational activity/situation and the guidelines were available to staff; all operation activities to be undertaken by the business were approved by the chief executive officer; no or little action can be taken by a staff on any matter without supervisor permission; and that written formal communications through established channels must be used on every engagement to be undertaken by the corporation.

The findings agreed with Bartol and Martin (2014) who argue that poor organizational structure can lead to overall delays in decision making, lack of co-ordination, failure to innovate, and escalating administrative costs which will make the organization largely inefficient, very expensive to run and ultimately uncompetitive in the contemporary highly dynamic market environment. The findings also agree with Robbins (2012) who offer that organizational structures must facilitate the achievement of organizations' purpose and strategy and allow the smooth functioning of organization technologies, hence the needs for constant organizational review, change and alignment in the business environment.

Inferential Statistics

To assess the relationship between the conceptualized aspects of corporate governance and financial stability of Commercial Banks in Kenya, the study performed both Pearson correlation and regression analyses.

Pearson Correlation Analysis

Table 8 below presented the Pearson correlations for the relationships between the various indicators of corporate governance and financial stability of Commercial Banks in Kenya.

Table 8: Pearson Correlation Matrix

	Financial stability	Board structure	Management-shareholder conflict	Regulatory environment	Organizational structure
Financial stability	1				
Board structure	0.7781	1			

	(0.000)				
Management-shareholder conflict	0.6008	0.594	1		
	(0.001)	(.034)			
Regulatory environment	0.7486	0.488	0.397	1	
	(0.000)	(.072)	(.095)		
Organizational structure	0.7631	0.551	0.676	0.493	1
	(0.004)	(0.119)	(0.052)	(0.739)	

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

From the findings, both positive and strong correlations were established between the predictor and dependent variables. Strongest and positive correlations were obtained between Board structure and Financial stability (r = 0.7781; p value = .000) and followed by Organizational structure and performance (r = 0.7631; p value = .004). Regulatory environment and Management-shareholder conflict also registered strong and positive correlations at (r = 0.7486; p value = .000) and (r = 0.6008; p value = .001) respectively.

All the independent variables were found to have a statistically significant association with the dependent variable at 0.01 level of confidence. Stigler (2002) offers that the Pearson product-moment correlation coefficient measure linear correlation (dependence) between two variables *X* and *Y*, giving a value between +1 and −1 inclusive, where 1 is total positive correlation, 0 is no correlation, and −1 is total negative correlation. He further demonstrates that P values less than 0.05 level of confidence can be considered statistically significant.

Regression Analysis

To establish the degree of influence of the independent and dependent variables, regression analyses was conducted among the variables, with the assumption that: variables are normally distributed to avoid distortion of associations and significance tests, which was achieved as outliers were not identified; a linear relationship between the independent and dependent variables for accuracy of estimation, which was achieved as the standardized coefficients were used in interpretation.

The regression analysis produced the Model Goodness of Fit, Analysis of Variance (ANOVA) and coefficients of determination as presented in table 9 below.

Table 9: Regression Analysis

Model Goodness of Fit

R	**R^2**	**Adjusted R^2**	**Std. Error of the Estimate**
0.771	0.594	0.587	0.046

ANOVA	**Sum of Squares**	**Df**	**Mean Square**	**F**	**Sig.**
Regression	4.181	4	1.394	3.135	0.025
Residual	15.562	38	0.445		
Total	19.743	42			

Regression coefficient results	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	7.724	2.006		3.850	0.000
Board structure	1.740	0.589	0.296	2.954	0.005
Management-shareholder conflict	1.722	0.697	0.338	2.471	0.018
Regulatory environment	1.644	0.689	0.287	2.386	0.022
Organizational structure	1.779	0.720	0.362	2.471	0.018

Dependent Variable: Performance

As presented in table 9, the model goodness of fit showed a correlation value (R) of 0.771 which depicted that there was a good linear dependence between the independent and dependent variables. With an adjusted R-squared of 0.594, the model showed that board structure, Management-shareholder conflict, Regulatory environment and Organizational structure explain 59.4 percent of the variations in the Performance while 40.6 percent was explained by other factors not included in the model. According to Howell (2002), measures of goodness of fit typically summarized the discrepancy between observed values and the values expected under the model in question.

Regression analyses produced the coefficients of determination and Analysis Of Variance (ANOVA). Analysis of variance was done to show whether there was a significant mean difference between dependent and independent variables. The ANOVA was conducted at 95% confidence level. According to Katz (2006) Regression analysis generates an equation to describe the statistical relationship between one or more predictor variables and the response variable. As presented in table 9, ANOVA statistics was conducted to determine the differences in the means of the dependent and independent variables to show whether a relationship exists between the two.

The P-value of 0253 implies that financial stability had a significant joint relationship with Board structure, Management-shareholder conflict, Regulatory environment and Organizational structure which is significant at 5 percent level of significance. This also depicted the significance of the regression analysis done at 95% confidence level. This implies that the regression model is significant and can thus be used to assess the association between the dependent and independent variables. Gelman (2006) provides that ANOVA statistics analyzes the differences between group means and their associated procedures (such as "variation" among and between groups).

The data in table 9 further revealed a positive relationship between Performance and all the independent variables.

Taking the regression model: $Y = \alpha + \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3$ X3 + ϵ; where, Y= Performance; α = Constant; β_1 - β_4 = Beta coefficients; X1 = Board structure; X_2 = Management-shareholder conflict; X_3 = Regulatory environment; X_4 = Organizational structure and ϵ = Error term, the established regression equation was:

Performance = 7.724 + 1.740 Board structure + 1.722 Management-shareholder conflict + 1.644 Regulatory environment + 1.779 Organizational structure

A change in Board structure would thus lead to a 1.740 change in Performance keeping all other factors constant; a unit change in Management-shareholder conflict would lead to a 1.722 change in Performance keeping all other factors constant and a unit change in the Regulatory environment would lead to a 1.644 change in Performance keeping all other factors constant while a unit change in Organizational structure would lead to a 1.779 change in Performance. This implies that among other factors, Board structure, Management-shareholder conflict, Regulatory environment and Organizational structure were key determinants of financial stability of commercial banks in Kenya.

Summary of Findings

The study sought to determine the effect of board structure on financial stability of Commercial Banks in Kenya. A majority of respondents affirms that board structure affects financial stability in their respective firms to a high extent, followed by those affirming to a very high extent, then to a moderate extent. It was also revealed that across a majority of the banks, CEOs do not double up as board members on boards. It was also found that the minimum number of board members was 6 while the maximum number was 13. This means that the board members were within the limits provided for by best corporate governance practice. The average number of board members for the listed companies surveyed was 9 members. It was established that most boards are long serving with at least 5 years of membership. A majority of respondents highly agreed that board meetings are held frequently; the board comprises at least three independent directors who comprise the majority of its membership; members of the board have a clear aptitude for exercising independent judgment; all the directors are responsible for the institution’s financial soundness and prudent approach to risk management; and that board chairman has the personal stature to withstand the influence of strong personalities in the senior executive ranks.

The study also sought to establish the effect of management-shareholder conflict on financial stability of Commercial Banks in Kenya. A majority of respondents affirms that management-shareholder conflict affects financial stability in their respective firms to a high extent, followed by the respondents affirming to a very high extent then those affirming to a moderate extent. Results presented revealed that a majority of respondents highly agrees that the executive works to minimize risk exposure by shareholders; there is clear understanding of business goals and shareholder expectations by management; and that compensation models are aligned with long-term firm wide profitability. A majority however only moderately agrees that decisions are made without fear at all levels of the organization, for the longer-term interest of the institution ; while a majority disagrees that self-interested behavior of managers precludes them from structuring a cooperative arrangement.

The study further sought to determine the effect of regulatory environment on financial stability of Commercial Banks in Kenya. A majority of respondents affirms that regulatory environment affects financial stability in their respective firms to a high extent, followed by those affirming to a moderate extent then those affirming to very high. A majority of respondents highly agreed that the banking Act had clear guidelines on financial stability; templates used to report to the regulator are uniform across the banking industry ; regulatory framework monitors performance in the financial stability; regulatory framework has set clear financial stability benchmark ; the templates are revised regularly in line with relevant changes in the industry; regulatory framework sets out penal actions in cases of misappropriation ; and that the classification of products is consistent in all the templates across the banking industry .

The study sought to establish the effect of organizational structure on the financial stability of Commercial Banks in Kenya. a majority of respondents affirmed that organizational structure affects financial stability in their respective firms to a moderate extent, followed by those affirming to a high extent, then to those who said organizational structure affect to financial stability is very high. A majority of respondents agreed that for every corporation mandate, there was an established department/division to deal with it; there were formal procedures on how to deal with every operational activity/situation and the guidelines were available to staff ; all operation activities to be undertaken by the business were approved by the chief executive officer; no or little action can be taken by a staff on any matter without supervisor permission ; written formal communications through established channels must be used on every engagement to be undertaken by the corporation; and that staff are asked to give their input on the adoption of new policies and procedures . Inferential statistics revealed both positive and strong correlations between the predictor and dependent variables. The strongest and positive correlations were obtained between Board structure and financial stability followed by Organizational structure and performance. Regulatory environment and Management-shareholder conflict also registered strong and positive correlations.

Conclusion

It was deduced from the foregoing finding that a majority of the commercial banks surveyed observe various corporate governance practices with respect to the board structure with a view to enhance financial stability in respective firms. It is particularly notable that in most banks surveyed, board meetings are held frequently; the board comprises at least three independent directors who comprise the majority of its membership; members of the board have a clear aptitude for exercising independent judgement; and that all the directors are responsible for the institution’s financial soundness and prudent approach to risk management.

It was evident from the findings that various measures were in place to ensure that management-shareholder conflict did not negatively affect the financial stability of respective commercial banks. It was particularly notable from the finding that in most of the commercial banks surveyed, the executive works to minimize risk exposure by shareholders; there was clear understanding of business goals and shareholder expectations by management; and that compensation models were aligned with long-term firm wide profitability.

The finding was of the implication that the regulatory environment in the country was keen on ensuring that commercial banks operating in the country were financially stable. It was notable that in the country, the banking Act had clear guidelines on financial stability; templates used to report to the regulator are uniform across the banking industry; regulatory framework monitors performance in the financial stability; and that regulatory framework has set clear financial stability benchmark.

It was seen from the findings that a majority of the commercial banks surveyed observed a formalized organizational structure with respect to flow of command and decision making. It was particularly notable that for every corporation mandate, there was an established department/division to deal with it; there were formal procedures on how to deal with every operational activity/situation and the guidelines are available to staff; all operation activities to be undertaken by the business are approved by the chief executive officer; no or little action can be taken by a staff on any matter without supervisor permission; and that written formal communications through established channels must be used on every engagement to be undertaken by the corporation.

With an adjusted R-squared of 59 percent, the model shows that board structure, Management-shareholder conflict, Regulatory environment and Organizational structure explain 59.4 percent of the variations in the Performance while 41 percent is explained by other factors not included in the model. In conclusion, the foregoing findings imply that among other factors, Board structure, Management-shareholder conflict, Regulatory environment and Organizational structure are key determinants of financial stability of commercial banks in Kenya.

Recommendations

Informed by the foregoing findings and the conclusions drawn thereof, the study recommends that for banks to have sustainable growth and stability they should embrace best practices of corporate governance which will ensure that shareholders wealth is looked after in the best way possible, that adequate risk management measures are put in place and that standards are not only in writing but that they are practiced on a day to day basis.

The findings provide shareholders with information that they have an important role to force banks' management to implement good corporate governance. In order to control the managers to implement good corporate governance, they should establish certain control mechanisms. The study informs government that it has to be concerned with good corporate governance practices in banks since they are unique from other sector.

The central bank of Kenya has to encourage banks to implement corporate governance practices through enacting rules and regulations. Corporate governance practices will ensure that banks maintain the level of risk they can handle and give depositors sufficiently safe level of their savings and investments.

We recommend that banks formally adopt and implement OECD Principles of Corporate Governance within their policies and procedures, and report on their compliance in their annual reports. Banks should develop corporate governance policies for the appointment of independent board members, establish and maintain better relations with their stakeholders, and establish the unitary model of board system, in accordance with existing legal provisions.

Banks should develop training programmes for their managerial personnel, as well as for board members, aiming at improving and advancing their corporate governance practices in the light of OECD principles. The Institute of Certified Public Secretaries of Kenya should come up with awards for banks that practice best practices of good corporate governance to encourage banks enhance their corporate governance.

Suggestions for Future Studies

This study delimited itself to Commercial banks in Kenya and it would be interesting to find out how corporate governance affect the financial stability of smaller lending firms like SACCOS. The present study has determined effect of corporate governance on financial stability of Commercial Banks in Kenya. The study was not however exhaustive as it employed a cross-section approach which may not be representative of the state of affairs in the long term. It is thus suggested that future studies employ a longitudinal approach, covering a period of at least 5 years in order to get more conclusive findings in the long term.

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