EFFECTS OF CORPORATE GOVERNANCE ON STOCK RETURN OF COMMERCIAL BANKS LISTED AT NAIROBI SECURITIES EXCHANGE

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DECLARATION

I, the undersigned, declare that this is my original work and has not been presented to any institution or university other than the University of Nairobi for examination or an award.

Signed: ____  ____ Date: _____**19/11/2020**_____

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This research project has been submitted for examination with my approval as the

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DEDICATION

This project is dedicated to my late parents, Henry Jonathan Riaga and Susan Akinyi Riaga who were both educationists and inspired me greatly to attain higher level of education. To Evelyn, Mercy, Stacy and Jonathan Riaga I would like to expresses my sincere gratitude for your patience with me during the period of this Research project.

ABSTACT

The purpose of the study was to determine the effect of corporate governance on stock returns of commercial banks listed in the NSE. The research design used in this study was descriptive. The population chosen for this study was the commercial banks listed in the Nairobi Securities Exchange. The use of the listed firms was due to data availability and reliability because all the quoted companies are required by law and NSE rules to file reports with the exchange and also CMA.In this study, the eleven listed profit-making banks at the Kenyan security market were involved in the study to investigate the effect of CG framework on stock returns.

The study found that from the board structure, majority of the respondents indicated that there was limited access to large board sizes that hinder the discussion of sensitive issues in the organization. The study found out that 75% of the commercial banks listed in the Nairobi Securities Exchange had adopted good corporate governance practices which enhanced balance of power. It was established that most banks ensured that proportion of outside directors had been greatly implemented in the organization; the required board size and the number of meeting in a year were also observed as required. The regression analysis further established that there was a significant relationship between stock returns and corporate governance practices.

The study concluded that the companies had exhibited an increase in implementation of good corporate governance practices which can be attributed to the high level of adoption of the guidelines, board size, proportion of outside directors and the number of meetings in a year. It also concluded that there is a significant relationship between stock returns and corporate governance practices; this means that, companies practicing good corporate governance practices are likely to enjoy higher stock returns. The study recommended that companies should highly consider the implementation of good corporate governance practices since they ensure balance of power and contribute to a strong association with the firm's profitability and market value. Managerial ownership also operates without showing any evidence of a negative inflection point. Moreover, CMA guidelines should be implemented in these companies as it contributes to good corporate governance.

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LIST OF ABBREVIATIONS

CAMELS	Capital Adequacy, Asset Quality, Management Efficiency, Earnings Ability and Liquidity
CBK	Central Bank of Kenya
CEO	Chief Executive Officer
CG	Corporate governance
CGF	Corporate Governance Framework
GDP	Gross Domestic Product
ROA	Return on Asset
ROE	Return on Equity

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The impact of corporate governance (CG) on firm performance continues to receive a lot of focus, in view of the growing competition of both local and multinational corporations world over that often intend to remain ahead of their competitors, in the business environment. This focus is as a result of the ever-emerging challenges that managers have to handle on a daily basis. For instance, the United States economy faced financial crisis in the beginning and end of year 2000, the financial crisis experienced by Asian countries in the late 90s, and the collapse of corporate organizations in Kenya in the last two decades (Nambiro, 2007), the most recent being Imperial Bank and Chase Bank cases that were put under receivership in October 2015 and in April 2016 respectively as a result of liquidity problems and poor governance are a few cases that inform the growing focus on corporate governance.

Agency theory points to the connection between the agent and principal, which posits the distinction of ownership from the control of a firm (Uwuigbe, 2012). Corporate governance in this respect concerns the guidelines that would effectively align the behaviour of agents (board of administrators and managers) with the desires of principals (shareholders and investors) in order to maximise investors return. The agents in this case must act on the best interest of the principals but not maximising their own utility, which often elicit the principal-agent problem when the corporations perform poorly or even when the corporation collapses (Mansourinia et al. 2013). The efficiency of CG framework adopted by the top-level management, in this theory referred to as agents determines the stock return of corporations.

The concept of corporate governance presently draws much attention in the field of finance and despite studies undertaken on the subject matter (Miring'u & Muoria, 2011; Wepukhulu, 2016); there remains much argument on the relationship between corporate governance on the performance, particularly of commercial banks in Kenya. Usually, the leadership structure adopted by any company or corporate body determines the ability of the corporate to efficiently handle both internal and external pressures that have some influence on performance (Miring'u & Muoria, 2011). Good corporate governance safeguards an organization from susceptibility to

future financial distress (Bhagat & Jefferis, 2002). It is postulated that well-governed corporations are essentially superior in performance and that corporate governance is the precursor of good performance (Donaldson, 2003). Several empirical researches have been commissioned to help recognise the impact of corporate governance on financial performance of commercial banks in Kenya. For instance, Mangunyi, (2011) in a study concluded that there is no noteworthy connection between Ownership structure and CG practices, as well as financial performance and CG practices. Otieno (2012) on the other hand noted that corporate governance contributes immensely on bank stability, banks abilities to offer sufficient liquidity and contributes to the performance of the institutions even during challenging market conditions. This finding is in agreement with other studies by Bebchuk, Cohen and Ferrell (2004) and Linyiru, (2006). This means that for commercial banks in Kenya to be able to record growth in the stock return, the management teams supported by the shareholders need to consider adopting and implementing corporate governance practices.

1.1.1 Corporate Governance

Morin and Jarrel (2001), defines CG as the leadership of a corporation aiming at balancing the interest of the organization and the interests of all the concerned parties such as clients, investors, suppliers and lenders, as well as taking into consideration the interest of the society and environment. Cadbury (1992) on the other hand considers corporate governance to be a system by which corporate establishments are directed with respect to the allocation of rights and duties among the stakeholders, like the shareholders, board, management team, and other stakeholders. This study adopts the definition by the Morin and Jarrel (2001), as the working definition of corporate governance. The management of corporations require well-coordinated leadership from top level managers. The efficiency of the boards in discharging their managerial functions, the transparency and full financial disclosures, and the ownership structure of the corporations are part of the corporate governance frameworks (CGF) that influence the productivity of the organizations.

The measures of corporate governance as provided by CBK Section 33(4) of the Banking Act cover shareholders, directors, CEO, management and adhering to the code of conduct. Good corporate governance should provide proper incentives for the board and management to pursue objectives. The measures include; (1) transparency and financial disclosure which should cover

financial reporting and auditing reports; (2) board size that emphasises on small boards of a maximum 19 members; (3) ownership structure and composition covering either block ownership, institutional ownership and managerial ownership, and (4) board composition of either internal and external directors, independent board of directors. This study will measure CG on the basis of the outline's framework.

1.1.2 Stock Return

Luis and Douglas (2005) defines investment return as the total revenue generated from an investment over a specified duration expressed as a proportion of capital employed. The return comprises of the earnings and the capital gains realized after an investment, which is often expresses in terms of a percentage. Conclusively, return refers to the profit realized on an investment that arises from increase in value, cash flows and interest paid as proceeds of trade which the investor earns from the investment.

Dimson and Marsh (1995) underscores that return refers to a yield received on investment, expressed as a percentage of the capital amount invested. However, there is a negative return that results from a loss instead of profit. In the stock market, return is measured based on the changes in the stock prices. The fluctuations of the prices of shares of listed firms at the NSE is considered to be a consequence of changes in particular principle factors such as the macroeconomic factors relating to inflation, interest rates and FDI among others and factors related the financial performance that lead to payment of dividends that influences demand for such company stocks. According to Kehinde (2012), capital markets are highly influenced by a number of factors that relate to investor behaviors. Stock return will be measured on the basis of market share price growth rate with a focus on ROA and ROE.

1.1.3 Relationship between Corporate Governance and Stock Return

Proper management practices that ensures setting of smart firm objectives and policies, financial planning, forecasting and control, efficient allocation of resources, ethical behaviour and professionalism of the management teams (agents) impacts the overall stock return of firms (Lee, 2006). Striking a balance between the firm's interests, and the interests of other stakeholders

such as clients, investors, suppliers, lenders, and society in general guarantees the existence of into the longer future.

Bhagat and Jefferis (2002), posits that good CGF assists to safeguard a company from vulnerability to future financial distress. This is essentially because better CGF facilitates superior access to financing for future growth and expansion; lower cost of capital thus maximising on returns, maintaining sound and health financial position and ensures more satisfaction of all stakeholders based on favourable treatment of all stakeholders and as a result attracting more investors and financiers (Donaldson, 2003).

Empirical studies continue to show the connection between CG and the performance of organizations. For instance, Bebchuk, Cohen and Ferrell (2004) in a study domiciled in the U.S.A found that well-governed corporations often record superior firm performance compared to the poorly governed firms. Irrespective of the analysis of internal long-term performance or considering the external stakeholders standpoint, there is strong evidence that good performing boards of administration benefit organizations (Epstein et al., 2003). Matama (2005), in another empirical study on CG and financial performance found a positive link between stock prices and return and corporate governance practices. This informs the study to try understand the impact of corporate governance, risk management and stock return of commercial banks trading at NSE.

1.1.4 Commercial Banks in Kenya

Commercial banking business involves accepting deposits, giving credit, money remittances and any other financial services. The industry performs one of the major roles in the sector of finance with a lot of emphasis on mobilizing of savings and credit provision in the economy. According to the CBK (2019), the banking sector encompasses of the CBK as the regulatory authority, 1 mortgage finance institutionand 42 commercial banks. Among the 42 commercial banks in the country, 30 are locally owned, 9 are microfinance banks and 14 owned by foreigners. Among the 42 commercial banks already established in the Kenyan banking sector only 10 of the 42 are listed at the NSE. In order to promote solvency, proper operation of financial systems and liquidity, the CBK mandates financial institution to comply with the regulation enlisted in the CBK circular. The main objective of the CBK guidelines and regulations is minimizing the creditors risk levels, reducing systematic risk, protecting the confidentiality in banking and

safeguarding the banks from negative activities like money laundry and terrorism financing among others. There exists four primary guidelines and regulations among others overseeing banking parts as per CBK: Risk Management Guidelines, Prudential Guidelines, guidelines on Business Activities, and Non-Operating Holding Companies Guideline (CBK, 2019).

1.1.4 Nairobi Securities Exchange

The NSE is the only security exchange in Kenya, the 4th largest in Africa in trading volumes and the 5th largest by market capitalization. In spite of this, it is still young and developing by the standards of advanced economies. In 2014, the NSE received formal approval from the Capital Markets Authority (CMA) to operate as a demutualized entity (NSE 2015). According to Nyasha (2014), reforms targeting the securities market implemented over the years include the formation of a regulatory body (the CMA), marking a shift from the self-regulatory system to the statutory regulatory system; the replacement of the "Call-Over" trading system, in favour of the floor-based "Open-Outcry System" and the reduction of listing costs.

Significant developments have been noted with the reforms leading to increased market capitalization and increased turnover even though the number of listed companies has not improved much and fluctuates at around 60 companies. According to Nyasha (2014) the challenges faced by the development of the stock market in Kenya include a lack of awareness, low investor confidence, lack of competitive pressure in the local market, a vulnerability to shocks, and the low level of liquidity in the capital market.

Ngugi (2003) argues that during the revitalization period of the NSE, a lot of efforts have been made to enhance market liquidity through policy reforms and this was confirmed by Nyasha (2014). Nyasha observes that these reforms have had significant contribution to the stock market liquidity through the influence of the level of stock returns on the volume of trading activities.

1.2 Research Problem

Finance agency theory posits the distinction of ownership from control of a firm, and desires the agents to operate in the interest of the principal in order to maximise the principal’s utility (Jerzemowska, 2006). Stewardship theory similarly puts forward that when managers are left alone, they act responsibly to secure the assets of the company under their control, and to

optimise wealth of shareholders' (Davis et al. 1997). However, there have been global happenings in the corporate sector that points to poor performance and collapse of high-profile financial institutions in the last two decades in what is considered to be the failure of agents to protect the business objectives of the shareholders.

The Enron scandal in the US that caused the decline of the market value of Enron from USD 80 billion in the month of August 2000 to below USD 1 billion in year 2001 (Simpson, 2016), and the collapse of Dubai Bank, Chase Bank and Imperial Bank in Kenya within a span of eight months between August 2015 and April 2016 points to a gap in governance to the interest of stakeholders. Based on the worldwide demand to fortify CG, CBK issued major guidelines on CG to commercial banks in 2001, 2006 and 2013 to deal with the mismanagement and poor performance commonly witnessed in corporate institutions (CBK, 2013). Nevertheless, the mismanagement and collapse of commercial banks have been reported thereafter, thus the need to ascertain whether or not CG impact stock return of banks.

Previous studies in this subject area also give conflicting position on the connection between CG and stock return. For instance, Love and Rachinsky (2007) noted that CG causes no significant influence on the performance of banks. Equally, Mangunyi, (2011) in a study concluded that there is no noteworthy relationship existing between CG practices and the ownership structure as well as financial performance. Conversely, Otieno (2012) found that CG contributes to bank risk minimization, stability, performance, and financial institution's ability to secure liquidity during difficult market conditions. Otieno's finding is in agreement with other studies by Bebchuk, Cohen and Ferrell (2004), Otieno et al 2015 and Linyiru, (2006). The inconsistent positions taken by the previous studies thus points to no consensus on the connection between CG and stock return, hence a gap that need to be filled. This study thus pursues to fill the gap to understand what is the effect of CG on stock return of commercial banks traded at Kenyan security exchange.

1.3 Research Objective

To investigate the impact of Corporate governance on stock return of listed commercial banks at Nairobi securities exchange.

1.4 Value of the Study

Understanding the impact of CG on stock return of commercial banks will be beneficial to all stakeholders. It will help the management teams from the board of administrators and other top-level managers to see the need to formulate sustainable CG policies that can strengthen CG in the firms, and to enhance making informed decisions that will ensure sustained productivity and better performance. Central bank of Kenya, which is the regulating body will equally consider the results of this study to formulate necessary policies, governance structure and regulations to guide commercial banks in Kenya, and whether to strengthen their supervisory role to strictly monitor adherence to the CG policy guidelines, particularly risk management in order to enhance stock returns of commercial banks and to protect the interest of all the investors in the industry.

The conclusions of the study will similarly benefit current and future researchers in the academic field to understand the significance and influence of CG in stock return of commercial banks and corporate organizations in general. It will add to the knowledge base in the finance specialization profession whether CG should be considered to be a determinant of stock return.

Finally, the shareholders whose objective is to maximise their wealth, depositors whose interest is the guarantee of being able to access their money whenever they need it, investors and creditors whose interest is to make returns and be paid back their debts will benefit on the outcomes of this study by considering the impact of CG practices on stock return when choosing managers, when deciding whether or not to lend, deposit and invest their money in a particular bank based on the adoption of CG practices.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter aims at reviewing the literature associated to CG and stock return of commercial banks. It outlines the agency and the stewardship theories that shows the nexus between good governance and identifies other determinants of stock return in the banking industry. Further, the chapter reviews both local and international empirical studies related to the topic of study that had been undertaken by early researchers.

2.2 Theoretical Review

2.2.1 Agency Theory

The traces its origin to the 1970s when scholars like Jensen and Meckling (1976) and Alchian and Demsetz (1972) among others looked at the agency problems that arose from the relationship between a principal and an agent. Agency relationship occurs when one partner in the transaction known as the principal transfers managerial authority to third party known as the agent, to an extent that the well-being of the principal is dependent on the decisions and choices made by the agent (Arrow, 1985).

The theory states that in an imperfect labour relationship and capital markets, characterised by disproportionate information, managers often pursue to maximize personal utility over the value benefit of company shareholders. The managers are anticipated to take decisions and actions that protect the desires of the principal in a manner that will maximise shareholders' wealth. Corporate governance practices embraced and implemented by the strategic level managers of the profitmaking banks determine whether the agents will maximise shareholders' wealth or collapse as witnessed in the recent past. The adoption of the CGF by commercial banks as stipulated by CBK will thus fulfil the objective of agency theory to ensure that bank managers and directors maximise shareholders wealth.

2.2.2 Stewardship Theory

Stewardship theory put forward by Donaldson and Davis (1991 & 1993) is a replacement of mistrust of the agency theory. The theory postulates that managers are not inspired by subjective goals, but relatively by their principles. According to the theory, stewards' behaviour will not deviate from fulfilling the interest of the principal and the goals of the firm, but will endeavour to optimize shareholders' wealth. The managers are inspired by the craving to accomplish their set principles, the necessity to realise their inherent satisfaction through successful execution of demanding tasks and the desire to exercise their obligation and power that consequently makes them receive respect and acknowledgment from others (Donaldson & Davis, 1991).

Stewardship theory further states that organizations need to establish structures that permit synchronization of goals such that the managers that favour the shareholders may realise high performance. This brings about the concept of CG that creates a balance between the firm's interests, and the interests of other stakeholders such as clients, investors, suppliers, lenders, and the environment and society (Morin & Jarrel, 2001). This theory is thus relevant to this study since the findings of the study will determine whether faithfulness of the bank stewards to CGP optimises shareholders wealth.

2.2.3 Stakeholder's Theory

Recent scholars have stated that the stakeholders' theory was embedded in the management discipline in 1970 and gradually developed by Freeman incorporating corporate accountability to a broad range of stakeholders (Al Mamun, et al., 2013; Keraro, 2014; Mwithi, 2016). They also noted Freeman (2010) who argued that stakeholder theory derived from a combination of the sociological and organizational disciplines. The researchers felt that the agency and resource dependency theories cannot suffice because of their emphasis on organisation as fragmented and closed social units independent of external forces.

To provide voice and ownership-like incentives to critical stakeholders, Freeman (2010) quoted Porter who recommended the stakeholders theory to US policy makers in 1992 so as to encourage long-term employee ownership and encourage board representation by significant customers, suppliers, financial advisers, employees, and community representatives. He also

recommended that corporations seek long-term owners and give them a direct voice in governance (i.e. relationship investors) and to nominate significant owners, customers, suppliers, employees, and community representatives to the board of directors.

The only meaningful way to study an organisation is to regard it as a system. According to Mitchell, VanBuren, Greenwood and Freeman (2015) organisation is a system of stakeholders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm's activities. He further states that the purpose of the organisation is to create wealth or value for its stakeholders by converting their stakes into goods and services. The stakeholder theory holds that corporations are social entities that affect the welfare of many stakeholders where stakeholders are groups or individuals that interact with a firm and that affect or are affected by the achievement of the firm's objectives (Donaldson Preston, 2015; Freeman, 2010; Reed, 2012). They further stated that the key to achieving this is to enhance the voice of and provide ownership like incentives to those participants in the firm who contribute or control critical, specialized inputs (organisation specific human capital) and to align the interests of these critical stakeholders with the interests of independent, passive shareholders. According to Mulili (2011), successful organisations are judged by their ability to add value for all their stakeholders. He further noted some scholars, consider the natural environment as a key stakeholder. Further, the ability to successfully interact with the external environment, in line with the resource dependency theory, can be a source of competitive advantage for a firm (Okpara, 2011).

Mackenzie (2014) noted a corporation adopts a reactive approach when it does not integrate stakeholders into its corporate decision-making processes and this results in a misalignment of organisational goals and stakeholder demands. Some authors attribute scandals such as those of Enron and WorldCom to the failure to consider stakeholder concerns in decision making (Currall, Frauenheim, Perry & Hunter, 2014; Clarke & Branson, 2012; Watkins, 2013; Zandstra, 2012). A proactive approach is used by corporations that integrate stakeholder concerns into their decision-making processes; such corporations also establish necessary governance structures (Schouten, Wade & Wit, 2014). The theory brings in the thinking of stakeholders' ownership variable in the study.

2.2.4 Transaction-Cost Theory

As defined by recent scholars, transaction cost theory was first initiated by Cyert and March (1963) and later theoretical described and exposed by Williamson (1996) (Hoskisson, Johnson, Tihany & White, 2015; Silanes, Shleifer & Vishny, 2012). They stated that transaction cost theory was an interdisciplinary alliance of law, economics and organizations. Further, they argued that the theory attempts to view the firm as an organization comprising people with different views and objectives. The underlying assumption of transaction theory, they concluded, was that firms had become so large that they in effect substitute for the market in determining the allocation of resources; in other words, the organization and structure of a firm could determine price and production. They also noted that the unit of analysis in transaction cost theory was the transaction and therefore the combination of people with transaction suggests that transaction cost theory managers were opportunists and arranged firms' transactions to their interests.

Williamson (2011) states that the transaction costs theory deals with the ideal transaction mode of corporations arguing that organisations choose this best possible mode between the extreme of market exchange and hierarchy, which leads to the lowest possible transaction and production costs. According to La-Porta, et al., (2012), transaction costs theory has been primarily introduced to developed economies where there are strong regulatory systems, social norms and mutual trust, however, emerging economies due to uncertainty and lower regulatory system increases transaction costs. Moreover, transaction costs theorist explains that a firm's environment is the main determinant of transaction costs. Hoskisson, et al., (2015) explained that where market transaction costs are high the hierarchical governance model will enhance efficiency. The theory brings the need of leadership composition of leaders who understands the firm's environment well in order to take control and monitor the transaction industry costs.

2.2.3 Theory of Liquidity and Regulation of Financial Intermediation

This theory was developed by Farhi, Golosov and Tsyvinski (2009). It speaks to the existence of two informational conflicts: (1) agents receive unobservable shocks and (2) can engage in trades that are not observable to intermediaries and regulating authorities. In the absence of guidelines, intermediaries provide no risk sharing whenever a shock arises from arbitrage opportunities and the obligation of regulation is not dependent on imperfectness of the markets for aggregate shock. The proponent of this theory identified a simple regulation on liquidity requirement known as liquidity cap to be put in place to limit client allocation of funds to unobservable trades. Instead, this provides for the sealed form results for the maximum liquidity needs and offer welfare gains of enforcing the requirements.

Farhi, Golosov and Tsyvinski (2009) proposed that imposing a liquidity cap on the short asset ought to be done at all times, noting that market failure, intermediaries do not understand how liquidity provided impact other intermediaries through trade on private markets. This assertion does not agree with the suppositions put forward by Allen and Gale (2004), which states that government only has a duty to control liquidity when aggregate shocks exists in the market. Corporate governance also includes efficiency in liquidity management to help firms withstand the market shocks and to enhance stock return of commercial banks. In this case, diverse intermediaries operating from different areas within the country need to implement different methods of liquidity regulations, depending on the primary nature of the shocks experienced. Liquidity and regulation is part of management efficiency actions, which is an independent variable in this study, thus relevance of this theory to the study.

2.2.4 Transaction Cost Economics Theory

This theory traces its origin from Coase (1937) who posits that it is possible for corporations to minimise costs when they focus on their core business devoid of engaging on non-core business activities in which they are not efficient. Firms have a duty to elect whether to offer a service in-house or to outsource based on which option saves costs and facilitates efficient performance on the core activity. Corporate governance in an organization should assist firms to ascertain the internal actions and dealings capable of minimizing transaction costs that may arise from

contractual hazards such as self-interested opportunism, asset specificity, cost efficiency, information asymmetries, and the problem of bounded rationality (Learmount, 2002).

Mangers therefore must consider the effects of internal versus external transaction costs, before deciding between keeping the company's activity or service in-house such a that it can remain efficient in its core business or to outsource from the environment. This consideration has prompted most corporations in Kenya including the commercial banks to concentrate on their core businesses and to outsource non-core activities such as security. Managing costs is a management efficiency attribute, which is an independent variable in this study and part of the CG framework tested in this study. This theory is thus at the centre of this study.

2.3 Determinants of Stock Return

There are a number of factors other than the variable of study that impact stock returns. This study discusses five determinants of return. They include; return on capital employed, short term and long-term investments, gearing ratio, inflation and management efficiency.

2.3.1 Profitability

Profitability ratios indicate the ability of the management to translate sales into profits. Return on capital employed is mainly measured using profitability ratios such as the gross margin, the net income margin and operating margin. ROCE is derived through division of the EBIT with the total capital employed in the investment. Capital employed in this case refers to the total assets employed in the business less the current liabilities and obligations the business has. The EBIT also known as the operating profit is the income the gross profit less the operating expenses (Kheradyar, Ibrahim & Mat, 2011).

2.3.2 Investments

Short term investment refers to where an investment in any property is held for a period under one year while long-term investments are help for a period beyond one year. The short-term investment funds may include; corporate notes, government bills, bank notes, cash, and various safe short-term debt instruments. Speculation on the daily trading by investors using short term investments is considered a risky business that can result into massive loss on investment.

Conversely the long-term investors usually incur less trading fees on their investments since the positions are held for a long period (Kariuki, 2013). Nonetheless, the long-term investors must also consider investing in firms with verified growth trajectory and stability and in order to make returns (Kheradyar, Ibrahim & Mat, 2011).

2.3.3 Leverage

Gearing ratio is an indicator of financial leverage, which demonstrates whether a firm funds its activities through equity and debt. The higher leveraged a company is, the riskier the company becomes (Adelegan, 2009). The risk in borrowing is basically because the creditors have to be paid back notwithstanding the poor performance of the firm (Gunsel & Cukur, 2007). A more geared company is more susceptible to slumps in the trading cycle since the interest paid reduces the earnings after tax that is shared with the shareholders in terms of dividends. As a result, returns reduce or negative returns may be realised to a point of bankruptcy (Danielson, Hirt & Block, 2009). Similarly, the risk perception of the company's stock has direct proportionality to the variability of its returns. High interest rates charged on highly risky assets also reduce cash flows by decreasing the profitability of the firms and reduces the present values of stocks as well as current stock prices (Nelson, 1992).

2.3.4 Inflation

An increase in general inflation in an economy reduces the purchasing power the dollar Culberson (2003). This means that inflation makes stocks less attractive having that dividends growth rate is not matched with inflation levels. It is noted that the price of stocks is influenced by inflation, consequently causing a decline in the stock prices and return. However, investors prospecting future returns from dividend-yielding stocks gains access to buy stock at cheaper price when inflation rate is rising, thus benefitting from attractive entry points (Huberman, 1981).

2.3.5 Management Efficiency

Management efficiency influences all the bank specific factors. The aptitude of the company managers to source sufficient capital needed to finance the firm's operations, efficiently deploy the resources, grow the firms asset value, competently manage the liquidity of the firm, maximize income, and as much as possible minimise the organizations operating costs defines

management efficiency (Sangmi & Tabassum, 2010). This efficiency is also confirmed by the firm's growth rate in relation to the total growth of assets, the rate of growth of the firms' earnings, the growth rate of the loan book, and the operating profit to income ratio (Ongore & Kusa, 2013).

2.4 Empirical Review

This section outlines the empirical evidences covering previous studies related to the topic of study. It covers both international and local evidence.

Rose (2007) did an empirical study to look at CG and performance. The researcher picked a population of all Danish companies traded at the Copenhagen Stock Exchange for the duration between 1998 and 2001, and using Tobin's q to value the effect of ownership structure on firm's performance, the outcomes indicated that ownership by banks impacted positively on performance. However, the cross-sectional regression analysis established that the rise in ownership by institutional investors does not influence firm performance. This study only used ownership structure as the only CGF, which may be inadequate to lead into a conclusion. Therefore, this study seeks to analyse more frameworks including transparency and financial disclosures, board size, and board composition not looked at by Rose.

Tandelilin et al. (2007) equally looked at the link between CG, risk management and performance of banking institutions among Indonesian banks. The researchers employed a sample of 51 banks in Indonesian for duration between year 1999 and 2004, and adopted the Triangle Gap Model to analyse both primary and secondary data. The study found that bank ownership structure as a framework of CG influenced risk management and bank performance. This researcher established no linear consequence of CG on bank performance. Despite the finding, the study by Tandelilin failed to consider other CG frameworks, which this study intends to include.

Enobakhare (2010) in another study focussed on CG and bank performance in Nigeria for the period 2003-2008, specifically looking at the correlation between institutional ownership and bank performance, foreign ownership on bank performance, board ownership on bank performance, and link between government ownership and performance of banking firms. Using

regression analysis, the researcher concluded that ownership structure and the CG culture adopted affected the profitability of the Nigerian banking sector. Enobakhare study was based in Nigeria, but the researcher in this study is domiciled in Kenya which may have different economic and business environment.

Ashenafi et al. (2013), in a separate study domiciled in Ethiopia scrutinised the CG mechanisms and their impression on performance of profitmaking banking firms for a period between 2005 and 2011. The researchers emphasized the connection between internal CG mechanisms that comprised; type of ownership structure, board of directors, audit structure, bank size, and external CG contexts such as; capital adequacy ratio, government regulation and control and provision for loss on loan as the independent variables, while ROA and ROE adopted as the dependent variables to measure performance. The researcher chose a sample of 9 profitmaking banks and the data collected analysed using both qualitative and quantitative methods. The study concluded that the size of the management board and the availability of audit committee in the board positively influenced ROA and ROE. Further, capital adequacy ratio employed as a proxy of external CG framework positively and expressively impacted ROA and ROE. Further, the lack of CG awareness, absence of organized stock exchange, absence of accounting and proper auditing, high government intervention, lack of national standards of CG, and feeble legal structure to protect the rights of the stockholders adversely affect CG and bank performance.

Miring'u and Muoria (2011) examined how CG influence performance in profitmaking state corporations in Kenya. The researchers used 30 profitmaking corporations owned by the state and data collected from 30 human resource officers. The primary and secondary data was evaluated using multi-linear regression and descriptive statistics techniques. The study asserted an existence of a positive link between ROE and the size and composition of the board of all the state corporations. The researchers concluded that well-governed corporations record superior performance, and that mismanagement, incompetence, wastage, bureaucracy, and imprudence by the directors and staffs are the leading causes of poor performance of state corporations.

Otieno (2012) equally undertook a research on the influence of CG on stock return of profit-making banks in Kenya. Using a cross sectional and analytical research design and Correlation and Multiple Regression Analysis, the researcher observed that CG is very significant on bank

performance, stability and bank's capacity to offer liquidity during turbulent economic situations. From the analysis, CG factors that include; CG practice, policies, and shareholders rights and responsibility were found to account for 22.4 % of the total financial performance of profitmaking banking firms. However, the study failed to focus on the structure of ownership by shareholders and the size and composition of the boards as independent factors, which this study intends to include.

Another study by Otieno et al (2015) also sought to study the likely influence of CG on financial performance of savings and credit cooperatives between May 2013 and December 2013. The researcher adopted a census method to collect data from 3 samples Sacco's. Using Spearman's rank correlation to analyse data, the results exhibited a substantial association between frequent financial reporting and financial performance of savings and credit cooperatives. Further, the study noted that the adoption of participative style of management improved the financial performance of Sacco's. However, no statistically significance was found between board size and financial performance. The study recommended that CG to be practiced in Sacco's and that financial reporting and disclosure be implemented always in addition to adopting a more participatory style of management.

Finally, a study by Wepukhulu (2016) focussed on the link connecting CG and performance of profitmaking banks in Kenya. After sampling 43 commercial banks and using descriptive statistics to undertake the analysis, the data collected showed that board independence and a CG framework had no significant connection with performance of commercial banking firms as measured by ROA, ROE and Tobin q ratio. The board size and institutional and block ownership structure had negative impact on ROE, but showed no statistically significant influence on the TBQ ratio. This study thus concluded that CG practices impact stock return of profitmaking banks in Kenya. Consequent to the outcomes, the study recommended that the regulator to me a member of the boards of commercial banks in the country in order to check their effective management and performance of banks.

2.5 Conceptual Framework

A conceptual framework is a detailed graphical description of the main study variables. The conceptual framework below demonstrates the connection between the independent and dependent variables of the study. In this case, stock return is the dependent variable. The independent variables relate to the CGFs. The framework also includes the existence of moderating variables which include control variables, touching on industry specific factors and the macroeconomic factors. From the study, it is expected that the CGF adopted by the bank influence the level of stock return at NSE. Further, the conceptual framework also acknowledges the existence of other moderating factors that based on the management structure may influence the effect of the CG on stock return. The framework has been designed from the reviewed literature and assumes a linear relationship between the dependent and independent variables. This is represented in figure 2.1 below.

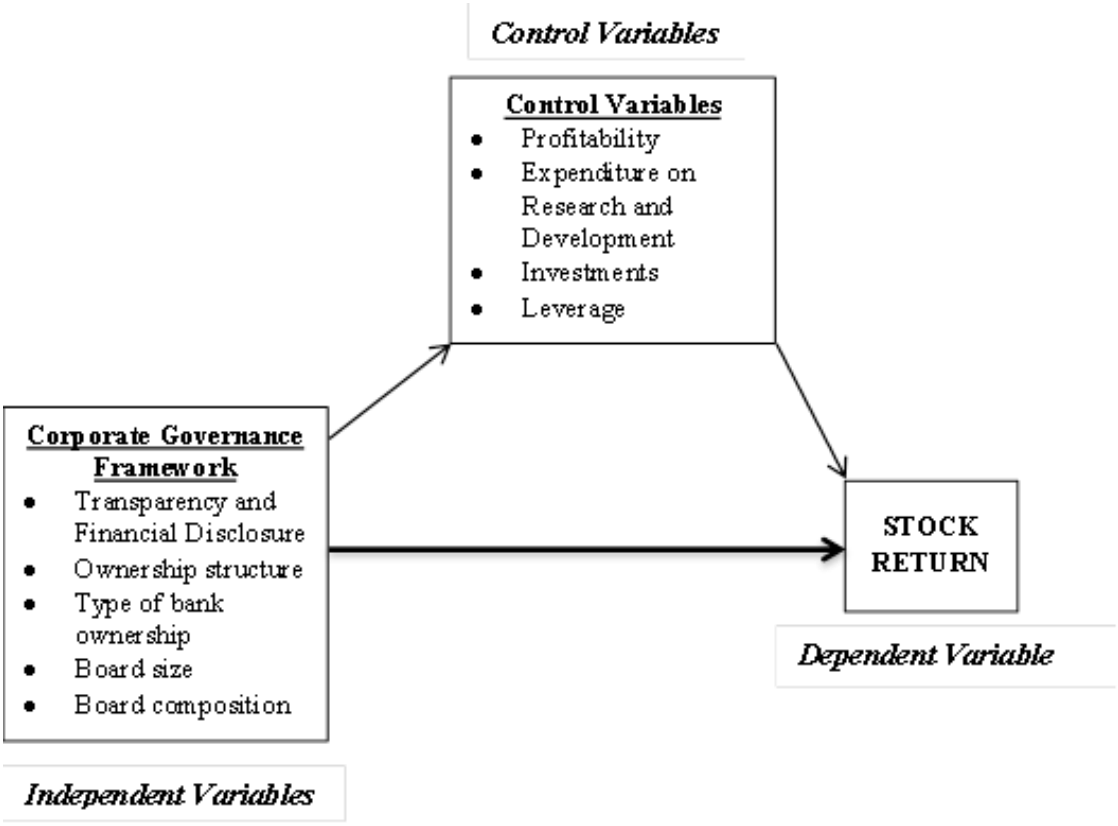


Figure 2.1: Conceptual Framework

2.5.1 Board Size

The Board of directors of an organization is a key mechanism to monitor manager's behaviour and to advise them. The largely shared wisdom regarding the optimal board size is that the higher the number of directors sitting on the board the less is performance. This leans on the idea that communication, coordination of tasks, and decision –making effectiveness among a large group of people is harder and costlier than it is in smaller groups, (Belkhir, 2006).

Limiting board size to a particular level is widely believed to improve the performance of the firm at all levels. Benefits arising from increased monitoring by larger boards are outweighed by poorer communication and cumbersome decision –making. Empirical studies on board size seem to provide the same conclusion: A big board is likely to be less effective in substantive discussions of major issues among themselves in monitoring management. Large boards are less effective and are easier for CEO to control (Lipton and Lorsch, 1992). In this case, Board size plays a major role on the performance of every prospering organization.

2.5.2 Board composition

Globalization and liberalization of financial markets, corporate governance scandals and increasing demands of stakeholders for accountability and transparency of organizations, brought the roles and tasks of board of directors (BODs) to the centre of corporate governance debate (Ingley and Van der Walt, 2005). BODs have various and important roles (Finkelstein and Money, 2003). According to Zahra and Pearce (1989), the main roles of BODs are control, service and strategy. Realization of these roles mainly depends on the characteristics of boards, which affect the performance of organizations, (Johnson et al, 1996).

In this study, focusing on these discussions, it is aimed to investigate the effect of board composition, measured in terms of insider director, outsider director and affiliated director presentation, on organizational performance of firms listed in NSE. BODs are in general the main decision-making body of organizations listed in NSE and they are primarily responsible for the fate of their organizations, therefore the study of the effect of these groups on organizational performance exists as an important research topic.

2.5.3 Ownership Structure

Ownership structure is the identity of company ownership and an important element of corporate governance which is potentially important. Ownership structure consists of two type, dispersed ownership to outside investors and concentrated ownership, (Surya et..al, 2005). Ownership concentration in some families or business group cause a big control to majority shareholder, which eventually a different treatment between shareholders emerge and the one who will be harm is the minority shareholders. Ownership concentration is determined by the number of share that is held by three biggest shareholders and counted with Herfindahl index which is the square amount of share proportion (in percent), (Firth et..al, 2006).

Investor protection is high when the management ownership is high because outside investors expect the manager with their share ownership significantly will act in the best interest of all the shareholders to minimize the negative impact from unanticipated crisis of their share, (Leung et..al, 2007). Durnec and Kim (2003) claim that the bigger the ownership that owned by the controller shareholders and it will improve the quality and performance of a firm. Juliana (2006), proves that a high ownership concentration can give a trustable commitment from the controller owner with a purpose to build reputation and not to misuse the interest of minority shareholders. In this regard, ownership concentration factor is one of the determinants in the performance of banks as business institutions.

2.5.4 Transparency & disclosure

Transparency is integral to corporate governance, higher transparency reduces the information asymmetry between a firm's management and financial stakeholder's (equity and bondholders), mitigating the agency problem in corporate governance (Sandeep et al,2002). The concept of Bank transparency is broad in scope it refers to the quality and quantity of public information on a bank's risk profile and to the timing of its disclosure, including the banks past and current decisions and actions as well as its plans for the future. The transparency of the banking sector as a whole also includes public information on bank regulations and on safety net operations of the central bank (Enoch et al, 1997).

2.6 Summary of Literature Review

This chapter outlined agency theory, stewardship theory, theory of liquidity and regulation and the transaction cost economics theory as theories that anchor this study. Four determinants of stock return other than CG were also outlined. These include liquidity management, efficiency in management, adequacy of capital, economic growth, asset quality, and political instability. The chapter also undertook an empirical review including both local and international evidences on the relationship between stock return and corporate governance.

Other than the study by Rose (2007), in which a cross sectional regression analysis found more ownership by institutional investors not to have any notable influence on firm performance, other studies by Tandelilin et al. (2007), Enobakhare (2010), Ashenafi et al. (2013), Miring'u and Muoria (2011), Otieno (2012) and Wepukhulu (2016) found a positive link between CG framework used and financial performance. However, this study notes that other CGFs like transparency and financial disclosures, board size, board composition, and type of bank ownership was not considered by the empirical evidences reviewed. This study thus seeks to expand the frameworks and to arrive at a more comprehensive well-considered conclusion on the impact of CG on stock return of commercial banking firms in Kenya.

CHAPTER THREE

METHODOLOGY

3.1 Introduction

Methodology chapter outlines how the research will be conducted. It expounds on the research design to be adopted, the size of the population under focus, sample size to be used to represent the population, the process to be used in data collection and highlights how data will be analysed.

3.2 Research Design

The study will adopt the descriptive research design. The design will facilitate the investigation of the impact of CG on stock return of commercial banks in Kenya. According to Christensen, Johnson and Turner (2011), descriptive design is a scientific technique which encompasses recitation of the movement of a subject devoid of influencing data. This design matches this study since the researcher will use stock return as measures of stock return without manipulating the variables, with the view to evaluate the natural movement of stock return based on the CGF adopted by the firm.

3.3 Population

Study population was narrowed to commercial banks traded at the Kenyan securities exchange market as at August 2018. The public commercial banks are regulated by the central bank of Kenya and are subject to the CGF stipulated by the CBK. However, all the profit-making banks and relevant stakeholders will considerably benefit from the findings of this study, to be guided whether or not they should fully implement CG practices. In this study, the eleven listed profit-making banks at the Kenyan security market will be involved in the study to investigate the effect of CG framework on stock returns. The study period will be between year 2006 when CBK issued the second CGF and 2015.

3.4 Data Collection

The researcher purposes to collect required data from existing secondary sources. This will include published annual financial reports, bank ownership structures information published by the respective companies between the period under study of between 2006 and 2015. The

required data will include; stock prices and returns of the entire sampled bank covering the study period. Data on independent variable on CGF will include; transparency and financial disclosures given by audit reports; board sizes and their efficiency in sourcing adequate capital, managing firm's liquidity and minimising operating costs; ownership structure, composition made public of the respective banks. The data collected will enable the researcher investigate the effect of CG practices adopted by the respective banks on the stock return of profit-making banks operating in Kenya.

3.5 Data Analysis

SPSS version 23 was applied in the data analysis. Findings were quantitatively presented with the use of graphs and tables. Descriptive statistics such as mean, standard deviation, skewness and kurtosis were utilized in summarizing the data obtained from the banks. Inferential statistics included regressions and Pearson correlation.

3.5.1 Diagnostic Tests

The study undertook several diagnostic tests to assess the applicability of the research structure. The study first assessed for normality through the Kolmogorov-Smirnov and Shapiro-Wilk tests of the residuals where in both tests, a non-important result (a p factor of greater than 5%) will be deemed an indication for normality. The study also assessed for multicollinearity using the tolerance and the variance inflation factors (VIF) where a tolerance figure of greater than 0.2 or a VIF of more than 10 was an indication of the presence of multicollinearity. Additionally, the study assessed for heteroskedasticity using the Levene test and the plotting of residual graphs and assess for serial correlation (autocorrelation) using the Durbin Watson test where a value of between 1.5 and 2.5 indicated that there exists no auto-correlation (Khan, 2008).

3.5.2 Analytical Model

Dependent variable in this study is stock return denoted by (Y), while the independent variables on CGF will be; (X_1), Size of the Board of directors(X_2), the structure of ownership its composition(X_3), Composition of the Board (X_4). This is represented below.

$$Y = \beta o + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_{4it} + \varepsilon$$

Where:

Y = Stock Return

βo = The intercept of the model.

X_1 = Transparency and financial disclosure

X_2 = Board size

X_3 = Ownership structure and composition

X_4 = Board composition

ε = An error term.

3.5.3 Operationalization of Variables

Table 3.5 Variables

Independent Variables	Operationalization of Variables	Empirical Studies
Transparency and financial disclosure	Financial reporting and auditing reports	Ashenafi et al. (2013), This study will slightly deviate from the studies by Rose (2007), Tandelilin et al. (2007), Enobakhare (2010), Miring'u and Muoria (2011), Otieno (2012) and Wepukhulu (2016) that looked at other variables of CG but not transparency and financial disclosure
Board size	Small board maximum 19 members	Wepukhulu (2016)Miring'u and Muoria (2011), Vallelado, (2008),
Ownership structure and composition	Block ownership, institutional ownership, and managerial ownership	Rose (2007) , Tandelilin et al. (2007), Enobakhare (2010)
Board composition	Internal and external directors, independent directors	Wepukhulu (2016)Miring'u and Muoria (2011)

3.6.3 Test of Significance

The study will employ a multivariate regression model test to investigate the existence of comparative significances of each of the four variables of the study with respect to stock return. This will be conducted at 95% significance level.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This section details the analysis, findings and elucidation of the secondary data obtained from the CBK and individual banks websites. The aim of the study was determining how corporate governance impact performance of Kenyan banks. The independent variables for the study were transparency and financial disclosure, Board size, ownership structure & composition and Board composition while the dependent variable was the stock return measured by ROA. Regression analysis was adopted to determine how the variables relate based on the study's objectives. In ascertaining the suitability of the analytical model, ANOVA was applied. The results were presented in tables and figures.

4.2 Descriptive Analysis

This analysis gives the average, maximum, minimum, standard deviation, skewness as well as kurtosis of the variables for the study. Table 4.1 illustrates statistics for the variables. SPSS was used in the analysis for the period stated (2015 to 2019) for all the 11 commercial and service firms whose data was obtained. The values are
illustrated below.

Table 4.1: Descriptive Statistics

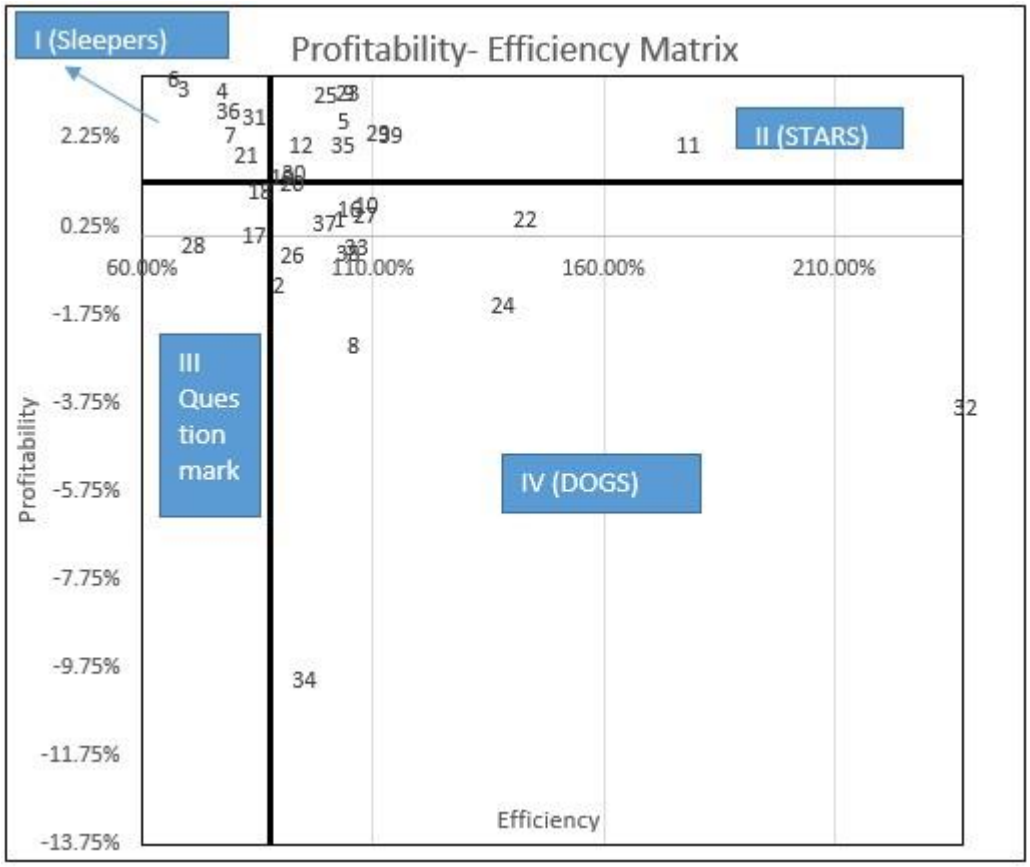
	N	Minimum	Maximum	Mean	Std. Deviation	Skewne		Kurtos	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
ROA	53	-.9823	.2018	-.0589	.22091	-2.430	.327	6.675	.644
Transparency &financial disclosure	53	2	26	13.92	5.636	-.487	.327	-.107	.644
Firm size	53	5.1575	8.2602	6.7511	.70086	.104	.327	.300	.644
Ownership structure	53	.0827	2.9022	1.3321	.76341	.419	.327	-.831	.644
Board composition	53	.0000	.8165	.28620	.21743	.788	.327	-.189	.644
Valid N (listwise)	53								

Source: Research Findings (2020)

4.3 Profitability Efficiency matrix

The study created a profitability efficiency matrix showing the profitability in contrast to the efficiency of the commercial banks of Kenya. Banks were indexed with numbers as shown in Appendix III. From the results, the Median for profitability was 1.23% whereas the median for efficiency was 87.56%. A matrix comprising of four quadrants as shown in table 4.2 below was created. Quadrant I is also referred as sleepers, quadrant II is also referred as stars, Quadrant III is also referred as Question Mark and Quadrant IV also referred as the Dogs. Quadrant I contains those banks with high profitability and low efficiency, Quadrant II is those banks that have high profitability and high efficiency, Quadrant III is those banks with low profitability and low efficiency and Quadrant IV is those banks with low profitability and high efficiency. From the findings Majority (15/39) of the banks were 'DOGS' having high efficiency and low profitability followed by 'STARS' with (14/39) having high profitability and high efficiency and thirdly the 'SLEEPERS' with (7/39) having a high profitability and low efficiency and finally the 'QUESTION MARK' were the least with only 3/39 banks having low profitability and low efficiency.

Table 4.2 Profitability-efficiency matrix



4.4 Diagnostic Tests

The data collected was subjected to diagnostic tests. The study presumed a significance level of 5% or 95% confidence interval so as to make variable deductions on the data adopted. Diagnostic tests were useful for ascertaining the falsity or truth of the data. Therefore, the nearer to 100% the confidence interval, the more accurate the data used is presumed to be. In this case, the tests conducted were normality test multicollinearity test, heteroskedasticity tests and autocorrelation test.

4.4.1 Normality Test

Shapiro-wilk test and Kolmogorov-Smirnov test was utilized for normality testing. The level of significance in the study was 5%. The outputs of the test are depicted in Table 4.3. The null hypothesis is that the data is distributed normally. If the Shapirowilk test and Kolmogorov-Smirnov tests contradict, the later test is picked over the former because it is more statistically

sound. Since the p value in both tests of all the variables is greater than the α (0.05), then the null hypothesis is not rejected. Hence the data series of all the variables is normally distributed

Table 4.3: Normality Test

	Kolmogorov-Smirnova		
	Statistic	**df**	**Sig.**
ROA	0.486	53	0.234
Transparency & financial Disclosure	0.326	53	0.112
Board Size	0.408	53	0.207
Ownership Structure	0.394	53	0.179
Board Composition	0.272	53	0.063

Source: Research Findings (2020)

The findings above indicated that data was normality distributed since the p values were greater than 0.05. Therefore, the null hypothesis of normal distribution was accepted meaning the researcher failed to reject the null hypotheses.

4.4.2 Autocorrelation Test

To test for autocorrelation, Durbin-Watson statistic was applied which gave an output of 2.261 as displayed in Table 4.4. The Durbin-Watson statistic ranges from point 0 and point 4. If there exist no correlation between variables a value of 2 is shown. If the values fall under point 0 up to a point less than 2, this is an indication of an autocorrelation and on the contrast a negative autocorrelation exist if the value falls under point more than 2 up to 4. As a common rule in statistics, values falling under the range 1.5 to 2.5 are considered relatively normal whereas values that fall out of the range raise a concern. Field (2009) however, opines that values above 3 and less than 1 are a sure reason for concern. Therefore, the data used in this panel is not serially autocorrelated since it meets this threshold.

Table 4.4: Autocorrelation Test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.559[a]	.312	.293	.0259	2.261

a. Predictors: (Constant), Transparency & financial disclosure, Board Size, Ownership structure & composition, Board composition. Dependent Variable: ROA

Source: Research Findings (2020)

4.4.3 Multicollinearity Test.

This can be defined as a statistical state where more than one predictors are highly correlated in a multiple regression model. It is an unwanted situation for independent variables to have a strong correlation. A combination of variables is said to exhibit high Multicollinearity in case there is one or more exact linear correlation among the study variables. VIF value and Tolerance of the variable were utilized where the values below 10 for VIF and values more than 0.2 for Tolerance imply no Multicollinearity. From the results, all the variables had a VIF values <10 and tolerance values >0.2 as illustrated in table 4.5 suggesting no Multicollinearity.

Table 4.5: Multicollinearity Test

	Collinearity Statistics	
Variable	**Tolerance**	**VIF**
Transparency & financial disclosure	0.392	2.551
Board Size	0.398	2.513
Ownership structure & composition	0.388	2.577
Board size	0.376	2.659

Source: Research Findings (2020)

4.4.4 Heteroskedasticity Test

The study checked for panel level heteroskedasticity by use of the Likelihood Ratio (LR) as indicated in the Table 4.6. This test used the null hypothesis that the error variance was homoscedastic. A chi-square value of 36.48 was produced by the likelihood-ratio test with a 0.0000 p-value. This value was substantial at 1 percent level and in this manner the invalid speculation of consistent fluctuation was rejected meaning the nearness of heteroskedasticity in the examination information as suggested by Poi and Wiggins (2001). To deal with this issue the examination utilized the FGLS estimation method.

Table 4.6: Heteroskedasticity Test

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
Ho: Constant variance
Variables: fitted values of ROA
chi2(1) = 36.58 Prob > chi2 = 0.0000

Source: Research Findings (2020)

4.5 Correlation Analysis

This test establishes the existence of an association between two variables. This may lie between a perfect positive and a strong negative correlation. This study utilized Pearson correlation to analyse the level of association between financial regulations and financial performance confidence interval at 95%, since it is more common in social sciences. A two tailed test was utilized. Table 4.7 shows the correlation analysis outcome.

Existence of a negative and statistically substantial correlation (r = -.483, p = .000, r =

-.218, p = .002) between asset quality and performance was revealed given by both

ROA and efficiency. Further results showed a positive substantial correlation between bank size and banks' performance existed as demonstrated by (r = .260, p = .000, r = .530, p = .000). Bank

liquidity had a positive substantial association with performance shown by (r = .154, p = .037, r = .147, p = .036). Capital adequacy showed a positive substantial impact on performance given by efficiency but an insignificant positive relationship when measured using ROA. Management efficiency exhibited a positive but weak association with performance when measured by either ROA or efficiency.

Table 4.7: Correlation Analysis

		ROA	Transparency& Financial disc.	Board Size	Ownership str. & comp	Liquidity	Board comp	Management efficiency
ROA	Pearson Correlation	1						
	Sig. (2-tailed)							
Transparency& Financial disc.	Pearson Correlation	.087	1					
	Sig. (2tailed)	.239						
Board Size	Pearson Correlation	.110	.167*	1				
	Sig. (2tailed)	.135	.017					
Ownership str. & comp	Pearson Correlation	-.483**	-.218**	.145*	1			
	Sig. (2tailed)	.000	.002	.049				
Board comp.	Pearson Correlation	.154*	.147*	.050	-.103	1		
	Sig. (2tailed)	.037	.036	.502	.163			
Management efficiency	Pearson Correlation	.113	.130	-.045	-.157*	.195**	.279**	1
	Sig. (2-tailed)	.126	.064	.542	.033	.008	.000	
**. Correlation is significa				ailed).				
(2 *. Correlation is sig				ailed).				
level (								

Source: Research Findings (2020)

4.6 Regression Analysis

The Model below presents the results when stock Return was measured using ROA after the regression.

4.6.1 Model Summary

Stock return as measured by ROA was regressed against four predictor variables; Transparency & financial disclosure, Board size, Ownership structure & composition and Board composition. With the values being regressed at 5% significance, the critical value from the F–table was compared with the value from the regression one acquired from the regression. The summary statistics are illustrated in table 4.8 below.

Table 4.8: Model Summary for ROA

Model	R	R Square	Adjusted R square	Std. Error of the Estimate	Durbin Watson
1	.559[a]	.312	.293	.0259	2.261

a. Predictors: (Constant) Transparency & financial disclosure, Board size, Ownership structure & composition and Board composition. Dependent Variable: ROA

Source: Research Findings (2020)

R squared, is the coefficient of determination which shows deviations in the response variable resulting from variations in predictor variables. From illustration in table 4.8 above, this value was 0.312, which meant that 31.2 percent variations in stock return of banks result from variations in the independent variables.

Other variables not considered are responsible for 68.8 percent variations in bank performance. Additionally, the findings showed the existence of a strong strong relation between independent variables performance as indicated by correlation coefficient (R) equal to 0.559. A Durbin Watson statistic of 2.261 indicated n serial correlation in the variable residuals because the value was greater than 1.5.

Table 4.9: Analysis of Variance for ROA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.054	5	.011	16.235	.000[b]
	Residual	.120	179	.001		
	Total	.175	184			

a. Dependent Variable: ROA

b. Predictors: (Constant) Transparency & financial disclosure, Board size, Ownership structure & composition and Board composition.

Source: Research Findings (2020)

ANOVA results produced a value of 0.000 lower than p=0.05. This confirms the sufficiency of the model in predicting how the independent variables affects performance as measured by ROA. Coefficients of determination were utilized in indicating the direction of the relation between the variables. The p-value under sig. column indicated the significance of the relation between the dependent and the independent variables. At 95% confidence, a p-value lower than 0.05 was recognized as a measurement of statistical significance. As such, a p-value greater than 0.05 shows that a weak association exists between the variables. The findings are illustrated in table 4.10 below

Table 4.10: Model Coefficients for ROA

Model			Unstandardized coefficients		Standardized coefficients	t	Sig.
			B	Std. Error	Beta		
1	(Constant)		2.347	7.046		.333	.771
	Board Size (BRD SIZE)	X_1	5.507	1.144	.689	4.814	.041
	Board composition (BRD COMP)	X_2	-24.887	4.813	-.681	-5.171	.035
	Ownership structure	X_3	5.592	3.747	.226	1.492	.274
	Transparency and financial composition	X_4	-3.049	2.342	-.138	-1.302	.323
	Frequency of board meetings	X_5	-1.246	.388	-.499	-3.214	.085

Source: Research Findings (2020)

Stock return = $2.347 + 5.507X1 - 24.887X2 + 5.592X3 - 3.049X4 - 1.246X5 + \varepsilon$

From the Model, the results revealed that when all factors are kept Constant, the stock return will be kept at 2.347. A unit increase in Board size will cause a 5.507 change on stock return when all other factors are kept constant. Similarly, a -24.887 change on stock return is made as result of a unit increase in Board composition when all other factors are kept constant. Furthermore, A unit increase in Ownership structure and transparency would result to a change of -3.049 and -1.246 respectively when all other factors are kept constant. Also, from the coefficients table Board size and Board composition were found to be statistically significant in predicting stock return as shown by p values of less than 0.005. Board Size exceeded the critical value of 1.96 implying a significant influence on the stock return.

4.7 Discussion on results.

In terms of magnitude, the findings indicated that Board composition (BRD COMP) had the highest influence on Stock return, followed by Ownership structure, Board Size (BRD SIZE), Transparency and financial composition, and Frequency of board meetings. The P-Values also indicated that only Board Size (BRD SIZE) and Board composition (BRD COMP) are significant in the bank's Stock Return, while Ownership structure, Transparency and financial composition, and Frequency of board meetings are not significant or linearly related to the bank's Stock Return.

Board Size (BRD SIZE), the number of board directors ranged from 3 to 7. Banks with larger number of board members performed better than those with smaller boards. This can be explained by the fact that bigger boards bring in diversity of ideas and experiences which positively contribute to financial performance. However, there is caution on the size of the board. Very big boards can also be a problem in terms of reaching quality decisions. Some of the decisions end up being compromises and some board members may also become joy riders.

Board composition (BRD COMP), the percentage of non-executive directors had significant but negative effect on financial performance. Firms with boards with a higher percentage of non-executive directors performed poorly compared to those with a smaller proportion. This could be interpreted to mean that the non-executive directors had negative influence or interfered with running of the firms such that they returned poor Performance compared those with smaller percentages of non-executive directors. This could be the reason why CMA's recommendation is one third of the board members as non-executive directors. Firms need to strike a balance between advantages of independence brought by non-executive directors and the disadvantage of interference. It could also imply that it is not just the proportions in terms of numbers but other factors like the expertise the non-executive directors bring into the firm matters.

Ownership structure had a positive but insignificant relationship with stock return. Banks with more insider ownership performed better than their counterparts. However, the relationship was insignificant meaning that how a bank is owned does not seem to influence the stock return of the of banks. However, the results could have been influenced by the respondents who found the question sensitive.

Transparency and financial composition had a negative but insignificant effect on stock return. This could be explained by the fact Transparency and financial composition is regulated in terms of what information is to be disclosed, at what frequencies, timing and mode of communication. For this reason, all firms reported high information disclosure but their financial results were varied meaning that information disclosure did not influence their stock return.

Frequency of meetings had a negative but insignificant effect on stock return. Banks performed well on meetings but still reported varied stock return results meaning that frequency of meetings per se did not influence their financial performance. This could be interpreted to mean that it is not the number of meetings held but the quality of decisions that come out of the meetings. However, the results could have been influenced by the fact that there is some degree of regulation in that CMA regulations require the board to meet regularly.

Findings concur with Sujeewa (2015) who conducted a study on how CG influenced the banks in Sri Lanka in terms of their stock returns. The study used primary as well as secondary data. Interviews were applied to collect the primary data of the research, while the yearly bank reports provided secondary data to the researcher. The study had a target population of 24 profit-making banks and a sample population of 8 commercial banks. The study collected data for the period between 2009 and 2013. To assess the relationship between profitability and CG, regression model was used. In the analysis of data, Panel data analysis was used. The study found that CG impacted Stock returns of banks positively.

CHAPTER FIVE

SUMMARY CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This section discusses the main findings, draw conclusions and make recommendations.

5.2 Summary of Findings

The objective of the study was to determine the relationship between corporate governance and stock return of listed commercial banks at Nairobi Security Exchange.

The study used regression analysis to find the relationship between Board Size (BRD SIZE), Board composition (BRD COMP), Ownership structure, Transparency and financial composition and Frequency of board meetings on one hand and stock return on the other. Forecasting model was developed and tested for accuracy in obtaining predictions. The findings of the study indicated that the model was significant. This is demonstrated in the part of the analysis where R2 for the association was 98%. All the predictor variables were also linearly related with the dependent variable thus a model five predictor variables could be used in predicting stock return.

On board size, the study found that there is a significant positive correlation between Board size and Stock return. This means that firms with bigger boards had reported better performance over the period under study. This is consistent with the findings of Kajola (2008) who found a positive and significant relationship between board size and return on equity. However, the findings are inconsistent with those of Ness et.al. (2010) who found no relationship between board size and stock return. They also contrast those of Yermack (1996) who found that companies with small boards reported better stock returns as measured using financial ratios.

With respect to board composition, the study found a significant negative correlation between board composition (the proportion of non-executive directors in the board) and stock return. This means that banks with a smaller percentage on non-executive directors are likely to have better stock returns than those with a greater proportion of non-executive directors. The findings contrast those of Khan et al (2007) who found that companies with a higher percentage of non-executive directors reported better stock returns.

On ownership structure, the study found a positive but insignificant correlation between insider ownership and stock return. This means that insider ownership has little effect on stock return of a firm. These findings are inconsistent with those of Khan et al. (2007) whose study revealed a positive relationship between ownership concentration and a bank's stock return.

The study found a insignificant negative relationship between Transparency and financial composition and stock return. This means that stock return of a bank is not significantly affected by its level of information disclosure. These findings contrast those of Oyoga (2010) whose study revealed a positive relationship between stock return in a bank and board governance disclosure. However, the findings of this study could have been affected by respondent's desire to appear to conform to expectation when filling out the questionnaire.

According to the findings of the study, the frequency of board meetings had negative but insignificant effect on stock return. This may be interpreted to mean that it is the quality of the discussions in the meetings and not necessarily the number of meetings itself that matters. These findings contract those of Mutisya (2006) and Langat (2006) whose studies revealed a positive relationship between frequency of board meetings and stock return.

5.3 Conclusion

This study sought to test the effect of firm specific corporate governance variables on stock return on listed commercial banks at Nairobi Security Exchange. The results of study are mixed with some variables board size and board composition dictating significant positive relationship, ownership structure revealing a positive but significant relationship while information disclosure and frequency of board meetings revealed negative but insignificant relationship with stock return. The study therefore concludes that only board size and board composition have an influence on stock return. Ownership structure, information disclosure and frequency of meetings do not significantly affect stock return. This means that banks should only consider board size and board composition in making decisions about their board structures as these are the two variables that significantly affect stock returns.

However, there may be other significant factors that affect stock return besides those used in the model.

5.4 Recommendations

The following recommendations are given to both the policy makers and researchers;

5.4.1 Recommendations on Policy

The research findings revealed that some banks who are members of NSE have not fully embraced corporate governance practices and these should be prevailed upon to ensure they fully comply with corporate governance guidelines. Although there is no empirical evidence to suggest that embracing corporate governance will itself improve stock returns, it is expected to combine with other factors to enhance a bank's stock return in the long run.

The study also revealed a major gender imbalance. Only a few banks had women directors in their boards. Although there is no empirical evidence from the study that inclusion of women directors in the board improves stock returns, in future, there may be need for affirmative action to correct this position in line with the current Kenyan constitution.

5.4.2 Recommendations for further research

This study was conducted using primary data and relied on information provided by the respondents. The same study could be conducted using secondary data for comparison purposes to find out whether the findings would be consistent. The study also used ROA as the stock return measure. The same study could be conducted using other stock return measures like Return on Capital Employed (ROCE) and Return on Equity (ROE). Further, the scope of the could be expanded to include in the target population those other firms that trade in the NSE through NSE member firms but are not themselves stock brokerage firms. Since corporate governance is a relatively new field of study, this same study could be repeated in future years to check the impact of new regulations that are continuously being introduced by CMA to govern the operations of stock brokerage and investment banks in Kenya. This study was based on six aspects of corporate governance namely board size, board composition, Chair duality, ownership structure (insider ownership) and frequency of board meetings. Further study may be carried out including more corporate governance aspects in the model for a more complete picture of the effect of all corporate governance aspects on a bank's stock return.

5.5 Limitations of the Study

The study suffered a number of limitations the major one being unwillingness by respondents to fill in the questionnaire as they considered the data requested sensitive. It took several days and persuasion to obtain data from some of the firms.

Secondly, the study relied on primary data provided by the respondents. Given that some of the issues under review are compliance issues, there is a chance that some firms could have given positive responses even where the responses should have actually been negative. The study did not verify the authenticity of data provided.

The study centered on the extent to which corporate governance affects stock return. However, stock return of a firm is affected by many other factors including political, social, economic and technological factors. These other factors that were not considered could have had an effect on the performance of the firms, which effect was not considered in the study.

The study considered only 6 corporate governance parameters but there are many more others which equally affect stock return. For instance, the study looked at mere numbers of board members but not their expertise in terms professional and educational backgrounds and experience. Ness et al (2010), in their study found a negative relationship between financial performance and boards with educators maybe because of limited exposure. They also found stock returns of banks whose boards have more finance people to perform poorly financially contrary to expectation. Tenure in the board was also ignored yet it was found to have a positive relationship with stock return, Ness et al. (2010).

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APPENDIX I

1. ABC Bank (Kenya)
2. Bank of Africa
3. Bank of Baroda
4. Bank of India
5. Barclays Bank of Kenya
6. Chase Bank Kenya (In Receivership)
7. Citibank
8. Commercial Bank of Africa
9. Consolidated Bank of Kenya
10. Cooperative Bank of Kenya
11. Credit Bank
12. Development Bank of Kenya
13. Diamond Trust Bank
14. Dubai Islamic Bank
15. Ecobank Kenya
16. Equity Bank
17. Family Bank
18. First Community Bank
19. Guaranty Trust Bank Kenya
20. Guardian Bank
21. Gulf African Bank
22. Habib Bank AG Zurich
23. Housing Finance Company of Kenya
24. I&M Bank
25. Imperial Bank Kenya (In receivership)
26. Jamii Bora Bank
27. Kenya Commercial Bank

28. Mayfair Bank
29. Middle East Bank Kenya
30. National Bank of Kenya
31. NIC Bank
32. Oriental Commercial Bank
33. Paramount Universal Bank 34. Prime Bank (Kenya)
35. SBM Bank Kenya Limited
36. Sidian Bank
37. Spire Bank
38. Stanbic Bank Kenya
39. Standard Chartered Kenya
40. Trans National Bank Kenya
41. United Bank for Africa
42. Victoria Commercial Bank **Source: CBK (2020)**

APPENDIX II

Profitability Efficiency Matrix

No	Bank	Efficiency	Profitability
1	ABC Bank	96.50%	0.41%
2	Bank of Africa	83.28%	-1.12%
3	Bank of Baroda	62.72%	3.33%
4	Bank of India	71.07%	3.32%
5	Barclays Bank	97.40%	2.63%
6	Citibank	60.48%	3.58%
7	Commercial Bank of Africa	72.84%	2.28%
8	Consolidated bank	99.49%	-2.47%
9	Co-operative bank of Kenya	98.50%	3.24%
10	Credit bank	101.00%	0.72%
11	Development Bank of Kenya	170.76%	2.08%
12	Diamond Trust Bank	86.84%	2.09%

13	Dubai Bank	50.03%	-13.75%
14	Ecobank	58.26%	-1.13%
15	Equity Bank	87.14%	3.65%
16	Family bank	97.30%	0.61%
17	First Community Bank	76.65%	0.05%
18	Guaranty Trust Bank	77.90%	1.03%
19	Guardian Bank	82.72%	1.33%
20	Gulf African Bank	84.87%	1.23%
21	Habib Bank Ltd	74.93%	1.85%
22	Housing finance Company ltd	135.39%	0.39%
23	I&M Bank	96.92%	3.27%
24	Jamii Bora Bank Ltd	130.59%	-1.54%
25	KCB Bank	92.16%	3.21%
26	Middle East Bank (K) Ltd	84.89%	-0.42%
27	M-Oriental bank ltd	100.69%	0.46%
28	National Bank of Kenya	63.46%	-0.20%
29	NIC Plc bank	103.52%	2.32%
30	Paramount Bank Ltd	85.26%	1.43%
31	Prime Bank	76.71%	2.72%
32	SBM Bank	230.80%	-3.89%
33	Sidian Bank	98.86%	-0.24%
34	Spire Bank Ltd	87.56%	-10.05%
35	Stanbic Bank Kenya Ltd	95.97%	2.09%
36	Standard Chartered Bank	71.06%	2.86%
37	Transnational Bank	91.99%	0.28%
38	UBA Kenya Bank Ltd	97.00%	-0.38%
39	Victoria Commercial Bank	106.23%	2.28%
		87.56%	**1.23%**