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**Governance of Banking Institutions in Africa: Perceptions
of Leading Players within the Kenyan Banking Industry.**

Dissertation

For the

Master of Research (Management and Business)

Faculty of Business and Law, The Open University, Milton Keynes, United Kingdom.

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Abstract

Following an agency theoretic approach, this study sets out to investigate how banking institutions in Kenya are governed, using primarily semi-structured interview data. The study is incentivised by inadequate research on corporate governance of financial institutions within emerging economies. Accordingly, the study adopts an exploratory research design seeking to understand how governance is perceived and practiced within banks, together with the impact of corporate governance on performance of the Kenyan banking industry. The findings suggest that corporate governance is perceived differently within various banking institutions. It also emerges that corporate governance is practised along four broad lines within banks in Kenya: (a) board governance; (b) influences from global stage; (c) auditing; (d) shareholders. The results also reveal that corporate governance as considered by participants, boosts the performance of the Kenyan banking industry along three performance yardsticks: (a) going concern value; (b) cost-income ratio; (c) return on earnings. The results evidence some differences between the local institutional characteristics and assumptions founding the Anglo-American corporate governance model adopted in Kenya; where banks with concentrated ownership exhibit mainly principal-principal conflicts rather than principal-agent problems. The study recommends two mandatory independent audits – half-year and end-year audits, in order to enhance the corporate governance mechanism of disclosure, and improve governance and financial performance.

List of Abbreviations

ADB – African Development Bank

AGM - Annual General Meeting

CCG – Centre for Corporate Governance

CG – Corporate Governance

CGP – Corporate Governance Practitioner

CMA – Capital Markets Authority

HIA – Head of Internal Audit

HREC – Human Research Ethics Committee

ICT – Information and Communications Technology

IMF – International Monetary Fund

IT – Information Technology

NPL – Non-Performing Loans

OECD – Organisation for Economic Co-operation and Development

OU – Open University

ROE – Return on Equity

TBL – Triple Bottom Line Reporting

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Chapter 1

Aims and Objectives

1.0 Introduction

This chapter describes the contextual background of Kenya's capital market and the banking industry, and an overview of corporate governance in Kenya. It then describes the problem statement and research objectives, followed by a list of research questions guiding the research. The chapter concludes by explaining on the aim of the research and layout of the dissertation.

1.1 Background Information about Kenya

This study is situated in Kenya, which makes an interesting context for research because the country has initiated necessary features to support corporate governance [hereafter CG], specifically matching those within developed countries e.g. formation of capital market regulatory institutions, implementation of international CG principles, establishment of investor arbitration mechanisms (Musikali, 2008). Although Kenya and the larger sub-Saharan African region recently introduced reforms aimed at improving investor protection and 'good' CG, the East African countries including Kenya were found to have weak investor protection and disclosure requirements rated by the IMF at 4.0 and 3.8 respectively (on a scale of 1 weakest and 10 strongest). This performance is disappointing particularly when compared to OECD countries that stand at an average of 6.0. The IMF thus recommended strict regulations of disclosure and related-party transactions, to enhance transparency and protection of shareholders. The organisation also recommends stiff penalties when directors abuse the CG process (IMF/World Bank, 2011). This is attributed to challenges that Kenya and other sub-Saharan African countries endure including corruption, poverty, political tensions and weak institutions (Kisiangani, 2012)

which hamper the effective implementation of CG. This research is timely given that Kenya recently launched a development programme, Kenya Vision 2030, which seeks to transform the country into middle-income economy. The government has expressed intention to exploit the financial services sector to fund the programme, and also attract more foreign direct investments to contribute to wealth creation and boost economic growth (Kenya Vision 2030, 2011). This study contributes to Kenya's development strategy by looking on ways of enhancing investor confidence, through improved CG in the management of banking institutions.

1.2 Background of the Kenyan Banking Industry

An outline of the background of banking industry in Kenya, which also forms the subject of this inquiry, is provided in appendix 1. In addition, major provisions contained within the Kenyan CG code are explained in appendix 2.

1.3 Statement of the Problem

This research purposes to investigate how CG practitioners within Kenyan banks perceive and practice CG, together with how this influences bank financial performance. This approach deviates from majority of preceding quantitative work which despite offering ability to make predictions and generalise findings, has continuously yielded mixed results, prompting an alternative inquiry into the subject, to allow for in-depth investigation. Overall, the scarcity of CG investigation on banks in Africa, coupled with a need to expand CG research through qualitative approach has spurred the interest in this study.

This research attempts to provide an explanation as to why CG may be seen as a necessary process within banks, as well as gauge senior managements CG actions as described against what is explained in the annual reports. It also evaluates the impact of existing CG guidelines on bank financial performance and eventual shareholder wealth. The study adopts agency theory in interpreting the research data, as discussed in the next chapter. To

my best of knowledge, no prior research has qualitatively investigated the CG of banking institutions in Kenya.

1.4 Research Objectives

- i. Identify perceptions of senior bank executives regarding the role of corporate governance within their banks.
- ii. Explore ways in which bank executives practice corporate governance based on their understanding of the corporate governance process.
- iii. Understand ways in which corporate governance influences bank financial performance.

1.4.1 Main Research Question

How do bank executives in Kenya practice corporate governance, and how does this impact on the banking industry's performance?

1.4.2 Research Sub-Questions

- i. How do bank executives perceive the process of corporate governance implementation?
- ii. How is corporate governance practised within Kenyan banks?
- iii. How does compliance with corporate governance guidelines impact on performance of banking industry in Kenya?

1.5 Layout of Dissertation

The organisation of this research is as follows: Chapter one presents an overview of the research, together with aims and objectives guiding the investigation. Chapter two provides a literature review, identifying gaps which help in generating the research questions listed in chapter one. Chapter two also appraises the theoretical lens adopted, and acknowledges other theories that were rejected. Chapter three accounts for the data collection methods selected, and the basis on which they were preferred over other data collection methods. Chapter four provides details data collection with participants. It also outlines the systematized approach to data analysis, from collection to interpretation. Chapter five delivers interpretation of the findings, relative to the research questions. Chapter six presents a summary of the research findings, and limitations.

Chapter 2

Literature Review

2.0 Introduction

This literature review seeks to justify the appropriateness of an agency approach in pursuing the research, and position the study within contemporary argument. The themes discussed in this literature review were informed by a literature mapping of key publications around the topic area (see Appendix 7). The first section discusses the meaning of CG and a rationalization of the theoretical approach adopted. The second section discusses the interaction between CG and banking institutions. The third section reviews the status of CG research in the African context. The fourth section outlines the role of banking in Africa's economic landscape. The fifth section reviews empirical work on the influence of CG on bank financial performance.

2.1 Conceptual Framework

CG is broadly defined as the way in which corporations are directed and controlled (Cadbury Report, 1992). However, CG has different meanings within various theoretical standpoints that influence researchers. The shareholder-focussed agency theory, perceives CG as structures through which suppliers of capital in a corporation are assured reasonable returns on their investment (Shleifer and Vishny, 1997). Proposed as an alternative view to agency approach, stakeholder theory defines CG as a "process by which corporations are made responsive to the rights and wishes of stakeholders" including employees, creditors, shareholders, and government (Demb and Neubauer, 1992, p.9). Furthermore, the resource-based view argues that CG should focus on the competitive advantage emanating from expertise and skills that board directors, particularly non-executive directors bring a company instead of over-emphasizing on monitoring them (Short et al., 1999).

Specifically this study gives attention to agency perspective, which posits that a firm embodies contracts between the shareholders (principals) as providers of economic resources, and managers (agents) who are trusted with controlling those resources to maximize value (Jensen and Meckling, 1976). This theory addresses the agency problem which arises when “decision making authority is delegated by principals to agents, and the agents use that power to promote their own well-being; which may not be in the best interests of principals” (Band, 1992, p.454). Although agency research has been the most popular paradigm within CG studies (Arun and Turner, 2004), this theory has attracted heavy criticism from writers as Hirsch and Friedman, 1986 (cited in Eisenhardt, 1989, p.57) who claimed that it is narrow and fails to address any clear problems; while Fehr and Falk (2002) argue that it does not account for any existing trust and cooperation between principals and agents. Nevertheless, Band (1992) contends that agency theory has been able to address a fundamental issue - agency problem within corporations, which conventional theories have not addressed sufficiently. Also, Eisenhardt (1989, p.72) emphasize that “agency theory provides a unique, realistic and empirically testable perspective, on problems of cooperative effort”, by offering “richer and more meaningful research” (Adams, 1994, p.11) in understanding “complexities of ensuring contracted agents’ accountability” (Lambright, 2008, p.223).

The researcher believes that agency theory is potentially helpful in understanding the CG situation within Kenyan banks, because of the following factors. Firstly, the institutional environment shaping the implementation of CG is Anglo-American in nature, which Kholeif (2008) argues as embodying agency problems, articulated through conflict of interest between shareholders and managers. Secondly, the potential for agency conflicts is high within Kenyan banks given the mandatory requirement for ‘adequate professional competence and experience’ demanded for senior bank executives under the Kenya Banking Act (2011). To comply, bank owners are compelled to recruit non-owner

professionals to manage their institutions thereby exacerbating the likelihood of agency issues (Jensen and Meckling, 1976). The suitability of agency theory as a basis for pursuing the research is further informed by Ahunwan's (2002) observation that, agency problems are likely to be common in developing countries such as Kenya, due to weak capital markets, existence of information asymmetry and inadequate judicial systems. By employing an agency theoretic lens, this study seeks to understand in depth how bank executives within Kenyan banks perceive the role of CG, and implement the CG code, along with how CG impacts on banking industry performance and realization of increased shareholder value. The study will also make potential contribution to the assumptions of agency theory in emerging countries.

2.2 Corporate Governance and Banking Institutions

While arguing for strong CG regulations in banks, compared to other non-financial firms, Macey and O'Hara (2003) noted that banking firms are unique institutions because of their liquidity production role, potential for conflict of interests between fixed and equity claimants, and an overly liquid asset structure. Zulkafli and Samad (2007) further noted that banks operate under strict regulatory environment compared to non-financial firms, since bank operations are encompassed by numerous moral hazard and information asymmetry issues. They cited the opaque nature of bank operations, and likelihood of insiders to allocate themselves credit as avenues which shareholder value may be compromised. Zulkafli and Samad (2007) maintain that banks require extra policing through effective CG systems, to supplement regulation, claiming that private investors too, have a role to play in promoting CG and easing pressure on government-backed regulations.

As Reaz and Arun (2006) argue, regulators primarily focus on protecting the financial system and give little attention to shareholders' interests. Andres and Vallelado (2008, p.2570) also maintain that, although increased regulation "can be considered as an

additional mechanism of CG”, it imposes bank-ownership controls and restricts banks operations, thereby potentially conflicting with shareholders goal of increasing equity returns. Andres and Vallelado further concluded that, while strong banking regulation is crucial for maintaining a sound financial system, it also reduces the effectiveness of CG mechanisms in dealing with CG problems, i.e. if a regulator’s primary objective is to control for systemic risk, there may be conflicts with shareholders expectations of increased share returns. It would therefore be interesting to listen to bank executives’ experiences in practising CG, together with considerations of how they go about balancing between the shareholders’ interests and regulatory demands. This might help to understand motivations for any selective compliance with the code.

Conversely, Hagendorff et al. (2010) examined the effectiveness of three board monitoring mechanisms: independence, CEO-chair duality, and diversity under different regulatory environments and established that these board characteristics were negligible in affecting bank performance in less-strict regulatory regimes, as they could not prevent value-destroying strategies. These writers’ found board independence and effectiveness to improve shareholder gains within strict regimes. Hagendorff et al. (2010) thereafter concluded that CG mechanisms and bank regulation are not substitutes, but complementary, and called for strict bank regulation for effective board monitoring and increased shareholder value. The findings from this research will ascertain whether Hagendorff et al.’s (2010) argument holds for Kenya. Seemingly, banks benefit from industry regulation in ensuring stability through stern measures and rigorous risk-checks. Accordingly, this study attempts to establish whether obligatory banking regulations in Kenya, deviate from shareholders expectations.

2.3 Corporate Governance in Africa

Amid rising global competition, Africa continually strives to appeal to foreign investors as a worthy investment destination, and Okpara (2011, p.184) calls for African countries to foster effective CG that promotes “managerial excellence and help firms to raise capital and attract foreign investors”. This pursuit of the ‘right’ CG standards has seen many developing countries rush to adopt CG codes that have been designed in developed countries, while others have given in to pressure from international donors who impose CG reforms in exchange for aid (Tsamenyi and Uddin, 2008). Kenya, for instance, officially endorsed a CG code in 2002 that borrowed heavily from the Anglo-American CG model (Musikali, 2008). However, insofar as these reforms were a way of pleasing international donors, their adoption brought hope that a poorly performing African corporate sector was finally rescued. Nonetheless, emerging evidence (Tsamenyi and Uddin, 2008; Wanyama et al., 2009) continues to cast doubt on effectiveness of CG systems in Africa. For instance in Ghana, Adu-Amoah et al. (2008) established that CG systems were ineffective for having overlooked the unique socio-political context of that country. These authors reported huge differences between actual and idealized benefits, and suggested a re-design of CG regulations within developing countries. They argued for African countries to move beyond ‘western’ systems of governance, and factor for peculiarity of local institutional environment – socio-political factors – should they desire to achieve effective¹ CG. Tsamenyi and Uddin (2008, p.10) also maintained that developing countries contexts are “dynamic and problematic”, due to their socio-cultural and political contexts that have the potential to hinder the effectiveness of imported CG models. Additionally, while agency perspective articulates CG problems as arising from principal-agent conflicts, this research recognises likelihood of principal-principal conflicts within privately-held banks where ownership structures comprise large controlling shareholders, usually the founders and

¹ CG is deemed as effective when its implementation achieves the desired outcomes, for instance, here board appointees serve to protect shareholders interests rather than for financial or other payments deriving from holding such role (Reaz and Arun, 2006).

minority shareholders (Chen et al., 2011). Whereas these studies largely focus on shortcomings of ‘imported’ CG codes within African countries, this research seeks to understand how Kenyan banks adapt to local institutional environment in implementing CG. This section relates to the second research question which seeks to explore how CG is practised in banks in Kenya.

2.4 Banking in Africa

Banks in developing countries are vital for economic progress as financial markets are typically underdeveloped, and they consequently occupy dominant position being the chief payment systems (King and Levine, 1993). Therefore, ‘good’ CG practices are argued to have wider implications on the overall economic development of developing economies (Reaz and Arun, 2006; Claessens and Yurtoglu, 2012). Arun and Turner (2004, p.371) call for stronger bank governance mechanisms after observing that “many developing economies have recently liberalised their banking systems through privatisation/disinvestments”. The writers argue that managers of these banks have subsequently acquired a lot of freedom in the way they run their banks, and need to be monitored for any excessive behaviour. Arun and Turner (2004) recommended that developing-countries governments, partially open-up their banking sectors to foreign banks to increase competition and subsequently impart ‘good’ CG on domestic banks. They also suggested that bank managers of privatised banks be gradually introduced to CG practices before divestment. In this respect Kenya, as with other African countries, has had heavy government participation within the banking sector, where government controls substantial stake within the banking industry. Moreover, Kenya’s banking industry dominates the financial sector, as the main provider of finance to the economy as the capital markets are still in their formative stages (Ngugi et al., 2009). This research is also a rejoinder to Roe and Peachey (2008, p.10) observation that “attention given by Kenyan research community to banking issues, and analysis of voluminous amount of banking data already available is disappointing”.

2.5 Corporate Governance of Banks in Africa

Despite few research attempts examining the influence of CG on firm performance, Tsamenyi and Uddin (2008) maintain that there is still a shortage of rigorous CG studies within the African context. Similarly, the African Development Bank (ADB) continues to encourage CG reforms within member countries in addressing weaknesses emanating from weak economic and political systems. Recently, ADB formulated a strategic plan encouraging African banks compliance with CG, with an intention to demand full compliance for financial support. ADB issued a CG Policy in 2007, highlighting the urgency for financial institutions to embrace strong CG practices for managerial excellence, and also for occupying a “key leverage point for mainstreaming CG across other sectors of the economy” when they lend (ADB, 2007, p.6). ADB further noted that adoption of ‘good’ CG principles would help curtail banks from irregularly giving credit based on familial and social networks, thus avoiding risks of defaults that impair performance.

This is particularly opportune because Kenya has in the past experienced a spate of bank failures due to mismanagement and excessive insider lending, which led to collapse of 23 financial institutions between 1984 and 1996 (Waiguchu et al., 1999, p.343). The writers mainly underscore non-compliance to basic management principles, and, poor lending practices as the genesis of those banking troubles. Nonetheless, Kenya was cited by ADB (2007) as having made reasonable progress in promoting CG, making it an interesting case to examine the influence of CG developments on bank performance.

Aboagye and Otieku (2010), in a study on Ghana also noted that between 1976 and 2007, twenty-three banks collapsed although their capital base was higher than 8% recommended by Basel Committee. They attributed the problem to ‘bad’ CG practices within banks, backing a previous Ghanaian central bank report that management incompetence, along with improper accounting practices was the main cause of failure. These researchers later

analysed effects of ownership structures and management attributes on performance, and established neutral association between CG and financial performance. They however emphasized need for the bank owners' to place particular importance on development of board and managerial competencies.

In Uganda, Matama (2008) discussed the significance of CG on bank performance, and claimed that CG contributes over 30% of total bank performance. CG was gauged by mechanisms of financial transparency, disclosure and trust, which were regressed against financial performance as expressed by capital adequacy, asset quality, earnings and liquidity. The author found trust which represented openness and reliability to be the most significant contributor of financial performance; while credit risk disclosure was the only variable found to have negative influence on banks' earnings. Matama (2008) argued that banks should maintain 'proper' governance practices particularly disclosure and transparency which help to build trust with stakeholders including shareholders, and boost firm value. Similarly, Reaz and Arun (2006) earlier claimed that transparency associated with disclosure of financial information, is particularly important in assuring shareholders of the soundness of their investment given the high-risk nature of banking business.

Recently, Nyamongo and Temesgen (2013) used panel data to examine the impact of CG on Kenyan banks performance. The researchers reported that banks are sensitive to large board size, and CEO-chair duality has neutral effect on performance; while presence of outside directors impacts favourably on performance. Nonetheless, these writers' failed to expound perhaps by incorporating primary data, why CEO-chair duality, a contentious variable in CG research (see Dalton and Dalton, 2011) would have a neutral impact on performance. Nyamongo and Temesgen's (2013) findings evidence a shortcoming for recommending Kenyan banks to only 'check' board size and increase ratio of independent directors. Similarly, they discuss CEO-chair duality whilst no evidence shows any bank that had a director holding the two roles simultaneously for the period under study.

2.6 Conclusion

After review of literature, this study has identified agency perspective as most appropriate in guiding the data interpretation process. CG problems were also found to be rifer within developing countries like Kenya. It has also been identified that banking business is heavily regulated, although the influence of regulation on CG effectiveness appears to be a contested area. In addition, the literature casts doubt on effectiveness of CG within developing countries, due to dissimilarities of institutional arrangements with those from which CG originates. This study thereby seeks to identify contextual factors impeding CG implementation, and adaptation measures employed to circumvent such obstacles within the banking industry. The research also aims to understand how foreign banks contribute to CG development within the banking industry. Lastly, the literature review points that CG within African countries is under-researched, with little understanding about it. To effectively address the areas identified in the discussion above, the research questions listed in chapter one will guide the study in locating appropriate evidence to deliver meaningful contribution of the topic under research. The first two research sub-questions have been designed to start with an outlook of CG within Kenyan banking industry, along with the way CG is operationalized. The last research sub-question seeks to examine the influence of CG on banking industry's financial performance.

Chapter 3

Methods of Data Collection

3.0 Introduction

This chapter describes rationale guiding the research design, choice of methods and data collection techniques, along with steps used in data analysis. The first section explains the appropriateness of the research design. The second section discusses the philosophical stance of the research. The third and fourth sections describe the data collection methods, and ethical considerations respectively. The last section describes the methodological limitations of this research.

3.1 Research Design

The research design adopted in this study was informed by the research questions generated from literature reviewed; and elaborates the strategy used to gather appropriate data to answer those questions. The questions are designed to guide the researcher in identifying perceptions constructed by senior bank executives, as unit of analysis; who are key CG practitioners within their institutions, to explore how they make sense of CG guidelines when they implement them. Subsequently, participants' experiences and practices are compared against the banking industry's performance, with a view to understanding how CG may be influencing performance of the banking industry in Kenya.

By adopting a qualitative approach, the study responds to increasing calls for more qualitative research within CG scholarship, citing the need for ensuing research to incorporate extensive fieldwork in order to better understand and document CG practices (Ahrens et al., 2011). Similarly, the qualitative research design has been incentivised by the need for a fresh methodological approach, given the large number of mixed empirical results emanating from preceding, predominantly quantitative CG works (Yoshikawa and

Rasheed, 2009). As Bansal (2013, p.129) argues, qualitative research is best suited to investigate issues in an area “where there exists strong theory, but inconsistent empirical findings”. Using the popular agency perspective, this study aims to employ a qualitative methodology to make a contribution that circumvents the pitfall of inconsistent findings by previous researchers.

For this purpose, the research incorporates in-depth, semi-structured interviews, with view to elicit rich narrations and deeper understanding of the topic under investigation. A sample consisting of six senior bank executives and two key CG stakeholders was carefully selected to allow for closer engagement with participants, in exploring “real-life” CG issues (Zattoni, et al., 2013), as opposed to generalizability usually involved with larger samples. Particulars of research interviewees who participated in this research are outlined in appendix 6, where pseudonyms have been used to protect their identities and that of their institutions. Strict confidentiality is thus ensured as stipulated in the University’s guidelines on research ethics. The interview data collected is also triangulated for evidence through, verification with other official and archival documentation, as a way of ensuring that the research upholds necessary rigor and reaches useful findings.

3.2 Research Approach and Rationale

The community of social science researchers is influenced by two major philosophical paradigms. One paradigm, positivism, considers the world to be external and views reality as being objective. Constructionism, the other stance, contends that reality is neither external nor objective, but socially constructed and given meaning by humans (Easterby-Smith et al., 2008, p.56). Although positivism has an advantage in generalizability of findings, this research forwent that to take advantage of the accuracy and contextual benefits associated with constructionism arguing that, “no empirical method can embrace all three criteria at the same time”, (Kuhn, cited in Zattoni et al., 2013, p.119). Consistent with this argument and to enable reliable interpretation, this study’s sample incorporates a

small number of participants, adequate to provide sufficiently rich data and permit deeper investigation of phenomena. A small sample size is justifiable in phenomenological studies seeking to investigate an in-depth problem, through interviewing in order to capture respondents' experiences (Crouch and McKenzie, 2006).

3.3 Data Collection Methods

Primary data forms the main data component, in the form of semi-structured interviews conducted with senior bank executives, representative from the capital market regulator and a corporate governance trainer. The open-ended nature of the interview questions enabled the researcher to control over the participants' feedback, and help to identify any new constructs regarding the way CG is perceived and implemented within Kenyan banks (Bansal, 2013), and also for laddering² purposes. In addition, field notes were also taken to capture researcher's reflections about interactions with participants' and their behaviour during the interview. Subsequently, the researcher collected secondary data in the form of bank annual reports, and Central Bank publications. This secondary data helps to cross-check the accuracy of the respondents' accounts, and enhance validity and reliability of the findings (Easterby-Smith et al., 2008).

3.4 Data Analysis

This study incorporates both thematic and content analytical techniques, with thematic analysis taking precedence as the research predominantly employs textual data derived from semi-structured interviews. This follows Grbich's (2012, p.20) recommendation for thematic analysis as a preliminary analytical procedure for qualitative interview data. Here, the interview data was transcribed into textual format before reducing it to patterns, which helped to understand respondents' opinions regarding their perception of the phenomena of CG and bank performance.

² Laddering - technique used by researchers to 'get more' from a question, by helping the respondent move from descriptive accounts to revealing the individual's value base (Easterby-Smith et al., 2008, p.146).

Subsequently, a content analysis was conducted through systematic review of documentary evidence including annual reports, bank websites and other archival documents. Curry et al. (2009) suggests that documents and other written materials are valuable sources of secondary data, an understanding of which helps in listening to respondents' accounts, and enhancing the understanding of transcribed data. This research therefore analysed secondary data for the three years, 2010-12, approximately a decade since the adoption of CG in Kenya (see appendix 2). This time period avails good opportunity to appraise the workings of CG within Kenyan banks, and make relevant and timely recommendations to policy.

3.5 Ethical Considerations

In line with ethical requirements guiding thesis research at the Open University, high ethical standards were observed at every stage of the research process in order to preserve the integrity of the research, and professionalism on the part of researcher. The researcher complied with all ethical guidelines by The Open University's Human Research Ethics Committee (HREC). Elaborate planning and constant consultation with supervisors culminated in the timely application of an ethics approval from HREC, which was granted a favourable opinion before the fieldtrip to Kenya (Appendix 3).

Moreover, the researcher has continued to safeguard the rights of the research participants through anonymization of their identities throughout this research. Also, confidentiality of data collected continues to be protected to maintain the trust bestowed on the researcher. The researcher has also maintained high degree of objectivity in order to minimise likelihood of researcher bias. A complete and more explicit description of ethical considerations taken into account in this research is provided in Appendix 4.

3.6 Methodological Limitations

This research has used a small sample size, due to time constraints within which the research fieldwork was planned and conducted. Careful sampling of data nonetheless enabled for representation of the banking industry in Kenya. Secondly, the purposive sampling procedure used in this research diminishes the generalizability of findings across other African countries. Future researchers seeking to conduct qualitative research and generalise their findings may benefit from use of mixed methods through incorporating quantitative data to permit larger and random sample sizes (Punch, 2005, p.187).

This being a qualitative research, the interpretation of findings reached may possibly be subject to other interpretations (Kunes, 1991, cited in Creswell, 2003, p.149). For instance, besides the implementation of CG, other factors such as favourable government policies and stable macroeconomic environment during the period under investigation may also have contributed to improved financial performance of banks, as shown in the data interpretation chapter.

Chapter 4

Collecting and Analysing the Data

4.0 Introduction

This chapter begins by describing the methods employed in collecting data, and afterwards discusses the data analysis techniques. At the end of this chapter, the researcher aims to account for the process followed in collecting data from participants, and also explain and justify the technique adopted in analysis of that data. This chapter thus seeks to develop the data collected into suitable form for interpretation so as to build an effective argument about the research.

4.1 Collecting the Data

The main consideration that motivated the adoption of qualitative approach in this research was its unique advantage in capturing human experiences in both spoken and written representations. Additionally being a qualitative research, this study benefited from the ability to use multiple sources of data comfortably (Punch, 2005, p.168). To this effect, this study predominantly used in-depth semi-structured interviews as the main data collection tools. Subsequently, documentary evidence in the form of secondary data was gathered from respective banks annual reports, central bank publications and media articles.

4.1.1 Sampling Procedure

This study adopted a deliberate sampling technique, where the researcher made decision regarding the participants to include in the sample, based on their wealth of experience about the topic of research, and willingness to contribute to the study. These individuals are active participants in the banking industry and the Kenyan corporate governance landscape, and were therefore deemed to be well placed to provide sufficiently rich information. Nonetheless, out of the initially identified interviewees, three interviews did

not materialize after the potential respondents declined to participate. This prompted me to approach the Kenya Bankers Association, an umbrella body of banks in Kenya, to enlist their support in my research. After a personal introduction to the Association's director for research, I explained the purpose of my research, and discussed the University's ethical guidelines governing the research.

During the discussion, the director agreed to send an email communication to member banks notifying them about my research fieldwork, with an appeal to accord me necessary support when I call on them. Nevertheless, the decision to participate in the research remained at their discretion. Given the limited timeframe within which to conduct the fieldwork, I was able to arrange for interviews with six bank officials from large private and public banks in Kenya. To get a broad view about the mechanics of CG in Kenya, opinions from other CG stakeholders – the Centre for Corporate Governance (CCG) and the Capital Markets Authority (CMA) were sought. CCG drafted the first CG guidelines that were later adopted by the government, while CMA is an autonomous institution which regulates the capital markets in Kenya, and enforces the CG code. Although the initial plan was to interview a respondent from the Central Bank of Kenya, the decision to include respondents from CCG and CMA was taken as an adaptation measure in response to refusal for interview, after contacting two different officials from the Central Bank who declined to be interviewed at the last minute without explanation (see appendix 5). This might be interpreted as an indication of how sensitive bank governance issues may be perceived within some institutions.

4.1.2 Primary Data – Semi-Structured Interviews

To answer the research questions sufficiently, the researcher conducted in-depth interviews with the intention of identifying how key actors within the Kenyan banking industry, perceive and practice CG. Face-to-face interviews were preferred over other data collection tools such as questionnaires because of the flexibility they offer in probing more deeply to

identify new leads, and explore new facets of phenomena; and intend to gain good understanding of participants' accounts of their lived experiences (Burgess, cited in Easterby-Smith, 2008, p.144).

Accordingly, eight interviews each lasting approximately 50 minutes were conducted with senior officials from six banking institutions, as well as CCG and CMA being leading players in supporting the development of CG in Kenya. Discussions with the research participants sought to understand how CG is perceived and practiced, together with how the process of CG influences bank financial performance. The researcher believes that a sample size of eight participants is sufficient to achieve the objectives of the research. This surpasses Guest et al.'s (2006) recommendation of six interviews on average, for phenomenological studies such as this investigation.

The semi-structured interviews were guided by an interview schedule (see appendix 8) that was sent to the participants ahead of the interview date, in order to allow them time to gather any information necessary to provide sufficient responses. In order to maximise from the conversations, the researcher adopted a personalised approach to interviewing, where each sampled banks' annual report were analysed before the interviews were conducted.

The interview questions were designed to elicit information around three broad areas:

- Respondents perceptions of corporate governance
- Implementation of corporate governance
- Corporate governance impact on performance

To improve the interview outcome as suggested by Easterby-Smith (2008, p.147), the researcher consistently observed the following practical issues: (i) a focus upon building trust with interviewees by assuring them that the interview data shall not be misused, and shall be used solely for academic purposes; (ii) use of simple language devoid of any

theoretical or technical concepts during the interviews; (iii) interviewees were given liberty to choose their preferred interview location, and all but two chose to sit in their offices, with the two preferring a hotel as neutral setting; (iv) interviews were tape-recorded to enhance the listening process and maintain clarity of the conversations. However, three interviewees declined to be tape recorded and this prompted me to balance between the interview discussion, and noting down brief answers of the questions asked.

All interviews began with an introduction of the researcher together with reasons for conducting the interview, and then the interviewee was given a copy of the *research consent form* where informed consent and permission to tape-record the interview was sought after careful review. Appendix 4 provides a copy of the research information and consent form used for this research.

4.1.3 Secondary Data – Documentary Data

Together with the semi-structured interviews, this research further used documentary evidence such as bank annual reports, Central Bank publications, and newspaper articles along with information from banks websites. Critics of secondary data (Wall et al., cited in Easterby-Smith, 2008, p.225) argue that it lags behind time, i.e. between publication dates and time research is conducted; plus the likelihood that corporate priorities may have changed during research. Nevertheless, this research capitalizes on the benefit of secondary data as a rich source of supplementary evidence to the interview conversations (Punch, 2005, p.184).

4.2 Data Analysis

4.2.1 Analysis of Interview Data

Transcription of interview discussions was the preliminary step in data analysis, where interview conversations were converted into textual data for ease of interpretation. As the study sample was relatively small, the researcher chose to manually transcribe the interviews in order to sufficiently acquaint himself with the data. Concordant with conventions of qualitative research (Rossman and Rallis cited in Creswell 2003, pp.181), this study adopted a more inductive approach in analysing interview data, remaining not only faithful to interviewees' opinions but also capturing the dynamics of context and time (Easterby-Smith, 2008, p.173).

Cognizant that there are several ways of analysing qualitative data (see Easterby-Smith, 2008, p.172); the researcher adopted thematic analysis in interrogating the interview data thereby articulating interviewees' expressions, in a more holistic manner that lacks in many quantitative studies. Thematic analysis is also argued to be an 'independent and reliable' approach to qualitative data analysis (Vaismoradi et al., 2013). Nonetheless, thematic analysis is criticized for its flexibility, which may result to multiple interpretations and impair consistency. To overcome this shortcoming, the researcher constantly referred back to the theory to enhance the outcome of the analysis process (Braun and Clarke, 2006).

The researcher adopted the generic analytical framework outlined below, in conducting qualitative thematic analysis, as recommended by Creswell (2003, p.191). Cicon et al. (2012) used thematic analysis and recognized its advantage in identifying broader CG themes besides the provisions included within national CG codes.

Table 1: Thematic Analysis

Step	Description
<i>Step 1: Organizing and preparing data</i>	Interview data collected and transcribed into text, in preparation for analysis.
<i>Step 2: Getting acquainted with the data</i>	Researcher reads through transcribed data trying to identify and link emerging concepts.
<i>Step 3: Data reduction</i>	Categories identified were grouped by common meanings, and thereafter assigned codes.
<i>Step 4: Describing themes</i>	Categories under each code were assigned a theme, and connected into a storyline to give detailed description backed by evidence from respondents' verbatim.
<i>Step 5: Reporting</i>	Meaningful patterns identified from the preceding stage, and relating to particular concepts of phenomena were then reported in narrative form.
<i>Step 6: Data interpretation</i>	Finally, the interview data collected was interpreted to answer the research questions following the theoretical lens adopted, and backed by prior research findings.

Given the massive amount of data collected during the research fieldwork, the coding process in data analysis helped the researcher to extract the important segments of participant feedback which were relevant to the study's research questions, based on the meaning they carried. For example, the following is an extract from one of the interviews conducted during the research fieldwork:

Researcher: What are your general views regarding the state of corporate governance in the Kenyan banking industry?

Respondent (CGP2): Generally good but there is still room for improvement. Banks are closely supervised [**“regulation”**] by CBK and for those that are listed, good governance practices are inevitable. Unfortunately, most banks just comply with the minimum regulations required by the CBK and very few companies take their own initiative towards adopting CG. But, I must say that CG has really helped us because we have not seen any major crisis in this industry in the recent past...the non-performing loans [**“non-performing loans”**] are now within manageable levels because of the rules such as the one

limiting directors' borrowing which was the single biggest cause of bank failures in the past due to excessive insider lending (codes assigned: PCG-R; FP-NPL).

From the excerpt above, two labels/codes were attached, PCG-R and FP-NPL. For the first code, 'PCG' stands for 'perception of CG' while 'R' stands for 'regulation'. For the next code, the first and second sets of letters are abbreviations of 'financial performance' and 'non-performing loans' respectively'. The names used in coding the data were picked from CG literature so that they could reflect the disciplinary perspective (Creswell, 2003, p.193). To further explain on the coding process, we can see respondent CGP2 observing that CG has achieved some relative level of success within the banking industry because of intense supervision by the regulator. The word regulation is the code that has been inserted to capture the meaning of that feedback to help in answering the research question. Still in the excerpt above, the respondent narrated that CG has helped the banking industry to control losses resulting from non-performing loans. The researcher has therefore used the code non-performing loans to represent one of the ways in which CG impacts bank financial performance. This process was performed iteratively for all the interview transcripts, where common codes were merged to form categories, which best answered the research questions set out in this research. The categories were further condensed into themes which helped to make sense of the research data. Appendix 9 illustrates a framework of the various codes and categories that emerged from data, together with their culminating themes which assisted in answering the research questions.

4.2.2 Analysis of Documentary Data

Secondary data, mainly annual reports and CG content from the banks websites was regularly reviewed both before, and after data collection. Review of secondary data ahead of the interviews helped to enhance the quality of the interview questions, by selecting the right questions to ask, together with an awareness of the answers to expect. This follows Curry et al.'s (2009) suggestion that documents and other written materials are valuable

sources of secondary data, which help in listening to interviewees' accounts and enhance understanding of transcribed data. The qualitative content analysis permitted the inspection of various sources of documentary data i.e. annual reports and websites, to identify how CG matters are communicated within banks, together with any influence this had on performance. This provided a basis for identifying discrepancies between what banks reported to be doing, against respondents' accounts of what they were actually doing.

Thus, inclusion of documentary analysis also contributed to enhanced reliability and internal validity of the findings, where secondary data was used to "make sense of the interviewees' reality and meanings" (Creswell, 2003, p.204), thus developing an accurate understanding of CG phenomena. This study will thus give a better insight about the way CG is understood by CG players within Kenyan banking industry.

4.3 Ethics in Collecting and Analysing Data

The researcher was consistently aware of all ethical obligations associated with the nature of this research. This follows from training gained from MRes tutorials, and other research training workshops where emphasis was placed on need to maintain good ethical practices. To avoid the ethical pitfalls associated with qualitative research, informed consent was particularly emphasized and respondents were voluntarily requested to participate in the research after full awareness about the research was made. In order to maintain mutual trust with the participants, the researcher has kept the responses from interviewees confidential, firstly by keeping the information in a secured server, and anonymising the interviewees' identities. Finally, the researcher endeavours to uphold an ethically responsible conduct (Silverman, 2011, p.87) in researching, by limiting the motive of this research to academic contribution and policy improvement than self-interests. Although no immediate benefits will be accrued by the participants, the researcher believes the effort has contributed to a better understanding of CG practices in the Kenyan banking industry, and identified ways through which CG may be further improved.

Chapter 5

Interpreting the Data

5.0 Introduction

This chapter provides an interpretation of research data in response to the research questions outlined in chapter one. The researcher aims to elucidate how key CG actors within the banking industry perceive and practise CG. The chapter closes by looking at what this means for bank financial performance. Quotes from interviewee accounts and the findings of pertinent CG studies have been included in the interpretation to support the argument of the researcher.

5.1 Broader Perspectives of Governance

Research question 1: *How do bank executives perceive the process of corporate governance implementation?*

Firstly, to fulfil the objectives of the research, this section reflects on the relevance of data to the first research question. The first two sections below provide interviewees' understanding of CG from theoretical and 'local' perspectives respectively. The third section delivers the relationship between regulation and governance. The fourth section looks at the sense that interviewees attach to CG and performance link. The final section shows how board governance is regarded in the banking institutions.

5.1.1 Meaning of CG

The research fieldwork began by seeking to find out what CG meant for the interviewees. In this regard, the most striking revelation was the observation that, behind the well-crafted CG statements about the way banks' define and practice CG, interviewees' accounts

presented contested understandings of CG. For instance, recalling the costly bank collapses of 1980s and 1990s in Kenya, a respondent remarked as follows:

In my opinion, good CG entails accountability and transparency; two main ingredients for the successful running of any business (CGP1, CMA).

Other notable meanings attached to the concept of CG by various respondents include:

CG are control mechanisms meant to help shareholders keep vigil of their funds...ensuring they're utilised in their best of interests...CG helps to attract and sustain investor confidence through assurance that their money is in right hands...(CGP2, domestic listed bank).

...CG entails structures necessary for proper running of a business...touching on all people not just the top management...it brings uniformity and order in the way business is conducted (CGP3, foreign private bank).

Interestingly, the interviewees' understanding of CG as narrated in their accounts tends to reflect the ownership structures of their institutions. For instance, the last two excerpts above suggest how a quoted bank's approach to CG may differ from a privately-owned bank. Respondent CGP2 for instance, who is from listed bank, defined governance as revolving around shareholders and top management; while respondent CGP3 saw CG as mainly guidelines for the general running of a firm.

CG is a measure that provides lifeline to poorly performing businesses so that they can be able to get back on their feet (CGP4, domestic private bank).

Whereas the overarching opinion depicted CG as a tool for corporate control, interviewee CGP4, identified CG to be a *panacea* mainly for struggling businesses, rather than an indispensable norm in the day-to-day running of a bank. This shows that some bank executives understand CG mainly from a strategic perspective, perhaps oblivious of the significant operational implications associated with CG. The account of interviewee CGP4 above might also be interpreted to suggest that CG is still a little known concept in the Kenyan corporate sector, as discussed in the next section.

5.1.2 Corporate Governance: A Foreign Concept?

The other sub-theme that emerged from the broader conceptualization of governance by majority of the interviewees opined CG to be a foreign ideology. Interestingly, despite the official adoption of CG by the government, more than a decade ago, CG is seemingly still viewed as a foreign standard that has little relevance to Kenya's corporate sector.

CG is still seen as a foreign concept that is less appreciated within many privately-owned banks...if you look at some of the family-owned banks around, telling them to bring outside directors' makes them anxious of losing control of a business they have built from scratch (CGP5, large private bank).

Majority of the respondents noted that CG requirements regarding disclosures and board independence are seen as intrusion to otherwise closely-held family/ethnic business interests, in a country where many banks are in the hands of private owners. This discussion evidences divergence of local institutional characteristics from the basis upon which Anglo-American CG model is premised. The agency implication in this instance thus shifts from principal-agent scenario to principal-principal conflict apparent within developing countries (Renders and Gaeremynck, 2012); where majority shareowners through familial shareholding might exploit minority shareholders.

Another interviewee added that:

Historically, we did not have CG...this thing is still in the nascent stages with many people gradually implementing it (CGP2, domestic listed bank).

This shows that CG is yet to fully integrate with the business culture and corporate structures in the banking industry, which may indicate a need to do a CG review to identify areas of misalignment, and make necessary customization for quick adaptability within the industry.

Although CG has been around for almost a decade now, it is still a relatively new concept to many companies in Kenya (CGP1, CMA).

Corresponding to the view above, respondents from domestic banks saw CG as mainly a preserve for multinational banks and other listed companies, which has little to do with their banks. The slow uptake of CG within the banking sector is therefore not surprising, given the fact that private banks dominate the banking sector, with listed banks constituting a very small proportion of the industry.

Nonetheless, there was a common view that albeit the exotic perception of CG, the banking industry has made significant steps in implementing key CG mechanisms compared to other sectors of the economy. This was attributed to intense regulation and enforcement by the regulator, a factor opined by the interviewees to be the main expediter of CG. This is elucidated in the next section.

5.1.3 Regulation and Governance

Debate has persisted on how much intervention a government should apply in the banking industry, which protagonists contend that effective bank CG requires regulator involvement (Mullineux, 2006), with critics charging that regulator motives diverge from the wishes of the bank owners (Caprio et al., 2007). For the respondents, the role of regulation in safeguarding CG was perceived as follows:

It is better if government intervenes in enforcing CG adoption...regulation is a sure way of ensuring a level playing field (CGP5, large private bank).

Another interviewee had this to say:

...why set up additional departments or hire extra outside directors to be just sitting and taking allowances? These are avoidable costs that people would do anything to prevent...if you remove the regulatory push, this bandwagon will slow down because it has cost implications (CGP3, foreign private bank).

The interviewees commonly noted that the active regulation of the banking sector, and which lacked in other non-bank industries, has led to increased adoption of CG within banking institutions.

While linking the high CG compliance levels within the banking industry to regulatory enforcement, another interviewee summed up that, banks are obligated to conform to certain standards to avoid the hefty fines and penalties that non-compliance attracts:

...for the banking industry, the regulator is strict, they have set rules of the game on what should be done by every bank as a minimum. If you're required to do something and you fail, there is a penalty, and it is not small money, usually to the extent of half-a-million shillings, and sometimes a million shillings...(CGP4, domestic private bank).

The statement above suggests that enforcement is the greatest driver of CG uptake within the banking industry, without which majority of the banks might not comply with CG. This explains the second research question that, many banks practise CG in order to avoid hefty fines or their boards being reprimanded by regulators.

Generally, based on the evidence from respondent feedback above, CG still appears not to have evolved to the levels where it can be left to market forces as a driver for compliance within the Kenyan banking industry. The mainstream opinion as narrated by interviewees is that, CG lacks an impetus of its own, and thus requires regulatory support. This agrees with Hagendorff et al. (2010), argument that regulation is complementary to CG, where it enhances shareholder wealth through effecting key CG mechanisms such as board independence, and monitoring roles. Not least, the interviewees' accounts testify that where CG is intertwined with banking regulations, the bank executives are obliged to implement those guidelines.

5.1.4 Corporate Governance and Performance Nexus

The influence of CG on firm performance has been riddled with conflicting views where advocates of CG (Bhagat and Bolton, 2008) cite favourable association between the two, while gainsayers (Brown and Caylor, 2006) argue that certain CG mechanisms have negative effect on performance. The respondents too shared diverse opinions regarding

their perceived value of CG on performance, implying that CG is still a contested subject. Though no respondent suggested negative association between CG and performance, deeper discussions showed their perceived impact of CG on performance ranging from a strong and direct to a near neutral links.

...CG brings proper structures that are necessary for proper running of the bank, with accruing benefits following later...if we have two banks where one adheres to good CG and another lacks proper CG structures, the former will have consistent performance while the latter will show a very erratic performance...(CGP5, large private bank).

This statement reflects the view amongst a section of interviewees that CG helps to not only improve performance but also achieve sustainable growth. The actual impact of CG on performance was cited as more visible in the long-run rather than instantaneous. For instance, interviewee CGP5, cited that good CG helps their bank to manage performance through ‘bad times’, while banks without proper CG structures stand to report decent performance only during boom times. Further reflection on the link between CG and performance shows CG as insurance that guarantees shareholders consistency of returns from their investments.

Similarly, another interviewee noted:

...there is a very strong link between CG and performance...CG is a check on a number of factors that can hamper performance if not restrained like conflict of interest, insider lending, and misappropriation of a bank's assets...all these factors if not checked could greatly hurt and even bring a big bank to its knees...(CGP6, CCG).

These interviewees appreciated that CG has a big role to play in improving performance and long-term survival of banking institutions.

Nonetheless, contrary views emerged where some interviewees narrated that no direct linkage exists between CG and performance. The lack of direct link may arguably indicate

that the influence of CG on performance is more visible in the longer-term rather than short-term. This group of respondents seemed to agree on one thing – although they don't dispute the need for good CG within banks, it has been *glorified* so much, as a 'magic touch' to business success, perhaps in an attempt to endear it to many managers:

...CG and performance have a negligible link...CG as a driver of performance? I would call it a constant that is on the far-end of the performance equation...the contributing effect is minimal...it's a negligible constant in the current environment (CGP3, foreign private bank).

During discussion, interviewee CGP3 claimed that CG has a long way before it can be directly attributed to performance within the banking industry. As narrated, a majority of the banks continue to report increased profitability, not because of CG but a growing number of Kenyans who continue to open bank accounts in a country where a large segment of population is still unbanked. This indicates that CG may possibly not be considered a priority within some banks since they still report good performance, thus lacking motivation to voluntarily embrace CG beyond the threshold required under law.

Surprisingly, a respondent observed that some local banks continue reporting impressive performance while lacking strong CG structures:

...some banks don't follow proper CG structures but they still perform well...most indigenous banks have backers...mainly people from a particular tribe or community who will always take their money to the bank and would die with it (CGP2, domestic listed bank).

In light of this remark, there may be suggestive evidence to explain why some domestic banks would appear cautious towards implementing CG, as compared to their foreign peers. These banks, as noted have an affiliation with certain tribal groupings which form a bulk of their customers and perhaps investors; and who will take their money to 'their'

banks with CG being the least of their concerns. This proposition opens a possible avenue for future research on whether socio-cultural factors inhibit the applicability of CG in Kenya.

Another respondent reported that indigenous banks outperform big foreign-banks perceived to have strong CG (see Juma, 2013), implying that there might be a dull side to CG. Alternative argument as to why foreign banks financial performance is overshadowed by domestic banks, despite being viewed as having advanced CG structures, might be interpreted to mean that CG may only be a factor among many that influence the performance of banks in Kenya.

5.1.5 Board of Directors

Under agency theory, an effective board is assumed to result in a contented principal, who must formulate an efficient contract to attract and retain the best agents and win their dedicated service (Eisenhardt, 1989). As to the role that boards should play in banks the respondents' views were quite varied.

...our board gives strategic direction...they decide we're going regional, and identify the country to venture into, and at what level...buying an existing institution or starting from zero...How much money to lay for that investment...(CGP4, domestic private bank).

Another view saw the board as a key link to getting business.

We didn't have outside directors before...but after the requirement for independence came into force, we went out looking for people who have a name...we can associate with them, and they can swing business to the bank because of the network they have...(CGP5, large private bank).

The above statements show that various banks tend to have different motivations when they set to fill board positions, perhaps consistent with their organizational objectives.

Some banks go for individuals who will network them with other businesses; while others seek professionals to steer them to greater growth and performance.

Also, the average age of most boards, as one interviewee stated, ‘previously dominated by retirees’ is falling as banks seek younger, more qualified individuals unlike in the past, when one’s status in society was the main basis of appointment.

...there has been a lot of push to get young people with expertise into boards...people are resigning as CEOs to become board members for purposes of ensuring that they can interrogate the management (CGP3, foreign private bank).

This was summed up by a local leading business newspaper as follows:

...CEOs, chief financial officers, and chief marketing officers...and serving managers are increasingly retiring to take up new boardroom roles in banking...(Ngigi, 2012).

This change of jobs according to the publication is as a result of rise in directors pay, which has seen banks ‘race to tap talent with deep knowledge of the business’ (Ngigi, 2012), amid heightened competition within the industry from more foreign banks. Expectedly, foreign banks entry in developing countries spurs competition and drives domestic banks to emulate ‘good’ governance (Arun and Turner, 2004).

For board size, the interviewees commonly agreed that while bigger boards might increase agency costs, decision making process wouldn’t be problematic with the right minds, as committees do much of the work with the board only having to ratify them.

...there is no universal board size. The nature of bank’s business is the main determinant of board structure...the size of a bank also determines the number of board committees (CGP1, CMA).

The above discussion challenges Nyamongo and Temesgen’s, (2013) conclusion that [unspecified] bigger boards adversely affect bank performance in Kenya. The respondent noted that banks usually tend to have larger boards than non-bank companies. Banks might

also have large boards due to Central Bank's mandatory requirement of four committees (Central Bank of Kenya, 2013), two extra committees compared to non-bank firms.

Regarding directors pay, interviewees cited that while there was a misconception that bank directors are overpaid, which may imply higher agency costs; the high pay was justifiable on two grounds. First, requirement for bank boards to be independent means most directors do not own shares in the banks they serve, and monetary remuneration was the other way they are paid. Also mentioned was the frequency of board meetings, necessitated by the nature of banking business.

Kenyan banks held on average 20 meetings apart from bank XXXX where directors had about 40...companies in other sectors held fewer than 15 board sessions, with those sitting in bank boards generating outsized fees (Omondi, 2011).

This shows that bank boards, unlike companies in other economic sectors, have wider roles and responsibilities, and indicatively high expectations bestowed upon them by the bank owners and government in steering their institutions to prosperity. This might also be interpreted to mean that whilst the frequent board meetings may raise agency costs, the bank owners benefit from improved performance, as directors' keep the management in check, ensuring that they perform to increase stockholder wealth (Zahra and Pearce, 1989).

5.2 Key Considerations in Maintaining CG within Banking Institutions in Kenya

Research question 2: *How is corporate governance practiced within Kenyan banks?*

5.2.1 Board Governance

All interviewees unanimously acknowledged that bank boards are pivotal for CG progress, and have the onus of ensuring appropriate CG is maintained. It was thus commonly agreed that an effective and properly constituted board was necessary for ‘good’ CG to flourish, as only a CG receptive board would enhance governance in their institution.

Remarks of initiatives taken to maintain ‘good’ governance included, board independence as narrated:

...in the past we never had independent directors, but today we have two and we're in the process of hiring additional independent directors...(CGP2, domestic listed bank).

...we're trying to increase board independence, how we're doing this is by having more non-execs on the boards, someone who has no stake in the bank and is purely independent...(CGP5, large private bank).

The interviewees stated that their institutions were appointing more [qualified] non-executive directors who could objectively interrogate the management, and by so doing fulfil their role of monitoring management behaviours (Eisenhardt, 1989).

Another approach mentioned by respondents in implementing CG was scouting for more directors who had vast expertise in risk management.

...the governance of banks is unique in the sense that we hold money entrusted to us by our customers...we take the risk. Because of that element of risk, whoever sits on the board of a bank must be able to understand that...(CGP4, domestic private bank).

...bank boards including the MDs should be financial experts and risk management professionals...our bank has tried to hire more directors into the board with these skills...risk management skills are especially important because the market is changing very fast (CGP2, domestic listed bank).

The above accounts indicate that risk is a significant consideration for boards in the banking industry in Kenya, and an effective board is expected to possess risk management know-how. Deeper conversations with interviewees disclosed that many of the risks the banks faced largely touched on customers - depositors and borrowers; showing that bank directors in Kenya have to balance between shareholder and customer interests (Macey and O'Hara, 2003). This indicates a shortcoming of Agency theory, which exclusively advocates for shareholder interests as the sole concern for directors (Eisenhardt, 1989). Thus, this theory needs to be further refined to reflect the broader fiduciary responsibilities of bank directors, unlike their non-banking firm counterparts, owing to the fact that non-shareholder constituencies supply more capital to banking institutions than the shareowners (Reaz and Arun, 2006).

Also cited to help in maintaining CG by the banks is subscribing directors to the Kenya Institute of Directors³, where they're constantly trained on governance and strategic leadership skills. The respondents also recognized the contribution of director trainings and seminars as another avenue through which 'good' CG is nurtured within the Kenyan banking industry.

...there are also continuous trainings of our directors in order to enable them discharge their board responsibilities more effectively...they are also reminded and

³ Institute of Directors (Kenya) - professional organization of individual corporate directors committed to principles of good governance and professional practice of corporate directorship in Kenya (see <http://www iodkenya.co.ke>).

made to understand the expectations, and functions of the board committees they serve in...(CGP5, large private bank).

...bank directors go for constant training, otherwise management may be ahead of them and their contribution in the bank may become irrelevant...our bank takes board members for continuous CG and leadership training as far as UK & South Africa. We also engage re-known management trainers locally...(CGP2, domestic listed bank).

Although frequent directors' trainings were considered to have been important in the development of CG, some respondents narrated that the content discussed during the seminars tended to be far too 'exotic'.

When we go for seminars, you find the case study is so far-fetched. The examples discussed do not fit within the local business context...directors' seminars should incorporate local and regional examples...(CGP5, large private bank).

Other notable initiatives cited by the respondents as boosting board governance, and helping to maintain CG in banks are highlighted next. Respondents opined that their boards met more frequently, a thing they attributed to the impressive aggregate performance of the banking industry in Kenya. They noted that this allowed their boards to deliberate on any emerging issues, and respond swiftly to new threats or business opportunities. This view is synonymous with Ngigi (2012), who noted that banks in Kenya had on average 20 board sittings, against a statutory requirement of 4 meetings per year.

...some Kenyans are returning from diaspora with a lot of experience having worked in leading organisations in UK, South Africa and USA...and taking up responsibilities in big local banks...where they are helping to sort things out...(CGP2, domestic listed bank).

This return of highly-skilled Kenyans, with experiences from the global stage has also been attributed as a significant factor in propelling CG within the banking industry.

5.2.2 Influences from Global Stage

Besides regulatory enforcement, respondents also cited interactions with international institutions to be a significant driver of CG within the banking industry. As narrated, this pressure emanated from the presence of foreign banks in the Kenyan banking industry, and desire to win business deals with foreign firms that demanded certain CG threshold.

...we partner with organisations outside the country, who through our bank invest in this country; they cannot come straight and invest, they will loan us money which we in turn loan out to our customers. What helps us to win their confidence is by having good governance (CGP4, Local private bank).

As respondent CGP4 stated, Kenyan banks have been under pressure to adopt 'good' CG so that they can appeal to other financial institutions overseas which use CG as a criteria before they can do business with a local bank.

Another interviewee, stated:

...we're intending to begin sustainability reporting...the good thing about sustainability reporting is that it has a lot of good CG as it looks at environment, human capital and financial sustainability of the bank...governance is intertwined in all that...(CGP2, domestic listed bank).

This respondent further noted that some foreign banks in Kenya already have in place triple bottom line reporting (TBL)⁴, which as opined, is favoured by external investors whom the bank targets. The statement further emphasizes the earlier opinion that foreign banks continue to play a major role in the development of CG within the Kenyan banking industry. This view concurs with Zaman (2007) who observes that TBL involves robust corporate planning and a great deal of CG, due to the associated disclosure and

⁴ Triple bottom line reporting measures organizational performance along three dimensions: economic, social and environmental sustainability with a view to safeguard continuous survival of business entity (Keay, 2011, p. 218).

transparency. This interpretation also opens up an avenue for further research on the role sustainability reporting plays in boosting 'good' governance and associated performance within the banking industry in Kenya.

5.2.3 Audit

5.2.3.1 Internal Audit

The respondents agreed that audit plays a big role in safeguarding 'good' governance within the banking industry. To begin with, internal audit was mentioned as one of the ways in which the board of directors as 'eyes' of the shareholders, police management actions. To this effect, the internal audit function was perceived as a first-line of defence towards the implementation of CG.

Internal audit's objectives are part of the deliverables that are aimed at promoting CG...internal audit interrogates the various management committees to see: (1) what deliverables are they given by the board? (2) Are they delivering? (3) how are they delivering? (CGP5, large private bank).

...they are the eyes of the board...they check whether a firm's systems are proper and if they find a problem, the internal audit should be the first people to raise the alarm...(CGPI, CMA).

The interviewees cited independence of internal audit department to be a key determinant in ensuring the effectiveness with which the function realised its objectives. It also emerged that the heads of internal audit (HIA) report directly to the board audit committee, and the CEO has no authority to fire the HIA. Moreover, the HIA only report to the CEO administratively in a 'dotted' line, to ensure that appropriate controls and governance systems are maintained.

Respondents also noted that banks are equipping their internal control staff with advanced ICT skills to ensure that they are effective even when they audit sophisticated banking systems at a time when the industry is continually embracing new technologies.

In the past you would find that the audit people only audited things which they know, mostly paper-based evidence...That is why fraud would occur in these areas but you would find very good internal audit reports, only to uncover a very serious fraud that has been running for some time...(CGP4, domestic private bank).

5.2.3.2 External Audit

Another way in which CG is maintained in the Kenyan banking industry is through the external audit function. As one interviewee stated:

External auditors confirm that financial statements are true and fair, and they give the actual representation of the firm financial position...they objectively assess the workings of the firm...(CGP1, CMA).

It was noted that external auditors help to attest all important information is disclosed to the shareholders and other pertinent stakeholders, and ensure that managers do not misappropriate the banks resources or hide their unpopular decisions.

Nevertheless, some respondents expressed concerns that the quality of external audit was increasingly compromised by close business links that existed between the banking institutions and some of the audit firms.

...at times the external auditors are compromised due to their involvement with the same banks that they audit...the biggest percentage of their revenues derives from consultancy work which they do for many of the banks, far more than the audit fees they charge them...as a result, if you're an auditor, you would not be able to

question so much. In fact, at times they have been accused of assisting the banks to manage/cover up questionable transactions...(CGP7, Foreign listed bank).

This account thus raises doubt on the effectiveness of external auditors as gatekeepers of CG within banking institutions in Kenya.

Another interviewee commented:

The value added by external auditors is limited...we have 44 banks which have to publish their audited accounts within 3 months after end of financial year, meaning the four main audit firms have very little time to give attention to fine details that may help to unearth serious issues in banks...(CGP2, domestic listed bank).

A few interviewees however mentioned that their banks had interim audits carried out on them, within the first half of the year to give the auditors an opportunity to identify anything they would like to spend more time on at the end of the year during the final audit.

5.2.3.3 CG Compliance Audit

Another way in which CG is maintained within the banking industry is by having a unit to closely monitor the implementation of laid down standards. This was commonly cited by the respondents to be another way of ascertaining that the banks are complying CG:

We have an independent department that ensure all the CG regulations that have been issued have actually been complied with (CGP7, Foreign listed bank).

This respondent stated that their compliance function ensures that all regulatory and group CG guidelines are fully complied with, and in the end assisting the bank to maintain all specified CG requirements.

Nonetheless, the Central Bank of Kenya has recently passed a requirement where all banks must set up compliance divisions whose heads report directly to the board, to safeguard independence.

...the institution should establish an independent compliance function that provides assistance to the board and management in complying with applicable laws, rules, codes and standards. (Guideline on Corporate Governance, CBK, 2013).

Whilst the Central Bank of Kenya has now made it mandatory for banks to have compliance functions, respondent CGP7 above noted that their institution already had the department in place. Further discussions revealed that the bank being a multinational, CG trickles down from the parent company, and this might be interpreted to mean that foreign banks continue to play a positive role in promoting 'good' governance within developing economies.

5.2.4 Shareholders

It clearly emerged that the role of maintaining appropriate governance is not an onus of the bank executives and industry regulators alone. Instead, shareholders as principals also have a role to play in promoting 'good' CG within the banking industry in Kenya. For instance, the Central Bank of Kenya's CG principles stipulates:

Shareholders of banking institutions shall jointly and severally protect, preserve and actively exercise supreme authority of the institution in general meetings. They have a duty, jointly and severally, to exercise that supreme authority. (Guideline on Corporate Governance, CBK, 2013).

The statement above coincides with the view held by some respondents from listed banks that:

We now have more empowered shareholders asking very strong questions during the AGMs...wonderful questions of cash-flow, and some of the key performance indicators...asking hard questions from directors about the expenditure of the company...those are the shareholders we need (CGP6, CCG).

Compared to 3 or 4 years ago, the shareholders in Kenya are a bit enlightened...the quality of questions at AGMs seems to be better...people are actually taking some time to read through the annual reports...(CGP1, CMA).

This statement indeed shows that shareholders are part and parcel to the CG process, and have a duty to play in ensuring that they elect the right people into the board, and appraise their performance closely.

Interestingly, deeper discussions revealed the extent to which majority of the listed banks go to make sure that their shareholders can comfortably participate in the running of their banks.

As you can see from our annual reports, we try to report in both English as well as Swahili so that even those investors who cannot read English are not left out...we were the first bank to do this, and nowadays nearly all banks are doing the same. As you can see from our annual accounts, apart from our parent company's shareholding, local individual investors form the bulk of our shareholding...(CGP7, foreign listed bank).

The above statement is an indication of the commitment by some banking institutions in ensuring that shareholders, as owners, are actively involved in implementing CG. It can also be interpreted as an adaptation technique used by the banking institutions in ensuring equitable shareholder treatment, and increase the comprehension of the banks' annual reports to both present and potential investors.

Although no Kenyan banking or other corporate laws require annual reports to be in Swahili language, as Tauringana et al. (2008) rightly points out, Swahili represents the African heritage, along with the fact that majority of investors have low levels of educational qualifications. These writers further attributes the rationale for dual language reporting as a way of increasing comprehension of the annual reports to present and potential investors. On reflection, this section implies that shareholders have a duty to actively participate in the CG process of their banking institutions.

5.3 Effect of CG on Financial Performance of Banking Institutions in Kenya

Research question 3: *How does compliance with corporate governance guidelines impact on performance of banking industry in Kenya?*

Further to the respondents' implied opinions that CG plays a crucial role in boosting performance of the Kenyan banking industry, (see section 5.1.4 above). Deeper discussions sought to understand how CG is manifested in their banks financial performance, through their 'eyes'. This helped to listen to the actual CG practitioners, examine effectiveness of CG standards and identify challenges encountered in pursuing improved organizational outcomes.

5.3.1 Going Concern Value

The main theme that emerged when respondents were asked to describe how CG is manifested in their banks performance, was the benefit of managerial excellence associated with CG. As noted, well managed firms are likely to remain going concerns in the foreseeable future.

Previously, CG issues were largely low priority areas in Kenya's banking sector.

Directors were never vetted, shareholders could start banks almost at will, the role

of the external auditors was not well defined...these deficiencies resulted in laxity by some boards, and management of institutions. The effect was imprudent lending practices, excessive investment in fixed assets, inadequate systems to measure, identify and control risks...leading to banking collapses of the 1980s and 1990s... (CBK, Bank Supervision Annual Report, 2001).

If it's known that a bank has so many frauds every other day and customers are losing money left-right-and-centre, no depositor would take their money and more importantly no investor would want to put their money in that bank because it might be declared insolvent any time...(CGP7, foreign listed bank).

These statements might be interpreted to mean that CG is not only seen as a tool for improving performance and consequently shareholder wealth, but firstly as a guarantee to potential investors that a particular bank is worthy investment, and reassurance to existing owners that their business will continue operating into the future.

5.3.2 Reduced Non-Performing Loans Portfolio

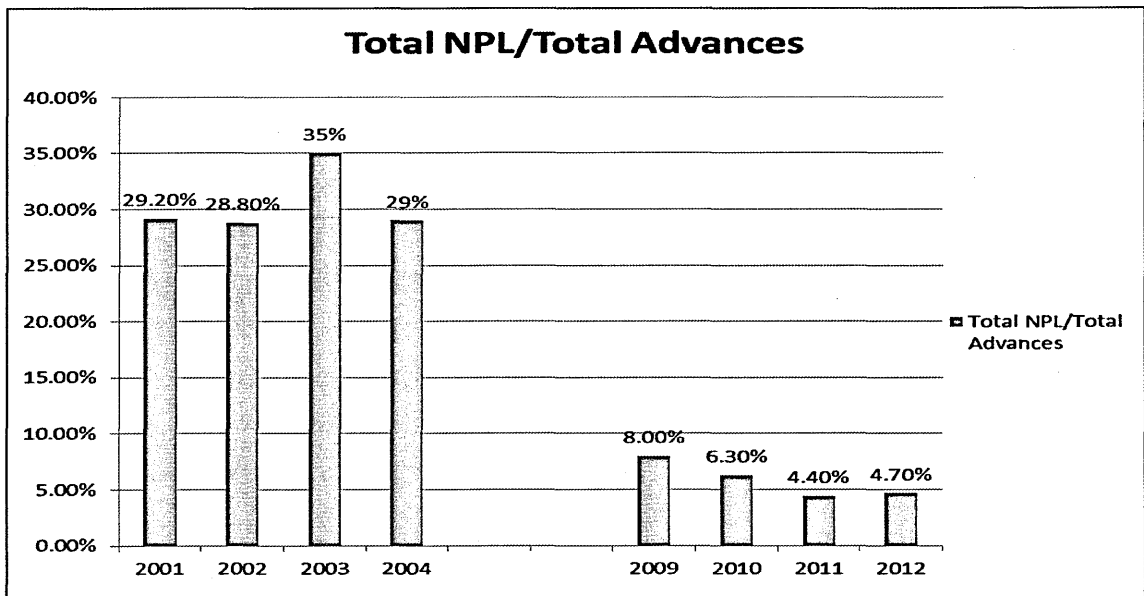
It was commonly recognized that certain CG mechanisms have assisted in maintaining non-performing loans portfolio within limits. The respondents further noted that reduced non-performing loans translated to better asset quality and more profitability in their banks.

...we have a [board] credit committee looking at the health of our loans, constantly reviewing how good our loan book is, and advising us on what to do when there are doubtful loans...(CGP4, domestic private bank).

The presence of a mandatory board committee on credit was viewed to play a great role in checking non-performing loans within banks in Kenya. Non-performing loans were cited to be the biggest burden that had led to insolvency and subsequent collapse of banks in the previous banking crises in Kenya (Brownbridge, 1998, p.13).

Figure 1 presents a comparison of non-performing loans portfolio for the last four years (2009-2012) with those before, around, and immediately after the CG was formally adopted in Kenya (2001-2004).

Figure 1: Net non-performing loans to total gross loans (Net NPLs/Gross Loans)



Source: Central Bank of Kenya – Bank Supervision Annual Reports

Consistent with the interviewees views, it is evident from the figure above that the size of non-performing loans portfolio within the Kenyan banking industry has remarkably dropped from an average of 25.8% between 2001 and 2004, to a low of 1.95% within the last four years.

While emphasizing the importance of CG in managing the size of non-performing loans, which in turn impacts on other performance measures, another interviewee stated that:

...when your loan book goes bad, you must immediately make provision in your interest and provision for the loans you're unable to recover. That provisioning

means your profits will slump immediately, and your core⁵ capital will also go down... (CGP8, Government owned bank).

CG, as pointed by the respondents continues to play a big role in keeping the non-performing loans portfolio within manageable levels, and consequently boosting the performance of banking institutions.

...the past bank failures were caused mainly by insider lending...the CG laws have now capped borrowing by directors to 20% of core capital, where such borrowing must be communicated to the Central Bank... (CGP2, domestic listed bank).

Thus, CG was felt to have an influence on performance because insiders can no longer borrow excessively, a problem attributed as the main cause of previous banking failures in Kenya (Brownbridge, 1998, p.13). Additionally, the current CG provision for banks to demand security while lending to insiders imply that, shareholders' capital is relatively secure than it was in the past.

Besides CG, another significant explanation for to the dramatic reduction in the size of non-performing loans is the establishment of credit reference bureaus in year 2008, allowing for the sharing of information about 'serial defaulters' whom according to the Central Bank of Kenya used to exploit the information asymmetry that existed in the past, by defaulting on loans borrowed from different banks (Central Bank of Kenya, n.d).

5.3.3 Cost Efficiency

The respondents also observed that increased compliance with CG regulations had contributed to increased efficiency. As noted, a big number of Kenya's population is still unbanked, leading to stiff competition as 44 banks look for ways to survive in a smaller

⁵ Core capital - fully-paid shares + previous year's reserves + any tier capital acquired + 50% per cent of current year's earnings.

market. Bank boards are therefore compelled to come up with strategic objectives to lower costs and remain competitive.

...the bank is always on the lookout for the latest ICT technology under the guidance of the board IT sub-committee which helps in identifying strategic ICT resources...we believe by investing in them we will reduce our costs such as wage bill...(CGP4, domestic private bank).

...our bank recently completed an acquisition of a massive ICT project which we're very confident will transform the bank...we have seen a drop in our operating costs and I can tell you we're set for long-term growth...(CGP2, domestic listed bank).

Respondents were unanimous that salaries and wages formed the biggest component of their costs, and that bank boards have a critical role to play in looking for strategic ways to lower costs. It also emerged that adoption of IT infrastructure was the most common method preferred for cost cutting as banks seek to position themselves for long-term growth.

Besides automation, agency banking⁶ was cited to be another cost-cutting measure used in the banking industry.

Due to hard economic times the bank repositioned itself for future growth...during the year we successfully recruited and obtained approval from Central Bank for over 2400 agents...this will lower our operating costs and grow our transaction based income (Annual Report, 2011, domestic listed bank).

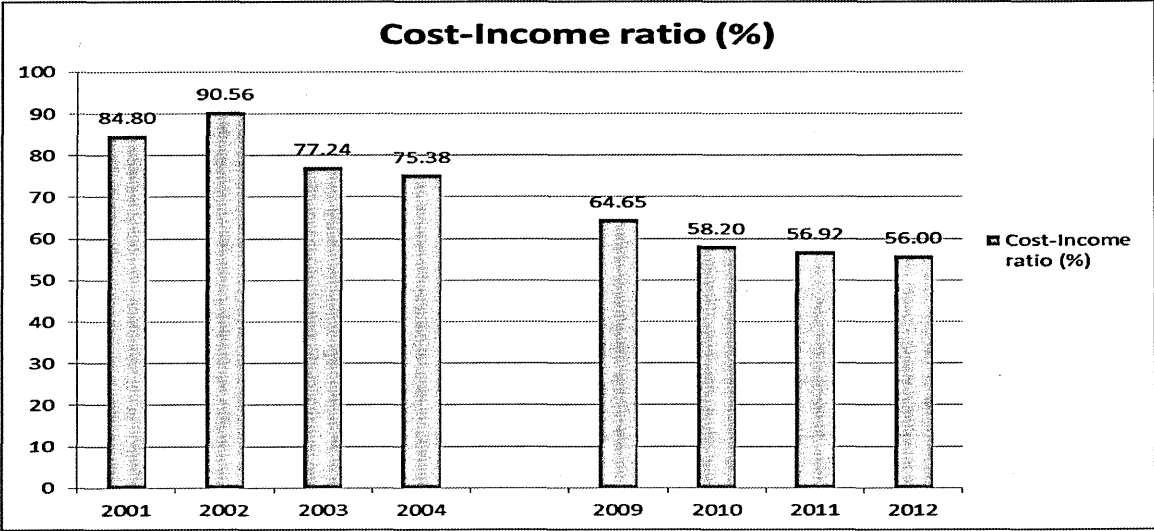
Agency banking was noted to have contributed to tremendous growth in income and reduction in the high costs associated with establishing new branches. The discussion

⁶ Agency banking – refers to a model of banking where banks engage third parties (agents) to offer certain banking services in their behalf (Central Bank of Kenya, <http://www.centralbank.go.ke/index.php/banksupervision#agent-banking>)

above might be inferred that boards in Kenyan banks continue to contribute immensely by identifying strategic avenues to reduce costs, and through strategic contribution deliver their mandate of increasing shareholder returns (Zahra and Pearce, 1989).

Figure 2 below shows a comparison in efficiency levels between two periods; before CG was enforced (2001-2004) and the period of investigation (2009-2012).

Figure 2: Cost-to-Income ratio



Source: Central Bank of Kenya – Bank Supervision Annual Reports

Consistent with the interviewees’ views, it is evident from the figure above that aggregate cost efficiency banking industry has improved from an average of 82% between 2001 and 2004, to 59% within the last four years. In line with agency perspective, the strategic role of boards in the Kenyan banks emerges as an important aspect in guiding their organisations to prosperity. This concurs with Andres and Vallelado (2008), that banking business requires directors who advise management appropriately and assist identifying and executing the right strategies. This section partly answers the third research question, where cost efficiency, which emanates from deliberate planning, is identified as major contributor to enhanced banking industry performance. This explains how CG impacts on bank performance in Kenya.

5.3.4 Earnings

The respondents further mentioned that their institutions had benefited from 'good' CG, as reflected in the increased earnings of the banks. Some of the successes attributed to CG include diversification of products to diversify revenue, and establishment of branches in regional countries which arise from bank directors' contribution to strategy. Some interviewees also cited that their boards had restructured their management structures to fit better within their banks objectives.

To increase our profit base, new products were introduced, and bank management structure realigned with the overall strategy...the bank has moved from purely wholesale banking to include retail banking (CGP5, large private bank).

This respondent stated that their bank's income has continued to rise with diversification of products and target clientele. For instance, respondents stated that their banks had moved beyond giving loans to mortgage and asset financing to expand their earnings. Additionally, the decision by the board to restructure executive structures might be interpreted to show that, the board exercised a critical duty of control over the agents in delivering shareholder value. Related to this interpretation, Zahra and Pearce (1989) argue that control is the most important task of a board in achieving organisational performance.

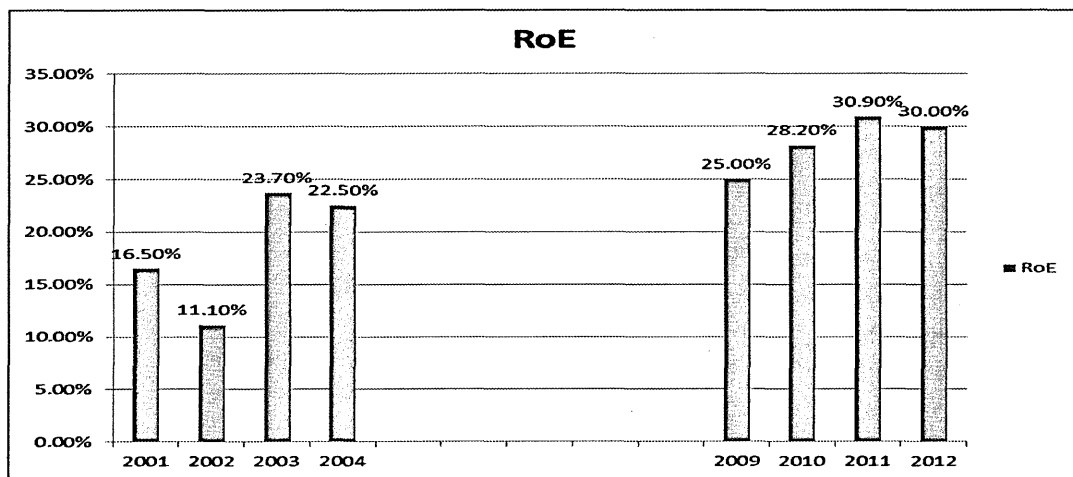
Some respondents also mentioned the decision to expand into neighbouring countries as another way they have managed to grow their revenues, and the wealth of their shareholders.

We are continuously considering opening more branches in the neighbouring countries in order to widen our market...we shall soon be expanding our operations into XXX country...(CGP3, foreign private bank).

Kenyan banks had subsidiaries with 282 branches operating in the region in 2012 representing an increase of 59 branches from 2011...(CBK, Bank Supervision Annual Report, 2012).

In answering the third research question, the narrations above show how bank directors while discharging their CG duties, make strategic choices that favourably impact on performance. The interviewees stated that the heightened regional presence of Kenyan banks had helped to improve the aggregate income of the banking industry. They cited this as an indication of the banks' leadership commitment to maximising shareholders wealth.

Figure 3: Return on Equity (RoE %)



Source: Central Bank of Kenya – Bank Supervision Annual Reports

The figure above shows relatively improved performance for RoE⁷ from an average of 18.45 between years 2001-04, to an average of 28.52 during the last four years. As the respondents pointed out, it might be inferred that banks in Kenya have continued to grow their network and products on offer as they seek to grow their income bases. This therefore provides explanation to the third research question, that adoption of CG has contributed positively to bank performance in terms of shareholder returns. This might be interpreted that CG leads to well-run banks whose directors constantly contribute to strategy, making critical choices that lead to better performance.

⁷ RoE-earnings realised from use of shareholders' funds, and shows a bank's financial health and efficiency with which management leverages profitability, asset management and financial gearing (Nyamongo and Temesgen, 2013, p.241).

5.4 Conclusions

The table below provides a summary of the main themes that emerged from interviews with reference to research questions guiding the study.

Table 2: Summary of main themes on CG perceptions, practice and performance that emerged from interviews.

Research question	Theme
How do bank executives perceive the process of corporate governance implementation?	<ul style="list-style-type: none"> a) Meaning of CG b) Corporate Governance: A Foreign Concept? c) Regulation and Governance d) Corporate Governance and Performance Nexus e) Board of Directors
How is corporate governance practised within Kenyan banks?	<ul style="list-style-type: none"> a) Board Governance b) Influences from Global Stage c) Audit <ul style="list-style-type: none"> i. Internal Audit ii. External Audit CG iii. Compliance Audit d) Shareholders
How does compliance with corporate governance guidelines impact on performance of banking industry in Kenya?	<ul style="list-style-type: none"> a) Going Concern Value b) Reduced Non-Performing Loans Portfolio c) Cost Efficiency d) Earnings

5.5 Explanation of the Main Research Question

How do bank executives in Kenya practice corporate governance, and how does this impact on the banking industry's performance?

While conducting the interviews, it emerged that CG is practiced along four broad lines within the Kenyan banking industry. First, the process of corporate governance begins with the board of directors. It was commonly agreed by all the interviewees that the board of directors as the apex organ within a banking institution, has the responsibility of maintaining appropriate CG structures and process. This includes constituting an independent and qualified board that would objectively interrogate the actions of the management. Therefore, in order to enhance the efficiency of the board of directors and ensure they perform their monitoring role effectively, the interviewees indicated that their banks send the board members on regular directors' trainings and seminars, where they're trained on current CG and strategic leadership skills. Next, two of the interviewees (CGP4 and CGP7) mentioned that they have links internationally, which have shaped how they approach CG. Foreign banks approach to CG is to a great extent influenced by their group structures, while domestic banks with foreign business connections also approach CG differently compared to other domestic banks without foreign contacts. For instance, CGP4 noted that their bank's interaction with other foreign banks had compelled them to adopt appropriate CG structures in order to win the confidence of their foreign partners, "*we partner with organisations outside the country...which loan us funds to invest in the country...what helps us to win their confidence is by having good governance*". For CGP7, being a subsidiary of a multinational bank means that their bank has to observe the parent company's group CG structure along with the Kenyan CG code, "*...whenever we practice CG, we have to put into consideration not only those regulations that are enforced by the CBK but also those CG guidelines that have been laid down by our parent company...*".

Thirdly, the role of auditing was mentioned as another way in which CG is maintained within banking institutions in Kenya. This study established that the internal audit role plays a primary role in in the CG process. As narrated by CGP5, “...*internal audit enables the interrogation of management to see if the deliverables assigned by the board have been achieved...*”. Interviewee CGP1 also noted that external audit function continues to support the process of CG within the Kenyan banking industry where banks’ financial accounts are verified for accuracy; “...*external audit helps in in the CG process by assuring the bank shareholders that the financial accounts they are given are a true and fair representation of their bank’s financial position...*”. Also, the interviewees noted that having a compliance unit within their bank structures has helped the institutions by ensuring that all laid down; group and other CG regulations are fully complied with, and in the process helped to foster good CG. As an example, CGP7 describes the importance of a compliance department as follows, “...*we have an independent compliance department that ensures all the CG regulations that have been issued are complied with...*”.

Fourthly, this study has found that many bank executives view CG as a collective responsibility, and thus try to involve the shareholders in the CG process. Majority of the interviewees from the listed banks emphasized how they publish their banks’ annual reports in dual languages – English and Swahili - to increase the comprehension of financial accounts even by the less educated shareholders, even though this is not required under the law. This has resulted in more enlightened shareholders who are able to ask more informed questions during the AGMs, “...*publishing our annual reports in English and Swahili means even those local shareholders who cannot understand English are not left out...*” CGP6.

The impact of corporate governance on the banking industry’s performance was found to be manifested along four performance benchmarks. First, the value of CG as described by the interviewees is not only for improving financial performance, but also as an assurance

to shareholders that their investment will continue as a going concern in the future. Second, insights from this study show that CG plays a crucial role in checking the level of non-performing loans portfolio which has resulted in better asset quality and improved profitability for the banking industry. This is evident in CGP4 response, “...*in our CG structure we have a credit committee looking at the health of our loan-book, and advising us on what to do when there are doubtful loans...*”. Another way, in which CG continues to foster the performance of banking institutions, is through capping on insider lending which had been the single largest cause of bank failure in Kenya was before: “...*CG laws have capped borrowing by directors to 20% of the core capital, meaning that the risk of excessive insider lending has now been controlled...*” CGP2. Third, interviewees’ feedback showed that having the right mix of qualities and skills of members sitting on the board has helped their banks to strategize for long-term survival. The interviewees also noted that CG has helped to position their institutions competitively with lower costs and increased income; “...*our board recommended the acquisition of ICT technology which has lowered our operating costs...*”. Fourth, through good strategic policies, many banks have been able to increase their base earnings by introducing new products such as mobile and agency banking, as well as expanding into neighbouring countries. This evidences shows how boards of directors can effectively perform their role of providing proper strategic direction, and which in turn impacts positively on the financial performance of their institutions.

Chapter 6

Findings

6.0 Introduction

This chapter links the research objectives with the narrative interpretation of the research evidence. It also presents the conclusions reached regarding the research questions set in the introduction section of this study. Section one discusses the main findings of the research, while sections two and three present the implications and limitations of the study's findings and research respectively.

6.1 Conclusions

After systematic review of extant literature, it emerged that prior quantitative research has not only presented mixed findings about the impact of CG on firm performance, but also very little investigation has been conducted within emerging economies (Tsamenyi and Uddin, 2008). Additionally, the research on CG of banks is also very minimal (Caprio et al., 2007). Thus, using the aforementioned observations as a starting point, this study purposed to fill these voids by carrying out an exploratory research on banking institutions in Africa using qualitative evidence from Kenya. Accordingly, the study's central research question sought to examine how banking institutions practice CG in Kenya, together with how this impacts on their financial performance. To answer this question adequately, the researcher developed three research sub-questions to guide the investigation in achieving the goals of the research. The first research sub-question sought to determine how bank executives, as agents of shareowners, perceive the CG process. Related to the first sub-question, the second research sub-question attempted to understand how CG is practiced within Kenyan banks. The third research sub-question presents and discusses how bank executives think of CG influence on the performance of banking industry in Kenya. The sub-sections below elaborate on the findings that resulted from this MRes research project.

6.1.1 Respondents' Perceptions of Governance

Research question 1: *How do bank executives perceive the process of corporate governance implementation?*

Being an exploratory research, this study's fieldwork began inquiring from the interviewees about their definition and understanding of CG. Evidence from the research results established that CG is widely perceived as an instrument for control in the administration of banking business. This study thus supports Zulkafi and Samad's (2007) argument that CG serves an important role in banking business, where government-backed regulation is supplemented by the added policing brought about by CG.

Whereas all banks are obligated to comply with some basic CG regulations, their approach to implementation vary, with publicly-listed banks using CG as an assurance to existing shareholders, as well as appeal to potential investors. Respondents from privately-owned banks on the other hand, viewed CG as a managerial handbook for the running of their banks. Privately-held banks also appear reluctant towards CG, considering it as a bother within their institutions, apparently likening its relevance to the publicly-listed banks rather than privately-owned banks. In line with Hagedorff et al. (2010), this finding indicates that effective CG within the Kenyan banking industry may only be realised through strict enforcement where CG mechanisms and bank regulation are taken as complementarities and not substitutes. This is because as the interviewees commonly indicated, CG is still in its nascent stages of development within the industry, and largely seen as a western solution to previous western problems. On this basis, a strict regulatory environment is best suited to continue promoting CG development within the banking industry, without which it appears CG would not thrive, as it was considered to lack an impetus of its own.

Differing views also arose when interviewees were asked to account for their perceived link between CG and performance, with some maintaining that strong and direct tie exist, while others stated that a weak link existed. On reflection, it seems that Kenya being a rapidly growing economy, there may be many factors to explain the performance of banking institutions besides CG. For instance, it may be possible for banks to report improved profitability without deliberate strategy as argued for in agency theory, but as a result of increased revenue from growth in clientele base, since a large proportion of Kenyan populace is still unbanked. Therefore, without appearing dismissive of the value added by CG to bank performance, this study finds that it might be possible for banks without proper CG structures to outperform their well-governed peers if they probably have a small customer base, at least in the short-term. Nonetheless, banks that practice good CG would possibly outperform such banks in the longer-term and achieve sustained growth of their shareholders funds. This finding also implies that profitability may not be a suitable performance metric in assessing the impact of CG on firm performance within emerging markets.

Another salient finding was that banks have varying stimuli when filling board positions. In some banks and consistent with assumptions of agency perspective, board appointments are reserved for individuals who possess skills to strategically guide the banks in realising their objectives. Nevertheless, a section of interviewees viewed board appointments as an opportunity to establish good relations with the central government, particularly for foreign banks, as well as win business through links created by the new directors. The latter finding diverges from agency perspective, as markets can be turbulent within developing countries, due to political tensions thus necessitating bank directors to overcome this by liaising with the government in power. This finding agrees with Tsamenyi and Uddin's (2008) work that, developing economies such as Kenya may be dynamic and problematic due to political and other considerations, and which if overlooked may undermine the

effectiveness of CG systems. This study therefore recommends to practitioners and policy makers the need to consider underlying socio-political environment in Kenya in order to maximize the effectiveness of CG mechanisms within the banking industry (Adu-Amoah et al., 2008).

6.1.2 CG Process within Banking Institutions in Kenya

Research question 2: *How is corporate governance practiced within Kenyan banks?*

Interestingly, respondents' views about their definition of CG, replayed again while interpreting how CG is practiced within banking institutions. Consistent with assumptions of agency perspective, the board of directors as narrated continues to play an important role of monitoring the actions of management on behalf of the shareholders (Jensen and Meckling, 1976). For instance, the appointment of individuals who are risk management experts to chair board audit committees enables the board of directors to avoid economic risks and minimise financial loss. In addition, corresponding with Aboagye and Otioku (2010) discussion, this study finds continuous directors' trainings as important feature in improving CG practice through enhanced governance competencies.

This study also demonstrated that the Anglo-American CG model lacks absolute congruence with local contextual arrangements. Whereas the model assumes CG problems between shareholders and management, it overlooks a serious aspect of principal-principal conflict, where minority shareholders risk exploitation by controlling shareholders (Chen et al., 2011). Furthermore, many banks were noted to be family-controlled implying potential for serious CG conflicts if the majority shareholders manipulate the CG process.

The audit function was mentioned as another way in which CG is enhanced, because of the disclosures, accountability and transparency involved in the process of auditing. The provision of assurance was considered essential in building trust with shareholders (Matama, 2008), and ensuring that insiders do not expropriate banks' resources thus

boosting a bank's value (Zulkaflī and Samad, 2007). This helps to reduce the likelihood of information asymmetry problem, where the management may possess more information regarding a bank's affairs, and thus make it much easier for the shareholders to monitor the actions of management to avoid conflicts of interest.

Those banks that have links with international organisations, such as IMF and other international partners which lend their money through Kenyan banks were also mentioned as playing a leading role in development of CG within the banking sector (Okpara, 2011). It is apparent from the narrative that foreign banks, particularly the large multinational banks, have contributed immensely in the enhancement of CG standards by imparting 'good' CG structures within the Kenyan banking industry.

The findings from this study also highlighted the increasingly important role performed by shareholders in maintaining 'good' CG within the banks. In a country that has a large segment of its population without formal education, one interviewee narrated that their bank publishes annual reports in two languages – English and Swahili (local language) in order for their shareholders to benefit from information disclosed. This leads to more enlightened shareholders who are able to interrogate the directors impeccably during the AGMs. This way, these banks embrace the peculiarity of the local social context (Adu-Amoah et al., 2008; Tsamenyi and Uddin, 2008) by giving all shareholders, as principals, an opportunity to easily monitor the actions of their agents.

6.1.3 Impact of Corporate Governance on Performance

Research question 3: *How does compliance with corporate governance guidelines impact on performance of banking industry in Kenya?*

This study has established that CG is still developing and very much regulatory driven, where majority of the banking institutions implement mainly those CG provisions that are enforced by the regulators. Thus, in light of Hagendorff et al.'s (2010) findings, this study establishes that the Kenyan banking industry has immensely benefited from the enforcement of certain CG provisions by the CBK. For instance, all respondents acknowledged that not a single banking institution has collapsed since a decade ago, after the official adoption of CG within the industry. This therefore shows a huge contribution of CG within the banking industry, compared to the past where 16 banking institutions collapsed in one decade to 1996, due to insolvency associated with poor management. The findings from this study have also established that CG not only enhances financial performance, but also safeguards the going concern value of a bank for its owners. This study thus advances CG research noting that prior CG inquiry does not address the going-concern value of a firm, which is by far the true value of a firm, as other performance measures may be easily manipulated by management for their own selfish objectives.

This study nevertheless rejects Reaz and Arun's (2006) argument that increased regulation may adversely affect shareholder welfare, as contagion risk which is a serious threat to banking business can only be eliminated through increased regulation which thus complements CG (Macey and O'Hara, 2003; Zulkafli and Samad, 2007). 'Good' CG was also found to have contributed to a reduction in non-performing loans portfolio, enhanced the operating efficiency of the banking industry and consequently maximize the wealth of the shareholders. In addition, while prior research has mainly used profitability, and, other market and accounting measures to gauge performance; I contend that the paramount value of 'good' CG within a developing economy such as Kenya is assurance to stockholders

that their investment will at the least remain going concern. This study further argues that in valuing a firm, other performance benchmarks are ancillary to going-concern value, as both local and foreign investors are attracted to firms that can weather the inevitable market turbulences present within many developing countries.

6.1.4 Conclusion

How do bank executives in Kenya practice corporate governance, and how does this impact on the banking industry's performance?

Generally, the development of CG within the banking industry in Kenya can be attributed to two main factors: government regulation and foreign influence. Government regulation takes place where the CBK actively enforces certain CG provisions, such as the mandatory requirement for banks to have in place an audit and nomination committees, with the former being headed by a qualified finance and/or accounting professional. The CBK also stipulates that all bank boards must meet at least four times every year (Hagendorff et al., 2010). Next, research insights indicate that foreign influence has also played a great role in the enhancement of CG within the Kenyan banking sector. This international inspiration occurs where local banks partner with other foreign banks, and are thus compelled to adopt certain CG structures in order to sustain their partnership with those institutions. The presence of foreign banks within the banking industry has also been found to embolden the adoption of CG by more local banks (Arun and Turner, 2004).

Additionally, there is evidence that CG players within the banking industry pay attention to the local institutional environment whenever they make some CG decisions (Adu-Amoah et al., 2008). A case is where all the listed banks targeted, confirmed that they publish their annual reports in both English as well as a local language – Swahili. This is not a legal requirement but rather an adaptation technique to the local context, where a large number of people have low levels of educational attainments and the banks therefore try to make

their financial accounts accessible to all their shareholders (Reaz and Arun, 2006; Tauringana et al., 2008).

A clear link between CG and bank financial performance was drawn by a number of respondents, who termed the discipline associated CG as having played a key role in cutting down on costs and consequently enhancing the financial performance of the banking industry (Matama 2008). Some of the ways in which CG has been found to boost the performance of the banking sector include the fact that more banks have by now better constituted boards, with more informed directors who are able to strategically guide their banks (Nyamongo and Temesgen, 2013). This is exhibited by the adoption of technology which has lowered the operating costs within the banking sector. As an instance, many banks have adopted other banking products such as mobile and agency banking, which has helped to expand their customer base and avoid the high costs associated with establishing new branches. Also, through good strategic steering, some banks have positioned themselves for future growth by establishing new branches in the neighbouring countries, thereby raising their revenues base.

Lastly, the requirement for banks to have in place credit committees has had a positive impact on the performance of the banking industry. It was clear that all bank boards have by now a functioning board credit sub-committee which frequently reviews their bank's loan book, and are able to warn the management on time whenever there are signs that the bank is struggling with an accumulating non-performing loans portfolio. This is particularly important given that all previous banking crises in Kenya were attributed to imprudent lending practices (Waiguchu et al., 1999). The consequence of this has been a drastic reduction in the level of non-performing loans, for the entire banking industry thus translating to higher returns for the shareholders (ADB, 2007).

6.2 Contribution of the Research

First, the study contributes to the scarce literature on CG of banks in Africa (Tsamenyi and Uddin, 2008; Wanyama et al., 2009). Second, this study also contributes to the development of CG inquiry through qualitative research by returning the call for more rigorous CG research (Zattoni, et al., 2013). Thirdly and pertaining to theory development, this research puts to question some of the assumptions underpinning the Anglo-Saxon CG model, as well as the agency theory. For instance, the potential for serious CG conflicts has been found to be more likely among principals, i.e. controlling and minority shareholders; as opposed to managers and shareholders since majority of the banks are privately owned. The research thus suggests that the Anglo-American CG model lacks congruence with the contextual background of Kenya, and would need to be customized to fit local institutional environment in order to enhance its effectiveness. Fourthly, there is also some evidence that banks which practice sustainability reporting have reduced information asymmetry between shareholders and executives, due to its associated high levels of transparency and disclosure, and therefore resulting in improved shareholder welfare within those banking institutions.

Likewise, this study's findings have implications for policy. Firstly, the nature of banking business in Kenya, a developing country, is surrounded by imminent risks including political tensions, currency volatility and other macroeconomic shocks. It is therefore imperative for bank-owners to hire directors who understand risk so that they can effectively contribute to their banks strategy, and steer them to prosperity. Secondly, to ensure effectiveness of external audit in supporting the CG process, this research shows that two mandatory audits within banks may be beneficial – interim (half-year) and final (end-year) audits. While final audit is a requirement for all banks, it was established that audit firms operate under a lot of duress and pressure, while conducting final year audits leaving them with very little time to give attention to fine details that may help to unearth

serious issues. Thus, interim audit would give auditors an opportunity to identify things to spend more time on during the final audit. Thirdly, there is need for investors to be engaged in the CG process, and relevant authorities should actively involve shareholders in designing and review of CG guidelines. To achieve this and for shareholders to fully benefit from this process, there is need to re-establish an association/lobby which can protect their interests, empower and enlighten them on their rights, and directors duties within their banks. Fourthly, there is need to limit not only the age of individual directors but also the number of years a director can serve in one board consecutively. This would help to bring fresh mind-set and more innovative strategies and avoid retention of status quo, and improve the level of governance and board effectiveness within Kenyan banking industry.

6.3 Limitations of the Study and Suggestions for Future Research

Although the researcher has attempted to follow requisite scientific procedures in carrying out this study, it suffers from some limitations. Firstly, this research has used a small sample size and is only representative of the banking industry in Kenya, and therefore lacks capacity to generalize its findings across any other African country. Future research may benefit from use of mixed methods where weaknesses within each methodology can be compensated for (Okpara, 2011). Secondly, the exclusive adoption of agency perspective which assumes that directors only monitor management and formulates strategy, makes the study oblivious of other important functions performed by boards, such as linking banks with potential customers. Future studies of this nature should adopt multi-theoretical perspectives in order to benefit from complementary views associated with multiple theories, and overcome limitations of individual theories (Zahra and Pearce, 1989). Thirdly, whilst present study adopted agency theory, which emphasizes that management are agents of shareholders (principals), it failed to include shareholders' views on CG in the analysis. Future researchers should strive to incorporate data from

shareholders to benefit from a complete picture. Fourthly, the respondents included participants who held different roles e.g. a CEO, head of finance, compliance manager, while others were risk and audit managers. Thus, the interview data may lack uniformity, as “respondents perspective about governance may be strongly influenced by the seat each holds” (Lorsch, 2012, p.87). Future studies should thus include input from a single role across their sample, or where this is not possible select more than one participant per institution. Lastly, due to scale and time constraints within which this MRes study was conducted, the findings reached are only suggestive but not conclusive evidence of the research problem. The ensuing PhD research has the benefit of time and scope plus resources, and will therefore offer a more definite argument of the research topic.

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Appendices

Appendix 1 - Background of Kenyan Banking Industry

Banks in Kenya are governed by the Companies Act (CAP. 486, Laws of Kenya), the Banking Act, (CAP. 488, in the Laws of Kenya) in addition to the Central Bank of Kenya Act (CAP. 491). The Central Bank of Kenya is the sole industry regulator.

Any individual holding a controlling-stake⁸ in any Kenyan bank must get clearance from the Central Bank of Kenya; and where such approval is refused that shareholder must give up voting rights and reduce the shareholding to a maximum of five per cent of the share capital within twelve months. This requirement emanated from an amendment to the Banking Act in 2009, after a parliamentary report noted that some prominent personalities had irregularly acquired huge loans, and then defaulted on repayment leading to collapse of a number of banks in the 1990s (Kenya National Assembly, 2009, p.39).

During the 1960s and 1970s, there were 10 banks which were mainly foreign-owned, and the financial sector experienced heavy government participation (Ngugi, and Kabubo, 1998). Four of the banks – two foreign and two government owned institutions – held over 80% and 50% of the banking industry's deposit liabilities and total assets respectively. Furthermore, this quartet collusively⁹ turned the industry into an oligopoly⁹. Throughout this time, the government would cap interest-rates and dictate sectors to which banks would direct credit – mainly agricultural, export, construction and manufacturing sectors; a move that was faulted for denying private sector the necessary credit, depressing savings mobilization and the eventual outward flight of capital (Ngugi, 2000).

⁸ A controlling/significant shareholder is an individual other than the government or public company who owns more than five per cent of share capital in a banking institution (Kenyan Banking Act., 2009).

⁹ Oligopoly – refers to a market situation in which control over the supply of a commodity is held by a small number of producers each of whom is able to influence prices and thus affect the position of the competitors.

Later in 1980s, in the wake of a seemingly ailing macroeconomic environment, the government deliberately lessened bank licensing requirements, as a way of encouraging more Kenyans to participate in the financial sector. This resulted to an increase in the number of banks to 23 in 1985 (Ngugi, and Kabubo, 1998). However, the low entry barriers were later criticized for the subsequent burgeoning of banks that were poorly managed and undercapitalized. This, coupled with inadequate supervision saw the financial sector reach the brink of failure in 1986, when 2 banks and associated non-banking financial institutions¹⁰ collapsed while many others endured severe liquidity problems.

In 1989, the government identified 9 troubled institutions that were bought out to form the government-owned Consolidated Bank of Kenya, while others underwent liquidation. These events led the government to considering other ways of shifting the financial sector's over-reliance on the banking systems, and the Capital Market Authority was formed in 1990 in a bid to develop alternative sources of capital through long-term debt and equity markets (Ngugi, 2000).

Kenya has undergone two phases of banking sector breakdowns, with the bank failures of the 1980s mainly attributed to poor economic conditions (Ngugi, and Kabubo, 1998). Surprisingly, the costliest banking sector failure occurred in the 1990s after enactment of various financial sector reforms and amendment of the Banking Act when "Central Bank of Kenya lost an estimated 10.2 billion shillings (£78.4 Million) – equivalent to 3.8 per cent of 1993 GDP – from frauds involving *political banks*¹¹" (Brownbridge, 1998,p.13). As Brownbridge observed, improper corporate governance practices including fraud and

¹⁰ Between 1974-79, commercial banks set up non-banking financial institutions as a way of circumventing stringent rules such as cash ratio and low capitalization requirements. In addition the non-banking institutions enjoyed higher interest rates while the banks were subjected to interest controls (Ngugi, 2001).

¹¹ In early to mid-1990s, a number of Kenyan banks had prominent politicians dominating their boards, and were thus christened political banks (Economist Intelligence Unit, cited in Brownbridge, 1998).

excessive insider lending, excessive ownership and politician-managers¹² were found to be the lead causes of the bank failures. Three years later in 1996, six more banks faced financial difficulties with five of them being placed under statutory management in 1998 due to poor management, insider lending and undue political pressures (Ngugi, 2001). From 51 institutions in 1996, there are currently there are 43 banks in Kenya, with 10 of them operating subsidiaries in neighbouring countries of Uganda, Tanzania, Rwanda, Burundi and South Sudan, Malawi and Mauritius; with 125 of the 282 bank branches operating in Uganda. This is a growth of 59 subsidiaries from a total of 223 branches in 2011 (Central Bank of Kenya, 2012). These past experiences and other issues will form the basis of this research in an attempt to understand how the banking industry in Kenya carries out corporate governance practices.

¹² Politician-manager refers to a politically active individual who also served as a member of bank's board of directors.

Appendix 2 – Major Provisions in the Kenyan Corporate Governance Guidelines

The corporate governance framework was developed in 2002, by the Capital Markets Authority, an independent regulatory agency that monitors and supervises the capital markets in Kenya. The code is assumed a ‘comply or explain’ stance, designed to allow ‘flexibility and innovative approach to corporate governance practices’, although companies are required to disclose extent of non-compliance and specify steps taken to become compliant.

The main provisions contained within the code include: (Source: CMA, 2002).

- **Board of Directors** –every board ought to have at least an audit and nominating committee, with directors’ remuneration linked to performance and approved by shareholders. Boards should comprise at least one third executive directors, and multiple directorships are capped to five companies. Directors except CEO are required to stand re-election every three years.
- **Separation of chairman and CEO roles** –code requires a separation of chair and CEO roles, with multiple chairmanships limited to two companies.
- **Shareholders** –every company is required to hold an annual general meeting, where shareholders can approve any major decisions in a company.
- **Accountability and audit** –the company’s accounts should be prepared according to International Accounting Standards, and inspected by independent auditors approved by the shareholders at every general meeting.
- **Related-party disclosures** –the board is expected to disclose all business related agreements entered into by related companies.
- **Membership to professional organisations** –the Chief Financial Officers, Company Secretary and company auditors of all listed companies are required to be members of internationally recognized professional bodies.

Appendix 3 – HREC Ethics Approval Memorandum



From Dr Duncan Banks
Chair, The Open University Human Research Ethics Committee
Email duncan.banks@open.ac.uk
Extension 59198

To Danson Kimani, FBL

Subject "Governance of banking/financial institutions in Africa."
Ref HREC/2013/1434/Kimani/1
Red form
Submitted 26 April 2013
Date 26 April 2013

Memorandum

This memorandum is to confirm that the research protocol for the above-named research project, as submitted for ethics review, has been given a **favourable opinion** by the Open University Human Research Ethics Committee by chair's action. The project is considered to be low risk.

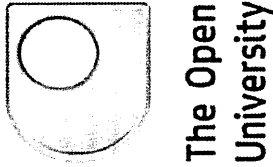
Please make sure that any question(s) relating to your application and approval are sent to Research-REC-Review@open.ac.uk quoting the HREC reference number above. We will endeavour to respond as quickly as possible so that your research is not delayed in any way.

At the conclusion of your project, by the date that you stated in your application, the Committee would like to receive a summary report on the progress of this project, any ethical issues that have arisen and how they have been dealt with.

Regards,

Dr Duncan Banks
Chair OU HREC

Appendix 4 - Research Project Information and Consent Form



Business School

**The Open University
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Research Project Information and Consent Form

Project Title

Governance of banking/financial institutions in Africa

Name of the Researcher

Danson Kimani – Master of Research Student (Business and Management), The Open University (UK).

Purpose of the Research

This research project is being undertaken as part of the MRes program, and is thus for academic purposes only. The main objective is to elicit a rich and deeper understanding from participants about their perceptions concerning the effectiveness of corporate governance regulations on the performance of commercial banks in Kenya. The data shall be collected using semi-structured interviews with senior bank managers as the primary research participants, together with detailed field observation notes.

Duration of the Interview

The duration of the interview is expected to last for approximately 45 minutes to one hour.

Benefits to the Participants

Whilst there are no immediate benefits for you as a participant in this project, it is hoped that this work will help to contribute to and encourage high quality research in the field of corporate governance and help to facilitate stimulating debate between practitioners, academics and policy makers, and in addition promote the implementation of best corporate governance standards. However, a summarised copy of the research report shall be provided to you for participating in the research process, once the final draft has been completed.

Risks to the Participants

The research process involves minimal levels of risk, and as a participant therefore you will not encounter any risks that exceed those risks encountered in the day to day activities. In addition, the researcher is under strict obligation to protect the research participants from any type of psychological distress or physical risks.



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Confidentiality and Data Protection

The researcher will take every possible precaution to uphold the confidentiality of the research participants' identities and data. The data collected from the participants will be used solely for research purposes and with their permission. If any participant does not agree to the use of any piece of the information provided by him/her for research purpose, such data will not be used. The interviews will be tape recorded and transcribed by the researcher later on. The researcher will also take all possible measures to protect the data collected from any unauthorised access, accidental disclosure, loss or destruction. The researcher shall keep the data under password protected storage. The audio data will be stored on the more secure Open University's servers where it will be accessible to the researcher only. The data shall not be kept with the researcher longer than required, and will be destroyed once this research project is completed and the dissertation has been submitted to the research school. For the benefit of participants, no personal information is required in writing or any other stage of this research and thus, the names of the participants and their institutions shall be kept confidential and will be coded and pseudonyms such as executive 1 or official 1 etc. shall be used to denote the individuals who participate in the research. Other pseudonyms such as Large public sector bank or Medium private sector bank shall also be used to denote the institutions. For purposes of this research, the researcher shall dutifully adhere to the provisions contained in the Data Protection and Freedom of Information Act, The Open University Code of Practice for Research and Those Conducting Research, the Ethics Principles for Research involving Human Participants, and the Economic and Social Research Council's Framework for Research Ethics. Therefore, data protection and confidentiality shall be maintained in strict accordance with the guidelines detailed herewith. The results of the data shall be disseminated in

the form of dissertation report and, possibly as an article for presentation at an academic conference or for publication in an academic journal.

Costs and Compensation

This research project is fully-funded by The Open University (UK), and will be undertaken for the purpose of completing the Master of Research dissertation module. As a research participant therefore, you are not expected to bear any extra costs during the research process. The researcher shall approach the participant at his/her place of work.

Voluntary Nature of Participation

Participation in the research process is voluntary and you have every right to decline participation. In case of agreement to be a participant, you still have the right to withdraw participation before all the research data are analysed and final results are concluded.

Contact Details

In case of any queries regarding this research project, please feel free to contact me or any of my supervisors at The Open University.

Danson Kimani (Researcher)

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hv74@openmail.open.ac.uk

Participation Agreement

I _____ have had the opportunity to read this **information and consent form**, ask questions where necessary and agreed to participate in this research project.

I have been informed about the purpose, duration, risks, and benefits of the project. I have also been assured about the confidentiality of the information, and that research data will be confidential to the extent allowed by law, and thus shall remain secure and only used for academic purposes including writing research article in an academic journal. I have also been informed that I have the right to withdraw from participation before all the research data are analysed and final results are concluded.

I understand that if I have any questions or concerns about this project, I can contact the researcher and/or his academic supervisors as listed above.

Participant's Signature

Date

Researcher's Signature

Date

Appendix 5 - Letter of Refusal of Research Interview

RE: Request for an interview appointment

Xxxx X. [Xxxx X@centralbank.go.ke]

Sent: 11 June 2013 06:02

To: 'Danson.Kimani' [Danson.Kimani@open.ac.uk]

Dear Danson,

Thanks for your email and the attachments which provide a clearer picture of your research. I have in particular reviewed the discussion questions. While this is a pertinent research, it would be difficult for I or my colleagues to provide responses to your questions. As CBK employees, the views we espouse are taken to represent the views of the Central Bank. In this regard, the views of the Central Bank as far as corporate governance in banks is concerned are codified in the Banking Act and the Prudential Guideline on Corporate Governance both of which can be downloaded from www.centralbank.go.ke I therefore regret that I am unable to be of further assistance to you but wish you well in your research endeavours.

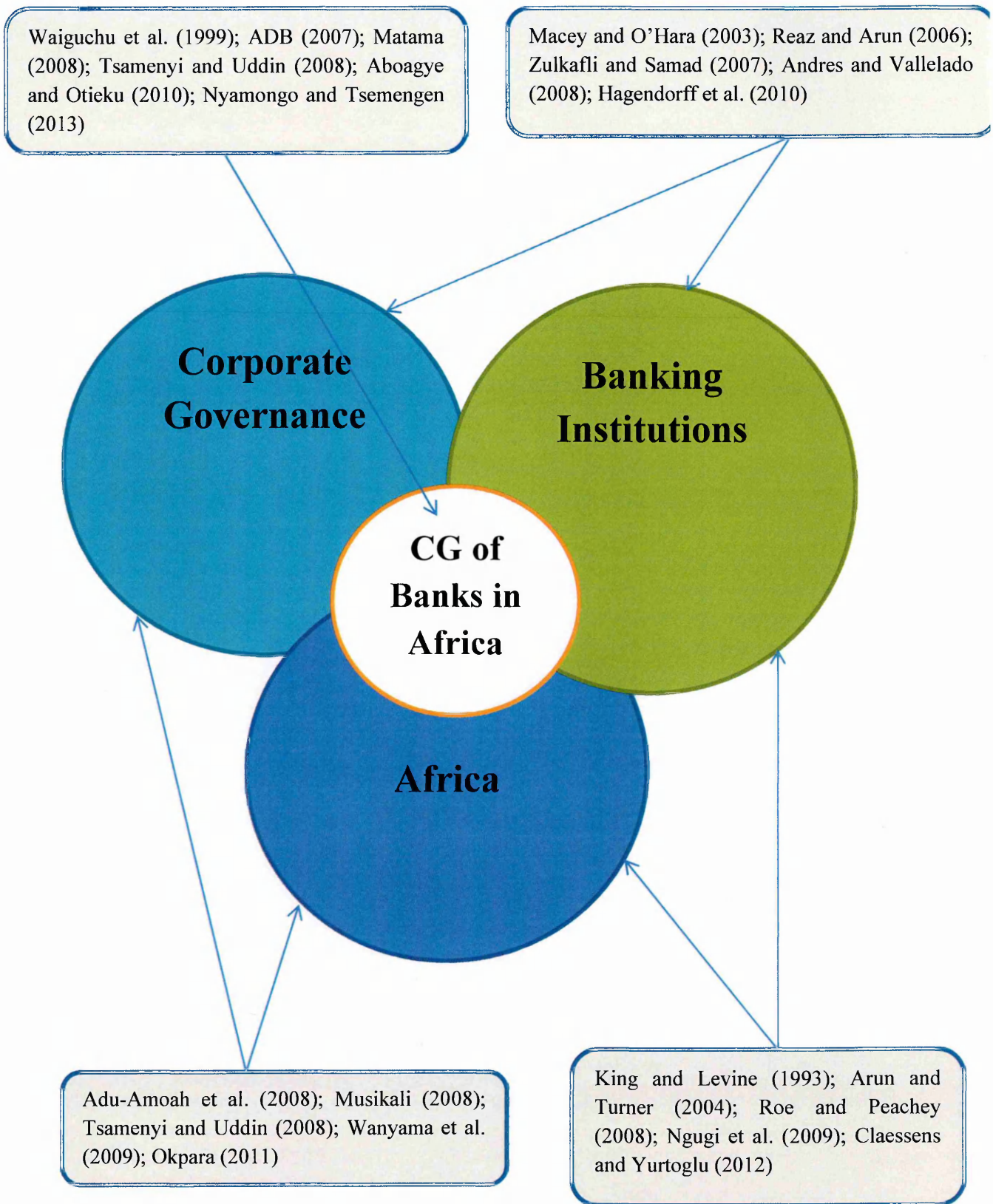
Regards

XXXX XXXX [Identity anonymized]

Appendix 6 - Interviewee Details

Interviewee	Organisation	Gender	Professional Qualifications	Experience
CGP1	Regulatory authority that developed the guidelines for good CG practices in Kenya	Female	Bachelors degree <u>Background:</u> Market supervision, Investor Education and Public Awareness	7 Years
CGP2	Large publicly-listed domestic bank	Male	Masters degree/ Certified Public Accountant <u>Background:</u> Head of Finance, Internal Audit	5 years
CGP3	Large private Pan-African bank	Male	Masters degree/ ACCA/Certified Fraud Examiner <u>Background:</u> risk, credit, compliance and audit.	8 years
CGP4	Large private domestic bank	Male	Masters degree/ CPA/Certified Information Systems Auditor <u>Background:</u> Credit, risk, auditing	12 years
CGP5	Large foreign private bank	Male	Bachelors degree/Certified Public Accountant <u>Background:</u> Audit, risk	6 years
CGP6	Organisation that developed the first code of standards on CG in Kenya	Male	Doctorate degree <u>Background:</u> CG training for Chairmen, Directors of Boards, Chief Executives, Senior managers	13 years
CGP7	Publicly Listed Multinational bank	Male	Masters degree <u>Background:</u> Internal Audit, Systems audit, compliance, risk, Accounting and Audit trainer	10 years
CGP8	Government owned bank	Male	Masters degree/Certified Public Accountant <u>Background:</u> Operations, credit, audit, compliance	8 years

Appendix 7 - Literature Map



Appendix 8 – Interview Schedule

Interview schedule for bank executives

- a) How would you define corporate governance? Do you think the current corporate governance regulations operating in Kenya are meeting their intended objectives?
- b) What are some of the initiatives that your bank has undertaken to comply with CG guidelines in Kenya?
- c) Do banks need special corporate governance arrangements from those pertaining in other non-financial firms?
- d) How would you define the relationship between corporate governance and bank performance in terms of profitability or other performance criteria?
- e) Do you think that corporate governance is best left to the market forces, or is there a need for an active enforcement by the Central Bank, or any other regulatory authorities?
- f) What do you consider to be the main factors that determine the structure and composition of bank boards in Kenya? Are age and gender considerations of relevance?
- g) How would rate the implementation of the corporate governance code? Do you think that enforcement of corporate governance by the relevant authorities has been adequate?
- h) What recommendations would you make to further improve the state of corporate governance in Kenya, particularly so within the banking industry?

Interview schedule for CMA respondent

- a) What are your general views regarding the state of corporate governance in Kenya?
- b) Is there a link between CG and bank financial performance?
- c) Is CG best left to market forces or is there a need for intervention by the government/regulatory agencies?

- d) What do you consider to have been the main influences on the development of CG in Kenya?
- e) Does compliance with CG guarantee effective management practices for the running of banks? Have you ever taken any actions as a result of non-compliance by some banking institutions?
- f) What is the role of audit function in the Kenyan CG environment?
- g) What do you consider to be the role of board? What do you think characterizes a good bank board?
- h) What local and/or international organisations does CMA cooperate with in improving the regulatory framework for CG in Kenya?
- i) Where do Shareholders come in when designing/revising the CG framework?
- j) What is your opinion regarding the overall Kenyan shareholder community?

Interview schedule for CCG respondent

- a) What are your general observations regarding the state of corporate governance in the Kenyan banking sector?
- b) Do you think there is a link between corporate governance and bank performance in terms of profitability or any other performance criteria?
- c) Do you think that corporate governance is best left to interaction of market forces, or is there a need for intervention by government/regulatory agencies?
- d) Are the current CG regulations operating in Kenya meeting their intended objectives?
- e) Do banks need different CG arrangements from the non-financial entities?
- f) How effective is the CG framework in Kenya? Do you consider its implementation and enforcement to be adequate?
- g) What do you consider to have been the main influences on the development of CG in Kenya?
- h) What recommendations would you make to further improve CG within Kenyan banking industry?

Appendix 9 – Framework followed in the coding process

Themes	Categories	Code
Perception of corporate governance (PCG)	Meaning of CG (M)	PCG-M
	CG: A foreign concept? (F)	PCG-F
	Regulation and governance (R)	PCG-R
	CG and performance nexus (P)	PCG-P
	Board of directors (BoD)	PCG-BoD
Implementation of corporate governance (ICG)	Board governance (BG)	ICG-BG
	Influences from global stage (G)	ICG-G
	Audit (A)	ICG-A
	Shareholders (S)	ICG-S
CG impact on financial performance (FP)	Going concern value (GC)	BFP-GC
	Reduced non-performing loans portfolio (NPL)	FP-NPL
	Cost efficiency (CE)	FP-CE
	Earnings (E)	FP-E