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BOARD MECHANISMS AND PROFITABILITY OF COMMERCIAL BANKS IN KENYA

MUGANDA MUNIR MANINI
LECTURER
DEPARTMENT OF BUSINESS STUDIES
JOMO KENYATTAUNIVERSITY OF AGRICULTURE & TECHNOLOGY
KENYA

UMULKHER ALI ABDILLAHI
STUDENT
FACULTY OF ECONOMICS & BUSINESS STUDIES
MASINDE MULIRO UNIVERSITY OF SCIENCE & TECHNOLOGY
KENYA

ABSTRACT

The role of effective board mechanism as key components of corporate governance has become an issue of global significance and has received new urgency due to various corporate scandals and failure. This study seeks to examine the impact of board mechanisms (audit committee size, audit committee composition, board size, and board composition) on profitability based on the annual reports of nine listed banks in Kenya in the period 2008 to 2012. Using multiple regression as a method of estimation the results of this study reveal that board size, board composition, audit committee size and audit committee composition have no effect on bank profitability in the selected sample. The study suggests that banks with effective board mechanisms may improve financial performance depending on the measure used although not all board mechanisms are significant. The study is significant because it can aid the policy makers in the formulation of policies, which can be effectively implemented for better and easier regulation of banks. The findings of the study have significant managerial and theoretical implications.

KEYWORDS

Board mechanisms, bank profitability, board size, audit committee, Kenya.

1.0 INTRODUCTION

The Board of Directors is responsible for the long-term strategic direction for profitable growth of the company whilst being accountable to the shareholders for legal compliance and maintenance of the highest corporate governance standards and business ethics. The Board performs a key monitoring function for dealing with agency problems in the firm (Fama, 1980; Jensen, 1993). Board mechanism is a key component in corporate governance which can be defined as a frame work that protect stakeholders rights by illustrating an effective board of directors, efficient internal control and audit in addition to reliable financial reporting and disclosure (Melvin and Hirt (2005). The separation of ownership and control in modern corporations leads to an agency problem where the agent operates the firm in line with their own interests, instead of shareholders (Jensen and Meckling, 1976). The need for corporate governance arises from these potential conflicts of interest among stakeholders such as shareholders, board of directors and managers in the corporate structure. Imam and Malik (2007) argues these conflicts of interest often arise from two main reasons. First, different participants have different objectives and preferences. Second, the participants have imperfect information as to each other's actions, knowledge, and preferences. Effective board mechanisms is intended at reducing divergence of interest and monitoring of controlling interests of the firm, in the absence of which firm value declines (Nanka-Bruce, 2009). According to Abu-Tapanjeh (2006) good board mechanism is a fundamental necessity to keep on running a firm successfully. It has long played a crucial role in enhancing the long-term value of stakeholders in the business environment. Board mechanisms provides structures that works for the benefit of the firm and can help in increasing firm's performance by reducing agency problem (Khan et al., 2011).

There are different board mechanisms adopted that safeguard the interests of the stakeholders (Sanda et al., 2005). Such board mechanisms include board size, board gender diversity, size of audit committee, and board of directors' educational qualification and experience. Many researchers have studied the impact of board mechanisms on firms' performance from different perspectives in different environments using a number of variables of interest (Sanda et al., 2005; Abu-Tapanjeh, 2006; Aljifri and Moustafa, 2007; Ibrahim et al., 2010; Al-Hawary, 2011; Khatab et al., 2011). The researchers' found mixed results on the relationship between corporate governance mechanisms and firms' performance.

Lupu and Nichitean (2011) argue good corporate governance of banks in developing economies is of even greater importance given the dominant position of banks as providers of fund. In developing economies banks are typically the most important source of finance for the majority of firms. A sound financial system is based on profitable and adequate capitalized banks. As it is said by different researchers, performance of banks is affected by good corporate governance practice and policies. Despite this aspect, little attention has been paid to the research of board mechanisms in less developed economies in general and particularly in Kenya. The aim of this paper is to examine the impact of board mechanism have on profitability of commercial banks in Kenya. The Banking industry is the subject of analysis in this study for two reasons. Firstly, even though information asymmetries exist in all sectors it is larger in banking industry since banks are generally more opaque than non-financial firms (Levine, 2003). This greater informational asymmetry between insiders (bank management) and outsiders (shareholders and depositors), and the opacity of their assets and activities in banking sector amplifies the agency problem. Thus, it requires giving special attention to banks corporate governance mechanisms. Secondly, banks are corporations which activate different areas of business. Banks have a dominant position in developing economic financial systems, and are important engines of economic growth (Levine, 1997). Hence, banking failure would affect the entire financial system and economy. Keeping this in view and the potential contribution of the banking industry to the economy of developing countries, this study is conducted to measure and analyze the impact of board mechanisms on firms' profitability using commercial banks in Kenya.

1.1 AN OVERVIEW OF THE BANKING SECTOR IN KENYA

According to the CBK (2010), the banking sector comprised 43 commercial banks, 1 mortgage finance company, 2 deposit taking microfinance institutions, 2 representative offices of foreign banks and 126 foreign exchange bureaus. In Kenya the corporate governance of banks is directed and supervised by the Central Bank of Kenya. The commercial banks in Kenya are licensed and regulated pursuant to the provisions of the Banking Act and the regulations and prudential guidelines issued by the Central Bank of Kenya. The Central Bank of Kenya monitors and controls the banking business and functions as regulators of the country's money supply. Accordingly, CBK issues directives on the size, composition and competence of board of directors. According to the Banking Act, the CBK is responsible for issuing directives on the qualification and competency to be fulfilled by directors; the minimum number of directors in the membership of the board of a bank, the duties, responsibilities and good corporate governance of the boards of directors of bank and the maximum number of years a director may serve in any bank. The Kenyan banking system is well regulated with the CBK conducting off-site and on-site surveillance. Over the last few years, the Banking sector in Kenya has continued to growth in assets, deposits, profitability and products offering. The growth has been mainly underpinned by an industry wide branch network expansion strategy both, automation of a large number of services and a move towards emphasis on the complex customer needs rather than traditional 'off-the-shelf' banking products. Players in this sector have experienced increased competition over the last few years resulting from increased innovations among the players and new entrants into the market

The financial liberalization reform of 1995 allowed the participation of private financial institutions in the economy. Private Banks' participation has increased and hence the share of their banking assets to total commercial banking assets increases. The banking environment in Kenya has, for the past decade, undergone many regulatory and financial reforms. These reforms have brought about many structural changes in the sector and have also encouraged foreign banks to enter and expand their operations in the country. Kenya's financial sector is largely bank-based as the capital market is still considered narrow and shallow (Ngugi *et al*, 2006). Banks dominate the financial sector in Kenya and as such the process of financial intermediation in the country depends heavily on commercial banks. In fact Ngugi *et al*, (2006) describes the banking sector in Kenya as the bond that holds the country's economy together. Sectors such as the agricultural and manufacturing virtually depend on the banking sector for their very survival and growth. Key banking sector policy developments which have taken place include the introduction of credit reference bureaus, Islamic banking, agency banking and licensing of deposit taking microfinance institutions (CBK 2010). As in most developing countries, financial sector policy in Kenya aims at achieving more effective intermediation, and improving soundness and depth (Ngugi *et al*, 2006). According to (Ngugi *et al*, 2006) the Kenyan authorities have chosen to pursue these goals within a distinctive strategic framework for the financial sector, and emphasize the importance of further strengthening corporate governance and accountability of financial institutions. Ensuring better corporate governance of corporations, financial institutions and markets is increasingly recognized as a pre-condition for the economic development.

2.0 REVIEW OF LITERATURE

This section reviews previous studies pertaining to the relationship between board mechanisms and firms' financial performance. The important empirical studies are summarized below in this section. The Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya set out good corporate governance requirements which listed companies should comply with and adhere to, observe and report on. Of particular interest is the composition and role of the Board, qualifications and experience of directors, board committees and general corporate governance. As listed companies, the commercial banks in Kenya need to adhere to best practice in corporate governance and also report on its said compliance on a regular basis

2.1 BOARD SIZE AND FIRM PROFITABILITY

The Board is responsible for the firm's corporate governance practices and recognizes its responsibilities to shareholders and other stakeholders to uphold the highest standards in economic, social, environmental and ethical matters by ensuring that the bank conducts its business in accordance with best practice in corporate governance. Kiel and Nicholson (2003) argue that board size is crucial to achieving the board effectiveness and improved firm performance.

Bathula (2008) studied the association between board characteristics and firm performance. Board characteristics which were considered in the research included; board size, director ownership, chief executive officer duality, gender diversity, educational qualification of board members and the number of board meetings. Additionally, firm age and firm size was used as control variables. Firm performance was measured by return on assets. To test the hypothesis a sample of 156 firms over a four year period data from 2004 to 2007 was used. The sample included all firms listed on New Zealand stock exchange. Empirical analysis was undertaken using Generalized Least Squares analyses. The findings of the study showed that board characteristics such as board size, chief executive officer duality and gender diversity were positively related with firm performance, whereas director ownership, board meetings and the number of board members with PhD level education was found to be negatively related. Firm age and firm size does not have significant influence.

According to Lawal (2012), board size affects the quality of deliberation among members and ability of the board to arrive at optimal corporate decisions. Therefore, identifying the appropriate board size is essential because size can be detrimental to corporate governance effectiveness beyond optimal level. However, determining an ideal size of the board has being an ongoing and controversial debate in corporate governance literature (Lawal, 2012). Many studies prefer that the number of board size must be between seven to fifteen directors (Ogbechie, et.al, 2009). However, other studies argue that the size of the board should be limited to seven or eight members (Lipton and Lorsch, 1992; Jensen, 1993). Jensen (1993) argues that a larger board leads to less effective monitoring due to coordination and process problems inherent in large board size. Larger boards can be less participative, less cohesive, and less able to reach consensus. Coordination, communication and decision-making problems increasingly impede company performance when the number of directors increases (Uadiale, 2010).

Al-Manaseer et al. (2012) also argues that boards with too many members lead to problems of coordination in decision making. Small board size are favored to promote critical, genuine and intellectual deliberation and involvement among members which presumably might leads to effective corporate decision making, monitoring and improved performance (Lawal, 2012). In contrast Klein (2002) suggested that larger boards are able to promote effective monitoring due to their ability to distribute the work load over a greater number of observers. Thus, board size can influence the financial performance of firms. Therefore, it is expected that commercial banks in Kenya with large board size are more likely to be more profitable; thus the following hypothesis is formulated:

H1: There is a relationship between board size and bank profitability.

2.2 BOARD COMPOSITION AND FIRM PROFITABILITY

The board needs to have the right balance between independent, non-executive and executive directors of diverse skills, expertise, competencies and experience to effectively guide the company and ensure that the objective of shareholder value maximization is achieved. The skills, knowledge and experience as well as the demographic profile of the board are regularly reviewed to ensure that the board composition remains appropriate given the dynamics of the banking industry. Board composition is part of the broader concept of board diversity. Boards are concerned with having the right composition to provide diverse perspectives. Greater non-executive directors representation on boards provides some additional skills and perspectives that may not be possible with an all executive director board (Boyle and Jane, 2011).

Board diversity promotes more effective monitoring and problem-solving. Boyle and Jane, (2011) suggest that non-executive directors will bring diverse viewpoints to the boardroom and will provoke lively boardroom discussions. Board diversity and independence is supported by different theoretical perspectives. Agency theory is mainly concerned about monitoring role of directors and argues representation from diverse groups will provide a balanced board so that no individual or group of individuals can dominate the decision-making of the board (Erhardt et al., 2003). The management may be less able to manipulate a more heterogeneous board to achieve their personal interests. Non-executive directors are associated with effectiveness in the oversight function of boards of directors. The oversight function may be more effective if there is diversity in board which allows for a broader range of opinions to be considered.

According to Erhardt et al. (2003), diversity of the board of directors and the subsequent conflict that is considered to commonly occur with diverse group dynamics is likely to have a positive impact on the controlling function and could be one of several tools used to minimize potential agency issues. From the stakeholders' theory, diversity also provides representation for different stakeholders of the firm for equity and fairness (Keasey et al., 1997). From resource dependency perspective, the board is a strategic resource, which provides a linkage to various external resources (Walt and Ingley, 2003). This is facilitated by board diversity. On the other hand, Haniffa and Hudaib (2006), revealed insignificant association between board composition and firm performance. However, many scholars now believe that an increase in board diversity leads to better boards and governance on the ground that diversity allows boards to tap on broader talent pools for the role of directors (Bathula, 2008). The following hypothesis is formulated based on the above discussion:

H2: There is a relationship between board composition and bank profitability.

2.3 AUDIT COMMITTEE SIZE AND FIRM PROFITABILITY

The role of the board audit committee is to review the bank's financial position and make recommendations to the board on all financial matters. This includes assessing the integrity and effectiveness of accounting, financial, compliance and other control systems. The committee deals with all matters relating to the financial statements and internal control systems of the banks including dealing with independent auditors and Central Bank of Kenya inspectors. It also provides the assurance that the banks complies with legal and regulatory provisions in its operations and business conduct.

Jensen and Meckling (1976) argue the audit committee plays a significant role in the monitoring process carried out by the directors of the firm and auditing is used by firms to reduce agency costs. In addition to that they revealed that most essential board decisions originate at the committee level, and this includes the audit committee. Audit committees thus, represent another internal governance mechanism whose impact is to improve the quality of financial management of a company and hence its performance.

Kyereboah-Coleman (2007) reported a significant positive relation between size of the audit committee and firm performance (ROA and Tobin's q) using the overall sample. Kyereboah-Coleman (2007) describe that size of the audit committee could be an indication of the seriousness attached to issues of transparency by the organization. However, only using Ghanaian sample the size of the audit committee showed a negative effect on performance.He explained as free-ridership and difficulty in consensus building in large groups leads to low performance.

In addition, Lin et al (2006) found significant positive association between audit committee size and occurrence of earnings restatement. It was explained that a certain minimum number of audit committee members may be relevant to the quality of financial reporting. Aldamen et al. (2011) reveals that smaller audit committees with more experience and better educational qualifications are more likely to be associated with positive firm performance. Based on the above discussion, the following hypothesis is formulated:

H3: There is a relationship between audit committee size and bank profitability.

2.4 AUDIT COMMITTEE COMPOSITION AND FIRM PROFITABILITY

The audit committee is a sub-committee of the board of directors and its primary role is to monitor and review financial statements (Yammeesri and Herath, 2010). An audit committee has a particular role of ensuring that the interests of shareholders are properly protected in relation to financial reporting and internal control (Habbash, 2010). The use of an audit committee is an important part of the decision control system for internal monitoring by boards of directors (Fama and Jensen, 1983). Monitoring is performed by external audit and audit committees. The existence of an audit committee improves the monitoring of corporate financial reporting and internal control and it helps to promote good corporate governance in turn this improves firms' financial performance by reducing agency cost (Al –Sa'eed and Al-Mahamid, 2011). Size is vital characteristics of audit committees (Habbash, 2010). Independence audit committee is necessary to achieve the negotiations and delegations carried out by the board members to positively affect their firms. Improving auditor independence is important to improve transparency of financial reporting. The audit committee should be independent from the management to improve the oversight role and protect the interests of shareholders. If the audit committee is independent from the organization's management and owners, they should be able to prevent management to manipulate the financial results (Beasley, 1996). Sommer (1991) points out that the presence of independent audit committee is an indicator of the commitment of the firm's corporate governance practice. Some of the previous literature suggest that the majority of audit committee members should be independent (Klein, 2006). However, some previous literatures provide evidence that there is a positive effect on the quality of financial statements with the presence of independent audit committees (Petra, 2007). Sunday (2008) studies the relationship between audit committee composition and firm in Nigerian listed companies, and he did not find a significant relationship between audit committees composition and firm performance. However, Sunday (2008) found that audit committee contributes to better share price if it has independent members, because they have better understanding of financial risk. Furthermore, Kyereboah-Coleman (2007) found that audit committee size has a positive relationship with the effectiveness to monitor misreporting. Based on the above discussion, the following hypothesis is formulated:

H4: There is a relationship between audit committee composition and bank profitability.

3.0 IMPORTANCE OF THE STUDY

The results of this study will contribute to commercial banks by identifying relevant corporate board mechanisms and how this affects bank profitability. The result of this study contributes to the existing literature by providing evidence on the relation between board mechanisms and banks' financial performance. The empirical results would also be useful for regulators, policy makers, managers and business people in making policies and decisions. It can serve as a stepping stone for future researchers who want to conduct study on related topic. To the best of the researcher's knowledge no empirical study has been undertaken to ascertain the impact of board mechanisms on financial performance of commercial banks in Kenya. The current study, therefore, seeks to fill this gap using panel data from the banking industry in Kenya.

4.0 STATEMENT OF THE PROBLEM

There is a renewed interest on the need to strengthen board mechanisms to ensure that managers and directors take measures to protect the interest of a firm's stakeholders. The role played by the Board of directors has become an issue of global significance and has received new urgency due to various corporate scandals and failures (Lawal, 2012). In Kenya, the boards of the banks are responsible for the governance of the banks and are committed to ensuring that its business and operations are conducted with integrity and in compliance with the law, internationally accepted principles and best practices of corporate governance and business ethics. In this respect, the board ensures that the banks comply with all relevant local legislation, including the provisions of the Banking Act and the prudential regulations issued by the CBK. Several studies have been done in developing and developed countries to investigate the relationship between board mechanisms and firm performance. However, the results of the previous studies are inconsistent. Further, studies that critically assess the impact of board mechanisms and firm performance are, so far limited in the country. This is perhaps due to the fact that both board mechanisms and other corporate governance mechanisms are new, and it is only now that they are recognized as important strategies in the process of corporate policy development in Kenya.

5.0 OBJECTIVES

GENERAL OBJECTIVE

The primary objective of the study is to examine the impact of board mechanisms on the profitability of commercial banks in Kenya.

SPECIFIC OBJECTIVES

1. To examine the relationship between board size and profitability of commercial banks in Kenya.
2. To investigate the relationship between board composition and profitability of commercial banks in Kenya
3. To investigate the association between audit committee size and profitability of commercial banks in Kenya
4. To examine relationship between audit committee composition and profitability of commercial banks in Kenya

6.0 HYPOTHESES

1. *H1*: There is a relationship between board size and bank profitability.
2. *H2*: There is a relationship between board composition and bank profitability.
3. *H3*: There is a relationship between audit committee size and bank profitability.
4. *H4*: There is a relationship between audit committee composition and bank profitability.

7.0 RESEARCH METHODOLOGY

7.1 RESEARCH DESIGN

The study utilized explanatory research design with a mixed approach as it sought to identify and evaluate the causal relationships among the key study variables. Mixed methods research provides better inferences as it is able to capitalize the strength of quantitative and qualitative approach and remove any biases that exist in any single research method (Creswell, 2003). Finally, a panel data study design was used. The advantage of panel data analysis is that more reliable estimates of the parameters in the model can be obtained between the different variables under consideration (Gujarati, 2004).

7.2 SAMPLING DESIGN
The population of the study was all commercial banks operating in Kenya in the period 2008-2012. According to the information obtained from Central Bank of Kenya there were 43 registered banks operating in Kenya of which nine are listed in the Nairobi Securities Exchange. The sample size for the study comprised a total of nine commercial banks which were listed on the Nairobi Stock Exchange (NSE) during the study period. Purposive sampling was used to get the sample in order to include a representation critical to providing answers to the research hypotheses.

7.3 DATA SOURCE AND COLLECTION METHODS
The data for this study was collected from secondary sources. The secondary sources of data were the audited financial statements of the sample commercial banks over a period of five years (2008-2012). Data for the study were extracted from the annual reports of the nine listed banks. The website of each of the banks was visited to collect necessary data for the study. In all, 45 observations were obtained after editing the annual reports of the nine banks and were used for the study.

7.4 DESCRIPTION OF VARIABLES AND MEASUREMENTS
7.4.1 DEPENDENT VARIABLES
Return on assets (ROA) is the measurement utilized to measure bank profitability. ROA is the earnings after tax divided by total assets of the bank.

7.4.2 INDEPENDENT VARIABLES
This section provides measurements of the board mechanisms as independent variables which are considered as follows. The size of a bank is calculated as the total number of directors serving on the board of directors. The board composition is measured as the ratio of independent directors to the total number of directors. The audit committee size is measured as the total number of members serving on the audit committee. The audit committee composition is measured as the ratio of independent members to the total number of members serving in the audit committee. The description of the study variables is presented in Table 1.

TABLE 1: DESCRIPTION OF VARIABLES

Variables	*Description*
Measures of bank profitability(dependent variable)	
Return on Asset (ROA)	Profit after tax/Total Asset
Measure of Board Characteristics (independent variable)	
Board Size (BSIZE)	The total number of directors serving on the board of directors
Board Composition)	The proportion of independent directors to the total number of directors
Audit Committee Size	The total number of members serving on the audit committee
Audit Committee Composition	The proportion of independent members on the audit committee

Source: Author's construction

7.5 MODEL SPECIFICATION
To estimate the impact of board mechanisms on the bank profitability of sample commercial banks in Kenya the following general empirical research model is developed.

$$\mathbf{Yit= \beta0 + \Sigma\beta KXit + \varepsilon it} \quad (1)$$

Where:
- Y*it* represents the dependent variable (ROA) of bank *i* for time period *t.*
- β0 is the intercept
- βK represents the coefficients of the X*it* variables
- X*it* represents the explanatory variables (BSIZE, BCOM, ASIZE and ACOM) of bank *i* for time period *t.*
- ε*it* is the error term

Therefore, the panel data model relating to the impact of board mechanisms on the bank profitability was stated as:

$$ROAit = \beta0 + \beta1(BSIZEit) + \beta2(BCOMit) + \beta3(ASIZEit) + \beta4(ACOMit) + \varepsilon it \quad (2)$$

Where:
i denote banks ranging from 1 to 9 (cross-sectional dimension).
t denote years ranging from 2008 to 2012 (time-series dimension).

DEPENDENT VARIABLES
ROA*it* Return on Asset for *i*th bank and time period *t*

INDEPENDENT VARIABLES
BSIZE*it* Board size for *i*th bank and time period *t*
BCOM*it* Board composition for *i*th bank and time period *t*
ASIZE*it* Audit committee size for *i*th bank and time period *t*
ACOM*it* Audit committee composition for *i*th bank and time period

7.6 DATA ANALYSIS AND PRESENTATION
Correlation and multiple regression analysis were employed to analyze data collected. The correlation analysis was used to identify the relationship between the independent and dependent variables using Pearson correlation analysis. The correlation analysis shows only the degree of association between variables and does not permit the researcher to make causal inferences regarding the relationship between variables (Marczyk et al., 2005). Therefore, multiple regression method is used to examine the relationship between the firm profitability and board size, audit committee size, audit committee composition, and board composition SPSS 17 software was used for analysis and the results were presented through tables.

8.0 RESULTS AND DISCUSSIONS
8.1.1.DESCRIPTIVE STATISTICS
Appendix 1 presents the descriptive statistics of the board mechanisms that influence the profitability of commercial banks in Kenya. The Table shows that the mean of board size is approximately 10.5 with a maximum of 13 members and a minimum of eight members. The mean of board composition is 76.40%, while the maximum and minimum are 92% and 50% respectively which means that some companies have a full independent board of directors, and some companies have one half dependent boards of directors. In regards to the board size and board composition, the Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya require that the board of directors should consist of at least three directors and 22 directors as a maximum. Further, that one third (33.33%) of the board of directors or three members of them should be independent directors. The mean of Audit Committee size is 4.8, while the maximum and minimum are 10 and 2 respectively. The Audit Committee size should have a minimum of three members in Kenya. Therefore, it is clear that the Audit Committee in the listed banks in the Nairobi Securities exchange have more than three members in average. The mean of Audit Committee composition is almost 85.67 %, while the maximum and minimum are 100% and 33% respectively. This implies s 85.67 % of the Committee members are independent while almost 14.33 % shows dependent members which means that some companies have fully dependent Audit Committee. Table 4.1 reveals that the mean of ROA is approximately 4.38% with a maximum of 7% members and a minimum of 1%. According to Flamini et al. (2009.) the average ROA in Sub-Saharan Africa,(SSA) was about 2%. Thus, the average ROA of listed Kenyan banks is above average of the SSA.

8.1.2 CORRELATION ANALYSIS

Appendix 2 summarizes the correlation between the independent variables and dependent variable. It displays that board size, board composition, audit committee size and audit committee composition are not related to the bank profitability (ROA). Furthermore, Appendix 2, also presents the correlations between the independent variables to each other. It shows that there exists relationships between board size, audit committee size, audit committee composition and board composition. The Board size has a positive significant relationship with board composition, which means that the size of board of directors plays a significant role in determining the board composition. In other words, large board size leads to larger board composition. However, board size has a negative significant relationship with audit committee size, which means that the board size is significant in determining the audit committee size. This implies that large board size leads to smaller audit size this could due to the fact the large board is already involved in this monitoring function hence no need for replication of roles. Besides, Appendix 2 also shows that audit committee composition has relationship with all the other independent variables. Meanwhile, audit committee size plays a significant role not only in determining the audit committee composition; as it has a significant negative relationship with audit committee composition, which means that larger audit committee leads to more executive (dependent)board of directors.

8.1.3 MULTIPLE LINER REGRESSION ANALYSIS

To assess the impact of board mechanism on bank profitability, the dependent variable ROA was regressed on the independent variable (board size, audit committee size, audit committee composition, and board composition). Appendix 3 shows multiple regressions which is related to ROA as dependent variable. The analysis in Appendix 3 indicates that the overall effect of the explanatory variables on the bank's profitability is statistically insignificant (overall p-value=0.086). This indicates that the independent variables determine 3.1% of the ROA variance. This means that there are other factors affecting ROA by 96.9%.Table 3 above shows that there is no statically significant relationship between all independent variables namely board size, audit committee size, audit committee composition, and board composition on the bank profitability (ROA).

9.0 FINDINGS

The results from Appendix 2 and 3 demonstrate that board size is negatively correlated with bank profitability, implying that a reduction in the board size of a bank is likely to trigger an increase in its profitability. However there is an insignificant relationship between board size and bank profitability (ROA). Based on this finding, the first hypothesis, which stated that there is a relationship between board size and bank profitability (ROA), is rejected. This finding is similar to some previous studies. Fama and Jensen (1983); Lipton and Lorsch (1992); Yermack (1996); Jensen (1993); Eisenberg et al. (1998); and Cheng (2008).who did not find significant relationship between board size and firm performance (ROE and ROA). Based on the analysis of this study, the argument by Klein (2002) and Andres and Vallelado (2008) that a large board size should be preferred to a small size because of the possibility of specialization for more effective monitoring and advising functions is not supported. It suggests that banks in Kenya that constitute large boards of directors should be burdened with some significant decline in their profitability. Shakir (2008), argues that the board size does not reflect its effectiveness. If the board has adequate experience and knowledge, it would be a crucial to ensure that the board functions effectively. Guest (2009) points out that the relationship between board size and firm performance may differ due to differences in national institutional characteristics and firm specific characteristics. In the other words, the functions of the boards are different due to differences in institutional backgrounds. Therefore, the expected relationship between board size and firm performance could be different as a result.

Evidence presented on Appendix 2 and 3 reveal board composition (proportion of non-executive directors) is negatively correlated with profitability of a bank. However, this is statistically insignificant. Therefore, hypothesis *H2* is rejected. This is consistent with some previous studies such as Haniffa and Hudaib (2006),Chaganti et al.(1985); Daily and Dalton (1992), Klein (1998); Kesner et al. (1986); Zahra and Stanton (1988); and Fosberg (1989) that no relationship exists between board composition and firm performance. This result does not necessarily contradict the notion that non-executive directors presence on boards may be useful and positive in general. Nevertheless, the high number of non-executive directors on the boards of sample Kenyan commercial banks does not necessary give them sufficient monitoring power. The result is not surprising because other studies that examined the association between proportion of non-executive directors on boards and firm performance also found insignificant result (Rose, 2007; Habbash, 2010).

Based on the result in Appendix 3, there is no significant relationship between audit committee size and profitability which imply that the third hypothesis is rejected. This result is consistent with studies by (Jensen and Meckling, 1976); Kyereboah-Coleman, 2007; Aldamen, et al., 2011 ;AbdurRouf (2011); Mak and Kusnadi (2005).). Kyereboah-Coleman (2007) point out that the size of the audit committee negatively influence performance using Ghanaian sample firms. Further, Sunday (2008) studied the relationship between audit committee composition and firm performance (ROA and profit margin) in 20 non-financial firms listed in Nigeria, and the result could not provide a significant association between them. This study result supports the notion that a certain minimum number of audit committee members may be relevant to the quality of financial reporting and to enhance financial performance. Free-riding and difficulty to reach in consensus in large groups inversely affect financial performance.

As shown in Appendix 3, the relationship between audit committee composition and profitability is not significant; this result rejects the fourth hypothesis which stated that there is a relationship between audit committee composition and firm performance (ROA).This result is consistent to Mak and Kusnadi's (2005) in Malaysia and Singapore. In addition, Sunday (2008) studies the relationship between audit committee composition and firm performance (return on assets and profit margin) in 20 non-financial firms listed in Nigeria, and he could not provide a significant association between them. This study result supports the arguments that the structure of the audit committee should also comprise a number of directors, which fairly reflects the Company's shareholding structure. The audit committee composition should not be biased towards representation by a substantial shareholder but should reflect the Company's broad shareholding structure. The composition of the audit committee should also provide a mechanism for representation of the minority shareholders without undermining the collective responsibility of the directors.

10.0 CONCLUSION

The objective of this paper was to examine the relationship between board mechanisms and bank profitability in Kenya. This study did not find any significant association between board mechanisms (board size, audit committee size, audit committee composition, and board composition) and bank profitability (ROA). Similar to Mak and Kusnadi (2005) and AbdurRouf (2011), this study found no association between audit committee size and bank profitability. In addition, the study investigated the relationship between audit committee composition and firm performance, and it did not find a significant relationship between them, which is similar to Mak and Kusnadi's (2005) and Sunday (2008) in Malaysia and Nigeria respectively. Furthermore, the study did not find evidence about the relationship between board size and firm performance, which is consistent to Topak (2011) who could not find a relationship between firm size and firm performance in the Turkish listed companies.

11.0 RECOMMENDATIONS

This study examined the impact of board mechanisms on firms' profitability by taking evidence from selected commercial banks in Kenya. On the basis of the findings and conclusions reached, the following recommendations were forwarded.

- This study revealed that the boards of banks are dominated non-executive directors and board diversity is very limited in Kenyan commercial banks. Thus, there is much to be done to improve the balance of boards in Kenyan banks with a great care about their qualification and competency. The board of directors of every listed company should reflect a balance between independent, non-executive directors and executive directors.
- The study recommends the board size of banks to be small in number to optimal level with better educational qualification since small board size with better educational qualification is more effective in monitoring managers and help to improve performance. However, the size of the board should not be too large to undermine an inter-active discussion during board meetings or too small such that the inclusion of a wider expertise and skills to improve the effectiveness of the board is compromised.

- Finally, the study recommends that Kenyan commercial banks should make their audit committee size small to improve their performance. Experienced directors should be assigned in committee based on their practical background to make them to contribute more in promoting good governance. The chairman of the audit committee should be an independent and non-executive director. The audit committee should have adequate resources and authority to discharge their responsibilities.

12.0 SCOPE FOR FURTHER RESEARCH

Based on the outcomes of this study, the following issues are suggested for further research. First, by further increasing the study population and the sample size to the whole financial sector. Second, by taking evidence from other industries and increasing the number of observations through the use of large sample size and long years data. The relationship between board mechanisms and firms' financial performance can also be further explained if future researchers conduct study including more board mechanisms variables.

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14.0 APPENDICES

APPENDIX 1: DESCRIPTIVE STATISTICS

	N	Minimum	Maximum	Mean	Std. Deviation
RETURN ON ASSET	45	.01	.07	.0438	.01466
BOARD SIZE	45	8.00	13.00	10.5111	1.12052
BOARD COMPOSITION	45	.50	.92	.7604	.13277
AUDIT COMMITTEE SIZE	45	2.00	10.00	4.8222	2.24913
AUDIT COMMITTEE COMPOSITION	45	.33	1.00	.8567	.22071
Valid N (listwise)	45				

APPENDIX 2: CORRELATION ANALYSIS OF RETURN ON ASSET (ROA) AND BOARD MECHANISM

		ROA	BSIZE	BCOM	ASIZE	ACOM
ROA	Pearson Correlation	1	-.065	-.129	.166	-.153
	Sig. (2-tailed)	.	.672	.397	.277	.317
	N	45	45	45	45	45
BSIZE	Pearson Correlation	-.065	1	.475(**)	-.450(**)	.474(**)
	Sig. (2-tailed)	.672	.	.001	.002	.001
	N	45	45	45	45	45
B COM	Pearson Correlation	-.129	.475(**)	1	-.667(**)	.365(*)
	Sig. (2-tailed)	.397	.001	.	.000	.014
	N	45	45	45	45	45
ASIZE	Pearson Correlation	.166	-.450(**)	-.667(**)	1	-.822(**)
	Sig. (2-tailed)	.277	.002	.000	.	.000
	N	45	45	45	45	45
ACOM	Pearson Correlation	-.153	.474(**)	.365(*)	-.822(**)	1
	Sig. (2-tailed)	.317	.001	.014	.000	.
	N	45	45	45	45	45

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

APPENDIX 3: SUMMARY OF REGRESSION RESULTS

MODEL SUMMARY(b)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.177(a)	.031	-.065	.01513

a Predictors: (Constant), AUDIT COMMITTEE COMPOSITION, BOARD COMPOSITION, BOARD SIZE, AUDIT COMMITTEE SIZE
b Dependent Variable: RETURN ON ASSET

ANOVA(b)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.000	4	.000	.324	.860(a)
	Residual	.009	40	.000		
	Total	.009	44			

a Predictors: (Constant), AUDIT COMMITTEE COMPOSITION, BOARD COMPOSITION, BOARD SIZE, AUDIT COMMITTEE SIZE
b Dependent Variable: RETURN ON ASSET

COEFFICIENTS(a)

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.050	.043		1.164	.251		
	BSIZE	.001	.003	.046	.237	.814	.643	1.554
	BCOM	-.010	.028	-.086	-.342	.734	.380	2.631
	ASIZE	.000	.003	.035	.090	.929	.162	6.156
	ACOM	-.008	.022	-.114	-.352	.727	.229	4.365

a Dependent Variable: RETURN ON ASSET

Source: SPSS regression results based on the data obtained from sample banks

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