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## Corporate Governance and Performance of Financial Institutions in Kenya

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### **Abstract:**

*The introduction of corporate governance code by the central bank of Kenya in early 2000, corporate governance has attracted an incomparable attention of researchers because of expanding financial troubles financial firms are experiencing everywhere in the globe. Recent scandals regarding the moral deficiency of some financial institutions have stimulated public sensitivity towards cooperative governance issues of these firms. This study's main objective is based on empirical analysis which seeks to establish the effects of corporate governance on firm's performance within the Kenyan financial sector, including the characteristics of the management body, i.e. Board size, ownership concentration, auditor's reputation, independent directors, CEO's duality and annual number of board meetings, firm's size and leverage i.e. financial risk management. The researcher did a rigorous desktop review of secondary information on 'cooperate governance' and 'performance' from 2014 to date in the online library of various documents, publications and reports including journals and magazines. Based on the previous studies reviewed, the researcher appreciated that corporate governance is the key to the global integrity especially for financial institutions whose existence is wholly dependent on trust and integrity. Different scholars have advocated for different measurers to corporate governance on the measure of firms' performance and the common identified are board size, ownership concentration and auditor's reputation have a positive and significant impact on firms' return on assets (ROA), whereas the percentage of independent directors and the annual number of board meetings have negative and significant impact on firms' return on equity (ROE). CEO duality is found to not be an important determinant factor of firms' performance, as the results suggest that it shows insignificant effect on ROA and ROE. Firm's size and leverage are found to have negative and insignificant relationship with firms' performance. The study, recommended among others that Financial Institutions should increase their board size but within the maximum limit set by the code of corporate governance and ensure that all regulations provided by Central Bank are fully complied with.*

**Keywords:** Corporate governance, firm performance, audit committee, CEO duality, board size, board composition, firm size, return on asset, return on equity

### **1. Background**

Corporate governance has been gaining momentum over the past years, notably from the 1990s. The corporate governance issue has increasingly been discursive since some major corporate scandals emerged in the corporate world decades ago and is ever since considered a mean to resolve conflicts between managers and shareholders (Okpara, 2012). Corporate governance issues have attracted numerous researchers consideration in the recent decades because of expanding financial troubles firms experience everywhere throughout the globe (Danoshana and Ravivathani, 2013). In firms, Corporate Governance is the framework by which associations are coordinated and controlled. It has a lot of connections between organization executives, investors and other partner's as it tends to lean on the forces of directors and of controlling investors over minority interests, the rights of employees, rights of creditors and other stakeholders. Corporate governance components characterize and direct how a firm is represented and its related control instruments (Korent, Dundek and Calopa, 2014).

Superior corporate governance helps shield, investor's capital and investments and the anticipated equivalent returns. Institutions that have gained more than normal corporate governance components are straight forward in their operations and interact effectively with investors thus making it possible for them to gain access to the financial markets that are relatively competitive on more ideal terms (Okiro, Aduda&Omor, 2015). World Bank 2015, reports that policy agendas have paid attention to the concept of corporate governance of firms in developed market for over a decade. The concept is gradually taking its place as a priority in the African markets. The Asian crisis and the observed poor performance of the corporate sector in Africa have brought a new attention to the concept of corporate governance (Dalton, C. M. and Dalton, D. R., 2013).

Kenyan financial Institutions are long-faced with varied complicated risks in their regular operations that are exposed to credit risks, liquidity risks, interest rates, exposure concentration risk, exchange rates risk, settlement and internal operations risks. Business banks' reliance on soul confidence of the clientele, the maturity mismatches between their assets and liabilities and their comparatively high indebtedness renders them vulnerable (Kimeu, 2017). Inadequate managerial policies for risk mitigation can negatively affect the individual banking institutions as well as the entire banking sector. This shows that low performance of a particular bank has a potential to affect the performance of other institutions in the same industry. The broader economy is additionally in danger from any prolonged and vital disruption to the economic system (Kimeu, 2017).

Corporate performance is concerned with the overall productivity in an organization in terms of stock turnover, customers, profitability and market share. The concept of performance is key to businesses because the major objective of businesses is to make profits (Iraoet al., (2013). Performance can be seen here as the success in meeting pre-defined objectives, targets and goals. Firm performance is thus the effectiveness of a firm in achieving the outcomes it intends to achieve within specified time targets. These outcomes can be explained as the measures by which the firm is evaluated, and broadly include the quality of governance. A firm's relative position within its industry determines where a firm's profitability is above or below the industry average. A firm attains above average profitability in long run through sustainable competitive advantage (Pfeffer & Salancik, 2012).

The range by which objectives of the firm and in this case financial objectives will be met or have been met is referred to as financial performance (Yahaya & Lamidi, 2015). A company's financial performance is subject to how effectively a firm uses its assets from its principal role of conducting business and its subsequent generation of revenues. Financial performance can also refer to the general well-being of a firm as far as finance is concerned over a certain period of time. Financial performance can as well be used to gauge or measure firms from the same industry or across different industries for comparison purposes. Financial performance, in summary, is a crucial objective that firms especially the profit-oriented firms desire or aim at to achieve (Kajirwa, 2015).

The measurement of financial performance is usually based on financial ratios such as liquidity ratios, activity ratios, profitability ratios, and debt ratios (Bouba, 2011). Financial performance can be measured from various perspectives including: solvency, profitability, and liquidity (Mwangi & Angima, 2016). Performance measurement for a company can be done through accounting-based measures calculated from firm's financial statements such as Return on Equity (ROE), Return on Assets (ROA), and Gross profit margin (Mwangi & Murigu, 2015).

Before looking further into the concept of Corporate Governance it is important to understand the meaning of the word Corporate and Governance. The word Governance derived from Latin word 'Gubernare' meaning thereby to rule or steer. Governance is a word with a pedigree that dates back to Chaucer and in his day the word carried with it the connotation wise and responsible, which is appropriate. It means either the action or the method of governing and it is in that latter sense that it is used with reference to companies. A 'corporation' in turn means 'a legal entity that exists independently of the person or persons who have been granted the charter creating it and invested with many of the rights given to individuals.

The corporate world comprises of institutions, like companies, firms, proprietorship, etc. Corporate governance is a philosophy, by which companies are directed, monitored, managed and controlled. Corporate Governance provides the fundamental framework for the culture of an organization, which ensures efficient functioning of enterprises on sound ethical values and principles. Broadly it is a system of structuring, operating and controlling a company with a view to achieve long-term strategic goals to satisfy shareholders, creditors, employers, customers and complying with the legal and regulatory requirements, apart from meeting environmental and local community needs. (Jayashree R and Kotna, 2016). They further argued that it is difficult to define corporate governance with only one definition. Hence there are various definitions of corporate governance as given by various experts from time and again. Some of the important definitions to understand the perspective to corporate governance properly are enumerated here below.

The 1992 Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury Report) describes Wolfensohn, President, World Bank, has said that 'Corporate Governance is about promoting corporate fairness, transparency and accountability'. Even the Experts at Organization of Economic Co-Operation and Development (OECD) have defined 'Corporate Governance as the system by which business corporations are directed and controlled'; it means according to them it is a structure which specifies the distribution of rights and responsibilities among different participants in the corporations. But today the concept of corporate governance has taken a new dimension and it runs as follows. 'Corporate Governance is the application of the best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders'

Kandet *et al.* (2015) in their research stated that the role of corporate governance is manifested in creating value for the corporation and supporting transparency; protecting shareholders' rights and ensuring their equal treatment, acknowledging the interests of all entities that develop relationships with the company, assuming responsibility by the Board of Directors, integrity and ethical behavior, transparency in implementing internal and external control systems to certify the validity of corporate financial reports. Good practices of corporate governance are those whereby the environment in which the business operates is fair, processes are transparent and companies held responsible for their actions. Weak corporate governance practices on the other hand usually leads to waste, mismanagement and higher levels of corruption in those organizations.

Nabil and Ziad (2014) noted that investor confidence is improved by effective structures of corporate governance which ensure that the corporate entity is accountable, reliable and quality of public financial information is enhanced and that the capital markets integrity and efficiency is enhanced. Olick (2015) summarizes that the key corporate governance

and administration aspects are structure of the board and its committees, composition of the board of directors, processes and procedures guiding the board, how independent the board is, auditing aspects, and how corporate information is disseminated and disclosed. Corporate Governance was brought in limelight through series of corporate failures such as Enron and World. Corn. These companies collapsed because of the corporate mis- governance and unethical practices they indulged in. Satyam scandal in India is also the case of corporate is-governance. Satyam case exposed the complete lack of accountability in the company and raised questions on corporate governance practices of the country. (Jayashree R Kotna, 2016)

Financial Institutions are the backbone of the economic sector of any country. The healthy economic condition of a nation is depicted through the sound functioning of its financial institutions. Financial institutions form a crucial link of a country's economic sector hence they are universally regulated industry and their well-being is imperative for the economy. Working of financial institutions is different from other corporate in many important respects, and that makes corporate governance of banking not only different but also critical. Hence corporate governance is conceptually different for financial institutions. If a corporate fail, the fall outs can be restricted to the stakeholders, but if a financial institution fails, the impact can spread rapidly through other financial institutions with potentially serious consequences for the entire financial system and the macro-economy. Thus, though guidelines are provided for working of a financial institution, corporate governance cannot be overlooked or discarded. Regulations, guidelines and corporate governance are complementary to each other in banking industry. (Jayashree R Kotna, 2016)

Currently, In Kenya the number of licensed Financial Institutions is 42 and there is one mortgage finance company. Out of these, Financial Institutions amounting to 39 and the mortgage finance institution are owned by private investors while the remaining 3 Financial Institutions are the only banks which Kenya Government holds a controlling ownership. Out of the 39 banks which are owned by private investors and 1 mortgage finance, 25 are owned locally (i.e. their major shareholders are citizens in Kenya) while 14 have foreign ownership. The rest of the local Financial Institutions are largely family owned (CBK, 2015). Financial Institutions in Kenya receive deposits from individuals then lend these funds in form of loans to other customers at higher interest rates thereby earning a profit.

Kenya's system of corporate governance in the financial sector was to a great extent influenced by: lessening of the rules governing the licensing of banks in 1982 and by the procedure governing privatization which began in the 1980's and became dominant in the 1990's. Due to this, there was a significant growth in the number of banks that did not implement proper governance structures with the resultant effect of poor governance and management culture in the industry (Mwangi, 2002). Despite the many attempts to assimilate the banking sector, most banks have been placed under receivership or liquidated. The factors responsible for their collapsing are attributed to weakness in internal control systems, inefficient management practices and poor governance. An example is the Continental Bank of Kenya which collapsed in 1986 as well as the Continental Credit Finance Ltd and in 1987 Capital Finance collapsed. Seven banks that had collapsed were integrated by the Government of Kenya forming the Consolidated bank (Nambiro, 2007). Recently, corporate governance in Kenya has been an issue which has led to the loss of investor's wealth in the tune of Kshs. 264 billion. The financial institutions affected include Chase Bank, CMC, Imperial Bank, National Bank and Trans Century (Cytonn Investment, 2015). The fall of Imperial bank which is now under statutory management and the collapse of Chase bank in March 2016 is an indication that the industry is still facing issues of poor governance and management practices. The Centre for Corporate Governance (2004) has outlined various reasons that might explain the collapsing of various banking institutions in Kenya. This includes; cases of insider lending and conflicting of various stakeholders' interests, regulatory and supervisory systems which are weak, risk management strategies which are poor, weak internal controls and practices of governance which are poor. This resulted to the Central Bank of Kenya outlining bolder and more detailed measures to prevent these negative effects and make stronger its major roles that it carries in the industry.

One of the largest stock exchanges in Africa is the Nairobi Stock Exchange (NSE), with the fourth largest trading volume across the continent. The NSE began in the early 1920s while Kenya was considered a colony under British control. It was an informal marketplace for local stocks and shares. By 1954, a true stock exchange was created when the NSE was officially recognized by the London Stock Exchange as an overseas stock exchange. There are more than 20 licensed stock brokers at the exchange. Currently the NSE is trading more than a 100 million shares each month, and plays a large role in the economic growth of Kenya.

The NSE has twelve listed financial institutions which are: Barclays Bank Ltd, Stanbic Holdings Plc, I & M Holdings Ltd, Diamond Trust Bank Kenya Ltd, HF Group Ltd, KCB Group Ltd, National Bank of Kenya, NIC Group, Standard Chartered Bank, Equity Group Holdings and the Co-operative Bank of Kenya. According to the Nairobi Securities Exchange bulletin the total value of shares issued by listed companies by the end of July 2018 was Kshs. 82 billion, while Equity market turnover for the month of August 2018 was Kshs 15.5 billion (NSE, 2018). All this money is held in banks' investor accounts. This is just a fraction of the loss Kenya will have to bear in case the banking sector collapses (Wepukhulu, 2015). This impact was felt with the recent string of collapse of Dubai Bank of Kenya, Imperial Bank of Bank and Chase Bank Kenya Limited in the years 2015 and 2016.

### *1.1. Statement of the Problem*

Corporate failures are usually preceded by financial hardship and declining firm performance. Several studies have been undertaken in a bid to find out if there is somewhat a connection between CG principles and a firm's financial performance. Olick (2015) in a research study concluded that the board size (in terms of membership numbers) has a positive and significant impact on the return on assets ratio. Batool and Gohar (2015) found that larger boards of directors inversely influence the financial performance of firms but also have a positive effect on corporate social responsibility image and reputation. Carty and Weiss (2012) found no correlation between bank failure and CEO duality while the study

results by Al-Shammari and Al-Saidi (2013) indicate that CEO-board chair responsibility duality positively impacts performance by a bank. Zhaoyang and Udaya (2012) concluded that the firms' size of the board and composition of non-executive directors in the whole board structure revealed a negative correlation to the value of the firm, also the effect of non-executive directorship on the financial performance of the firm was negative.

Locally, Ogega (2014) and Rotich (2015) studied the effect of ownership structure on financial performance of Financial Institutions in Kenya and therefore concentrated only on one element of corporate governance, that is, ownership structure. The various form of ownership structure was investigated. They include government ownership, domestic ownership, corporate ownership and individual ownership. Adhiambo (2014) concentrated on board size and found that a large board size tends to impact performance negatively. Kalungu (2012) study on the impact of corporate governance on financial performance of Financial Institutions of Kenya narrowed down on a few variables of corporate governance practices. Therefore, there exists a gap in literature on whether corporate governance contributes to performance. Most of the studies examined above have not provided a conclusive finding on whether corporate governance influences performance of Financial in Kenya. This study seeks to fill this gap by examining how the ownership structure, board diversity, board size, board independence, number of meetings, and code of corporate governance influence performance of financial institutions.

The outline of the paper is as follows. Section two presents the literature review. Section three introduces research methodology. Section four presents the discussion and results. Section five provides contribution and implications.

## 2. Literature Review

In this section, the related literature is reviewed. It presents the theory that guides that study and the empirical literature that surround the topic in discussion.

### 2.1. Agency Theory

Agency theory was developed by Jensen and Meckling in 1976. This theory argues that a relationship exists between the principals who are the company's shareholders and the agents who are the managers and executives of the company. Meckling's and Jensen's proposition on agency theory commend that the segregation between ownership and management may result in agency problems being experienced in many modern organizations (Jensen & Meckling, 1976). The principal, who gives the agent some decision-making authority, incurs agency costs arising from the divergence of shareholders' interests with those of company. Agency theory contends that the main concern of corporations is how to write contracts in which agent's performance is measured and incentivized to act in the principal's interests (Jensen & Meckling, 1976).

Incentives such as stock options, bonuses, and profit related pay can be used as a method of aligning interests of the agent with those of the principal since these are directly related to how well the result of management decision serves the shareholder decisions. Agency theory advocates for self-interest by the managers and employees. This calls for the agents to conduct their duties while keeping the interests of the principals in mind. The agents are governed by rules made by the principals, with the maximizing of shareholders value as the main objective. Hence in this theory a more individualistic view is applied (Kimeu, 2018).

### 2.2. Stewardship Theory

Stewardship theory stresses on the top management's role of being stewards thereby integrating these roles to be part of the organization. This theory recognizes that the structures are important, in that they empower the stewards thereby giving them maximum control which builds the stewards trust and eventually minimizes monitoring costs. Executives and directors will work in such a manner as to maximize financial performance by increasing the wealth and profits of the shareholders so as to ensure their reputation is protected as organizations decision makers in doing this, they aim at being seen as stewards who are effective of their organization thereby protecting their careers (Nganga, 2018).

### 2.3. Empirical Literature

To analyze corporate governance further, various dimensions have been interrogated to establish their independent influence to performance in firms.

### 2.4. Institutional Ownership

Institutional investors are organizations which marshal large sums of money that they invest in companies. They take the form of banks, mutual funds or insurance companies among others. Due to their ability to influence the board decisions, absorb monitoring costs and engage in active ownership of the firm, their presence might positively affect firm performance. Institutional investors are known to play a very critical role in the debate on company's shareholder value creation as they will always strive to maximize shareholder value (Fama & Jensen, 2013). The Cadbury Committee viewed institutional investors to have a very special role in trying to ensure that their recommendations are adopted by companies as they use their influence as owners to ensure that the companies in which they have invested in comply with the Code (Cadbury Report, 1992). Similar sentiments were echoed by Greenbury Report (1995), Hampel Report (1998). These three influential committees on corporate governance matters clearly emphasized the role of institutional investors in companies as far as enforcement of corporate governance issues is concerned.

Studies on the relationship between institutional ownership and firm performance provide mixed results. According to Brickley, Lease and Smith (2008) institutional investors can be categorized into two major groups namely:

pressure sensitive institutional investors and pressure resistant institutional investors. Pressure-sensitive institutional investors refer to those institutional investors who are likely to have both investment and business relationships with firms in which they hold equity. They include insurance companies, banks, and non-bank trusts. For such investors to protect their business relationships, they may be less willing to vote against the decision brought forward by the management (Brickley, Lease, & Smith, 2008).

Heard and Sherman (2013) argue that investment and business relationships held by institutional investors could create conflict of interest between institutional investors and the management since the power gained from their ownership may be tampered by their reliance on the firm for business. This raises the likelihood that there will be a negative relationship between high presence of pressure-sensitive institutional investors and firm performance and therefore it is expected that there will be a positive relationship between high presence of pressure-resistant institutional holders and firm performance (Nyamongo&Temesgen, 2013).

#### 2.4.1. Board Diversity

Board diversity defined as the inclusion of persons of both genders within the organizational structure. However, board diversity is not limited only to gender diversity, but only diversity based on age, religion, occupation and job groups, and diversity in terms of members' experience (La Porta &Schleifer, 2015).

Denis (2011) argues that the concept of board diversity enables organizations to reflect the structure of society and properly represent the gender, ethnicity and professional backgrounds of those within it. Boards of directors in a company need to have the right composition to provide diverse viewpoints. Board diversity supports on the moral obligation to shareholders, stakeholders and for commercial reasons by obtaining extensive decisions (Darmadi, 2013). Gender diversity is considered part of the broader conception of board diversity and many scholars have shown that few women sit on corporate boards. When compared to men, most women directors possess staff/support managerial skills, such as legal, public relations, human resources and communications rather than operating and marketing skills. Board diversity should also greatly consider the technical expertise of the board members.

Darmadi (2013) indicated that organizations that have board members with at least, university degrees in variant fields enhances organizational performance. This is because the board has the capability to tackle different performance perspectives as opposed to a tunnel performance vision that non-diversified boards face

#### 2.4.2. Block Ownership

Block ownership is defined as the ownership where an organization has a majority shares owned by shareholders who influence strategic objectives of the organization (Jensen, 2011). In this regard, block ownership in financial Institutions mean that instead of managers making decisions on firms' performance, shareholders' do. As such, Black, Jang and Kim (2013) content that block ownership on its own is not sufficient to determine the ultimate performance of banks. For instance, if performance objectives adjudicated by block owners is not properly implemented by managers, then, performance will not be enhanced. Good corporate governance in a company depends on a combination of two factors namely: how investors' rights are protected, and ownership concentration (Bonn, Yoshikawa, &Phan, 2014).

A study conducted by Berle and Means (2002) suggested that there exists a positive relationship between block ownership and firm performance. However, other studies by Fama and Jensen (2013) and Kee and Hao (2011) did not observe the existence of such a relationship. These findings did indicate that block ownership is only relevant to the extent that the owners institute market policies and performance objectives geared at enhancing banks performance. Failure to institute these policies and internal restructuring means that at the end of the day, the banks will not be able to compete effectively in the market place, and thus, yield average to below average performances. However, Denis (2011) argues that the studies on block ownership can lead to challenges of liquidity necessary for operations if owners fail to raise sufficient capital, and thus, hamper performance objectives for their banks.

#### 2.4.3. Board Size

Board size is defined as the number and mix of both Executive Directors and Non-Executive Directors on the Board of the Institution (Fama& Jensen, 2013). Board size has been a subject of significant research in terms of its relationship with firm performance. There is a convergence of agreement on the argument that board size is associated with bank financial performance (Andre &Valladolid, 2008; Bonn et al., 2014; Gakeri, 2013). However, other scholars like Lam and Lee (2008) and Moscu (2013) argue that the size of the board in itself is not significant but rather the quality and effectiveness of the board. The size of the board should be large enough to incorporate key skills and perspectives, and yet small enough to allow for the active involvement of all the members and the smooth functioning of meetings (Wepukhulu, 2015). There is a belief that the number of directors can affect the performance of a company, especially its financial performance.

It is argued that within a certain range, the larger the board, the more effective it is in its statutory duties of monitoring the management. While there may be no one size fits all recommendation for what constitutes an optimal board size, a board size of 8-10 is often recommended, including the chairman (Shiah-Hou& Cheng, 2012).

There are mixed findings on how board size impacts on firm performance. On one hand, it is argued according to the resource dependency theory, that board of directors with their high-level links with the external environment are expected to play an important role of establishing relationships that can enable the firm access information that can be used to its advantage. Given the unique operating environment in which banks operate, it is expected that bank boards be larger than boards in other sectors (Central Bank of Kenya, 2013). The larger board size is further aggravated by their complex organizational structure and the presence of diverse committees such as lending and credit risk committee, audit

committee among others, whose composition entails presence of a board member. Generally, bigger banks have bigger boards. Given that the banking sector is different from other sectors, additional knowledge and experience provided by larger boards contributes to better bank performance (Opondo, 2012). This is because non-executives perform an important role and are central to effective resolution of agency problems between managers and shareholders in these kinds of firms. Among other responsibilities, non-executives should critically assess, approve and review the financial and operational decisions of executive management (Fama& Jensen, 2013).

In some cases, a large board size is perceived as a limit on board effectiveness for varying reasons. Large boards prevent meaningful dialogue among directors and it is easier for the CEO to control and manipulate larger boards (Love & Rachinsky, 2007). Yoshikawa and Phan, (2003) find that large boards are a creation of the CEO so as to entrench himself in the company. Thus, for the board to be free from the management and effective control of the CEO, the board size should be small (Bonn, Yoshikawa, & Phan, 2014). Linyuru (2014) is in consensus with the finance literature that large boards impair firm performance. He argues that as board size increases, they become less effective at monitoring management because of free-riding problems amongst directors and increased decision-making time. The ineffectiveness is further aggravated by increased ability of managers to avoid decision making. De Andres and Vallelado, (2008) find an inverted U-shaped relationship between bank performance and board size and further find that inclusion of more directors to the company's board should benefit the monitoring and evaluation.

### 2.5. Chief Executive Officer Duality

Chief Executive Officer (CEO) duality occurs when the CEO and chairman positions are held by the same person in an organization (Lam & Lee, 2008). Board leadership structure is an important corporate governance mechanism, which is reflected in the positions of chairman of the board and CEO. Both agency theory and stewardship theory have addressed the leadership structure of the board. Separation of the role of CEO and chairman of the board is largely grounded in the agency theory which assumed that due to the agency problem, it is necessary to monitor the performance of the CEO and the board to protect the stakeholders' rights including shareholders (Nyarige, 2012). This recommendation was made by the Cadbury Report in 1992; in Dutch Peters Committee Code in 1996 and the Belgian Commission of Banking and Finance). Professional theories on CEO duality come with two different approaches: In terms of agency theory, duality negatively affects the corporate performance while the stewardship theory says the opposite. According to the Centre for Corporate Governance, combining the role of chair of the governing board and the CEO might result in CEO dominance, which will lead to ineffective monitoring of the management and monitoring by the board (Centre for Corporate Governance, 2004).

### 2.6. Codes of Corporate Governance

Codes of good governance are a set of best practices recommendations issued to address deficiencies in a country's governance systems by recommending a set of norms aimed at improving transparency and accountability among top managers and directors (Nyamongo& Temesgen, 2013). In most legal systems, codes of good governance have no specific legal basis, and are not legally binding. Thus, enforcement is generally left to the board of directors and external market forces. It is only in a few countries e.g. Nigeria- in the case of the corporate governance for banks, Germany and the Netherlands in Europe that the law attaches explicit legal consequences to the codes (Elewechi, 2012). Even if, compliance with code recommendations is traditionally voluntary, evidence shows that publicly quoted companies tend to comply with the codes more than non-quoted firms. The content of codes has been strongly influenced by corporate governance studies and practices, and their implementation is considered a paramount factor to avoid governance problem and hence increase firm performance (Centre for Corporate Governance, 2004).

The Kenya Capital Markets Authority issued the Code of Corporate Governance Practices for Issuers of Securities to the Public (2015). This Code succeeds the Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya, 2002. The Code sets out the principles and specific recommendations on structures and processes, which companies should adopt in making good corporate governance an integral part of their business dealings and culture (Capital Markets Authority, 2015).

The Code advocates for the adoption of standards that go beyond the minimum prescribed by legislation. The Code has moved away from the 'Comply or Explain' approach to 'Apply or Explain', which approach is principle-based rather than rule-based, and recognizes that a satisfactory explanation for any non-compliance will be acceptable in certain circumstances. The approach therefore requires boards to fully disclose any non-compliance with the Code to relevant stakeholders including the Capital Markets Authority with a firm commitment to move towards full compliance within a stipulated timeline. However, the Code contains mandatory provisions which are the minimum standards that issuers must implement, and these are replicated in the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002.

An effective board of directors should have an appropriate number of qualified and experienced members, nominated through documented procedures (Fourier, 2006). As part of good corporate governance, institutions should have documented policies on the procedures for establishing boards of directors in terms of size, gender composition, skill mix, experience, terms of office, removal and replacement (Opondo, 2012). Similarly, the CMA Guidelines prescribe that the board of directors should also develop an appropriate staffing and remuneration policy, including appointment of the chief executive and senior management staff (CMA, 2015)

Objectivity as a code of corporate governance is defined as the act of being impartial and unbiased when dealing with organizational duties and responsibilities (Stepanova&Invantova, 2013). Commercial banks should develop mechanisms that enhance organizational financial performance. One of the ways to do this is by ensuring that the banks

corporate governance includes code of objectivity. Objectivity in dealing with loans is one of the key aspects of organizational financial performance (La Porta, Lopez, & Shleifer, 2009). According to Bassem (2009) banks with well-developed code of objectivity have a higher financial performance compared to organizations that do not have such provisions. In addition, an effective board should consist of members sourced from other organizations to enhance independence and objectivity. Such board members may bring new perspectives from their respective organizations, which in turn, may improve the strategic direction given to the management team (Opondo, 2012).

Additional key elements of good corporate governance include management of accountability and efficiency in the utilization of resources (Mang'unyu, 2011). Efficiency and accountability can only be enhanced through objective implementation of organizational performance goals. In cases where an organization does not have clear performance objectives, then code of objectivity will not be of great importance to financial performance. Bank employees will not be able to properly articulate their performance parameters (Kisiyena, 2011). There is also need for financial Institutions to be objective in formation of standing committees such as nomination and remuneration committee to ensure that only qualified individuals are included in such boards, and Audit committee to oversee implementation of auditing rules on activities (Opondo, 2012). Transparency is also crucial component of good corporate governance. It reduces information asymmetry between an institution's management and financial stakeholders (Black, Jang, & Kim, 2013).

### 3. Research Methodology

Extensive literature review was carried out in order to paint a broader picture of corporate governance and performance of financial institutions in Kenya. The researcher assessed the effect of various corporate governance dimensions that were considered in the study include Institutional ownership, financial risk management, Board diversity and codes of corporate governance, board skills, independence, committees, board size and board diversity. We reviewed secondary data from various secondary articles including reviewed journals and various theses and dissertations where we focused on the dimensions of corporate governance as dependent variables and dimensions of performance independent variables.

### 4. Discussion and Results

Existing literature on corporate governance of financial institutions literature identified various dimensions of governance influencing financial institutions performances.

Institutional investors are organizations which marshal large sums of money that they invest in companies. They take the form of banks, mutual funds or insurance companies among others. This raises the likelihood that there will be a negative relationship between high presence of pressure-sensitive institutional investors and firm performance and therefore it is expected that there will be a positive relationship between high presence of pressure-resistant institutional holders and firm performance (Nyamongo & Temesgen, 2013).

Board diversity defined as the inclusion of persons of both genders within the organizational structure (Brickley, Lease, & Smith, 2008). Board diversity supports on the moral obligation to shareholders, stakeholders and for commercial reasons by obtaining extensive decisions (Darmadi, 2013). Gender diversity is considered part of the broader conception of board diversity and many scholars have shown that few women sit on corporate boards. When compared to men, most women directors possess staff/support managerial skills, such as legal, public relations, human resources and communications rather than operating and marketing skills. Board diversity should also greatly consider the technical expertise of the board members.

Block ownership is defined as the ownership where an organization has a majority shares owned by shareholders who influence strategic objectives of the organization (Jensen, 2011). A study conducted by Berle and Means (2002) suggested that there exists a positive relationship between block ownership and firm performance.

Board size is defined as the number and mix of both Executive Directors and Non-Executive Directors on the Board of the Institution (Fama & Jensen, 2013) There is a convergence of agreement on the argument that board size is associated with bank financial performance (Andre & Vallelado, 2008; Bonn et al., 2014; Gakeri, 2013).

Board independence is one of the highly debated issues in corporate governance studies due to its ability to influence board deliberations and ability to control top management decisions and company results (Black, 2001).

Based on a wide range of positive findings on the relationship between board independence and firm performance CBK recommends that non-executive directors should not be less than 3/5 of board size in order to enhance accountability in the banking sector (CBK, 2013).

Code in 1998 (McColgan, 2011) Duality represents a problem because people that are responsible for the firm's performance are the same with those who evaluate the efficiency. This situation makes difficult the correct evaluation of the firm's performance and may result to underperformance of the company in the long term, as such an arrangement concentrates too much power in the hands of one executive and may lead to low performance. As qualified as the CEO or Chairman may be, assigning too many responsibilities to his subject may lead to inefficiency if one or both positions are held (Moscu, 2013)

As such, code of objectivity enhances transparency in financial transactions that are pertinent to the performance of commercial banks. Objectivity also enhances disclosure which is desirable in procurement process in terms of tendering methods, tender evaluation, award, as well as staff training and development which is essential in commercial banks financial performance (KIPPRA, 2006).

## 5. Contribution and Implications

This study sought to investigate corporate governance and performance of financial institutions in Kenya. Overall, the study reveals that adoption of good corporate governance enhances organizations performance. In addition, the study shows that higher performance is achieved when organizations adopt the various corporate governance dimensions together. This is demonstrated by the fact that although inconsistent empirical findings were reported on the influence of the various corporate governance dimensions, being positive, negative or no associations, the composite score of corporate governance was significant in influencing firm's performance. Further, from the various tests of corporate governance dimensions the pertinent results reveal that board skills and board committees are important determinants of firm performance. Drawing from these results, we conclude that possession of requisite skills is an important consideration while appointing board members.

The result show that corporate governance mechanisms do influence the FI's performance, by referring to this result, we hope that banks try to implement the right corporate governance system and policies until they can reduce probability of failure and bankruptcy and can also increase reliability for investors and investments.

The study found out that a positive relationship exists between financial performance and size of a FI. This study recommends that FIs' management and directors should aim at increasing their asset base by coming up with measures and policies aimed at enlarging the banks' assets as this will eventually have a direct impact on financial performance of the bank. From the findings of this study, big FIs in terms of asset base are expected to perform better than small FIs and therefore FIs should strive to grow their asset base.

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