THE EFFECT OF CORPORATE GOVERNANCE ON THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

ABSTRACT

The main purpose of this paper is to investigate the effect of corporate governance on the performance of 38 commercial banks in Kenya over the period 2008-2012. Specifically, this study examined board size, board composition and CEO duality and how they affect the financial performance of commercial banks in Kenya.

This study adopted analytical research design. The study population was all commercial banks in operation as at December 2012 and analysis was done using multiple linear regression models to investigate the relationship between governance variables and bank performance. The paper uses two measures of performance, i.e. return on assets (ROA) and return on equity (ROE), as the dependent variables and three measures of governance – namely the board size, independent directors, and CEO duality – as the independent variables.

The study found out that there is no evidence of a linear relationship between a bank’s performances as measured by its ROA and ROE and its corporate governance. The contribution of CEO duality towards the financial performance of a bank could not be established by the study. Also, multiple linear regression models is not an appropriate model for estimating the impact of corporate governance factors of board size and composition on bank’s financial performance.

The study recommends that for us to measure the effect of corporate governance on financial performance of commercial banks we need to include other mechanisms of corporate governance other than board size, board composition and CEO duality and that to comprehensively understand how board size, board composition and CEO duality affects performance of commercial banks other more complex models have to be used such as the baseline model.