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# Effect of Board Size and Board Share Ownership on the Financial Performance of Commercial Banks Listed at the Nairobi Securities Exchange in Kenya

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## ABSTRACT

Financial performance of commercial banks in Kenya has been deteriorating due to low investments caused by poor corporate governance practices, as reported by instances where boards of directors have refused to embrace good corporate governance practices, resulting in poor financial effectiveness. The research sought to ascertain how the board size and board share ownership affect the financial performance of commercial banks listed on the NSE during the years 2016 to 2020. A descriptive research design was adopted and was anchored on agency theory. Secondary data was obtained from the listed commercial banks published on the Kenyan Investors website, Capital Markets Authority Library, Nairobi Securities Exchange websites, and their websites. Inferential and descriptive statistics were utilized in data analysis and the Panel Data Regression Model was analyzed using Stata 16. Findings showed that the average board size for the 12 NSE-listed commercial banks in 2016 was 12, 10 in 2017, 8 in 2018, 11 in 2019 and 9 in 2020. Average board share ownership was 2.10% in 2016, 2.32% in 2017, 2.61% in 2018, 2.92% in 2019 and 3.12% in 2020. The study recommends commercial banks to have a bigger board which might have more specialized skills, well-rounded expertise, and closer supervision of upper management which would eventually lead to optimal judgments and better financial performance.

**Keywords:** Board size, board share ownership, financial performance, commercial banks, NSE

## INTRODUCTION

In both emerging and developed countries, academic circles have long disputed the link between the arrangement of the board of executives of a company and monetary success (Adams & Mehran, 2012). It is significant in Kenya's banking industry, where numerous banks have collapsed as a consequence of shady activities and schemes that have eroded investor trust. The legal obligations of boards of directors vary based on the activities and business of the bank. The board size, the occurrence of assemblies conducted, share possession and the board's gender variety all help the board in playing a major duty in a bank's financial success. Inuwa et al. (2015) note that by punishing top management, board size impacts effective board characteristics in governance mechanisms, whereas board meetings and board members' attendance help members in performing their responsibilities and fiduciary obligations. According to Korenkiewicz and Maennig (2023), having more women on the board makes the board's rules more efficient since women are more stringent and trustworthy. Aebi, Gabriele and Markus (2012) noted ownership of board shares to be an effective strategy for aligning the board's interests with those of the equity investors. Following previous CG and financial reporting issues in Kenya, regulators and companies have recognized the need for robust corporate governance for long-term sustainability.

The effect of board characteristics, which is affected by factors like “the size of the board and board share ownership” on financial performance has generated mixed findings (Inuwa et al., 2015). Top management may be driven and controlled by strong board characteristics, resulting in efficient, effective, and solid operations that improve commercial bank financial performance. It describes the senior management’s and board of directors’ duties and levels of authority in carrying out bank transactions and affairs (Azar, Habibi, & Botyari, 2014). Strong board characteristics are a crucial and efficient corporate governance mechanism, according to empirical evidence, that performs two key roles in commercial bank performance in finances: to provide business evaluation and resources and to oversee top management in representing shareholders.

Even though a reduced size of the board allows its members to share ideas and come to optimum conclusions that positively impact the financial performance of a bank (Mamatzakis and Bermpei, 2015), Aebi et al. (2012) claimed that board size does not matter in financial performance. Through board meetings, directors may gain information about bank operations, which helps them reach the bank’s goals by monitoring, advising, and supervising senior management, resulting in enhanced financial performance (Inuwa et al. (2015).

In Egypt, board share ownership and ROA are not related (Desoky & Mousa, 2012), however, Horvath and Spirollari (2012) disagreed, arguing that top management would be stimulated by board share ownership, leading to higher ROA and ROE for insurance businesses in Nigeria. According to Kajola (2008), foreign governance systems benefit banks in weaker institutions, such as Africa. As a consequence, the governance structure of the board, namely board characteristics, becomes helpful. As a consequence of the above, strong board qualities contribute to financial success. According to Bouaziz (2010), allowing board members and senior executives to hold bank shares would push them to make choices enhancing commercial banks’ financial results. This research will try to figure out how board size and board share ownership relate to commercial banks listed on the NSE.

## THEORETICAL FRAMEWORK

The study was anchored on agency theory. Jensen and Meckling (1976) created this concept based on the agent and principal connection to solve the challenges they encounter as agency costs. Shareholders, or business owners appoint directors to supervise the organization’s operations. The board of directors employs, appoints, supervises, controls, and monitors senior management’s operations on behalf of the owners.

Agency theory describes the association between principals and agents namely shareholders, managers or corporate executives. Agents are paid by the shareholders – the company principals or owners to work, according to this viewpoint. According to Kapopoulos and Lazaretou, (2007), the corporation’s running is transferred to the principles by the managers or directors – shareholders’ agents. According to the theory, an organization’s workers or bosses may be self-interested. Here agents are expected to behave and make choices in the best benefits of the principles.

Despite the agency thesis’ popularity, some scholars have pointed out several flaws (Shukeri, Shin & Shaari, 2012): agency theory presupposes that a contract will resolve all principal-agency disputes; director’s duties are limited to recruiting, supervising, and directing, and there is no clear information regarding their future; contractual agreements are normally either for a certain amount of time or for an indefinite period; the principle is preoccupied with increasing wealth at the same time having a restricted role within the business. Wepukhulu (2016) notes that, while making operational choices, the firm’s senior management, who are in great demand, has a conflict of interest with the shareholders.

Agency theory is defined by Dibia and Onwuchekwa (2013) as "the process that helps in bridging the gap between the agent and the principle." As a consequence of investors looking for competent and technical employees to run their organization, this arose (Yihua, 2010). According to the Malaysian Corporate Governance Blueprint (2011), as a consequence, investors were forced to nominate competent members of the board to supervise the principal's company activities. Consequently, Adams and Mehran (2012) note that the board of directors had to fulfill its fiduciary duties while simultaneously representing the investors' interests. Ongore et al. (2015) emphasize that; directors are professionally obligated to systems and techniques for effective monitoring in minimizing agency issues since they are the final decision-makers. Agency theory was used to study the impact of board size and share ownership in the board and how the monetary performance in profitable banks is influenced by the characteristics of the board.

## LITERATURE REVIEW

### Board Size

Thao (2014) explored how financial performance in the Istanbul Bist manufacturing business is influenced by board size. One hundred and thirty-six (136) manufacturing companies were targeted and stata software was used to conduct data analysis. Results showed that heteroskedasticity, autocorrelation, and correlation between the units, the error term variance was not equal to the unit matrix when estimating a regression model. There was an association of board size, ROA, and Z Altman score.

A study on the connection between board size and corporate performance was undertaken by Wu and Li (2015). The study used empirical research methodologies to evaluate the association between business board size and corporate performance, using 372 businesses from the US S&P 500 as a sample from 2013 to 2017. Results revealed that corporate performance and board size had a negative relationship.

Raymond, Paul, and Eyoung (2010) investigated the correlation between the size of the board and reputational and financial corporate performance in Colombian top firms recognized by MERCO. Eighty-four (84) Colombian big corporations in Colombia from 2008 to 2012 were used as a sectional sample and the research used cluster and correlations analysis to define and cluster enterprises depending on control and characteristics of their performance. Results showed that big boards are associated with good corporate reputation and bad performance in the financial aspect.

### Board Shares Ownership

Mamatzakis and Bermpei (2015) used dynamic panel threshold analysis to evaluate how corporate governance influenced investment bank performance in the United States. Stewardship and agency theories were applied in the research. A criterion of 8.54 percent board share ownership was determined in the research. Banks with board share ownership below the threshold reported that performance was negatively affected at a 1% significance level by any increment in ownership. Consequently, performance was positively influenced in banks that had ownership of board shares over the threshold at the 5% significance level.

Horvath and Spirollari (2012) explored how a Nigerian insurance firm's ownership structure influences performance. The study targeted 17 insurance companies where secondary panel data was collected. The researchers used regression models for analysis and found out that Nigerian insurance businesses' ROE and ROA were significantly influenced by institutional share ownership and board share ownership. To maintain long-term survival, the research recommended that listed firms' share ownership be sustainable.

Board characteristics' influence on the financial success of Australia's Fortune 500 companies was explored by Victor, Ionel and Carmen (2014). They based their findings on secondary panel data. Board share ownership positively and considerably influenced TBQ, but had no impact on ROA or ROE. ROE and ROA were significantly and positively influenced by Block ownership, but a statistically significant negative impact on TBQ.

## METHODOLOGY

The descriptive research design was used. The 12 banking companies registered on the NSE between 2016 and 2020 were the study's target group. Quantitative secondary data was gathered from information provided by Kenya's NSE regulator, the Capital Market Authority of Kenya (CMA), as well as annual financial statements published by NSE-listed commercial banks. The research was fully based on secondary data gathered from yearly financial statements published by twelve commercial banks for five years from 2016 to 2020 and STATA 16 was used for analysis. Both regression and pearson's correlation analysis was done to gauge the relationship strength and direction of the study variables.

## RESULTS

### Average Board size of the 12 commercial banks listed at the NSE in Kenya

The research pursued to establish the average board size of the 12 NSE-listed commercial banks in Kenya for 5 years (2016-2020) the findings are shown in Figure 1

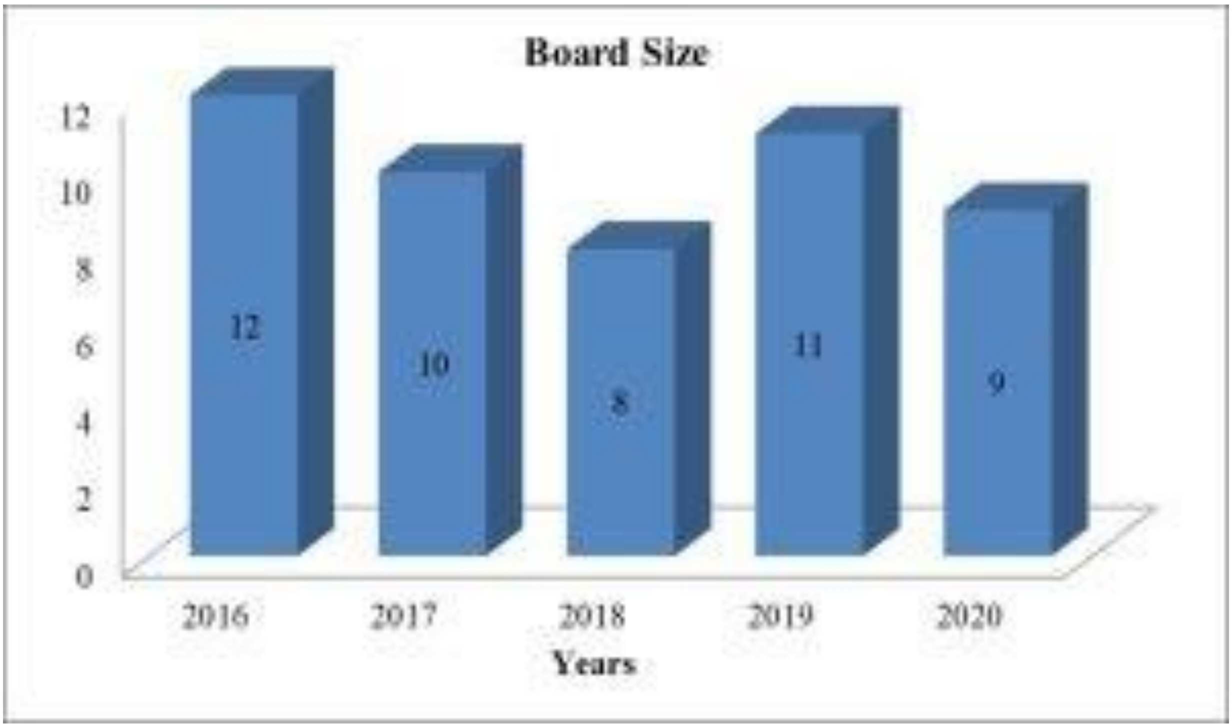


**Figure 1: Average Board size of the 12 NSE-listed commercial banks in Kenya**

Results showed that the average board size for the 12 NSE listed commercial banks was 12 in 2016, 10 in 2017, 8 in 2018, 11 in 2019 and 9 in 2020. The results imply that the highest average board size was 12 in 2016 and lowest in 2018 with 8 members. The study findings contrast with the findings of Thao (2014) findings which point to a favorable relationship between board size and ROA. Consequently, another research finding implies that the size of the board doesn't affect return on equity. Moreover, Wu and Li (2015) argue that more agency costs mean more coordination and communication costs. Larger boards and more non-executive directors have more collective information, which aids in monitoring.

**Average board share ownership for the 12 NSE-listed profitable banks in Kenya**

The study determined the average board share ownership for the 12 NSE-listed commercial banks from 2016 to 2020.


**Average board share ownership for the 12 NSE-listed commercial banks in Kenya**

The findings revealed that the average board share ownership for the 12 NSE-listed commercial banks was 2.10% in 2016, 2.32% in 2017, 2.61% in 2018, 2.92% in 2019 and 3.12% in 2020. This implies that there has been a gradual increase in the average board share ownership for the 12 NSE-listed commercial banks for the 5 years (2016-2020).

The findings match with Victor, Ionel, and Carmen (2014) who reflected that board portion possession positively and considerably influenced TBQ, but had no impact on ROA or ROE, according to the research. ROE and ROA were significantly and positively influenced by Block ownership, but a statistically significant negative effect on TBQ. ROE and ROA were noticeably but negatively influenced by board size; but did not affect TBQ. In addition, Aebi et al. (2012) also revealed that bank size and leverage significantly affected financial performance. Despite having a comprehensive corporate governance structure in place, the research found that putting it into reality was challenging, with mixed outcomes.

**Regression analysis**

This was done to establish the relationship between the variables. The test results of the study variables are as in Table 1.

**Table 1: Regression results**

| Goodness of fit | Test Statistic | P-Value |
|---|---|---|
| Adjusted R Square | 0.323 | |
| R Square | 0.466 | |
| F Statistics (4, 55) | 12.275 | $0.041^b$ |

| Dependent Variable= Service delivery | Linear Regression Results | | |
|---|---|---|---|
| | Coefficients | t-statistic | P-Value |
| Constant | 1.342 | 5.697 | .000 |
| Board size | 0.267 | 3.554 | .001 |
| Board Shares Ownership | 0.433 | 5.954 | .000 |

The financial performance of listed commercial banks without predictor variables is 1.342, as per the results. This implies that listed commercial banks will always have a level of financial performance of 1.342. The results also demonstrate that a unit change in the size of the board is positively associated with a 0.267 times alteration in the performance of registered profitable banks in Kenya. The findings go hand in hand with those of Kaid and Mohammed (2012), that the size of an organization's board of directors significantly affects its success. A unit change in board share ownership is associated with a 0.433. The findings discussed in this study are in tandem with those of Mamatzakis and Bermpei (2015) who found that performance was positively influenced in banks that had ownership of board shares over the threshold at the 5% significance level. Moreover, Aebi et al. (2012), discovered that the bank size and leverage significantly affect financial performance. Despite having a comprehensive corporate governance structure in place, the research found that putting it into reality was challenging, with mixed outcomes.

## CONCLUSION AND RECOMMENDATIONS

The study found a positive association between board size and the monetary performance of commercial banks in Kenya ($r= 0.382$, $p<0.05$). Size allows board committees to monitor, oversee, and advise senior management as required by the regulator. Board ownership of shares and commercial bank financial performance in Kenya are moderately correlated ($r= 0.572$, $p<0.05$). Board share ownership aligns board members with shareholders. Employee share option programs and dividend payouts are the greatest ways to compensate board members through board share ownership. Larger boards may include specialized talents, perfectly blended experience, and a closer oversight of senior management, leading to realistic decisions and better financial performance for Kenyan commercial banks.

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