THE CONTRIBUTION OF TRANSPARENCY AS CORPORATE GOVERNANCE PRACTICE ON FINANCIAL PERFORMANCE OF BANKS IN KENYA: A CASE STUDY OF COMMERCIAL BANKS LISTED IN THE NAIROBI SECURITIES EXCHANGE

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Abstract

The purpose of this study was to establish the contribution of transparency as a tenet of corporate governance to listed commercial banks in Kenya. Kenyan banks have had a big challenge when it comes to transparency therefore creating an interest for the study. The target population included all the commercial banks listed in the Nairobi Securities Exchange. Primary data was collected by use of questionnaires while secondary data was sourced from past studies, reports and other publications. Data analysis was conducted using descriptive statistics such as percentages, frequency distribution and on regression analysis.

Keywords: Corporate governance, transparency

1.0 Introduction

Banks are fundamental asset of a healthy economy. Arguably, for banks to have smooth operation it is attributed to how strong a financial system may be. Several theories and practices demonstrate that there are loads of factors that shape governance of a business organization or firm; for example, the Principal –agent theory (Mallin, 2007) and the stewardship theory (Dickie, 2000) present organizational governance in diverse ways. It is therefore, fair for banks to be governed by a set of rules and policies that reflect the interests of all shareholders. Theories have been brought out to discuss corporate governance of a business organization or firm; for example, the Principal –agent theory (Mallin, 2007) and the stewardship theory (Dickie, 2000) present organizational governance in diverse ways. It is therefore essential for banks to be governed by policies that reflect corporate governance practices.

There are several studies that have been done in developed countries for example UK and USA in regards to corporate governance and the results vary due to the differences in rules and polices put forward to enhance governance. The studies have shown that governance and transparency have a contribution in the financial performance of firms regardless of differences in rules and policies. However corporate governance in Kenya has become more and more popular among organizations due to its results of sustainable environment. In addition, Kenya has had poor governance system in the banking industry attributed to weak corporate governance practices, lack of internal controls, weaknesses in regulatory and supervisory systems, massive bankruptcies, and conflict of interest,

which led to collapse of many financial institutions with others going under receivership (Centre for Corporate Governance, 2004) resulting from weak systems of corporate governance (Carney, 2005).

2.0 Statement of the problem

The banking sector acts as a medium through which savings are mobilized to facilitate development. This is evidence that banks play a vital role in promoting investment. In the course of this system, national savings are accumulated and invested in productive sectors of the economy leading to national wealth creation in a broader context (Centre for Corporate Governance, 2003).

In every organization or bank, transparency as a tenet of corporate governance is vital and recommended tool for smooth running operations, handling contemporary issues and also for better results in financial performance. In this view, economic performance becomes a distorted measure of the effectiveness in which an organization can utilize assets from its principal approach of trade and engender proceeds. This concept is also employed as a broad appraiser of an organizational general economic vigor under a specified period, and can be utilized in comparing analogous organizations across identical industries or to evaluate banks or sectors in totality. Precisely, it seeks to evaluate how well a company is using its resources to make profits. Arising from these factors, this study sought to establish the contribution of transparency as a corporate governance practice on financial performance within the banking industry in Kenya with the aim of determining the role of transparency as a corporate governance practice on financial performance of commercial banks in Kenya.

3.0 Objective of the study

The main objective of the study was to determine the contribution of transparency to financial performance of listed commercial banks in Kenya.

4.0 Significance of the study

The study was a significant endeavor in establishing if there is correlation between transparency and organization performance especially for listed banks in the NSE. The study will be of much significance to the financial and banking industry regulators, academicians, as well as the entire banking industry (including microfinance and Saccos).

5.0 Literature review

The Basel II committee on banking highlighted the importance of banks to adopt effective CG practices for enhancement of their operations. The extent of success of corporate governance varies from countries to countries due to lack of uniformity on factors alleged to be pillars of corporate governance. Such structures diverge due to regulations and policies, which must not be steady across all global nations. Recognizing this, good CG can be accomplished in spite of the model employed by the bank. The Basel II committee highlights four important pillars relevant to corporate governance. The committee notes the significance of these pillars in monitoring, controlling and managing risk. The pillars lay emphasis on the importance of oversight duties which if implemented may lead to well functioning credit rating process and system (Basel II Norms, 2005).

The question of CG within the country has been a zenith agenda for several years. Despite the tight regulatory framework, corporate governance continues to weaken in Kenya to some extent especially in banks whereby the government has shareholding for example National Bank of Kenya. Kenya's CG alarm was aired purposely on the manner in which banks are ran and directed. According to the Centre for corporate Governance of Kenya (CCG) (2004), focus on CG in the financial sector is crucial mostly because the banking industry became highly exposed to scrutiny by the public and many lessons were learnt because of the risks involved including adverse publicity brought about by failings in governance and stakeholder relations for instance, the collapse of banks such as Trust Bank, Daima Bank, and Euro Bank just to mention a few cases (CCG, 2004). Arguably, CG in Kenyan banks is a substantially more multifaceted matter than in the majority of the other economic areas. This is because banks strive to conform to similar rules of good authority as other firms but issues like internal power, capital sufficiency and funding, risk management and conformity all have an impact on their environment of domination.

5.1 Relationship between corporate governance and bank performance

Tandelilin et al. (2007) observed that management and owners of banks showing efforts and intention to implement good CG increase market credibility, and, subsequently, collect funds at lower cost and risk. Thus, it could be stated that healthier CG will result into towering presentation (Tandelilin et al., 2007). This is sustained by an experimental study carried out by La porta et al. (2002) on bank's performance from 27 developed countries. The evidence from their research

results proved that there is superior assessment of firms in states with protection of minority shareholders.

In an effort to shed more radiance on the relationship between corporate and firm presentation, Coleman (2007) did a research in Africa aiming 103 listed firms on South African, Kenyan, Ghanaian, and Nigerian stock exchanges. The research results of the research points out those huge and more self-governing boards develop firm worth and when the CEO serves as board chair, it has unhelpful consequence on presentation and such firms or organizations utilize less debt. In his findings he discovered that a CEO’s term in administrative center increases firm’s productivity while board action strength has a depressing result on firm productivity.

5.2 Bank transparency

Transparency is integral to CG, higher transparency reduces the information asymmetry between a firm’s management and financial stakeholder’s (equity and bondholders), mitigating the agency problem in CG (Matema, 2003). The concept of Bank transparency is broad in scope, as it refers to the quality and quantity of public information on bank’s risk profile and to the timing of its disclosure, including the banks past and current decisions and actions as well as its plans for the future.

Weak transparency makes banks’ asset risks opaque. Stock market participants including professional analysts such as Moody’s encounter difficulties in measuring banks credit worthiness and risk exposures. Ball, R. (2001) argues that timely incorporation of economic losses in the published financial statements (that is, conservatism) increases the effectiveness of CG, compensation systems, and debt agreements in motivating and monitoring managers. For instance, improved governance can manifest in a reduction of the private benefits that managers can extract from the company or in a reduction of the legal and auditing costs that shareholders must bear to prevent managerial opportunism.

This research on transparency as a practice of corporate governance in accounting tends to exploits the function of accounting information as a resource of reliable information variables that support the existence of enforceable contracts, such as compensation contracts with payoffs to managers contingent on realized measures of performance, the monitoring of managers by boards of directors and outside investors and regulators, and the exercise of investor rights granted by existing security laws. There are a number of issues to consider in this regard. First, the existence of a strong financial accounting regime is likely a precondition for the existence of a vibrant stock market and

in its absence the notions of equity based pay and diffuse ownership of firms become moot (Ball , 2001; Black 2000).

6.0 Research methodology

This study adopted a descriptive research design. According to Mugenda (2003), descriptive research is a process of collecting data in order to test hypothesis or to answer questions concerning the current status of the subjects in the study. The study adopted a stratified random sampling technique to come up with the required sample. The population consisted of all 12 commercial banks listed in the Nairobi Securities Exchange. The study targeted about 200 staff members working at the various banks with operations in Thika town. The study used both primary and secondary data sources in gathering data for analysis. The primary data source used a semi-structured (matrix) questionnaire consisting of both open and close-ended questions (Mugenda & Mugenda, 2003). Data processing and analysis incorporated percentages, frequency distribution tables. Financial performance was analyzed by use of regression analysis.

7.0 Results findings and recommendation

7.1 Transparency

Table 7.1 Timely Release of Financial Information to Shareholders

Banks release financial information to their shareholders and customers on time	Frequency	Percentage
Strongly disagree	2	5.88
Disagree	3	8.82
Neutral	2	5.88
Agree	14	41.18
Strongly agree	13	38.24
Total	34	100

The respondents gave mixed responses regarding whether banks release financial information to their shareholders and customers in a timely way. Surprisingly 5.88% and 8.82% of the respondents claimed that shareholders do not get their financial information in a timely manner. A further 5.88% was not sure whether this happens or not. However, a good majority of 41.18% and 38.24% agree and strongly agree, respectively, that banks release such information in a timely manner.

Table 7.2 Responsibility of external auditors in enhancement of the bank's financial statement and adequacy of internal controls

External auditors have the duty of issuing opinion concerning the integrity of the bank's financial statement and adequacy of the bank's internal controls	Frequency	Percentage
Strongly disagree	2	5.88
Disagree	3	8.82
Neutral	4	11.76
Agree	11	32.35
Strongly agree	14	41.18
Total	34	100

The research wanted to establish the role of external auditors in issuing opinion regarding the integrity of the financial statement of the banks. This question led to some interesting statistics, which the research recommends future researchers to investigate: there is need of establishing why the respondents varied so much in this question (although those who agree and strongly agree are the majority). From the table 4.6, 41.18% and 32.35% of the respondents indicated that the external auditors play a decisive role in this task. Therefore, these findings indicate that external auditors are so essential in the harmonization of this information.

7.3 Bank Policies in Setting and Providing Direction to the Governance of the Bank

Table 7.3 Bank Policies on Directing Bank Governance

Bank policies set aside and offer direction to the governance of the bank	Frequency	Percentage
Strongly disagree	0	0
Disagree	0	0
Neutral	1	2.94
Agree	8	23.53
Strongly agree	25	73.53
Total	34	100

The respondents indicated that bank policies play a leading role in setting and providing direction towards the bank's governance. From the data in table 4.4, it is clear that 97.06% of all the survey respondents agreed or strongly agreed that the bank policies have a major role in this. Precisely, 23.53% and 73.53% of the respondents agreed and strongly agreed with this statement. Therefore, bank policies are essential in directing the overall corporate governance of the organizational operations.

7.4 Bank's responsibility of keeping records on related transactions that require shareholders approval

Table 7.4 Responsibility of Keeping Records on Related Transactions for Shareholders' Approval

Banks have the responsibility of keeping records on related transactions that need shareholders' approval	Frequency	Percentage
Strongly disagree	1	2.94
Disagree	3	8.82
Neutral	8	23.53
Agree	14	41.18
Strongly agree	8	23.53
Total	34	100

The research was also interested in establishing whether banks have the responsibility of keeping records on related transactions, which call for the approval of the shareholders. From the analysis, 2.94 of the respondents strongly disagreed with the statement, 8.82% disagreed with it, while 23.53% were neutral concerning the same. However, 41.18% and 23.53% of the respondents agreed and strongly agreed with the statement.

The urge for transparency leads to the use of external auditors who offer advise on the integrity of the bank's financial statements, as well as adequacy of their internal controls as demonstrated by the 32.35% and 41.18% of the respondents who agreed and strongly agreed with this argument. It was also clear that banks have effectual internal audit processes, which appraises their compliance with laws, regulations, and bank procedures/policies. Finally, banks have the responsibility of maintaining records on connected transactions requiring the approval of their shareholders.

7.5 Financial performance of banks in Kenya

Table 7.5 Regression Analysis

Dependent Variables	R	R Square	Adjusted R Square	Std Error
Liquidity	**0.570**	**0.332**	**-0.314**	**16.27949**
Capital adequacy	**1.016**	**0.918**	**0.815**	**323.67125**
Assets quality	**0.511**	**0.282**	**-0.474**	**7.43598**
Earnings after Tax/ shareholders funds	**1.009**	**0.906**	**0.796**	**5.68958**
Earnings after Tax/ Total assets	**0.856**	**0.659**	**0.427**	**2.35569**
Net interest/Total income	**0.927**	**0.768**	**0.590**	**14.2005**
Interest income/Total assets	**0.835**	**0.629**	**0.481**	**1.05865**

The data from table 4.19 showed that most of the ratios have a relationship with corporate governance practices and this included return to shareholder, capital adequacy and net interest to total income. Return on equity is a measure of an organization's profitability by showing how much profit a firm generates with the capital shareholders have invested. From the results ROE had an adjusted R square of 0.796.This shows corporate governance tenets contributes to a firm's profitability.Net income is an important measure of how profitable the company is over a period of time and from the results in Table 4.19 adjusted R square of Net income of 0.481 even though had the lowest compared to to other ratios but still remained acceptable for this particular study.

In a nutshell the corporate governance practices remained relevant in contribution to a company's profitability and therefore the management should come with strategies and polices to uphold the corporate governance practices and therefore enhancing the financial performance.

8.0 Conclusion

Undeniably, effective corporate governance among the Kenya banks is a key contributor to the financial performance and profitability of most banking institutions. The board has the mandate of maintaining effective organizational corporate governance policies that aim at directing the organizational functions and procedures. Through effective corporate governance, organizations have managed to fight against such famed social evils as corruption, fraud, and possible conflicts among others. Therefore, corporate governance is a fundamental rudiment for the economic proliferation of the Kenyan banks.

9.0 Recommendations

The research observed that transparency is key performance indicator among the banks. Therefore, this paper recommends the design and adoption of transparency policies, which should aim at ensuring that the banks have sufficient control measures against different organizational misdeeds. For instance, internal and external auditors should be utilized in generating financial reports to avoid the collapse of the banks as was the case with some previous banks.

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