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RELATIONSHIP BETWEEN NUMBER OF RISK GOVERNANCE MECHANISMS AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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ABSTRACT

Commercial banks contributes to economic growth in any country and they are expected to yield good financial returns. However, performance of banks in Kenya has been declining. This may be attributed to many factors including risk exposure. This study therefore sought to establish the relationship between number of risk governance mechanisms adopted and financial performance of commercial banks in Kenya. The study is significant to financial institution management, Central Bank of Kenya, Scholars and the government. The target population was all the 42 commercial banks operating in Kenya. The study adopted longitudinal research design covering a period of five years (2013 - 2017). The study used secondary data extracted from annual audited financial statements and reports of commercial banks. Regression analysis and multicollinearity tests were carried out using SPSS. The study found a significant positive relationship between number of risk governance mechanisms and financial performance. From the results, it is established that the number of risk mechanisms adopted by a bank has a positive relationship with the return on assets (a regression coefficient of $R=0.191$, $p=0.011$, $R^2 = 0.036$, Adjusted $R^2= 0.031$, $p<0.05$). The study concludes that, number of risk governance mechanisms have a significant positive relationship with financial performance of commercial banks in Kenya. The study recommends commercial banks to adopt several risk governance mechanisms to manage risk hence improving financial performance.

KEY WORDS: *Number of risk governance mechanisms, Financial performance*

INTRODUCTION

Commercial banks have been faced with risks globally and this has affected their operations. To counter this, banks have adopted a number of anti-risk mechanism such as the institution of boards of governance whose mandate includes the bank oversight role executed through various board committees (Nibedita, 2018). The board committees play an important role in corporate governance of preparing reports for the full board of governance for development of policies (Chen & Wu, 2016).

Africa has had its share of bank failure that has been attributed to poor management and excess risk taking (Odipo, 2007). In South Africa, for the past 30 years, over 20 banks have been deregistered because of poor management and liquidity problems (BusinessTech, 2018). In Democratic Republic of Congo, International Bank for Africa in Congo was forced to limit its cash withdrawals when the Central Bank terminated its credit amount because of mismanagement (Napier, 2016).

It is in the board committee meetings where the actual activity of risk management take place and not the full board of the bank (Chen and Wu, 2016). According to Kamazima, Mathenge and Ngui (2017), the number of board committees has a positive influence on the financial performance of stock exchange listed commercial banks. A comparative study by Kimeu (2017) observed that the number of risk mechanisms has a statistical influence on performance of commercial banks.

Previous studies (Nibedita, 2018; Arfan and Nasir, 2014; Apollo, Mandalika and Said, 2018) observed that corporate governance, audit committee and board composition has a positive impact on performance of some commercial banks in Bangladesh and Pakistan. This studies however failed to show how the number of risk governance mechanisms affects the firms performance. Apollo *et al.*, (2018) found that the variables of board composition had no significant influence on the financial performance of banking industry. This study was done in Indonesia. Muturi (2013) observed a significant relationship between board committees and financial performance of some other large commercial firms

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in Kenya. Mohamed (2015) observed that there is a statistically significant relationship between board committees and market value. On contrary, Puni (2015) found no statistically significant impact of board committees on the financial performance of the listed firms in Ghana suggesting a need for a comparative study in other economies such as Kenya. Carter, D'Souza, Simkins and Simpson (2010) observed that there is no significant relationship between board committees and financial performance of United States corporations.

From the literature reviewed, there is limited information on the relationship between number of risk governnace mechanisms and financial performance of firms. Few studies have been done on the Kenyan commercial banks justifying a need to establish the relationship between the number of risk mechanisms and financial performance of commercial banks in kenya.

OBJECTIVES

The specific objectives of this study was to establish the relationship between the number of risk governance mechanisms and the financial performance of commercial banks in Kenya

METHODOLOGY

The study employed longitudinal research design. This enabled the analysis and comparison of secondary data collected from the commercial banks for the study period (2013-2017). The secondary data was collected from the published audited financial statements and reports of the targeted commercial banks. Similar studies done previously by (Kamazima *et al*, 2017 and Kimeu, 2017) also used longitudinal research design. For this study, longitudinal research design was ideal since it helped to establish the relationship between number of risk governance mechanisms and financial performance of commercial banks in Kenya, over a 5-year period.

SAMPLING DESIGN

The research adopted a census sampling design in which all 42 commercial banks in Kenya participated in the study. This sampling design was considered appropriate since the population of the commercial banks in Kenya is not large and therefore it could be managed through census.

STATISTICAL DESIGN

Once the data was extracted from the consolidated financial statements, it was scrutinized for completeness and consistency. Data was then analyzed by use of both descriptive and inferential statistics. Correlation and regression analysis were used to establish relationship between dependent and independent variable. Data was analysed with the help of Statistical Package for Social Science (SPSS) and suitable regression model as follows:

$$\mathrm{Y}_1 = {}_{\beta 0} + {}_{\beta 1}X_1 + \varepsilon$$

GEOGRAPHICAL AREA

The research focused on all the commercial banks regulated by the Central Bank of Kenya

RESULTS

Commercial banks use different mechanisms to manage risks therefore it is important to establish whether there exists a relationship between number of risk governance mechanisms and return on assets (RoA). Data on the number of risk governance mechanisms for different commercial banks in Kenya was therefore extracted. This data was analyzed for 2013-2017 financial years and presented according to different tiers of commercial banks. Table 1 shows the results on the number of risk governance mechanisms adopted by the various commercial banks in Kenya between 2013 and 2017.

Table 1
Number of risk governance mechanisms adopted by in commercial banks

Tier	2017	2016	2015	2014	2013	Mean
I	4.38	4.25	4.63	4.38	4.13	**4.35**
II	5.50	6.20	6.20	6.40	6.20	**6.10**
III	3.88	5.95	5.79	5.63	5.53	**5.35**
Mean	**4.58**	**5.47**	**5.54**	**5.47**	**5.28**	**5.27**

Source: Research data, 2019

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Tier I indicated the lowest mean (4.35) while Tier II showed the highest mean (6.10) number of risk governance mechanisms. Generally, there has been a decrease in the mean number of risk mechanisms from 5.28 in the year 2013 to 4.58 in 2017. The study also hypothesized that there is no significant relationship between the number of risk governance mechanisms and financial performance of commercial banks in Kenya. To test this hypothesis a regression analysis was done. The findings are presented first as per the tiers and secondly the overall. Table 2 shows the regression results according to the tiers.

Table 2
Regression analysis as per tier

Tier	R	R^2	Adjusted R^2	P value
I	0.255	0.065	0.04	0.112
II	0.385	0.148	0.13	0.006
III	0.292	0.085	0.075	0.006

Source: Research data, 2019

The results showed a positive relationship for Tier I banks, however the relationship was not significant since the p value is 0.112 which is greater than 0.05 the acceptable margin. For Tier II banks, the relationship showed a significant positive relationship of coefficient of correlation R=0.385, p<0.05. In Tier III banks, the coefficient of correlation was R=0.292 with a p-value of 0.006. This shows that there is a significant positive relationship between number of risk governance mechanisms and RoA for Tier II and III. An overall regression analysis was done and the findings presented in Table 3.

Table 3
Regression analysis between number of risk governance mechanisms and return on assets

	β	SEb	β	T	Coefficients
Constant	1.244	0.428	-	2.909	
Main effects					
Number of risk mechanisms	0.166*	0.064	0.191*	2.581	
R					0.191*
R Square					0.036*
Adjusted R Square					0.031*
R Square Change					0.036*
Model F Change					6.660
Model Summary df					1
Sig. F Change					0.011
Durbin Watson					0.827

Note: Dependent variable, Risk committee
*The significance levels *p<0.05; p**<0.01*

Source: Research data, 2019

From the results, it is established that the number of risk mechanisms adopted by a bank has a positive relationship with the return on assets (a regression coefficient of R=0.191, p=0.011, $R^2 = 0.036$, Adjusted $R^2= 0.031$, p<0.05). The null hypothesis is therefore rejected and the alternate hypothesis that states that there is a statistically significant relationship between number of risk governance mechanisms and financial performance is accepted. From the findings, $R^2 = 0.036$ indicates that number of risk governance mechanisms can explain 3.6 percent of the variations in the RoA which is significant at p=0.011 and the unstandardized coefficients which represents the slope of the regression β= 0.166 indicates that an increase by one unit of the number of risk governance mechanisms adopted by the commercial banks will increase the RoA by 0.166 units. The constant β= 1.244 indicates that when the commercial banks have zero risk governance mechanisms, the RoA will be 1.244 units.
The regression equation model will therefore be: -

$$Y = 1.244 + 0.166_{NM} + \varepsilon$$

Where;
Y - Financial performance indicated by RoA
NM – Number of risk governance mechanisms
ε - Error term

It is concluded that number of risk governance mechanisms is significantly related with financial performance since as the number of risk governance mechanisms increases, the return on asset also increases. Indeed (Kamazima, Mathenge and Ngui, 2017; Kimeu, 2017) found a statistical significant relationship between number of risk mechanisms and financial performance while Bernaddette and Conna (2015) found that corporate governance mechanisms influences the performance of commercial banks. However, Carter, D'Souza, Simkins and Simpson (2010) found a negative relationship between the number of risk governance mechanisms and financial performance. Such variations may be explained by differences in financial operation sectors and country GDP differences.

SUGGESTIONS

The study recommends commercial banks to adopt several risk governance mechanisms to manage risk hence improving financial performance.

CONCLUSION

The study found a significant positive relationship between the number of risk governance mechanisms adopted by commercial banks and their financial performance. This study therefore concludes that the number of risk governance mechanisms is positively related to the financial performance of commercial banks in Kenya.

AREA FOR FURTHER RESEARCH

This study was limited to a certain extend based on its methodology and findings. The study therefore makes suggestions for further research based on this limitation. First, the study focused only on commercial banks in Kenya and the findings cannot be generalized to the other banking sector and therefore the study recommends that similar study should be done on other banking sectors for example micro finance banks and SACCOs.

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