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MODERATING EFFECT OF BOARD COMPOSITION ON THE RELATIONSHIP BETWEEN CREDIT COMMITTEE AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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ABSTRACT

The existence of a stable banking sector in a country play a significant role to the economic development. Over time, commercial banks have encountered various challenges that have affected their operations. To mitigate this challenges, the banks have enhanced the oversight role of the board and also established credit committees. All this aims at enhancing performance. However, there is limited knowledge of the moderating effect of board composition on the relationship between credit committee and financial performance of commercial banks in Kenya and this study aimed at addressing this gap. The study is significant to both shareholders and stakeholders of commercial banks. The target population was all the 42 commercial banks operating in Kenya and it 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 no statistical significant moderating effect of board composition on the relationship between credit committee and financial performance of commercial banks in Kenya. The study therefore concludes that board composition does not moderate the relationship between credit committee and financial performance of commercial banks in Kenya.

KEY WORDS: *Board composition, credit committee, financial performance, commercial banks, Kenya*

INTRODUCTION

Different commercial banks have different committees formed by the board of governance as a mechanism of risk management. The board committee reports are presented to board of governance for discussion, approval and adoption. The number of board meetings has a statistically significant influence on the performance of commercial banks (Kimeu, 2017). Ekadah and Mboya (2009) observed that board diversity does not affect the performance of commercial banks in Kenya suggesting a need to investigate how the frequency of board composition may affect the financial performance of commercial banks. Ruparelia and Njuguna (2016), board remuneration affects the financial performance of commercial banks, while Magembe, Ombuki and Kiweu (2017) found that corporate governance accounts for the performance of commercial banks. Such observations create a gap since other board governance factors for example the board composition. Nganga (2017), found that board independence, gender diversity, board size and board-director duality affect the financial performance of commercial banks in Kenya. The study, however, failed to show how if board composition specifically the board size moderates the relationship between credit committee and financial performance of commercial banks.

According to Makokha (2014), financial performance of insurance companies is not significantly influenced by board size, however, the findings may be different for commercial banks. According to Mamatzakis, Zhang and Wang (2017), companies with higher board sizes are associated with a higher risk taking. This studies, however, failed to link the board size with the financial performance. Indeed, Shkendije (2014) found that companies with large board size are associated with dismal performance becauses of challenges in coordinating a large size. All these studies were done in outside Kenya and the findings may not be similar if a similar study was conducted in Kenya.

Ingari (2017) looked at how board membership qualifications, gender diversity and board independence affects the performace of commercial banks in Kenya. Board members with higher experience and diversity leads to better performance of the bank. This study, however, failed to discuss how the board composition specifically the board size affects the performance of commercial banks. Lundqvist and Vilhelmsson (2018) found that corporate

governance does not significantly affect the credit ratings. The study used panel data and was carried out in America hence creating the need to carry out simmilar study in Kenya using other research designs. Bernaddette and Corina, (2015) found that governance mechanisms influences performance of commercial banks. This study was done in a developed country and the findings can not be generalised to a developing country.

Koriang (2014) found a positive relationship between number of meetings and the performance and there is need also to establish the moderating effect of board composition. Kiambati *et al.,* (2013), observed that board size has an effect on the profitability of commercial banks in Kenya. Ngwenze and Kariuki (2017) showed that corporate governance has no significant influence on the performance of listed agricultural firms in Kenya. Ojulari (2014) found a negative relationship between the number of board meetings and the financial performance in Nigerian firms.

Maniagi (2018) observed a negative relationship between credit risk and financial performance. The study recommended that bank managers should manage credit risk but it fails to link the various effect of risk management mechanisms to financial performance. Chou and Buchdadi (2017) found that meeting attendance increases the profitability of commercial banks in Indonnesia a country with a different GDP from Kenya, there is need therefore to carry out a similar study here in Kenya.

Olayinka, Osariemen, Olojede, Opeyemi and Usman (2018) found that risk governance negatively impacts on the financial performance of commercial banks. Muchemwa and Padia (2016), found that there is no relationship between board size and performance of the firm. The study used cross-sectional research design and multiple regression analysis to analyse data.

Topal and Dogan (2014) did a study on the impact of board size on the performance of firms and found a positive relationship between board size and firm performance. Ogada, Achoki and Njuguna (2016) found a positive relationship between board size and financial performance. This study focussed on merged institutions and used mixed methodology research design and purposive sampling method. The results cannot be generalised to the banking sector since it was limited only to merged institutions.

Kiambati *et al* (2013) did a study on the role of board size on the financial performance of commercial banks and found a positive relationship between board size and financial performance. A similar study was done by Oludele, Oloko and Olweny (2016) on the impact of board size on the financial performance of the listed manufacturing companies in Nigeria and that found a positive linear relationship between the two variables. The study was done in Nigeria and focussed only on manufacturing listed firms in Nigeria. The findings may not be generalised to the banking sector because of differences in the operation structure and risk hence there was a need to carry out similar study here in Kenya.

Orozco and Vargas (2018) found a significant positive relationship between the board size and financial performance in top companies in Colombia using correlation and cluster analysis for the period 2008- 2012. Uwuigbe and Fakile (2012) found that banks with larger board sizes recorded lower profits compared with banks that had smaller board size. The study by Uwuigbe and Fakile (2012) contradicted the study done by Orozco and Vargas (2018). The difference in the findings may be attributed to the difference in the sectors.

Shunu, Bii and Ombaba (2017) found a positive relationship between board size and performance of listed companies in the stock exchange and there is need to carry out a similar study for commercial banks. Similar findings were observed by Ogada, Achoki and Njuguna (2016) on the effect of board size on the financial performance of merged institutions. The study used mixed research design and purposive sampling to collect primary data. The study found that board size had significant effect on financial performance of merged institutions.

For this study, board composition was indicated by the size of the board. From the literature reviewed above, there are varied results on the effect of board size and this study sought to establisg the moderating effect of voard composirion indicated by board size on the relationship between credit committee and financial performance in commercial banks in Kenya.

METHODOLOGY

Research design

For this study, longitudinal research design was used. It was ideal since it helped to establish the relationship between board composition, credit risks and financial performance of commercial banks in Kenya, over a 5-year period.

Location of Study

The study was done in Kenya focusing on all the commercial banks in Kenya.

Validity and reliability of research instrument

Pre-testing the data extraction through the experts in the academic field and also experts in the banking sector ensured its validity. Inputs from all these experts were incorporated and it helped to improve the data extraction form from its initial form to the final form. On the other hand, commercial banks are guided by ISA (International Standards of Accounting) and IFRS (International Financial Reporting Standards) and this ensured reliability of the data extracted from the annual consolidated financial statements and reports.

Sample Size and Sampling Procedures

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. Commercial banks in Kenya are categorized into three different Tiers as shown in the table below:

Table 1
Category of Bank Tier

Category	Market share	Number	Sample size
Tier I	Over 5%	8	8
Tier II	1%-5%	11	11
Tier III	Below 1%	23	23
Total		42	42

Source: CBK annual report 2017

RESULTS

In this study board composition indicated by board size was the moderator, credit committee was the independent variable and financial performance was the dependent variable. Different commercial banks have different sizes and composition of board size and credit committee that help in finding ways of minimizing risk exposure to the banks. In our previous results before the moderator, a significant positive relationship between credit committee and financial performance was observed with a regression coefficient R=0.591 (Table 1) to test the hypothesis that stated that there is no significant moderating effect of board composition on the relationship between credit committee and financial performance of commercial banks in Kenya, a linear regression was done between values after moderator of credit committee and financial performance. The regression analysis of the moderating effect of board composition on the relationship between credit committee and return on assets is presented in Table 1.

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Table 1

Moderating effect of board composition on the relationship between credit committee and return on assets

	Model 1				Model 2				Model 3			
	β	SEb	β		β	SEb	β		β	SEb	β	
Constant	1.167**	0.413**			1.150	0.762			2.665*	1.245*		
Step 1												
Credit committee	0.236**	0.081**	0.215		0.236**	0.081**	0.215**		-0.159	0.270	-0.145	
Step 2												
Board composition					0.002	0.67	0.002		-0.146	0.117	-0.163	
Step 3												
CC*BS									0.038	0.025	0.426	
R				0.215**				0.215				0.243
R Square				0.046**				0.046				0.059
Adjusted R Square				0.041				0.036				0.043
R Square Change				0.000**				0.000				0.013
Model F Change				8.565**				0.001				2.358
Model Summary df				1				1				1
Sig. F Change				0.004				0.979				0.126
Durbin Watson												0.898

Note: Dependent variable, Credit committee
*The significance levels *p<0.05; p**<0.02*
Source: Research data, 2019

As shown in Table 1, model 3 presented interaction effects of (R= 0.243, R^2= 0.059, Adjusted R^2 = 0.043, F = 0.013, F- change =2.358, p=0.126, p>0.05). This is an insignificant relationship of correlation coefficient of R=0.243, change in R^2 = 0.013). It is therefore concluded that there is no significant moderating effect of board composition on the relationship between credit committee and return on assets. From the results, the regression equation will therefore be: -
$Y = 1.167 + 0.236_{CC} + \varepsilon$……….Model 1
$Y = 1.150 + 0.002_{CC} + \varepsilon$……....Model 2
$Y = 2.665 + 0.038_{CC} + \varepsilon$……….Model 3
Where:
Y- Financial performance indicated by RoA
CC- Credit committee
ε - Error term

The findings of this study contradict Ogada *et al*, (2016) did a similar study and found significant positive effect of board size on the financial performance of merged institutions. The difference maybe attributed to the difference in the sectors under study and also the research design since Ogada *et al*, (2016) used mixed reserch design and purposive sampling to collect primary data, this study used longitudinal research design. The study also contradicts the findings of Shunu, Bii and Ombaba (2017) who that found board size had a significant effect on financial performance of listed companies. The difference may be as a result of difference in the sectors and operating principles.

FINDINGS

The study found that there is no statistical significant moderating effect of board composition on the relationship between credit committee and financial performance of commercial banks in Kenya.

CONCLUSION

The study concludes that board composition indicated by board size does not moderate the relationship between credit committee and financial performance of commercial banks in Kenya.

RECOMMENDATIONS FOR FURTHERS STUDIES

The study recommends that further study should use other analysis techniques like multivariate analysis and also other researches can be done using other research designs.

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