

# Corporate Governance Strategy and Firm Value in the Context of Commercial Banks in Kenya

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**Abstract**— Abstract—Firm value is dependent on Corporate governance which leads to increased value. High valued firms attract more investors. Towards firm value protection, minimum capital requirements were raised by the Central Bank of Kenya from 250 million to 1 billion shillings on commercial banks to cushion bank shareholders value. Despite the increased oversight and regulatory efforts on corporate governance to protect and enhance firm value, some commercial banks have recorded low firm value. Hence, this study sought to investigate the effect of corporate governance on firm value of commercial banks in Kenya. The study was anchored on Agency Theory. Explanatory research design was adopted. Target population was forty four Kenyan commercial banks, where a census was conducted. Secondary data was collected from published financial statements and bank websites for the period 2009 to 2018. STATA version 13.0 was used for data analysis. Descriptive and inferential statistics specifically panel regression was used in data analysis. The study findings established that there is a statistically significant effect between corporate governance and firm value of commercial banks in Kenya. Therefore, the study concluded that firms with good corporate governance have high firm value. And as such, these calls for the management of the commercial banks improve corporate which will go a long way in improving firm value. There is also need for Central bank of Kenya, Capital Markets Authority and Nairobi Securities Exchange to emphasis on corporate governance to enable achievement of high firm value.

**Keywords**— Corporate Governance, Firm Value, Commercial Banks in Kenya.

## I. INTRODUCTION

Corporate governance regulations in Kenya are enshrined in the Capital Markets Act (cap. 485A) of 2002 which underpinned the importance of corporate governance [1]. In most developing nations which have different socio-economic and political contexts compared to western economic and financial systems, have adopted Organization of Economic Cooperation and Development(OECD) Corporate governance codes [2] noted that in the year 2000, the Private Sector Corporate Governance Trust (PSCGT) was published; Guidelines were on voluntary adoption by complying or explain approach. PSCGT contributed to the development of

corporate governance guidelines that the Capital Market Authority (CMA) issued in 2002 and were made mandatory [3]. The guidelines focus on performance and good governance, the board, rights of shareholders and maximization of value [4]. [5] Musikali posits that there is a positive effect between corporate governance and value of the firm. Off-balance sheet items as observed in ICB and GBL where ICB had a six year old board member and GBL had two board members without say. Larger boards may enhance access to a variety of resources and improved executive supervision. Large boards are more symbolic, but poor communication associated costs may be high than benefits [6]. According to Capital Markets Regulations (2016) striking of a balance of skills, independence and company knowledge are important for corporate governance operations to be effective. Regulations by CBK are on single borrower limit, liquidity, board attendance, investment in land, buildings and insider lending. However there are distortions in financial performance ratios due to manipulation by management and fraudulent accounting scandals. Cost of capital is at times treated as a financial performance measure by researchers [7]. This study adopted the liquidity ratio to measure financial performance in testing the mediation effect of financial performance on the relationship between corporate governance and firm value. Firm value can be measured using measures as Tobin's Q, CAPE ratio (cyclical adjusted price earnings). Market value measures are normally used for public listed companies. CAPE ratio was adopted in the current study as it corrects for short run fluctuations in EPS as it takes into account inflation to enable comparability of different periods. CAPE ratio is calculated as market price divided by average EPS for ten years. Therefore, this study sought to examine the effect of corporate governance on firm value. Consequently, a null hypothesis; corporate governance does not have a significant effect on firm value of commercial banks in Kenya.

## II. LITERATURE REVIEW

This study is anchored on Agency Theory. The proponents of the theory explained the separation of the principal who are the owners and agents who are managers of a firm. [8] Jensen and Meckling stated that agency relationship is due to separation of owners of the firm and the management of the firm. The separation leads to managers who are agents to being entrusted the rights of making decisions by the shareholders

who are the principals. Conflict of interest by the managers arises when they maximize on their own benefits at the expense of owners of the firm destroying shareholder wealth. Management have been found to making funding decisions that are detrimental to firm value in achieving short term goals. Contracts between the management and owners of the firm should be those that encourage the management to be motivated to work and increase shareholders value. Most studies on corporate governance have been anchored on agency theory due to the principal and agent relationship [9]. The theory helps explain the board structure role in the reduction of the agency principal conflict. Directors have a significant influence on the share price is positively and significantly influenced by effective framework of corporate governance and equal treatment of shareholders [10]. On the contrary, the negative influence of share price comes as a result of transparency and disclosure, and that share price is influenced significantly and positively by equal treatment of shareholders. This study adopted the descriptive research design because of low statistical rigor, even though the generalization of findings is largely limited with this research design. [11] Basyith, Fauzi and Idris found a significant relationship between board structure and performance. They study focused on the relationship between ownership and board structure on firm performance in Indonesia. The study used a balanced panel data for 45 blue chip firms listed from 2010 to 2014 and adopted logistic regression. Use of blue chip companies limits generalization of findings because some banks included in the current study are unlisted. The current study covered a longer period of ten years and have additional variables as board diversity and transparency, and this study sought to determine if additional explanatory variables strengthened this relationship [12]. Zulkafil and Samad in their study found that CEO duality is significantly positively related with market based performance, contradicting other studies that found a negative effect. The study examined the structure of the board and valuation in emerging markets in Asia. Data from 107 banks listed in nine Asian countries was used and pooled generalised least squares model was adopted. The current study incorporated other corporate governance elements which are not factored in Zulkafil and Samad study. The present study sought to determine if findings in Asian markets are applicable in Kenya. [13] Amoll findings indicate that gender, age and level of education have a significant relationship on performance while ethnicity and independence has no relationship. The study examined composition of the board and performance of companies in Kenya. Performance in the current study was treated as a mediating variable. A descriptive research design was adopted in this case. Due to low statistical rigor of descriptive research design, drawing of inferences is limited. Also, a limitation with the study was that it assumed a direct relationship ignoring other mediating and moderating factors as financial performance and the regulatory frame work.

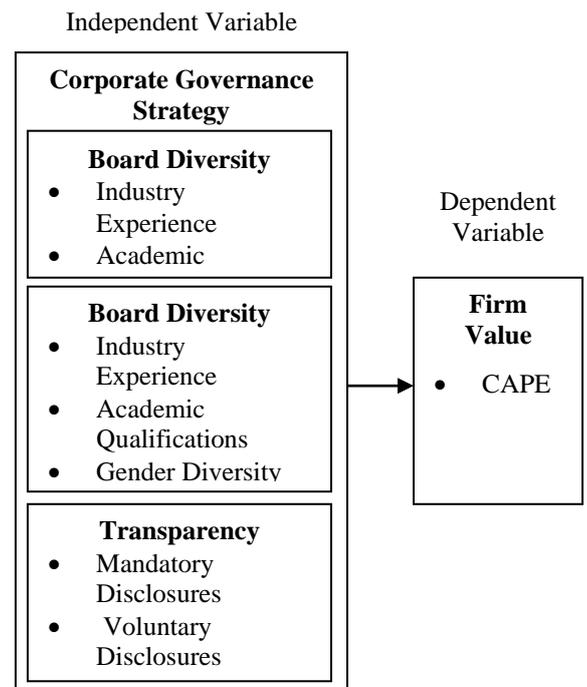


Figure 1. Conceptual framework

### III. METHODOLOGY

Research design therefore provides specific direction for a study [14]. Explanatory research design was adopted to enable test of the effect of board structure on firm value of Commercial banks in Kenya. When the researcher is concerned with identifying factors that cause change and explain the operation of a phenomena without manipulation then explanatory research design is deemed appropriate [15]. The study adopted Panel linear regression analysis. As suggested by Greene a panel linear regression model was estimated since the data had cross-section and time dimension by Al Manaseer [16]. A regression model was adopted to test the relationship between financial performance and firm value. CAPE ratio was obtained by the current market price per share divided by average EPS for ten years.

empirical model:

$$Y_{it} = B_0 + B_1 X_{it} + \epsilon_{it}$$

Where:

$Y_{it}$  = Firm value,  $B_0$  = constant,  $B_1$  = beta coefficient,  $X_{it}$  = Corporate governance,  $\epsilon_{it}$  = error term.

### IV. RESULTS AND DISCUSSIONS

The study tested the null hypothesis: Financial performance does not have a significant mediating effect between corporate governance and firm value of commercial banks in Kenya. The effect between corporate governance and firm value of commercial banks in Kenya.

TABLE I. REGRESSION COEFFICIENTS

| CAPE ratio         | Coef.    | Std. Err. | Z    | P> z  | [95% Conf. | Interval] |
|--------------------|----------|-----------|------|-------|------------|-----------|
| Board Diversity    | 0.022691 | 0.067856  | 0.33 | 0.738 | -0.15569   | 0.110303  |
| Board Structure    | 0.684861 | 0.310235  | 2.21 | 0.027 | 0.076811   | 1.292911  |
| Transparency Index | 0.071683 | 0.034422  | 2.08 | 0.037 | 0.004217   | 0.139148  |
| cons               | 0.474599 | 1.528816  | 0.31 | 0.756 | -2.52183   | 3.471023  |

R-sq: = 0.2671

Wald chi2(3) = 12.74

Prob > chi2 =0.0052

Source:Research Data (2019)

Findings indicate that corporate governance was a good predictor variable of firm value. This study findings concur with Koerniadi, Krishnamurti, Tourani-Rad, and Alireza who found that those organizations that have good governance have lower levels of risk in relation to composition of the board, rights of shareholder. Corporate governance accounts for up to 26.71% of the variation in firm value of commercial banks in Kenya other factors held constant ( $R^2=2671$ ).

Since the study used random effect regression modelling, the model significance was determined by Wald Chi-Square. The results indicate that the model fitted to test the relationship between corporate governance and firm value was statistically significant (Wald  $\chi^2(3) = 12.74$ , Prob>  $\chi^2 = 0.0052$ ). The finding indicates that the model had a goodness of fit further implying that corporate governance significantly predicted firm value.

#### CONCUSLION AND RECOMMENDATIONS

Corporate governance was found to have a significant positive effect on firm value of commercial banks in Kenya. The study concluded that commercial banks in Kenya with high firm value have better corporate governance. This study recommends that policy makers from commercial banks should focus on corporate governance in terms of board structure and transparency in order to achieve high long term goal of firm value. part must be writtern a refine and summary of your results and macth with your experiemnts works.

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