International Journal of Management and Commerce Innovations ISSN 2348-7585 (Online)
Vol. 12, Issue 1, pp: (60-68), Month: April 2024 - September 2024, Available at: www.researchpublish.com

BOARD SIZE AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS LISTED AT THE NAIROBI SECURITIES EXCHANGE, KENYA

[1]Dickson Sintei Muntolol, [2]Dr Francis Githagia

[1]Student, Kenyatta University

[2]Lecturer, Kenyatta University

DOI: https://doi.org/10.5281/zenodo.11090986

Published Date: 30-April-2024

Abstract: **This study sought at determining effects of board size on financial performances of twelve commercial banks listed at NSE. The hypotheses of agency, stakeholders, and resource dependency supported the factors employed where the study was subjected to explanatory method of design. Secondary data is going to be obtained from NSE, and bank financial statements within time frame of 2015-2022 and subjected to normality, multicollinearity, heteroskedasticity, autocorrelation and linearity diagnostic tests before being analyzed using inferential analysis and descriptive statistics. Ethical standards were duly followed. The outcome demonstrated that board size of Kenyan listed commercial banks has an insignificantly positive financial performance effect; It was discovered that the relationship of interest rate with board size positively affected financial performance but in an insignificant manner. The study recommend that the board size should be reviewed to ensure that such board size tallies with the size of the firms responsible to avoid excessive remunerations to many board members in Kenya. This would allow for quick decision making that would facilitate the financial performance of listed commercial banks in Kenya.**

Keywords: **Board Size, Interest Rate, Financial Performance, Return on Assets.**

1. BACKGROUND TO THE STUDY

To regain the trust of investors and draw private or foreign direct investment, corporate governance practices are required in Kenya's banking sector. Increased director responsibility, financial reporting, and business structural openness can all help with this. Adopting good management procedures results in better resource distribution, which boosts operational effectiveness and profits. Excluding good board traits procedures can have a negative impact on inferences about business success, according to Mwalati & Chitiavi (2013). For instance, this had an impact on Kenya's banking industry in the 1990s when a number of banks failed and lost depositor money. Kenya has now benefited from good corporate governance policies and board characteristics. Regulations by Central Bank of Kenya (CBK) relating to corporate governance as listed in the Kenyan Banking Act provided guidelines and support for all banks within Kenya, including listed commercial banks which have acted as a cushion effect for increased financial performance (Kiragu, 2018). However, failure in the Kenyan banking system is due to non-implementation of policies regarding corporate governances and prudential regulations prescribed by CBK (CBK, 2015)

1.1 Board Size

Board size consists of all members constituting a board. Board size can influence the effectiveness and growth of a firm including decision implementation (Chaudhary & Gakhar, 2018). A firm can either have a large board size and a small

board size (Oziegbe & Okenwa, 2021). A large board size according to Ilaboya and Obareth (2015) incurs more remuneration to the board members thereby affecting financial performance. Furthermore, Onyali and Okerekeoti (2018) opined that a small board size results in the effectiveness of the board members due to adequate and sufficient remuneration which will enhance their quality of duties delivery.

1.2 Interest Rate

The interest rate represents the cost that capital owners are ready to accept from fund borrowers, as well as the cost that lenders are willing to charge to lend money to businesses in exchange for consumer goods. At loan application point, interest rates and the cost of the loan were both agreed upon (Caporale and Gil-Alana, 2010). When lending rates are not capped, according to Boudriga, Boulila, and Jellouli (2019), banks can more easily charge a greater risk premium and lend money to more people (Mwangi, 2017).

1.3 Financial Performance

Kenya's commercial banks have seen a 1.7 percent decline in return on assets (ROA) in 2020. As a result, Kenyan banks earned less money from their assets in 2019 than they did in 2018, when the ROA was 2.6 percent. The indicator peaked in 2016, at 3.2 percent, during the time period studied. The CBK had a net surplus of KShs 41,530 million in 2020, compared to KShs 26,138 million in 2019. The excess is deposited in the General Reserve Fund. Due to the influence of USD strength, an unrealized foreign currency gain of KShs 24,475 million was recorded in 2020, 2019: KShs 5,122 million. Despite the difficult operating environment caused by the COVID-19 pandemic, the listed bank made a significant rebound in 2020, as shown by increase in profitability, with Core Earnings Per Share (EPS) climbing by 136.0 percent. The increase in EPS is primarily due to a 19.2 percent increase in Non-Funded Income (NFI), compared to a 1.1 percent fall in 2019 due to the expiration of the fee and commission waiver on loans in March 2021. In the first half of 2021, Net Interest Income increased by 17.6%, compared to 10.9 percent in the first half of 2020. Provisioning levels for most publicly traded banks fell during the period, and we expect this trend to continue in 2021. Financial performance will be measured by using ROA in this study.

1.4 Commercial Banks Listed at Nairobi Securities Exchange, Kenya

The banking sector is listed under the NSE platform, and 12 commercial banks are listed under the sector. The twelve commercial banks listed are Absa Bank Kenya PLC, Diamond Trust bank Kenya Ltd, Stanbic Holdings PLC, Equity Group Holdings, I & m Holdings Ltd, Standard Chartered Bank Ltd, HF Group Ltd, KCB Group Ltd, The Co-operative Bank of Kenya, National Bank of Kenya Ltd, NCBA Group PLC, and BK Group PLC (NSE, 2021).

2. STATEMENT OF THE PROBLEM

Numerous researches on board size and financial performances have been done. Oyerogba, Memba and Riro (2016) conducted research on connections between board sizes and financial' performances of 70 firms listed on NSE in Nigeria. Muller (2014) examined impacts of board size on financial performances of companies listed on London LSE, Shunu, Bii and Ombaba (2017) determined to study effects of board size on registered banks listed at NSE in terms of firms' financial performances which is different from listed commercial banks. Kenya, which provides a diverse natural, political, and economic background, was the site of this study. Yakob *et al* (2021) used Tobin Q as dependent variable. Olokoyo, Okoh, Ezeji and Uzohue (2020) in their study recorded significant implications of sizes of boards on financial' performances of commercial banks in Nigeria. The conflicting results, environmental, political and economic, time period and industry of study thereby calls for further research as this investigation seeks to determine board size effect on financial performances of commercial banks listed at NSE, Kenya.

3. OBJECTIVES OF THE STUDY

The objective of this study was to examine effects of board size on on NSE listed financial performances of commercial banks in Kenya.

4. RESEARCH HYPOTHESES

The study hypothesis was: $\mathbf{H_{01}}$: Board Size has no significant effect on financial performance commercial banks listed at the Nairobi Securities Exchange, Kenya.

5. LITERATURE REVIEW

5.1 Theoretical Review

Agency Theory

Jensen (1976) is interested in finding solutions to issues that may occur in office affiliations, i.e., between managers and owners (such as financial experts) (such as affiliate specialists). Issues that arise when wants and goals of the boss and head are in conflict are two areas that agency theory covers, making it impossible for the supervisor to monitor what the boss is doing, and the problems that occur when the head and authority are in danger. Given varied risk guarantees, the head and chairperson are likely to take on a variety of roles. Agency theory describes relationships between principal and agents who acts as principal's representative in an organization (Jensen & Meckling's, 1976). The two parties' relationship benefits from the division of ownership and control, which also secures shareholders' interests, lowers agency expenses, and aligns main agents' interests (Müller, 2014).

Parties to corporate partnership have specified their duties in detail as follows: To make sure that effective system of governance is followed, principals select and appoint governors, including executives and assessors. Partnership between corporation's agent and principal is prone to disputes since the agents' normal financial goals vary from directors (Zenner, 2014). All organizations are responsible for resolving office difficulties, according to (Karuti, 2014), which in part motivated the development of activity requirements to do so. In order to motivate operators act in ways that are compatible with realistic concern about authorities, these measures include creating mechanisms like assessment of performances for administrators, specialist functioning control, fiscal rewards, and sharing of threat knowledge for greater reliability.

The effectiveness of agency theory in establishing the correlation between board characteristics with respect to size (Jensen & Meckling, 1976) makes it applicable to this study. The agency hypothesis has some limits given that it is known that certain boards of directors may not be completely independent and that stakeholder dependence on them is harmful. The notion that boards are impartial is frequently untrue. Rashid (2015) discovered that chairman of more than 85% of Fortune 500 manufacturing companies has previously served as CEO.

5.2 Empirical Review

Board Size and Financial Performance

Oyerogba, Memba and Riro (2016) researched on relationships between board sizes and financial performances.70 companies listed at Nigerian Stock Exchange (NSE) between 2004 and 2013 were employed as the target population in determining the study's research objective. Secondary data was collected from publicly available accounting records of the companies and yearly reports released by CBN and NSE and were further submitted to inferential analysis and descriptive statistics. ROCE was dependent variable, whereas board size was independent variable. Findings demonstrated that board sizes of publicly traded companies have considerable impacts on their profitability. The aforementioned study, meanwhile, only included commercial banks listed on NSE. As a result, the investigation looked at how board qualities affect financial performances of commercial establishments listed on Kenya's NSE.

Mwaura (2017) carried out a study to examine relationships between board sizes and financial performances of commercial establishment in Kenya. The study employed cross-sectional research design and census sampling technique; 43 commercial banks operational within 2012-2016 were used as target population for research. Websites of companies' annual reports and financial statements were accessed to gather secondary data. Board sizes was independent variable, while ROA was dependent variable. Positive association between board size and financial' success was found after descriptive, correlation, and regression analyses were applied to secondary data. However, earlier analysis employed cross-sectional research and did not simply include listed commercial banks; it also included all Kenyan commercial banks. As a result, this study further investigated how sizes of boards affects financial performances of commercial institutions listed on Kenya's NSE and utilize explanatory design of research.

6. RESEARCH METHODOLOGY

explanatory research design was used for this study as it is effective when there is no sufficient research to tackle specific objectives of a study. The twelve commercial banks listed at NSE, Kenya as of December 2020 is going to be the study's target population.

Regression model for this research was on the regression function below:

$ROA = \beta 0 + \beta_1 BS_{it} + \epsilon$

Where:

$\beta 0$ = Constant

ROA = Rates on Assets

BS = Board Size

β_1 = Coefficient of Regression Analysis

ϵ = Error Coefficient

The following models were utilized to evaluate moderating effects of interests rates on associations between board size and financial performances:

$ROAit = \beta 0 + \beta 1\ BSit + \beta 2MVit + \varepsilon\ it$

$ROAit = \beta 0 + \beta 1\ BSit + \beta 2MVit + \beta 3\ BC*MVit + \varepsilon\ it$

Key:

i= Bank

t= Time period

ROA = Return on Assets

BC= Board Size

MV= Moderating Variable (Interest Rate).

BC*MV= Interaction term

$\beta 0$= Constant

A census sample technique was employed for this study's purposes in order to include all listed Kenyan banks on the NSE. secondary data which is the quantitative data was be gathered from annual reports and publications of CBK and NSE websites, additional data was also gotten from the listed commercial banks published financial statements. Independent variable data was collected for this research is data based on board size, while dependent variable was data based on ROA. The data was within the time frame of 2015 to 2020.

The study utilized inferential analysis and descriptive statistics, examination of data. Inferential analysis was based on regression analysis to determine effects of board size on financial performances (ROA) while correlation method of analysis was utilized to reveal relationships between board size and financial performances. Using descriptive analysis, data was analyzed using measures of central tendencies. Following the analysis was presentation of research results gathered in tables.

To ascertain the reliability, normality and effective of the data variables, normality, multicollinearity, heteroskedasticity, autocorrelation and linearity tests will be carried out.

7. RESEARCH FINDINGS AND DISCUSSSIONS

The NSE-listed data of the commercial banks were submitted for descriptive analysis to identify the critical elements that most precisely describe the behaviour of board size and the financial performance of the banks. Table 1 provides a synopsis of the processed information in a descriptive manner.

Table 1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Financial Performance	86	.1587737	.0922373	-.1099505	.421771
Board Size	88	9.272727	1.609792	6	11
Interest Rate	88	8.8525	1.36769	7	10.67

Source: Study Data (2023)

Financial performance has a mean average of 0.158, as depicted by the outcome in Table 1. This is in line with the listed commercial banks' 0.092 standard deviation of financial performance. This demonstrated that the survey's results varied between the lowest and highest ratios, which were -0.109 and 0.421. Board size was 9.272 on average. The standard deviation for the board's size is 1.609. Despite the variance in the data, the size of the board falls within a range of 6 and 11 members as minimum and maximum values respectively. The outcome of the study implies that interest rate ranges from a minimum of 7 to a maximum of 10.67% in Kenya.

7.1 Diagnostic Tests

Normality Test

To allow for distribution normality of the residual of the variables under investigation, it is critical that the sample taken from the population of the research be representative of the population. This is based on the premise that residuals should be dispersed in a way that accurately represents the population's true mean. Shapiro-Wilk test outcomes used to check the residuals' normality are shown in Table 2.

Table 2: Shapiro-Wilk Test for Normality

Variable	Obs	W	V	z	Prob>z
Financial Performance	86	0.93620	4.648	3.380	0.00036
Interest Rate	88	0.91923	5.996	3.946	0.00004

Source: Study Data (2023)

size and interest rate had p-values that were less than the 0.05 level of significance. The null hypothesis was refuted for the variables with p-values less than 0.05 as a result because the residuals across the observations are not regularly distributed. In accordance with the central limiting theorem, data are regarded sufficient for the study's analysis when the sample size for the research is 30 or more because they are believed to be regularly distributed. Consequently, such results are acknowledged to be normally distributed because the sample size is more than 30 observations employed for the study.

Multicollinearity Test

The variance inflation factor (VIF) evaluates how closely the explanatory variables are related to one another in a statistical model. When the VIF coefficient is high and exceeds 5, it is believed that associations have an impact on the outcomes of the surveys. The VIF products are shown in Table 3.

Table 3: VIF Tests for Multicollinearity

Variable	VIF	1/VIF
Board Size	1.61	0.619386
Interest Rate	1.17	0.851362
Mean VIF	1.41	

Source: Study Data (2023)

The results of the VIF for the survey were displayed in Table 3. All of the explanatory factors used had VIF values < 10. This suggests that there are no substantial collinearity problems with the model, making it suitable for the study's future analysis. As a consequence, the model has no collinearity problems, which demonstrates that subsequent OLS processes can be carried out. Given that the mean VIF is 1.41, significantly below the cutoff of 10, this conclusion is drawn.

Heteroscedasticity Test

Table 4 demonstrates the outcomes of the Breusch-Pagan test, which was used to identify whether or not a model exhibits heteroscedasticity.

Table 4: Breusch-Pagan/Cook-Weisberg test for heteroskedasticity

Breusch-Pagan / Cook-Weisberg test for heteroscedasticity
Ho: Constant variance
Variables: fitted values of Financial Performance
Chi2(1) = 0.15
Prob > chi2 = 0.7024

Source: Study Data (2023)

The estimated probability Chi-square is 0.7024, which is higher than the 0.05 level of significance. As a consequence, the null hypothesis can be accepted and it can be said that the model is homoscedastic. This result supported the idea that the study's conclusions may be used to inform policy. In this case, the parameters of the study can be relied upon for further estimation.

Autocorrelation Test

The circumstances indicate that there is a link between the residuals of the variables over various time periods. The performance of the empirical model is impacted by the occurrence of this issue in OLS estimation, which leads to incorrect outcomes. Table 5 presents the results of the Breusch-Pagan test that was used to determine how much a model produces autocorrelation.

Table 5: Autocorrelation Results

Breusch-Godfrey test for serial correlation	
Chi2(1)	= 36.62
Prob > chi2	= 0.0000

Source: Study Data (2023)

A p-value of 0.0000, which is less than the asymptotic level of 0.05, is indicated by the autocorrelation products as shown in Table 5. The outcome showed that there is autocorrelation presence in the model, which led to the null hypothesis rejection that there is no autocorrelation in the model. For this issue to be overcome, robust standard errors regression parameters provided solution to this problem.

Stationarity Test

The Fisher-type test was used to determine if the factors being studied were stationary. Table 6 puts forward the Fisher-type outcomes.

Table 6: Fisher-type test for Stationarity

Variable	Fisher-type Statistic	P-value	Comment
Financial Performance	40.5325	0.0094	Stationary
Board Size	85.5266	0.0001	Stationary
Interest Rate	94.2171	0.0081	Stationary

Source: Study Data (2023)

The findings of the stationarity of are shown in Table 6. P-values for the variables at the 0.05 level of significance showed that they are stationary. This suggests that interest rate, board size and financial performance are stationary, meaning that their variance and means have remained stable over the duration of the study period. Therefore, every variable is free of unit roots at the important asymptotic level.

Model Specification test

The Hausman test outcomes are presented in Table 7.

Table 7: Model Specification Results

	(b)	(B)	(b-B)	Sqrt (diag(V_b-V_B))
	Fixed	Random	Difference	S.E.
Board Size	-0.1901368	0.0140504	-0.2041872	0.0977596
$Chi^2(4)$	0.03			
$Prob>Chi^2$	0.9849			

Source: Study Data (2023)

The Hausman test outcomes shown in Table 7 validated the null hypothesis. The estimator suggested choosing the random effect model rather than the fixed effect model parameter estimates according to the empirical findings in Table 4.6. The Hausman test, which relies on the 0.05 level of significance, generated a prob > chi2 value of 0.9849, which is higher and

above the 0.05 cutoff point. Based on the outcomes of the investigation, the random effect regression model was chosen above the fixed effect model.

Regression Analysis

The Table 8 produced the outcomes to illustrate how listed Kenyan financial performance of commercial banks was affected by board size.

Table 8: Direct Effect Regression Results

Financial Performance	Robust Coef.	Std. Err.	Z	P>z	[95% Conf.	Interval]
Board Size	.0069955	.0138918	0.50	0.615	-.020232	.034223
_cons	.3110146	.1293537	2.40	0.016	.0574861	.5645431
R^2	0.1440					
Wald $Chi^2(4)$	14.65					
Prob>Chi^2	0.0055					

Source: Study Data (2023)

Table 8 displayed the outcomes of the direct effect of the regression. The significance of the model was assessed using the outputs in Table 8. The outcomes indicated that the model exhibited an F-value of 14.65 which corresponds to the p-value of 0.0000. The results demonstrated the model's goodness of fit, indicating that board size had an effect that is significant on Kenyan-listed financial performance of commercial banks. Board size explained 14.40% of the changes in the listed financial performance of Kenyan commercial banks, as demonstrated by the R-square, which measures the changes in financial performance arising from the explanatory factors. The constant of the regression line yields a positive number (0.311), which stands for the origin, implying that all things being equal, financial performance of the listed commercial banks would be positive.

The results showed a positive board size coefficient of 0.006, which is insignificant but indicates that, when the 5 percent threshold was taken into account, board size directly affects the Kenyan-listed commercial banks financial performance. The results showed that the financial performance of the listed commercial banks would increase by 0.006% as board size increased.

Moderation Effect, Step One

The moderating effect of interest rate was tested and the outcome is shown in Table 9.

Table 9: Moderation Effect, Step One Results

ROE	Coef.	Robust Std. Err.	z	P>z	[95% Conf.	Interval]
BS	-.0063298	.0080005	-0.79	0.429	-.0220104	.0093508
Interest Rate	.0138528	.0035819	3.87	0.000	.0068323	.0208733
_cons	.1058652	.1161169	0.91	0.362	-.1217198	.3334501
R^2	0.0237					
Wald Chi^2	27.11					
Prob>Chi^2	0.0000					

Source: Study Data (2022)

Table 9 showed that the model's R squared is 0.0237. This is due to the fact that board size and interest rates have poor explanatory power and could only account for 2.37 percent of the variances in the listed financial performance of commercial banks. The Wald chi2 was used to assess the significance of the model and was found to be significant at the 0.05 level of significance with a statistical value of 27.1 and a p-value of 0.0000. Both board size and interest rates have an effect that is significant on listed financial performance of commercial banks in Kenya.

Table 9 demonstrated that board size and the incorporation of interest rates as explaining variables had an adverse effect on the Kenyan listed financial performance of commercial banks. The products also demonstrated that the interest rate had a positive and significantly affected the financial performance of Kenyan-listed commercial banks. Interest rate had effect on financial performance significantly. Having emanated from the theoretical literature, interest rate plays a significant role in

the determination of listed commercial banks in Kenya's financial performance in Kenya. On the basis of this, step two of the moderating effect was performed.

Moderation Effect, Step Two

The step-two model's results are presented in Table 10.

Table 10: Moderation Effect, Step Two Results

Financial Performance	Coef.	Robust Std. Err.	z	P>z	[95% Conf.	Interval]
BS	-.0205482	.0225871	-0.91	0.363	-.0648181	.0237216
Interest Rate	-.0069521	.0260659	-0.27	0.790	-.0580403	.0441361
BS* Interest Rate	.0018862	.0023235	0.81	0.417	-.0026677	.0064401
_cons	.2624499	.2654066	0.99	0.323	-.2577375	.7826372
R^2	0.0345					
Wald Chi^2	21.85					
Prob>Chi^2	0.0001					

Source: Study Data (2022)

An R-squared of 0.0345 in Table 10's findings supported the concept that board size, interest rates, and their interactions had limited explanatory power. Only 3.45% of the variation in the financial performance of could be attributable to board size and interest rates in general. The significance of the model was demonstrated by the Wald chi2 statistics value of 21.85 and the corresponding p-value of 0.0001. This implies that board size, interest rates all together have significant effects on the listed financial performance of Kenyan commercial banks.

The financial performance improved from the moderator's presence as well as the interaction of board size and interest rates. When all other factors are held constant, the interaction between board size and interest rates has a positive effect on the financial performance of Kenya's listed commercial banks, as indicated by a coefficient of 0.262. Consequently, the Kenya's listed financial performance of commercial banks increased by 0.001% when the interaction of board size with interest rates increased. More specifically, board size*interest rates insignificant effect on the Kenyan listed financial performance of commercial banks.

8. HYPOTHESES TESTING

8.1: Effect of Board Size on Financial Performance of Listed Commercial Banks in Kenya

The investigation's findings demonstrated that the board size does not significantly affect the commercial banks listed financial performance in Kenya, but it does so positively. With these results, the null hypothesis that board size has no significant effect on the listed Kenyan financial performance of commercial banks was upheld, proving that board size had no significant effect on these banks' financial performance. The lack of significance of this result may be linked to the board's size, which makes it challenging to reach timely judgements that could improve the Kenyan commercial banks' financial performance. The survey's findings are congruent with Mwaura (2017) reported positive link of board size with financial performance. Shunu, Bii and Ombaba (2017) documented that financial performances of firms was impacted positively by the size of the board. The outcome, however, are inconsistent with the assertion made by Oyerogba, Memba, and Riro (2016) that board sizes of publicly traded firms have a significant impact on their profitability. The study's conflicting results may have resulted from its various execution contexts.

9. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

9.1 Summary of Findings

The regression outcome demonstrated that board size of Kenyan listed commercial banks had an insignificantly positive financial performance effect. The positive effect suggested that a larger board will stimulate the Kenyan listed commercial banks' financial performance. The board size of NSE commercial banks listed has a positive but insignificant effect on financial performance. The implication is that the listed commercial banks' financial performance would improve if the size of the board is increased.

9.2 Conclusion

The investigation was specifically used to examined the effect board size has on the listed financial performance of Kenyan commercial banks. The inquiry arrived at the conclusion that board had no significant effect on the Kenyan-listed financial performance of commercial banks on the NSE. Although the size of the board insignificantly affects the financial performance of Kenyan commercial banks listed on the NSE, the size of the board has the potential of affecting the financial performance of the banks in Kenya.

9.3 Recommendations

These recommendations were produced by this inquiry based on the results of the explanatory variables. According to the study, the Kenyan listed financial performance of banks was not significantly affected by board size. This indicates that in order to enhance the financial performance of Kenyan listed banks on securities exchanges, the size of the board should be reviewed to ensure that such board size tallies with the size of the firms responsible to avoid excessive remunerations to many board members in Kenya. This would allow for quick decision making that would facilitate the financial performance of listed Kenyan commercial banks.

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