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Firm Characteristics and Financial Performance of Quoted Commercial Banks in Kenya

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Abstract:
The role of commercial banks in economic growth and development, income generation and job creation is crucial especially in developing countries. With the increasing trend of sudden corporate failures in both global and local context, shareholders and management are increasingly becoming more concerned with the factors that affect financial performance of firms. The study, therefore, sought to determine the effects of firm characteristics: the number of years in operation of the firm, the market share of the firm and board characteristics, on the financial performance of quoted commercial banks in Kenya. This study adopted the descriptive research design and was a survey of the eleven commercial banks listed on the Nairobi Stock exchange. The study used secondary data obtained from the companies audited financial statements and data recorded on a secondary data collection sheet and analyzed using the panel regression analysis. The study found out that an increase in market share and board characteristics will lead to an increase in financial performance of the quoted commercial banks in Kenya. Similarly, an increase in number of years in operation will lead to a decrease in financial performance of quoted commercial banks in Kenya. This implies that the banks improve their financial performance by increasing its market share and focusing on the board characteristics. The study recommends that managers need to analyze financial performance over time and establish ideal asset size, board characteristics, market share and develop relevant strategies to maximize productivity and improve performance of the quoted commercial banks in Kenya. Further studies should be done to investigate the effects of firm characteristics on the remaining commercial banks not quoted at the NSE and other sectors of the economy. Researchers, academicians and students should carry out studies to investigate possible firm characteristics and factors that affect financial performance of commercial banks in Kenya.

Keywords: *Firm characteristics, financial performance, board, quoted commercial banks*

1. Introduction and Background

Globally, there has been an increasing interest in the firm attributes that affect firm performance. With increasing global competition, technological changes and changes in customer demands for financial services, firms cannot afford to retain all structures in order to make high returns and sufficiently meet customer demands (Brealey, Myers and Allen, 2013). Firm characteristics differ from a firm to another and they distinguish one firm from the other and are mainly determined by the decisions of management and the board. The financial performance of commercial banks can be affected by internal and external factors. The internal factors are individual bank characteristics which affect the financial performance; they include the customer base, capitalization, operational efficiency, risk management, promotional strategies, extent of diversification of products and the investment and use of technology in the operations of the banks.

Banking sector plays a significant role in the growth of economies all over the world in terms of employment, source of finance, import and export facilities, payment settlement and financial management. Bank performance can be both financial and non-financial; financial performance of a bank is measured in terms of its profitability, asset size and quality, liquidity levels and liquidity. Non-financial performance parameters include customer service and satisfaction, efficiency in the banks' processes and involvement in social responsibility. Pilbeam (2018) indicates that financial institutions are facing numerous challenges caused by rapid changes occurring in information technology, trends towards business combination, statutory laws, marketplace, and global competition and accounting standards. These factors affect the operations of a firm; hence the firms' management needs to understand, analyze and consider them in the formulation of policies and business strategies in order to remain competitive and relevant.

2. Statement of the Problem

The Banking sector in Kenya has experienced numerous developments according to the 2020 CBK annual sector report; these developments include mergers and acquisitions, leverage on technology and entry into new markets. The banking sector's focus has also broadened to include long term issues such as climate change, environmental sustainability, diversity and integrating these factors in decision making. The developments have contributed to the growth of the commercial banks in terms of deposits, customers and loan books. With the different banks growing and

expanding to different African countries it remains unclear whether the strategies and attempts to penetrate foreign markets, which, in turn, alters firm characteristics has an effect on the financial performance of Commercial banks in Kenya.

Kenya's banking sector continues to grow and draw interest from local investors and international players as well as observed in the continued entry of new international players (http:www.centralbank.go.ke). The growth of the banking sector is instrumental to the economic growth of the Kenyan economy. Kenya, being a developing country, availability of credit is a key ingredient to the exploitation of economic opportunities. Factors that influence the financial performance of commercial banks can be internal or external. Internal factors are individual bank characteristics, mainly influenced by management and board decisions, which affect performance such as the capital base, customer base, bank assets, operational efficiency and risk management practices. This study sought to determine the effect of specific bank characteristics that is the number of years in operation, asset base, market share and board characteristics on the performance of quoted commercial banks.

3. Objectives of the Study

The study sought to achieve the following specific objectives:

- To establish the effect of number of years in operation of the bank on financial performance of quoted commercial banks in Kenya
- To determine the effect of market share on financial performance of quoted commercial banks in Kenya
- To determine the effect of board characteristics on financial performance of quoted commercial banks in Kenya

4. Research Hypotheses

The study sought to test the following null hypotheses:

- H_{01}: Number of years of operation of the bank does not have a significant effect on financial performance of quoted commercial banks in Kenya.
- H_{02}: Market share does not have a significant effect on financial performance of quoted commercial banks in Kenya.
- H_{03}: Board characteristics do not have significant effect on financial performance of quoted commercial banks in Kenya.

5. Scope of the Study

This study focused on the Commercial banks in Kenya, specifically the eleven commercial banks quoted on the NSE in order to determine the effect of firm characteristics: number of years in operation; asset size; market share and board characteristics. The findings will be useful in drawing conclusions of all the commercial banks in Kenya. The focus of the study was the financial performance over a five-year period that is between 2016 and 2020. The average bank performance indicators were computed to draw conclusions on the topic. The study utilized financial data obtained from audited financial statements and annual reports by NSE and financial ratios calculated as well as plotted on graphs, tables and findings used to draw a conclusion on the research topic.

6. Significance of the Study

The study will be beneficial to the management of Commercial banks who are responsible for decision making, in making decisions and policies on firm characteristics particularly on the growth strategies, board characteristics and Assets size. The commercial banks regulator, CBK and stock market regulator NSE will find this study useful in developing guidelines on bank characteristics and performance. Researchers, students and academicians will use the findings of the study as a guide to develop research topics and a source of knowledge in answering questions relating to the topic.

Investors in the banking sector stand to benefit by utilizing the research findings in their analysis of investment especially while making investment decisions. Financial institutions and lenders of credit will use findings of the study to assess the firms' overall credit worthiness in the course of lending to the institution.

7. Literature Review

7.1. Theoretical Review

The study was guided by the financial intermediation theory, market power and efficiency theory, agency theory and transaction cost theory: these theories identified for the study are those that relate to firm characteristics and financial performance.

The financial intermediation theory was proposed by Bisignano (1992) in the attempt to explain the role of technology in the movements of finances in an organization. Financial intermediation is a process which involves surplus units depositing funds with financial institutions who then lend to deficit units. Financial intermediaries exist due to market imperfections. Commercial banks in Kenya contribute significantly to financial intermediation of the economy, as such their success means flourishing economy while the failure leads to the deterioration of the economy. Banks accept deposits from customers and lend the same to other customers as loans for immediate use. Commercial banks also intermediate between traders by transferring funds and enabling settlements through transfer of funds.

Market power and efficiency structure theory was proposed by Shepherd (1986) in an attempt to explain how firms gain power in an industry and how they cement their industry leadership and dominance by developing efficient structures. The market power theory states that increased external market forces result into market power which is

defined as the capacity of an organization to increase its prices without losing all its clients. In banks, as in other business organizations, Market Power can take two forms: differentiation of products and services, or ease of search. There is a trade-off between differentiation and loss of legitimacy which is optimized at a strategic balance point (Shepherd, 1986).

Commercial banks in Kenya have embraced technology and introduced new products such as mobile banking and lately recruiting agents across the country in order for more customers to access the banks' products and services thereby increasing their customers and market share. Efficiency structure theory suggests that enhanced managerial and scale efficiency leads to higher concentration and then to higher profitability.

Agency theory was developed by Jensen and Meckling, and proposes that agency costs arise from conflicts of interest between shareholders and managers of the company. Agency costs are defined as the sum of monitoring costs incurred by the principal, bonding costs incurred by the agent, and residual loss. Lower agency costs are associated with better performances and thus higher firm values, all other things being equal. Agency theory states that management and owners have different interests (Jensen and Meckling, 1976). Companies that separate the functions of management and ownership will be susceptible to agency conflicts. They show that regardless of who makes the monitoring expenditures, the cost is borne by stake holders. The Agency theory explains the relationship between the principals and the agents in the business (Pandey, 2010). For this study the principals are the shareholders of the commercial banks while the agents are the board of directors. This theory was applied in this study in order to determine the effect of the board characteristics on the performance of the Quoted commercial banks.

The transaction cost theory of the firm was proposed by Ronald Coase. According to this theory, people begin to organize their production in firms when the transaction cost of coordinating production through the market exchange given imperfection is greater than within the firm. The transaction cost theory tries to explain why companies exist and why companies expand or source out activities to the external environment. Commercial banks exist to offer financial services to customers with the sole aim of making profit. Lately, firms adopt strategies aimed at reducing costs, and common services are outsourced from providers at a lower cost than hiring permanent staff.

7.2. Empirical Review

The study reviewed several studies on firm characteristics and financial performance. Nyamiobo, *et al.* (2018) examined the effect of firm characteristics on financial performance of listed firms in the NSE in Kenya. The study explored the specific effect of financial leverage, liquidity, company size and company's age on the financial performance of the listed Firms in Kenya. Secondary data was obtained from annual published accounts of the listed firms at NSE. Multiple linear regression was used to observe the relationship between the dependent and independent variable, data was then analyzed using descriptive and inferential statistics. The study found that firm characteristics have a direct effect on the financial performance of the listed firms at the NSE in Kenya.

Afey and Warui (2019) carried out a study to find out the effect of firm characteristics on financial leverage of firms listed on the NSE, Kenya. The study targeted the 65 listed firms and assessed a sample of 32 firms using secondary data from 2003 to 2017. Panel regression, and correlation and panel data was obtained and analyzed using descriptive statistics. The study found out that firm size, profitability, liquidity, tangibility and growth had a negative significant relationship on financial leverage of a firm. The study recommended that management sets up strategies of growth and expansion and that the firms listed at the NSE should check on their tangibility levels to improve financial leverage.

Kwautommai and Enemali (2019) examined the impact of firm characteristics and financial performance of consumer goods firms in Nigeria. The specific firm characteristics were the firm size, firm age and leverage. The study used both financial and non-financial data of five listed firms for the period from 2007 to 2016. Descriptive statistics, Pearson's correlation and multiple regression analysis were used in analysis of data. The study found that firm size has a negative relationship with financial performance, firm age has a positive relationship with financial performance and that leverage had a positive relationship with financial performance of the Consumer goods firm in Nigeria.

Wafula (2020) carried out a study on firm characteristics and financial stability of Commercial Banks in Kenya. The study sought to establish the effect of operational efficiency, capital adequacy, bank liquidity, profitability and asset quality on the financial stability of commercial banks in Kenya. The study focused on 17 fragile commercial banks period from 2011 to 2018. The study found that operational efficiency had a significant positive effect on financial performance, capital adequacy had a significant negative effect: bank liquidity had an insignificant negative effect; asset quality had a significant positive effect, while exchange rate had a statistically significant negative effect on the financial stability of the commercial banks in Kenya. The study recommended mergers and acquisition of the fragile banks as well as the establishment of limits on insider loans.

8. Research Methodology

The research design adopted for the study was the descriptive design. For purposes of this study, the population was all Commercial Banks in Kenya. In view of the current study, target population was 11 commercial banks quoted at the NSE. The study used secondary data. Secondary data for the study was collected from audited financial statements of the various commercial banks and periodic reports by NSE using a secondary data collection sheet.

Data was analyzed using Panel Regression Analysis. The regression function for the study was as captured below:

$$\mathbf{Y_{1it} = \beta_0 + \beta_1 X_{1it1} + \beta_2 X_{2it2} + \beta_3 X_{3it3} + \epsilon}$$

Where,

Y= Bank Performance (Profitability and asset quality)

$\mathbf{X_1}$= Number of years in operation

$\mathbf{X_2}$= Asset size

X_3= Market share
β_0= Constant term
β_1, β_2 and β_3= regression coefficients
i= the specific bank
t= time period or the year
ϵ= Error term

9. Results and Findings

This section is a presentation of results and findings obtained from field data. Both descriptive and inferential statistics have been employed specifically using regression and ANOVA to establish the significance of the model and also to establish the relationship between firm characteristics and financial performance of quoted commercial banks in Kenya.

9.1. Descriptive Analysis of the Population

This summarizes the population characteristics of the data analyzed for five-year duration to determine relationship between firm characteristics and financial performance of quoted commercial banks in Kenya. The firm characteristics including number of board members, years of operation, gender of board members and the education qualifications of the members were used to evaluate whether they have any effect on the financial performance of the banks.

The study sought to establish the number of years the banks were in operation since their establishment as well as the number of board members they had. From the study, findings revealed that KCB had the longest period in operation with 124 years followed by Standard Chartered Bank with 110 years. DTB, CFC Stanbic Bank, NCBA, Housing Finance, Cooperative bank, I & M Holdings, ABSA and Equity Bank follow in that order ranging from 74 years for Barclays to 32 years. We can deduce that KCB has the longest period of operation while Equity Bank has the least. This implies that the various banks have been in operation for different number of years

The study sought to determine the gender of the bank board directors. From the study, findings revealed that majority of the board of directors in the banks were male. Female board members were in small numbers. From the findings, it can be noted that KCB and CFC Stanbic had an equal number of male and female board members. Coop Bank had 24 board members, only 2 of which were female, registering the highest number of all the banks listed. The rest of the banks had an average of 2-3 female board members. From the findings we can conclude that all the quoted commercial banks have incorporated both genders in the board of directors.

The study sought to establish the academic qualifications of the board members of the banks. From the study, findings revealed that majority of the board members in all the banks had masters and graduate degrees. A few board members had PhDs and professional qualifications such as CPA, CPS and ACCA. The findings imply that the board of directors consists of qualified members with the necessary academic qualification capable of making the right decisions and policies to guide the operations and improve financial performance.

9.2. Inferential Analysis

Panel regression was used to analyze the data and the research findings are presented below.

9.2.1 Hausman Test

Hausman test was carried out to determine whether fixed effect or random effect model was appropriate and the following results were obtained:

	Coefficients (b) fixed	(B) random	(b-B) Difference	sqrt(diag(V_b-V_B)) S.E.
YEARSOFOPE~N	-1.834636	-.0263009	-1.808335	.6396862
MARKETSHARE	.6729054	4.268358	-3.595453	.77858
ASSETSIZE	-.0000275	-.0000763	.0000488	.0000134

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                b = consistent under Ho and Ha; obtained from xtreg
  B = inconsistent under Ha, efficient under Ho; obtained from xtreg

  Test:  Ho:  difference in coefficients not systematic

              chi2(2) = (b-B)'[(V_b-V_B)^(-1)](b-B)
                      =       22.58
            Prob>chi2 =      0.0000
            (V_b-V_B is not positive definite)
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Table 1: Hausman Test

The p value of 0.00 is less than the alpha value of 0.05, hence the rejection of the null hypothesis and therefore the fixed effect model was appropriate for the analysis.

9.2.2. Model Summary

The model summary below was used to reveal the relationship between firm characteristics and financial performance of the quoted commercial banks in Kenya.

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Fixed-effects (within) regression               Number of obs     =         55
Group variable: COMPANYID                       Number of groups  =         11

R-sq:                                           Obs per group:
     within  = 0.4828                                         min =          5
     between = 0.0416                                         avg =        5.0
     overall = 0.0203                                         max =          5

                                                F(3,41)           =      12.76
corr(u_i, Xb)  = -0.9839                        Prob > F          =     0.0000
```

Table 2: Model Summary

The table shows the summary of the model, eleven banks were observed for a period of five years with a total of 55 observations. The Overall R^2 the coefficient of determination was 0.0203 that is 20.3%. The correlation coefficient was 0.9839. This implies a strong negative correlation between the independent variables and the error term other factors not catered for by the model.

The F (3,41) was 12.76 with a p value of 0.00; this implies the overall fitness of the model used in the analysis.

ROE	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
YEARSOFOPERATION	-1.834636	.6457564	-2.84	0.007	-3.138767	-.5305045
MARKETSHARE	.6729054	1.199519	0.56	0.578	-1.749572	3.095383
ASSETSIZE	-.0000275	.0000206	-1.33	0.190	-.0000692	.0000142
_cons	143.1228	41.28454	3.47	0.001	59.74697	226.4986
sigma_u	53.280667					
sigma_e	4.4815118					
rho	.99297497	(fraction of variance due to u_i)				
F test that all u_i=0: F(10, 41) = 10.08					Prob > F = 0.0000	

Table 3: Coefficients

The following regression equation was developed based on the findings.

$Y = 143.122 – 1.8346 X_1 – 0.0002X_2 + 0.672 X_3 + 53.28$

Where: Y: Financial Performance (Profitability, Liquidity and asset quality); X_1 = Period of operation; X_2 = Asset base; X_3 = Market Size.

According to the regression equation established, taking all factors (period of operation, asset size and market share) constant at zero, the financial performance of the quoted commercial banks will be 143.12 units. This implies a fairly positive significant correlation between firm characteristics and financial performance of commercial banks in Kenya. Results presented further indicate that taking all other independent variables at zero, a unit increase in period of operation will lead to a -1.8346 decrease in financial performance of quoted commercial banks. A unit increase in the asset size will lead to a 0.0002 decrease in the financial performance of quoted commercial banks. Also, a unit increase in market size will lead to a 0.672 increase in the financial performance of quoted commercial banks in Kenya.

The P-value for the period of operation is 0.007; this value is less than 0.05, hence we reject the null hypothesis and conclude that the period of operation had a significant negative effect on the financial performance of quoted commercial banks in Kenya. The asset size, with a p-value of 0.190; market size with a p-value of 0.578; all the values are greater than 0.05. Therefore, we fail to reject the null hypothesis sets and conclude that asset size and market size and do not have significant effects on the financial performance of quoted commercial banks in Kenya.

10. Summary

From the analysis, it can be observed that firm characteristics do not have significant effects on the financial performance of quoted commercial banks in Kenya. The model equation shows that the period of operation affects the financial performance negatively. In essence, if there is an increase in the period of operation, the performance of the bank is expectedly going to decrease. Again, a unit increase in market size increases financial performance of the quoted commercial banks with 0.672 units. This indicates that there is a positive relationship between market size and financial performance of quoted commercial banks.

The model also shows that if there is an increase in asset size, the return on assets which represents the measure of financial performance will, in turn, increase at a rate of 0.122. The outcome as represented in the model shows that those banks, which choose to increase their asset base, will, in turn, have an increased financial performance since their ROA will tend to rise. Further, those commercial banks that, on the other hand, choose on board characteristics, will also tend to increase their profitability, thus financial performance.

However, a further analysis of the various variables under consideration and their respective coefficients indicate that the effects of firm characteristics on the financial performance of quoted commercial banks do not have a significant effect. The summary model's multiple correlation factor (R) is only 0.559 which is greater than 0.5, hence, indicating a strong level of relationship between the predictors and the dependent variable. Similarly, the coefficient of determination of the model, which is only 20.3%, indicates that firm characteristics variables used in the model can only explain 20.3% of the dependent variable which is financial performance. The remaining 79.7% can only be explained by other variables not under consideration in this model. This, therefore, means that it cannot conclusively be said that firm characteristics do have a significant effect on the financial performance of quoted commercial banks in Kenya.

An analysis into the coefficients of the independent variables, namely - period of operation, asset base, market size and board characteristics indicate that the coefficients of the four variables are not statistically significant in determining the rate of change of the financial performance of quoted commercial banks in Kenya. This shows that they are not significant in explaining financial performance of quoted commercial banks. Consequently, there exist other major factors that affect the financial performance of quoted commercial banks. Therefore, firm characteristics (while affecting the financial performance of quoted commercial banks in Kenya) play a very minimal role.

11. Conclusions

The main objective of the study was to investigate the effects of firm characteristics, mainly the period of operation, asset size, market size and board characteristics on financial performance of quoted commercial banks in Kenya.

Findings indicate that the coefficient of determination is 0.0203; that is 20.3% variability of firm characteristics in financial performance; hence the financial performance is not significantly affected by factors under consideration. Using ANOVA, the F-ratio of F (3,41) and p value of 0.000, which is less than 0.05, shows how the independent variables are statistically significant in predicting the dependent variable. According to the regression equation taking all factors constant, financial performance of quoted commercial banks will be 143.12. This indicates an overall positive significant correlation between firm characteristics and financial performance of commercial banks.

The study findings indicate that board characteristics positively affect the financial performance of quoted commercial banks. For this study board characteristics were number and gender of board members, academic qualification and years of experience. We can conclude that in order to improve their performance, quoted commercial banks need to be concerned of the board characteristics and ensure they engage the best team, an adequate number, both male and female with the right academic and professional qualifications.

According to the findings, number of years in operation negatively affects the financial performance of the quoted commercial banks. A unit increase in the period of operation will result in a decrease of the financial performance of the commercial banks. This implies that the quoted commercial banks tend to be productive in the first few years of operation and deteriorates as the period increases. Based on the findings, market share positively affects the financial performance of the quoted commercial banks. We can, therefore, conclude that as the market share increases, in terms of numbers of customers and the loan book, financial performance of the commercial banks tend to increase.

11.1. Recommendation for Practice

The study found that the firm characteristics under consideration have an influence on the financial performance of the quoted commercial banks. Findings indicate that the period of operation and asset size negatively influence the financial performance, while market share and board characteristics positively influence the performance of commercial banks. The study findings indicate that the quoted commercial banks perform well in the few years after establishment. The management should strategize to increase its market share to maximize productivity since the findings indicate that market share positively affects financial performance. The management should ensure it engages the right number, qualified and board members with adequate experience as well as be gender sensitive since board characteristics have a positive influence on the financial performance of the quoted commercial banks.

11.2. Recommendation for Policy

Commercial bank regulators should make relevant policies and decisions with regard to the ideal market share, asset size, and board characteristics of the commercial banks in order to improve performance. Management of the commercial banks need to develop relevant policies to increase their market share, to remain relevant over the years in the industry and to retain the right and qualified board members.

The government and the regulator of commercial banks should develop policies that guide the number, gender and qualification of board members to improve the performance of the banks.

12. Areas for Further Study

The study findings indicate that the firm characteristics under consideration had a P value > than 0.05, hence the conclusion that there is no significant effect on the financial performance of the quoted commercial banks in Kenya. Further studies should be undertaken to investigate other firm characteristics that influence the financial performance of commercial banks. The study focused on the commercial banks quoted at the NSE; there is a need to study the effect of the firm characteristics on the remaining commercial banks in Kenya in order to make conclusions. Further studies should be done on firm characteristics that affect the financial performance of other sectors of the economy in Kenya such as the Agricultural, Industry and manufacturing, Mining, Transport, Energy, and Tourism.

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