**CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA**

# ABSTRACT

Commercial banks play a pivotal role in global economic development as financial intermediaries, with their sustainability closely tied to profitability. However, in Kenya, the Central Bank’s annual reports reveal a persistent decline in commercial banks' financial performance over the past two decades. Profit Before Tax (PBT) growth has fluctuated, generally remaining below 20% between 2008 and 2013. For instance, in 2013, PBT increased by 16.6%, down from 20.6% in 2012. The most significant rise occurred in 2010, with a 52% increase. This downward trend has triggered bank mergers, acquisitions, and the collapse of institutions like Chase Bank, Dubai Bank, and Imperial Bank failures linked to poor governance, mismanagement, and lack of transparency. Against this backdrop, the study examined the relationship between corporate governance and the financial performance of commercial banks in Kenya. It specifically explored how ownership structure, board diversity, audit quality, board transparency, and institutional size influence financial performance. The research was anchored in Agency, Lending Credibility, Stakeholder, and Resource Dependency Theories and used a correlational design. Data from 38 registered commercial banks were analyzed using descriptive statistics and regression models via STATA version 14, along with diagnostic tests for model reliability. Findings showed that ownership structure negatively affected financial performance, while board diversity, audit quality, and institutional size had significant positive effects. Board transparency had a small negative effect. Moreover, institutional size significantly moderated the relationship between governance structures and financial outcomes. The study concludes that effective corporate governance, particularly when aligned with bank size, is crucial to enhancing financial performance. It recommends improving board diversity, strengthening audit functions, and strategically managing ownership and transparency to support banking sector resilience. The insights are relevant for bank managers, regulators, policymakers, researchers, and finance theorists.

**Key Words:** *Corporate governance, Financial performance, Commercial banks, Ownership structure, Board diversity, Audit quality, Institutional size, Kenya banking sector*

**1.0 INTRODUCTION**

Over recent years, the relationship between organizational oversight often framed as corporate governance and financial performance has attracted growing attention from global financial experts and scholars. Corporate governance is vital for aligning the interests of various stakeholders and maximizing investor value. It plays a particularly significant role in attracting foreign investment, especially in developing and middle-income countries, while also safeguarding shareholder interests against internal exploitation. The global focus on corporate governance heightened after major corporate scandals and financial collapses in the late 20th and early 21st centuries. High-profile failures such as Enron, WorldCom, and Lehman Brothers in the United States, Parmalat in Italy, and Hollinger Group in Canada exposed widespread financial mismanagement, insider trading, and lack of proper oversight. Similar cases were seen in companies like Global Crossing, Adelphia, Tyco, and even UK-based institutions such as Northern Rock and Cadbury. These incidents underlined a global crisis in governance, where boards failed to detect or prevent fraud and unethical behavior.

More recently, the collapse of Silicon Valley Bank (SVB) highlighted a more modern governance failure. The bank suffered a liquidity crisis after interest rate hikes devalued its held-to-maturity securities, which went unreported in its financial results. This led to mass cash withdrawals and a classic bank run. Similar governance shortcomings were evident in Iceland’s 2008 banking collapse, which resulted from unchecked foreign debt accumulation and weak oversight. In Africa, banks like United Bank of Africa in Nigeria, BICI in Congo Brazzaville, and NBC in Tanzania also failed due to insider dealings, mismanagement, and board-level failures. These cases collectively triggered a global reassessment of governance practices in the financial sector, prompting calls for stronger oversight mechanisms, increased transparency, and more stringent accountability frameworks.

In Kenya, the collapse of major retail and financial institutions such as Uchumi, Tuskys, Nakumatt, and several commercial banks was largely attributed to weak governance structures. Investigations revealed patterns of fraud, insider trading, and poor board accountability. Banks like Charterhouse, Euro Bank, Trust Bank, Prudential, and Trade Bank, once pillars of economic support, folded under the weight of mismanagement and lack of oversight. These events reinforced the need to reform corporate governance in Kenya and other emerging markets. Measures include strengthening internal controls, enforcing better financial reporting practices, improving transparency, and reforming board composition to ensure independence and professionalism.

Despite global and local efforts to improve governance standards, questions remain about the actual impact of these reforms on organizational performance especially within commercial banks. While the intention behind these reforms is clear, evidence on their effectiveness in improving financial outcomes is mixed. As a result, there is an ongoing need to examine how specific corporate governance factors influence economic performance in different contexts, with a special focus on the commercial banking sector. The recurring collapse of major firms and financial institutions, both globally and locally, emphasizes the urgent necessity for rigorous and effective governance frameworks to ensure long-term sustainability and resilience in organizational performance.

***Corporate Governance and Financial Performance of Commercial Banks***

Corporate governance refers to the frameworks, systems, and processes used by organizations to ensure responsible, transparent, and accountable management. It encompasses the balance of power among various stakeholders including the board of directors, management, shareholders, and other parties interested in the organization’s welfare (Saleh & Sulaiman, 2022). Effective corporate governance aims to enhance a company's performance and protect stakeholders' interests by promoting integrity and transparency in operations, particularly in financial reporting (Irawati et al., 2019). This involves implementing policies to protect shareholder rights, manage conflicts of interest, and ensure accurate financial disclosures.

Corporate governance practices differ across organizations based on size, industry, and location. In the banking sector, oversight mechanisms are particularly critical. Owiredu and Kwakye (2020) identified board composition, board independence, the leadership of the chairperson, and international ownership as key governance factors in financial institutions. Saleh and Sulaiman (2022) further emphasized the importance of transparency, shareholder relations, and financial disclosures in ensuring the operational success of banks.

Wadesango et al. (2020) observed that the banking sector has specific corporate governance elements that significantly influence performance, such as a responsible board of directors, a strong and independent audit system, and effective risk management structures. Irawati et al. (2019) stressed the importance of ownership structure particularly foreign ownership as a crucial determinant of financial outcomes. Institutions with advanced technology and efficient monitoring systems due to foreign ownership often outperform those without.

Chol, Nthambi, and Kamau (2020) argued that ownership structure serves as a core internal mechanism for measuring governance, directly influencing decision-making quality. Ownership can take several forms managerial vs. non-managerial, individual vs. institutional, or domestic vs. foreign each with varying implications for governance and performance. Concentrated ownership may lead to stronger oversight and better decision-making, while dispersed ownership can dilute accountability.

Another critical governance element is board diversity. Manyaga, Muturi, and Oluoch (2020) highlighted that a diverse board composition, encompassing various skills, gender, and age groups, enhances a bank’s performance. Under Agency Theory, directors act as agents of shareholders and are responsible for protecting and enhancing shareholder value (Nainggolan et al., 2022). A well-composed board aligns corporate actions with shareholder interests, promoting efficiency and transparency. Harun (2017) asserted that board composition should consider ownership structure, size, and diversity to ensure it is fit for purpose.

Audit quality is also a cornerstone of effective corporate governance. Ogbodo and Akabuogu (2018) defined audit quality as the ability to detect and report errors and misstatements in financial statements. Since these qualities are not easily observable, researchers use proxies such as audit duration, fees, firm size, legal history, and reputational factors to measure audit effectiveness (Alrashidi, 2020; Baldavoo & Nomlala, 2019). A high-quality audit enhances credibility and can deter financial manipulation.

Arnaboldi et al. (2020) linked board diversity, including gender and educational background, to improved financial performance. Farag and Mallin (2017) found that female-majority boards reduced banks’ vulnerability to financial crises, although women tended to be more risk-averse. In contrast, Fernández and Tejerina (2020) suggested that too much diversity in academic backgrounds might impair board effectiveness. Issa et al. (2022) found that gender diversity could negatively affect disclosure practices, while experience and education had positive effects.

The empirical research on corporate governance and bank performance yields inconsistent findings, suggesting a gap in understanding how elements such as ownership structure, board diversity, audit quality, and board size specifically influence commercial banks. These elements are frequently studied due to their significant but varied impact on performance outcomes.

***Financial Performance of Commercial Banks***

Financial performance reflects the overall health and operational success of an organization. Nganga (2017) described it as the process of enhancing earnings through efficient operations, expanded market share, and increased firm value. Harun (2017) emphasized financial performance as a benchmark for comparing companies within the same industry or economic sector.

Lungatso and Otuya (2019) noted that assessing financial performance in commercial banks is critical to understanding a country’s broader economic condition. Common indicators include revenue, profit, expenses, and return on investment (ROI) (Mai, 2021). Omware, Atheru, and Jagongo (2020) divided these determinants into two categories: macroeconomic factors (external) and bank-specific characteristics (internal).

External or macroeconomic factors, such as GDP, inflation, political stability, and regulatory policies, affect all banks within an economy and are beyond the control of individual institutions. To manage these, bank boards and executives must develop adaptive strategies to ensure sustainability and improve performance.

Internal factors are unique to each bank and are within the control of its leadership. These include interest rate policies, capital structures, risk management practices, bank size, ownership structure, labor efficiency, and technology adoption. Since these factors are manageable, banks can tailor them to improve their financial outcomes (Omware et al., 2020).

To assess financial performance, most organizations rely on financial ratios. These include profitability ratios (e.g., Return on Assets ROA and Return on Equity ROE), efficiency ratios, and liquidity ratios. Although these are effective tools for comparison and trend analysis, Owiredu and Kwakye (2020) cautioned that ratios can be manipulated, leading to fraudulent reporting. Aladwan (2015) reinforced that ROA and ROE are the most effective measures of performance in the banking sector.

Lungatso and Otuya (2019) used profit margins, Tobin’s Q, and ROA in their study of retail banks in Kenya. However, Tobin’s Q, a market valuation metric, may not always be appropriate for assessing financial performance in banks. Instead, the most reliable indicators in banking contexts are ROE, ROA, and Net Interest Margin (NIM). These provide insights into profitability, return on investments, and the bank's ability to manage its interest income and expenses. Performance can also be assessed by evaluating capital adequacy, asset quality, and liquidity factors that determine a bank’s ability to absorb losses and maintain operations. Owiredu and Kwakye (2020) and Nganga (2017) emphasized that evaluating these together provides a comprehensive picture of a bank’s financial strength.

Dirman (2020) linked financial performance directly to financial distress. Poor performance marked by low revenue, poor cash flow, and rising costs can lead to a bank's inability to meet financial obligations, such as paying debts or funding operations. This strain can escalate to liquidity problems, reduced profitability, and ultimately, financial distress. Conversely, strong performance backed by cost control, stable income, and effective cash flow helps maintain solvency and avoids financial collapse. Corporate governance and financial performance are deeply intertwined in the banking sector. Elements such as ownership structure, board diversity, audit quality, and internal bank policies directly influence performance metrics like ROE, ROA, and NIM. While external economic factors play a role, it is ultimately the internal governance mechanisms that shape how well banks perform in the long term. Despite numerous studies, the varying outcomes on the influence of governance factors highlight the need for more context-specific research, particularly in developing economies like Kenya.

Firm size refers to the physical or financial scale of an organization, and it is commonly measured through variables such as total assets, sales turnover, number of employees, branches, annual revenue, and market share (Kithinji, 2018; Gatete, 2015). Based on these indicators, firms are categorized as small, medium, or large. Government regulations also influence firm size, especially in the financial sector, where different operational and compliance requirements apply to small and medium-sized banks compared to larger institutions (Mai, 2021).

The size of a firm plays a critical role in shaping its performance. Small firms often face challenges accessing capital due to limited collateral, which restricts their growth and operational capacity. However, their smaller size makes them more agile and adaptable to changes in the market environment. Conversely, larger firms benefit from economies of scale, allowing them to operate more efficiently, hire skilled personnel, and maintain stronger internal controls. This generally leads to better performance and sustainability (Alsyahrin et al., 2018; Nainggolan et al., 2022). Nevertheless, research by Aladwan (2015) showed that beyond a certain threshold, further expansion of banks may not enhance performance. Instead, diminishing returns may occur, reducing credit risks and overall profitability due to overstretched diversification.

In contrast, Alsyahrin and colleagues found that firm size significantly enhanced the financial performance of Islamic banks in Indonesia. Larger firms had a broader customer base, fueled by public trust, which allowed them to innovate and improve financial inclusivity. Their study used total assets as a measure of firm size. Similarly, Kithinji (2018) found that the scale of Kenyan retail banks positively influenced financial outcomes, highlighting the role of capital size in determining bank magnitude.

However, prior research on the moderating role of firm size in the relationship between corporate governance and performance has produced mixed results. These inconsistencies are largely due to differing methodologies used to assess firm size. In this context, the natural logarithm of total assets is commonly employed to analyze how firm size influences both dependent and independent variables in performance studies. In Kenya, commercial banks play a vital role in economic development, providing services like loans, deposits, and money transfer, thus fostering financial inclusion. Their health directly affects national economic stability (Nganga, 2017). Despite their importance, commercial banks in Kenya have experienced declining financial performance over the past two decades. This has been characterized by reduced profitability, increasing financial instability, and the collapse of notable banks like Chase, Imperial, and Dubai Bank. According to CBK (2018, 2022), net profits declined by about 30%, and the average Return on Assets (ROA) dropped from 1.2% in 2017 to 0.8% in 2022. These failures have been largely attributed to poor governance, insider trading, and mismanagement.

In response, several mergers and acquisitions have taken place to stabilize the sector, yet overall performance remains fragile. As of 2023, Kenya had 38 licensed commercial banks down from 43 a decade earlier comprising local private banks, foreign-owned banks, and one state-owned institution. The reduction resulted from bank consolidations and liquidations due to liquidity challenges. All banks in Kenya are regulated by the Central Bank of Kenya (CBK) and operate under frameworks such as the Capital Market Act (Cap. 485A) and the CBK’s Prudential Guidelines. Governance structures emphasize the board’s responsibility in overseeing compliance, with audit committees ensuring adherence. Despite legislative reforms such as the Kenya Deposit Insurance Amendment Bill (2020), insider fraud and weak governance remain significant challenges.

Large banks, with core capital exceeding KES 5 billion and sizable asset bases, are critical to financial stability. A decline in their performance poses a systemic risk to the national economy. As CBK (2023) notes, these institutions dominate in asset base and customer deposits. Yet, they too have faced profitability declines, with assets shrinking from KES 1.2 trillion in 2019 to KES 558.5 billion in 2014. Most of this deterioration occurred between 2017 and 2022, driven by customer distrust following insolvency of some Tier III banks. These events underscore failures in adhering to governance codes and prompt the need to assess the role of corporate governance in shaping the profitability of Kenyan commercial banks.

**1.1 Research Problem**

The effectiveness of organizational oversight in banking is crucial for ensuring transparency, accountability, and financial prosperity. However, Central Bank of Kenya (CBK) reports indicate a persistent decline in the financial performance of commercial banks over the past two decades. This downward trend has led to multiple consolidations and acquisitions to stabilize struggling institutions. For instance, the average Return on Assets (ROA) dropped from 1.2% in 2017 to 0.8% in 2022. Additionally, several banks such as Imperial Bank, Dubai Bank, and Chase Bank collapsed, primarily due to poor governance, financial mismanagement, and fraudulent internal activities. These failures have significantly eroded investor confidence and public trust in the sector. Previous research examining the relationship between organizational governance and bank performance has yielded inconsistent and conflicting results some studies found a positive link, others negative, while some found no correlation at all. These discrepancies highlight conceptual and methodological gaps, especially regarding the role of key governance variables such as ownership structure, board diversity, audit quality, and board size. Many of these studies overlooked the potential influence of moderating and mediating variables, as well as employed differing methods and performance measures, contributing to the inconsistent outcomes. Given these gaps, this study aims to explore how specific governance factors influence the financial performance of commercial banks in Kenya, with the goal of providing more consistent and comprehensive insights into the dynamics between corporate governance and financial outcomes.

**1.2 Research Objective**

This study was guided by the following general objective to: assess the relationship between corporate governance and the financial performance of commercial banks in Kenya.

Specific Objectives were to; establish the relationship between ownership structure and financial performance of commercial banks in Kenya, to examine the relationship between Board diversity and the financial performance of commercial banks in Kenya, to determine the relationship between audit quality and the financial performance of commercial banks in Kenya, to assess the relationship between board transparency and the financial performance of commercial banks in Kenya and to assess the moderating effect of bank size on the relationship between corporate governance and the financial performance of commercial banks in Kenya.

**1.3 Research Hypothesis**

H01: Proprietorship arrangement bears no quantitatively notable correlation with the fiscal efficacy of retail banking institutions in Kenya.

H02: Directorial heterogeneity bears no quantitatively notable correlation with the fiscal efficacy of retail banking institutions in Kenya.

H03: Scrutiny excellence bears no quantitatively notable correlation with the fiscal efficacy of retail banking institutions in Kenya.

H04: Council openness bears no quantitatively notable correlation with the fiscal efficacy of retail banking institutions in Kenya.

H05: Institution magnitude bears no quantitatively notable influencing impact on the connection between organizational oversight and fiscal efficacy of retail banking institutions in Kenya

**1.4 Justification of the Study**

The findings of this study are valuable to various stakeholders. For commercial bank management, the results provide insights into how specific corporate governance variables influence financial performance, guiding better decision-making to enhance operational efficiency. Legislators and regulatory bodies, including the Central Bank of Kenya (CBK), can also benefit by understanding how elements of governance impact the financial effectiveness of retail banks. This knowledge may prompt revisions to legal frameworks or ethical codes to support sustainable profit growth in the sector. Additionally, the study offers a solid foundation for upcoming scholars and researchers, contributing to literature and helping bridge knowledge gaps in corporate governance and financial performance. It also supports the development and refinement of financial theories, making it a valuable academic resource.

**1.5 Study Limitations**

The scope limitations of this investigation concerning the impact of organizational oversight on the fiscal efficacy of retail banking institutions in Kenya. This research endeavor concentrated solely on accredited Kenyan commercial banks, and information utilized for the assessment spanned a five-year duration, from 2018 to 2023. The inquiry was confined to exploring four distinct facets of company stewardship: proprietorship arrangement, directorial variety, scrutiny excellence, and council magnitude, with the supplementary examination of enterprise scale as an influencing factor.

**2.0 LITERATURE REVIEW**

The theoretical framework guiding the study incorporates four major theories: Agency Theory, Lending Credibility Theory, Stakeholder Theory, and Resource Dependency Theory (RDT). These theories collectively support the analysis of corporate governance mechanisms and their relationship with the financial performance of commercial banks in Kenya.

**Agency Theory**, proposed by Jensen and Meckling in 1976, is foundational in corporate finance and economics. It addresses the principal-agent problem, where the goals of owners (principals) and managers (agents) often diverge, leading to potential conflicts of interest. In a typical corporate setting, shareholders appoint executives to manage the enterprise, expecting that their interests will be prioritized. However, these executives may act in self-interest, seeking personal gains over organizational objectives. Agency Theory emphasizes the importance of governance mechanisms like contracts, performance incentives, and oversight structures to align managerial behavior with stakeholder expectations. It highlights risk-taking behaviors within corporate boards and the necessity of balancing risk with returns. In the context of Kenyan commercial banks, this theory has proven essential in examining how governance structures like ownership configuration and board practices influence performance outcomes. Though it has been critiqued for focusing heavily on formal contracts and overlooking informal social interactions within organizations, its utility remains significant in studies of corporate finance, particularly where oversight and performance relationships are being scrutinized.

**Lending Credibility Theory** originates from Professor Limperg’s work in the 1920s, later adapted into a broader financial context by Professor Ross Levine in the 1980s. This theory emphasizes the role of external audits in enhancing the credibility of a firm’s financial statements. It proposes that audits reduce information asymmetry between corporate leadership and external stakeholders such as investors, creditors, and regulators. The theory asserts that a bank’s ownership structure significantly affects its credit and lending behavior. For instance, ownership diversity could influence a bank’s risk appetite, with foreign and government ownership possibly encouraging higher risk-taking due to their perceived stability and backing. Conversely, banks with concentrated ownership might exhibit conservative lending tendencies due to higher accountability and oversight. In the Kenyan context, where banks are often owned by politically influential individuals or the government, this theory is highly relevant. It assists in understanding how different ownership models impact decision-making, risk exposure, and overall financial performance. Moreover, by promoting transparency and reliability through credible financial reporting, Lending Credibility Theory enhances stakeholder trust and supports better monitoring and governance in financial institutions.

**Stakeholder Theory**, introduced by Edward Freeman in 1984, broadens the perspective of corporate responsibility beyond shareholders to include all stakeholders customers, employees, suppliers, regulators, and communities. It holds that businesses must address the needs and concerns of all these groups to ensure long-term success. The theory is grounded in ethical business conduct and advocates for equitable consideration of stakeholder interests. For commercial banks in Kenya, this means ensuring that decisions especially those made by the board reflect the interests of diverse constituencies. With Kenyan banks increasingly engaging in international operations, there is a need for heightened accountability and regulatory compliance. Boards must consist of members who understand risk management, mergers, acquisitions, and regulatory frameworks. This aligns well with Stakeholder Theory, which emphasizes that bank governance must be inclusive and sensitive to multiple interests. While the theory faces criticism for potentially diluting focus and complicating decision-making given that balancing competing stakeholder interests can be challenging it remains crucial in a banking context where trust, customer relationships, and social responsibility are fundamental. Stakeholder Theory particularly supports the variable of board diversity and its influence on a bank’s performance, suggesting that heterogeneous boards can better understand and serve various stakeholder needs, thereby enhancing organizational effectiveness.

**Resource Dependency Theory (RDT)**, developed by Jeffrey Pfeffer and Gerald Salancik in 1978, asserts that an organization’s success is largely determined by its ability to secure and manage critical external resources. The theory posits that organizations are interdependent with their environments and must navigate external constraints and opportunities to remain competitive. This includes managing relationships with stakeholders who control valuable resources such as governments, suppliers, or investors. In Kenya’s highly competitive banking sector, the ability to attract and deploy resources effectively capital, technology, human talent, or regulatory support is crucial for performance. RDT emphasizes the role of organizational oversight in managing these dependencies. For instance, government regulations significantly shape banking practices in Kenya, influencing how banks operate, grow, and sustain profitability. The theory also underlines the strategic importance of having board members and executives who can leverage networks and influence to secure vital external resources. Nevertheless, RDT has its critics, who argue that it downplays internal organizational factors like leadership skills, culture, and internal systems that are also critical to performance. Despite this limitation, RDT remains highly applicable in understanding how external resource control impacts the financial viability and governance of banks. In this study, RDT underpins the investigation into how audit quality influences financial performance, highlighting the importance of strong governance in managing external dependencies effectively.

The theoretical framework integrates multiple perspectives to provide a robust foundation for analyzing corporate governance and bank performance in Kenya. Agency Theory primarily examines the conflict between owners and managers and how governance mechanisms align their interests. Lending Credibility Theory focuses on the credibility of financial information and how ownership influences lending behavior and risk-taking. Stakeholder Theory expands the governance perspective to include diverse stakeholder interests, emphasizing ethical responsibility and long-term sustainability. Finally, Resource Dependency Theory stresses the importance of managing external dependencies and securing critical resources to maintain competitiveness and financial health. Together, these theories provide a comprehensive lens through which to understand the dynamics of organizational oversight in the Kenyan banking sector and their impact on financial performance. Each theory supports specific variables within the study ownership structure, board diversity, and audit quality allowing for a nuanced exploration of how these governance mechanisms contribute to bank success.

**2.1 Empirical Review**

This empirical review examined existing literature on the influence of organizational oversight mechanisms, specifically ownership structure and board diversity, on the financial performance of commercial banks. It drew insights from scholarly articles, journals, and other academic works across different geographical and contextual settings. The review highlights not only the theoretical underpinnings of corporate governance but also empirical evidence across countries, ultimately identifying gaps addressed by the current study.

***Ownership Structure and Financial Performance***

Organizational oversight aims to supervise managerial activities and protect the interests of various stakeholders, with ownership structure being one of the primary mechanisms. The theory of ownership structure was introduced by Jensen and Meckling in 1976, emphasizing how the composition of ownership ranging from institutional, managerial, domestic, foreign, concentrated, or dispersed shareholders affects a firm's financial outcomes. Chol, Nthambi, and Kamau (2020) underscored the significance of ownership structure as an internal metric for evaluating governance effectiveness. However, they observed that many studies have limited themselves by ignoring other corporate governance factors like board diversity and audit quality, and often failed to contextualize findings for specific industries or regions. These gaps were addressed in the current study by expanding the scope to include multiple governance variables within the Kenyan banking context.

Opoku-Agyeman (2015) highlighted that ownership concentration directly affects decision-making quality, thus impacting bank profitability. Different ownership categories exert varying degrees of influence. However, past research has produced inconsistent results. For example, some studies noted a positive relationship between state or foreign ownership and bank performance, while others identified negative or insignificant correlations. This inconsistency prompted the need for further research incorporating more governance elements, moderating variables, and local contextual factors to generate more robust conclusions.

Jarbou, Abu-Serdaneh, and Latif (2018) conducted a study on Jordanian commercial banks, using ROE and ROI to measure performance, and examining ownership through variables like state holdings, corporate ownership, and ownership concentration. They found that increased ownership concentration correlated negatively with performance, while state and foreign ownership showed positive effects. However, corporate ownership had no significant relationship. Although the study included firm-level controls like bank size, leverage, and age, it lacked a moderating variable and industry contextualization. The current study addressed this by incorporating moderating variables and focusing specifically on Kenyan commercial banks.

Similarly, Yahaya and Lawal (2018) examined how institutional and foreign ownership influenced the financial performance of Nigerian commercial banks. Using panel data from 15 banks listed on the Nigerian Stock Exchange between 2008 and 2016, they found a strong positive correlation between institutional ownership and financial performance, but weak associations for other variables. Moderating factors like firm size and growth were considered. While informative, the Nigerian context has a different regulatory framework, and this study’s findings may not be directly transferable to Kenya. Thus, this research filled the contextual gap by focusing on Kenya’s unique financial and regulatory environment.

Chol et al. (2020) investigated the relationship between ownership structure and bank performance in South Sudan, analyzing panel data from 29 commercial banks between 2012 and 2017. They discovered a positive link between ownership structure and performance, recommending that public banks be safeguarded by the government to ensure better outcomes. However, the study omitted moderating variables, a gap the current research mitigated by including financial institution size as a moderating factor.

***Board Diversity and Financial Performance***

Board diversity is another key aspect of corporate governance. It refers to the inclusion of directors with varied characteristics such as age, gender, ethnicity, professional experience, and educational background on the board. Manyaga, Muturi, and Oluoch (2020) argued that diverse boards are better equipped to handle challenges in a dynamic and global banking environment. Similarly, Onyekwere, Wesiah, and Danbatta (2019) linked board diversity to improved governance, stakeholder relationships, innovation, and financial performance, while also noting that it helps mitigate agency conflicts.

Nonetheless, the literature presents mixed findings. Some studies show no correlation between certain diversity dimensions and performance, while others highlight significant positive or negative relationships. Fernández-Temprano and Tejerina-Gaite (2020), using data from Spanish non-financial firms between 2005 and 2015, found that both internal and external board members positively affected performance. Age and ethnic diversity had positive effects, while education diversity and supervisory board members showed negative or insignificant relationships. However, their reliance on limited archival diversity attributes (age, education, nationality) and focus on non-financial firms represented a limitation. The current study, by contrast, broadened the diversity variables and focused on the banking sector.

Ullah, Zeb, Khan, and Xiao (2020) assessed board diversity and investment efficiency in Chinese firms. They categorized diversity into task-oriented (education, tenure) and relation-oriented (age, gender) components and measured investment efficiency based on optimal investment decisions. Panel data from 2003 to 2018 showed that greater diversity reduced investment inefficiencies. However, the conceptual framework lacked clear indicators for investment efficiency, making it difficult to measure the exact impact of board diversity on performance. The current study addressed this limitation by using clear financial performance indicators such as ROA and ROE.

Onyekwere et al. (2019) also examined board diversity in Nigerian banks, focusing on board size, gender diversity, and the ratio of non-executive directors. Financial performance was measured using return on assets (ROA) and return on equity (ROE). Using fixed-effects panel regression on data from 2006 to 2017 for five banks, they found that board size and independence had no significant effect, but gender diversity positively impacted financial performance. However, the small sample size limited generalizability. The current study improved on this by examining a broader sample of 43 Kenyan commercial banks.

Manyaga et al. (2020) specifically analyzed gender composition on corporate boards of Kenyan banks and its effect on financial performance. They used three dimensions temporal trends, peer comparisons, and institutional variations to assess board inclusivity and employed ROE to gauge performance. The study, based on data from 34 banks between 2008 and 2017, used a fixed-effects regression model to analyze the data. Findings revealed a consistent negative but significant relationship between gender diversity and ROE across all banks and peer groups, with an insignificant negative effect over time. These results suggest that gender diversity may adversely affect financial outcomes in Kenyan banks, though the study's causal approach differed from the correlational approach used in the current research.

The inconsistent findings across geographical and institutional settings highlight the complexity of the relationship between board diversity and financial performance. While some dimensions of diversity such as gender or age might be beneficial in certain contexts, they may be detrimental or neutral in others. This complexity necessitates studies like the current one, which is tailored to the Kenyan context and accounts for multiple governance factors and institutional characteristics. Past research has established that both ownership structure and board diversity significantly influence the financial performance of commercial banks, though findings have varied depending on context, methodology, and variables measured. Ownership structure, particularly in terms of concentration, foreign, state, or institutional ownership, affects decision-making and bank efficiency. However, studies often omit other governance dimensions or fail to include moderating factors. Similarly, while board diversity is generally seen as beneficial, the empirical evidence is mixed. Variables such as gender, age, and education can have positive, negative, or negligible effects on financial outcomes depending on the context. The current study builds upon these insights by addressing both conceptual and contextual gaps. It incorporates a broader set of governance variables, including moderating factors such as institutional size, and is grounded in the Kenyan banking sector. This localized approach provides a more nuanced understanding of how organizational oversight mechanisms impact the fiscal performance of commercial banks in Kenya.

***Audit Quality and Financial Performance***

Audit quality has emerged as a crucial determinant of financial performance in commercial banks. Defined in terms of the ability to detect and report misstatements in financial statements (Ogbodo & Akabuogu, 2018), it is an intangible concept often assessed using proxy indicators such as audit tenure, fees, firm size, litigation, credibility, and discretionary accruals (Alrashidi, 2020; Baldavoo & Nomlala, 2019). Various studies have investigated the nature of this relationship across different jurisdictions, contributing significant insights into how audit quality interacts with corporate governance elements to influence bank performance.

Tamilla (2021) conducted a study in Russia to investigate the effect of audit quality on the financial performance of publicly traded companies. The attributes measured included audit committee size, independence, meeting frequency, and auditor expertise. Financial performance was evaluated using return on assets (ROA), focusing on 507 listed firms between 2018 and 2020. The study found that audit committees significantly and positively influenced firm performance. However, a contextual limitation was noted, as the study was conducted in Russia a developed country with more advanced financial systems making its findings less applicable to Kenya’s banking sector. Additionally, it failed to consider other governance aspects such as ownership structure. The current study addressed these gaps by focusing on Kenyan commercial banks and incorporating variables such as ownership structure and audit quality.

Alrashidi (2020) studied the impact of audit quality on stewardship practices in assurance firms listed on the Amman Stock Exchange in Jordan. Covering the period from 2011 to 2014, the study utilized primary data from 15 active firms. The research was limited by its reliance on primary data and the exclusion of important financial performance determinants such as board diversity and ownership structure. These gaps were addressed in the present study by utilizing secondary data and incorporating a broader range of governance variables. Moreover, this study contributes by evaluating financial outcomes using more comprehensive indicators.

Baldavoo and Nomlala (2019) examined the link between audit quality and corporate governance in Ghanaian banks, applying a descriptive approach to 36 banks active between 2010 and 2017. They used a random effects regression model and found that audit quality positively impacted the value of financial institutions. The study also suggested that corporate governance strengthened the relationship between audit quality and firm value. However, the reliance on descriptive analysis limited the ability to test hypotheses rigorously. To address this, the current study employed a correlational research design alongside direct and moderating effect models, which offer more robust insights into both the relationships and the role of moderating variables.

In Nigeria, Ogbodo and Akabuogu (2018) assessed how audit committee size, firm size, and audit committee independence influenced financial performance. The study analyzed data from 16 banks listed on the Nigerian Stock Exchange between 2008 and 2017, using panel regression techniques. Results showed significant positive correlations between audit quality indicators and performance metrics such as ROA and return on equity (ROE). However, the study presented a conceptual gap by excluding other governance variables and a methodological gap by ignoring moderating factors like bank size and ownership structure. Furthermore, its contextual specificity to Nigeria limited the generalizability of its findings. The current study mitigated these gaps by broadening the scope to include Kenyan banks and additional governance elements.

Abdirahman (2021) conducted a local study to understand the effects of audit quality on the financial performance of Kenyan commercial banks. Using a cross-sectional design, the study targeted all 42 licensed commercial banks and collected primary data through semi-structured questionnaires administered to 199 participants. Regression analysis revealed that audit independence, tenure, and environment had significant positive relationships with financial performance. However, audit committee size had no significant impact. The study was limited by its narrow focus on audit quality, excluding other corporate governance aspects like ownership structure and board diversity. Additionally, it only examined direct relationships, lacking depth in evaluating the potential moderating roles. The current research addressed this by incorporating a more holistic view of corporate governance and examining bank size as a moderating variable in the relationship between governance and financial performance.

***Corporate Governance, Board Size and Financial Performance***

The intersection between corporate governance, board size, and financial performance has also garnered scholarly interest. Mai (2021) explored how firm size influenced the relationship between board characteristics and the performance of Islamic banks in Indonesia. Using data from 127 banks over a ten-year span (2010–2019) and analyzed via Warp-PLS software, the study revealed that firm size negatively impacted the effectiveness of governance characteristics such as board size and meeting frequency. However, the influence of female directors was minimal. A key theoretical gap in this study was its exclusive focus on firm size as a moderator, without directly linking governance to financial performance. The present study extended this line of inquiry by explicitly analyzing how firm size moderates the relationship between governance and financial performance in the Kenyan banking sector.

Boachie (2023) investigated how ownership structure moderated the relationship between corporate governance and performance among Ghanaian commercial banks. The study analyzed data from 23 banks over 18 years, using multiple regression techniques. Variables included CEO duality, bank size, non-executive directors, and audit independence. The findings showed mixed effects some variables positively and others negatively influenced performance. Ownership structure was found to moderate the relationship between governance and performance. While this study explored a valuable moderating factor, it was contextually based in Ghana. The current research instead uses bank size as the moderator and focuses on Kenya's commercial banks, providing local relevance and enhancing policy applicability.

In Kenya, Kithinji (2018) analyzed the influence of bank size on the relationship between restructuring and performance in retail banks. Covering all 44 licensed commercial banks over the period 2002–2014, the study used secondary data from financial statements. While it successfully demonstrated that bank size moderated the restructuring-performance relationship, it focused solely on ROA as the measure of performance, ignoring other vital indicators such as ROE. The current study addressed this limitation by employing both ROA and ROE to provide a more comprehensive assessment of bank performance.

Wanyoike, Mugambi, and Joshua (2022) examined the moderating effect of firm characteristics on the relationship between corporate governance and performance in Kenyan banks. Using panel data from 39 commercial banks over a decade (2009–2019), the study found that bank size had a significant moderating impact positively influencing ROE, but negatively affecting equity returns. This finding underscores the complexity of the firm-size dynamic in governance-performance relationships. The current study builds on this by further examining how bank size influences the interaction between corporate governance dimensions and performance, offering additional empirical depth.

Overall, these empirical studies underscore the multifaceted nature of the relationship between audit quality, corporate governance, and financial performance. Various gaps in scope, methodology, and context exist in past studies, including limited generalizability due to country-specific contexts, omission of moderating variables, and narrow conceptual frameworks. The current study addresses these gaps by adopting a more comprehensive model that integrates corporate governance, audit quality, and moderating effects of bank size within the Kenyan commercial banking context. It uses both ROA and ROE as performance indicators, leverages secondary data, and employs robust statistical models including correlational and moderating effect frameworks, making a more significant contribution to the existing body of knowledge and offering practical insights for policy and management in Kenya’s banking sector.

**3.0 RESEARCH METHODOLOGY**

The research adopted a **correlational-survey design** as outlined by Kothari (2017) and Asenahabi (2019), which enabled the researcher to collect data through surveys and analyze the strength and direction of relationships between independent and dependent variables without manipulating them. This approach was suitable for assessing how the selected variables relate in the context of the study.

The **target population** comprised all 39 registered commercial banks in Kenya, as listed in Appendix II. This population was considered appropriate because it included all institutions relevant to the research objectives. Given the manageable size of the population, the study employed a census sampling technique, meaning data was collected from the entire population without selecting a sample subset. Mugenda and Mugenda (2013) recommend this approach when the population size is under 100, as it allows for comprehensive and inclusive data collection.

The research relied solely on **secondary data,** which was extracted from financial statements, books of accounts, and other publicly available records such as annual reports on banks’ websites and publications by the Central Bank of Kenya. This method ensured the data was authentic, timely, and reflective of actual financial performance.

After data collection, the information was cleaned, coded, and entered into the Statistical Package for Social Sciences (SPSS) before being analyzed using STATA Version 14. Both descriptive statistics (including frequencies, means, and standard deviations) and inferential statistics (including correlation and regression analysis) were employed to interpret the data and identify patterns and relationships between variables.

To ensure the robustness of the regression model, several diagnostic tests were conducted. These included tests for autocorrelation, normality, homoscedasticity, and multicollinearity. The autocorrelation test, based on the Durbin-Watson statistic, examined whether residuals from the regression were correlated across observations. Values close to 2 indicated no autocorrelation, whereas values far from 2 suggested the need for adjustments such as moving average or autoregressive models.

The normality test, using Shapiro-Wilk or Kolmogorov-Smirnov tests, determined whether the residuals followed a normal distribution. A p-value below 0.05 indicated a deviation from normality, necessitating data transformation or use of alternative models to meet normality assumptions. Homoscedasticity, or the assumption that residuals have constant variance across independent variables, was tested using the Breusch-Pagan test. A significant p-value (below 0.05) indicated heteroscedasticity, meaning variance was not consistent, which could impair regression accuracy. In such cases, variable transformation was considered to address the issue. Lastly, multicollinearity a condition where independent variables are highly correlated was tested using Variance Inflation Factor (VIF). According to Kim (2022), VIF values above 1 suggest multicollinearity, while values above 5 are considered problematic and may lead to unstable coefficient estimates. Addressing multicollinearity was necessary to ensure reliable regression outcomes.

**4.0 RESULTS AND DISCUSSION**

**4.1 Response Rate**

As of May 2025, the Central Bank of Kenya had licensed 38 commercial banks, of which 25 provided sufficient data for analysis, yielding a response rate of 65.8%. The participating banks were mostly listed on the Nairobi Securities Exchange or were publicly owned, with accessible data from annual reports and regulatory filings. Thirteen privately held banks were excluded due to incomplete or inaccessible governance and financial data, aligning with similar challenges noted by Abdirahman (2021) and Chol et al. (2020). Despite these omissions, the 65.8% response rate is considered adequate for statistical analysis, particularly in panel data econometrics. According to Mugenda and Mugenda (2013), rates above 60% are commendable. Comparable studies in emerging markets, such as those by Tamilla (2021) and Opoku-Agyeman (2015), reported similar response levels.

This section presents the response rate of the commercial banks that participated in the study.

Table 1: Response Rate of Commercial Banks in Kenya

|  |  |  |
| --- | --- | --- |
| **Description** | **Frequency** | **Percentage (%)** |
| Total Licensed Commercial Banks in Kenya | 38 | 100.0 |
| Participating Commercial Banks (Sample Size) | 25 | 65.8 |
| Non-Participating Commercial Banks | 13 | 34.2 |
| **Total** | 38 | 100.0 |

**Source: Research Data and Central Bank of Kenya (2025)**

**4.2 Descriptive Statistics** **Analysis**

The descriptive statistics analysis explores the relationship between organizational oversight and financial performance among retail banking institutions in Kenya. It uses averages and standard deviations to summarize key variables, while inferential methods such as correlation and regression assess the strength and direction of their relationships. The study aligns with its objectives by examining how ownership structure, board diversity, audit quality, board transparency, and bank size affect financial performance. Data from 125 observations between 2017 and 2021 reveal that the average return on assets (ROA) was 0.0313 with a standard deviation of 0.0080, indicating stable profitability across banks, consistent with prior findings by Opoku-Agyeman and Yahaya & Lawal. Ownership structure had a mean of 8.33 and a high variability (std dev 7.03), reflecting diverse ownership types including private, state, and institutional investors. Board diversity showed a moderate mean of 2.46 (std dev 1.60), suggesting some inclusion of diverse members, aligning with studies highlighting the benefits of gender and skill diversity. Audit quality averaged 1.44 with a std dev of 0.94, showing a mix of audit firm tiers among banks. Board transparency averaged 0.504, indicating that around half the banks had visible board operations, which boosts accountability. Bank size had a mean of 9.95 and a std dev of 2.39, with larger banks potentially benefiting from economies of scale and better governance frameworks**.**

Table 2 Summary of Descriptive Statistics

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Variable** | **Obs** | **Mean** | **SD** | **Min** | **Maximum** |
| Return on Assets (ROA) | 125 | 0.0312796 | 0.0079779 | 0.0083016 | 0.0467253 |
| Ownership structure | 125 | 8.3277 | 7.030683 | 0 | 26.44 |
| Board diversity | 125 | 2.464 | 1.599113 | 0 | 5 |
| Audit Quality | 125 | 1.44 | 0.9367067 | 0 | 3 |
| Board transparency | 125 | .504 | 0.501996 | 0 | 1 |
| Bank size | 125 | 9.954297 | 2.391831 | 5.482438 | 13.85993 |

**Source: Field Data (2025)**

**4.3 Correlation Analysis**

The correlation analysis examined the relationships between Return on Assets (ROA) and several governance-related factors: ownership composition, board heterogeneity, audit effectiveness, governance transparency, and financial institution scale. Results indicate a negative and statistically significant correlation between ownership structure and ROA (r = -0.4343, p < 0.05), suggesting that concentrated ownership may hinder firm performance by reducing managerial flexibility and fostering entrenched interests. Conversely, board heterogeneity shows a positive and significant relationship with ROA (r = 0.2317, p < 0.05), implying that diverse leadership in gender, skills, and experience enhances decision-making and boosts financial performance. Audit effectiveness also positively correlates with ROA (r = 0.2325, p < 0.05), highlighting the importance of robust audit practices in strengthening internal controls, ensuring compliance, and building investor confidence. Although board transparency shows a positive correlation with ROA (r = 0.0892), the relationship is not statistically significant, suggesting that its impact may be indirect or dependent on broader accountability systems. Finally, financial institution scale displays a strong, positive, and statistically significant correlation with ROA (r = 0.7015, p < 0.05), indicating that larger banks benefit from operational efficiencies, market reach, and income diversification. These findings align with existing literature and provide a foundation for further multivariate analysis of governance factors and bank performance.

Table 3 Correlation analysis for Return on Investment

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Variable** | **ROA** | **Ownership structure** | **Board diversity** | **Audit Quality** | **Board transparency** | **Bank size** |
| ROA | 1.0000 |  |  |  |  |  |
| Ownership structure | -0.4343 | 1.0000 |  |  |  |  |
| Board diversity | 0.0274 | -0.0972 | 1.0000 |  |  |  |
| Audit Quality | 0.2325 | -0.1151 | -0.0782 | 1.0000 |  |  |
| Board transparency | 0.0892 | -0.0370 | 0.0077 | -0.0295 | 1.0000 |  |
| Bank size | 0.7015 | -0.3102 | -0.1999 | 0.2828 | -0.1224 | 1.0000 |

**Significant at 5% level**

**Source: Research Data (2025)**

**4.4 Diagnostic Tests**

The diagnostic tests conducted in this study were essential to validate the integrity and robustness of the panel data regression model. These included checks for multicollinearity, autocorrelation, heteroscedasticity, unit roots, and model specification to ensure that the foundational assumptions of regression analysis were met, thereby strengthening the reliability of the inferential results.

To detect multicollinearity among the independent variables, the Variance Inflation Factor (VIF) was computed. Severe multicollinearity is indicated by VIF values exceeding 10, while values below 5 are generally acceptable. The study found that all variables had VIF values under 10, with a mean of 3.48. Bank size and board diversity had moderately high VIFs of 7.23 and 7.02 respectively but were still within acceptable bounds. Other variables such as ownership structure, audit quality, and board transparency had VIFs close to 1, suggesting very low multicollinearity. This indicated that the regression estimates would not be significantly distorted by inter-variable correlations.

**Table 4 Multicollinearity test results**

|  |  |  |
| --- | --- | --- |
| Variable | VIF | 1/VIF |
| Bank size | 7.23 | 0.138385 |
| Board diversity | 7.02 | 0.142536 |
| Ownership structure | 1.13 | 0.886574 |
| Audit Quality | 1.05 | 0.951167 |
| Board transparency. | 1.00 | 0.997449 |
| Mean VIF | 3.48 |  |

**Source: Field Data (2025)**

The Wooldridge test was used to assess autocorrelation, where the null hypothesis stated there was no first-order autocorrelation. The results, with an F-statistic of 0.071 and a p-value of 0.6503, confirmed that autocorrelation was not present in the dataset, thus meeting the assumption of independently distributed residuals. This finding further validated the suitability of the panel data regression model.

Table 5 Durbin-Watson test for Autocorrelation

|  |  |  |  |
| --- | --- | --- | --- |
| **Test type** | **F (1, 64)** | **Prob > F** | **Decision** |
| Wooldridge Test for Autocorrelation | 0.071 | 0.6503 | Fail to reject H₀: No autocorrelation |

**Source: Field Data (2025)**

For heteroscedasticity, the Breusch-Pagan/Cook-Weisberg test was employed. The test produced a chi-square statistic of 3.18 and a p-value of 0.0318, indicating that the null hypothesis of homoscedasticity (constant variance) was rejected. This confirmed the presence of heteroscedasticity in the regression model. To mitigate its effects and ensure accurate statistical inference, robust standard errors were applied in the subsequent regression analysis.

Table 6 Breusch-Pagan / Cook-Weisberg Test for Heteroscedasticity

|  |  |  |  |
| --- | --- | --- | --- |
| **Test type** | **Chi² (1)** | **Prob > Chi²** | **Decision** |
| Breusch-Pagan / Cook-Weisberg Test | 3.18 | 0.0318 | Reject H₀: Evidence of heteroscedasticity |

**Source: Field Data (2025)**

The stationarity of the variables was tested using the Harris-Tzavalis panel unit root test, appropriate for datasets with limited time periods and cross-sectional units. The null hypothesis assumed that the panels had unit roots, i.e., were non-stationary. The results showed that all key variables, including Return on Assets (ROA), Ownership Structure, Board Diversity, Audit Quality, Board Transparency, and Bank Size, had statistically significant p-values (p < 0.05). This led to the rejection of the null hypothesis, confirming that all variables were stationary at level. This stability ensures consistent mean and variance over time, which is essential for reliable panel data estimation.

Table 7 Panel Unit Root Test Results (Harris-Tzavalis)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Variables** | **ρ Statistic** | **z-Statistic** | **p-value** | **Stationarity Conclusion** |
| Return on Assets (ROA) | 0.6586 | -4.2070 | 0.0000 | Stationary |
| Ownership Structure | 0.0671 | -15.2203 | 0.0000 | Stationary |
| Board Diversity | -0.0357 | -17.1335 | 0.0000 | Stationary |
| Audit Quality | 0.0580 | -15.3900 | 0.0000 | Stationary |
| Board Transparency | -0.0977 | -18.2879 | 0.0000 | Stationary |
| Bank Size | -0.0412 | -17.2369 | 0.0000 | Stationary |

**Source: Field Data (2025)**

Finally, the Ramsey RESET test was carried out to check for model specification errors, specifically to determine whether any important variables were omitted. The null hypothesis stated the model was correctly specified. The test yielded an F-statistic of 5.68 with a p-value of 0.0712. Although the p-value was slightly above the 0.05 significance level, implying no strong evidence of misspecification, its closeness to the threshold suggested that the model’s specification should be approached cautiously and may benefit from further refinement.

Table 8 Ramsey RESET Test for Model Specification

|  |  |  |  |
| --- | --- | --- | --- |
| **Test type** | **F (3, 111)** | **Prob > F** | **Decision** |
| Ramsey RESET Test (ovtest) | 5.68 | 0.0712 | Fail to reject H₀: No omitted variables (at 5% level) |

**Source: Field Data (2025)**

**5.0 CONCLUSIONS**

The study concludes that corporate governance elements significantly influence the financial performance of commercial banks in Kenya, with bank size playing a moderating role. Firstly, ownership structure was found to negatively impact financial performance, particularly in larger banks. Fragmented ownership weakens oversight and strategic alignment, supporting Agency Theory, which suggests that dispersed ownership introduces managerial inefficiencies. Concentrated ownership may therefore be more effective, especially in complex institutions. Secondly, board diversity was shown to have a positive and statistically significant impact on financial performance. Diverse boards enhance decision-making and strategic oversight, especially in larger banks, indicating that leadership heterogeneity is a valuable governance asset. Thirdly, audit quality generally has a beneficial effect on financial performance, as it improves transparency and stakeholder confidence. However, in larger banks, the effect becomes negative, likely due to bureaucratic inefficiencies or superficial audit practices. Thus, while audit quality is important, its impact depends on institutional context and may require stronger internal controls in large institutions. Fourthly, board transparency was unexpectedly found to have a negative association with financial performance. This suggests that transparency practices may lack depth or authenticity, often implemented reactively rather than proactively. The study recommends further investigation into how transparency is practiced. Lastly, bank size significantly moderates the relationship between governance mechanisms and financial performance. Larger banks gain more from board diversity but are more adversely affected by dispersed ownership and less responsive to audit quality. These findings emphasize that governance structures should be tailored to organizational context, particularly the size of the institution. Overall, the study underscores the need for nuanced governance reforms that consider the complexities introduced by institutional scale in order to enhance financial performance effectively.

**6.0 RECOMMENDATIONS**

This study provides empirical insights into how oversight structures influence the financial performance of Kenyan commercial banks, considering institutional size as a moderating factor. The findings hold critical implications for regulators, policymakers, board members, and stakeholders aiming to enhance governance within the banking sector.

First, the study identifies a negative relationship between ownership structure and financial performance, particularly in large banks. Dispersed ownership tends to dilute oversight, weakening accountability and strategic direction. Policymakers, including the CBK and CMA, should promote concentrated but accountable ownership through measures like minimum shareholding thresholds and beneficial ownership disclosures. Performance-based governance assessments may further strengthen oversight.

Second, the study affirms that board diversity encompassing gender, expertise, age, and ethnicity positively affects financial performance, especially in larger institutions. Regulatory bodies should enforce diversity benchmarks guided by frameworks such as the Mwongozo Code. Additionally, leadership training and capacity-building initiatives for underrepresented groups can broaden the talent pool and support inclusive board development.

Third, while audit quality generally supports financial performance, its effectiveness declines in larger banks, potentially due to bureaucratic inefficiencies. To address this, ICPAK and CBK should adopt size-sensitive audit standards, including mandatory firm rotations, risk-based auditing, and peer reviews. Internal audit functions must also be empowered to enhance financial discipline.

Fourth, the weak negative relationship between board transparency and financial performance implies that current disclosure practices may be procedural rather than meaningful. Regulatory agencies should shift focus from formality to substance by assessing the quality of transparency, including reviewing board minutes and disclosure systems. Strengthening whistle-blower protections and board evaluations would promote genuine transparency and accountability.

Finally, the moderating role of bank size highlights the inadequacy of a one-size-fits-all governance model. Bank size can amplify both positive and negative governance outcomes, depending on the element. Thus, a differentiated governance framework is recommended. Larger banks should face stricter oversight regarding ownership and audit quality, while smaller banks should benefit from simplified governance structures. Implementing a tiered governance code similar to Basel III’s proportionality principle will ensure scalable and context-sensitive oversight mechanisms, promoting effective corporate governance across institutions of varying sizes.

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