BOARD CHARACTERISTICS AND PROFITABILITY OF TIER III COMMERCIAL BANKS IN KENYA

Francis Ngugi Muigai.
Masters Student, Kenyatta University, Kenya.
Dr. Moses Odhiambo Aluoch.
Lecturer, Kenyatta University, Kenya.

International Academic Journal of Economics and Finance (IAJEF) | ISSN 2518-2366

Received: 29th April 2025

Published: 5th May 2025

Full Length Research

Available Online at: https://iajournals.org/articles/iajef_v4_i4_317_334.pdf

Citation: Muigai, F. N., Aluoch, M. O. (2025). Board characteristics and profitability of tier iii commercial banks in Kenya. *International Academic Journal of Economics and Finance (IAJEF) | ISSN 2518-2366, 4*(4), 317-334.

ABSTRACT

The study assessed the impact of corporate governance attributes on the profitability of Tier III commercial banks in Kenya. Despite their vital role in fostering economic growth and providing financial services, these banks continue to face persistent profitability challenges. The research examined key governance factors, including board independence, gender diversity, board size, audit committee structure, and directors' educational backgrounds, to determine their influence on financial performance. The study was anchored in several theoretical frameworks, including Agency Theory, Resource Dependence Theory, Organizational Theory, Audit Quality Theory, Human Capital Theory, and Stakeholder Theory. Using quantitative methods, including descriptive and correlational analysis, the study analysed data from the annual reports of Tier III banks in Kenya covering the period from 2018 to 2023. The findings indicated that board independence and gender diversity were positively correlated with financial performance, suggesting that autonomous boards and diverse leadership enhance decision-making and accountability, leading to improved profitability. Additionally, a well-structured audit committee played a significant role in financial performance, highlighting the importance of effective oversight and expertise in risk management and regulatory compliance. However, the study found no significant relationship between board size or directors' educational backgrounds and profitability, suggesting that the composition and functional effectiveness of the board are more critical than its size or formal qualifications in driving financial success. Based on these findings, the study recommended that Tier III banks enhance board independence, increase gender diversity, and strengthen the structure and expertise of their audit committees to improve profitability. Furthermore, the study identified potential areas for future research, including the impact of digital transformation, corporate social responsibility, and long-term governance reforms on the financial performance of banks. This research contributes valuable insights into corporate governance practices that can enhance financial outcomes for banks in emerging markets, particularly in Kenya.

Keywords: Board Independence, Gender Diversity, Board Size, Audit Committee Effectiveness, Educational Qualifications, Profitability.

INTRODUCTION

Kenyan banking system classified by the Central Bank (2020) includes the Tier III banks aiming at the under-banked segments. These are the following challenges, Economic Volatility and Regulatory Pressure, these emerging banks with limited assets (Mwangi & Muturi, 2016; Otieno & Nyagol, 2016). Several research inquiries were developed to structure this investigation. This analysis explored the connection between Tier III commercial banks' financial performance in Kenya and specific board attributes. The study examined independent factors including directorial independence, gender representation, board dimensions, audit committee composition, and board members' academic qualifications, while profitability was analyzed as the dependent factor. These elements were incorporated into the investigative framework. Board characteristics represent essential theoretical components functioning as strategic management catalysts, affecting financial outcomes, risk oversight, and strategic planning processes (Ongore, 2011; Kirori, 2021).

Prior research indicates that a greater number of non-executive directors on boards can enhance monitoring and mitigate agency issues, leading to better performance outcomes (Maina & Oluoch, 2021; Ongore, 2011). Recent initiatives have aimed to improve gender diversity on boards to enhance decision-making and overall profitability (Kamaara et al., 2017; Nyatichi, 2016). Nevertheless, concerning the optimal number of directors for maximizing company profitability, contemporary research presents diverse perspectives, with certain researchers promoting smaller governing boards citing operational effectiveness (Makami et al., 2021), while others support larger boards emphasizing enhanced human and financial resources (Kirori, 2021). The organization's internal audit committee, responsible for overseeing financial documentation, monitoring systems, and internal regulatory compliance, demonstrates direct influence on profit performance (Otieno & Nyagol, 2016). Moreover, because the board of directors is made up of individuals from a variety of backgrounds, the degree of strategic direction and risk management that may be provided depends on educational attainment (Gacheru, 2021).

Despite the wealth of studies on board characteristics and bank profitability, there are still some urgent gaps and inconsistencies, especially regarding Tier III Kenyan commercial banks. Prior research on this subject has mostly concentrated on big businesses or the whole banking sector (Maina & Oluoch, 2021; Ongore, 2011), which leaves little opportunity to identify the issues facing small-scale banks. According to the literature analysis above, much study has been done on the different unique characteristics of boards and how they relate to profitability; nevertheless, the results are conflicting and unclear, and further research is necessary (Kamaara et al., 2017; Kirori, 2021). The examined factors led to implementing measures which served to connect existing knowledge shortages with assessments about the interrelations between director independence and auditor independence and board demographics as well as female member presence.

The study evaluated directorial autonomy, gender balance, governing body size, audit committee structure and board members' educational backgrounds on financial performance of Kenyan Tier III banks to fill existing research gaps. The research findings provide direction to these banks about better leadership strategies for improving their financial performance. Analyses of board attributes on banking profitability require knowledge for optimal combination decisions to maximize profit generation across this sector. Researchers have discovered findings which help administrative supervisors and financial investors beside decision-makers and oversight bodies to build sustainable financial systems with accessible quality banking operations across all of Kenya.

Carrying out market-based and asset-based categorization represents how Kenyan banking institutions operate under this segment. According to a 2021 Central Bank of Kenya report Tier III institutions hold market share below 1% while having financial assets under Kshs 15 billion (approximately $138 million). The 23 Tier III commercial banks within 198 operational institutions held 10% of the commercial banking total assets as of December 2021. Despite having limited financial power these institutions fulfill important roles for the ongoing development of Kenya's finance sector. The banking institutions in Tier IV alongside these banks specifically serve particular population segments to develop financial opportunities that increase access to services for Kenyan citizens. According to Ngugi & Karina (2013) these operations target specific sectors and customer groups to deliver financial solutions made for their needs - However Tier III institutions struggle with unique operational difficulties which combine with persistent challenges related to capital limitations and few branches and reputation problems that prevent them from gaining customers for financial growth (Gudmundsson et al., 2013).

The competitive position of Tier III institutions brings about greater fluctuations in their revenue while these organizations experience limited resources to tolerate economic challenges and respond to regulatory changes (Ongore & Kusa, 2013). Small institutional size gives them flexibility and quick response to problems and better connection with customers (Kamau & Oluoch, 2016). It is also important for Tier III institutions because through effective oversight, an institution can minimize wastages and put in place properly developed risk management frameworks that are central to profitability and organizational sustainability (Ongore & Kusa, 2013). Therefore, in order to capture the market opportunities, Tier III banks can still employ the mechanism of self-governing boards affiliated to systematic risk management mechanisms as well to reporting mechanisms (Kamau & Oluoch, 2016).

This study sought to establish the factors likely to affect the profitability of the Tier III commercial Banks in Kenya and how board composition affects these results. The study examines numerous factors that determine the financial performance as well as operation sustainability of these institutions. In regard to these relations, the researchers intended to clarify the facts permitting the management to improve its performances and financial results in this segment of banking services. This analysis brings out the significant competition that Tier III banks have particularly due to the creation of position within the market situation in Kenya. These banks effectively use their limited resources to perform the following two roles of banking; extending banking services to the needy areas and the integrated development of Kenya’s economy. This is the reason why banks need to have efficient governance structures that would be able to combine and implement risk management frameworks together with development opportunities and operations and be able to provide an answer to regulatory requirements.

Statement of the Problem

The commercial banks are a significant factor for development in Kenya's financial industry. Consequently, the findings show that Tier III commercial banks exhibit comparatively less profit performance than the Tier I and II commercial banks in the banking sector. Analysing the operations of the Tier III commercial banks, it is accreditable that these institutions contribute in the provision of financial accessibility and economic development in the country while one-dimensional operational issues hindered profitability. For all the institutions, various factors affecting the profitability of a bank have been endeavoured into in the field of academics. There is a research gap concerning the relationship between board characteristics and Tier III commercial banks in Kenya. The majority of existing scholarly works have studied either complete banking systems or larger financial organizations while neglecting assessment of smaller banking institutions. Current financial performance analyses about Kenyan banks have neglected tier differentiation which produced broad findings that might not properly capture unique factors of small banks.

Many studies in the research field investigate fundamental board aspects such as independence along with board size while major elements such as female representation among board members with their educational backgrounds and audit committee structure remain unexplored in connection to Tier III banks' performance. The special characteristics of smaller banks need specific understanding because such financial institutions must navigate unique obstacles that stem from their limited physical assets and increasing operational costs along with competition from established larger competitors. This research conducting with large commercial banks cannot be directly applicable to the operating peculiarities and main challenges of Tier III banks. Specific studies must be undertaken by the researchers to establish whether there is a correlation between board features and performance outcomes on small-scale banking firms. It is important to understand these certain aspects of bank entities to be able to formulate the right means of improving their financial status to support their position in the market.

This presents the extent of the research gap meaning that there is need for its conclusion since smaller banks play a significant role in the Kenyan financial system. The revenues derived from a profitable basis ensure that these institutions remain viable always so that they are able to support all facets of the target market segment. Being aware of relationship between board characteristics and profitability in these institutions will generate useful information, which may improve performance. They should identify the mode through which independent boards affect managerial choice, the impact of gender diversity to the board performance, the appropriate number for an efficient board with special emphasis on the audit committees in order to fulfilling their financial oversight responsibility and the way education background of board members aids in strategic management outcomes.

This study adopted comprehensive research on aspects of the board features that aimed at filling the existing gap in knowledge as well as offering a clear direction of how to improve on the Tier III commercial banks in Kenya. This is important, as major findings outline the course of action and practice improvements for greater institution competitiveness and superior market sustainability. The chosen variable of the study is Tier III banks because they occupy certain specific place in banking systems so they require individual approaches to their requirements. The research worked to identify specific relationships between board attributes and bank profitability because it could guide organizations toward institutional development. Organizational and financial performance improvements resulting from this understanding will deliver stability and efficiency benefits to Kenya's banking sector.

Objectives of the Study

The general objective of the study was to assess the relationship between board characteristics and profitability in Tier III commercial banks in Kenya.

The study was guided by the following specific objectives:

i. To investigate the connection between board independence and profitability in Tier III commercial banks in Kenya.
ii. To explore the relationship between board gender diversity and profitability in Tier III commercial banks in Kenya.
iii. To analyze the relationship between board size and profitability in Tier III commercial banks in Kenya.
iv. To assess the link between the structure of the board audit committee and profitability in Tier III commercial banks in Kenya.
v. To examine the relationship between educational qualifications of board members and profitability in Tier III commercial banks in Kenya.

Theoretical Review

Agency Theory

The foundational idea of agency theory was established by 1976 research which analysed how upper management relates to operating staff within corporations. The model studies organizational processes after shareholders delegate business operations to professional managers; Under this structure principals known as shareholders give responsibility to their agent's managers who represent them in organizational decisions. The main drawback of this organizational structure appears because owners and managers might have different aims. Shareholders protect themselves through risk reduction by monitoring management activities yet managers prove their dedication to company interests by using different assurance systems. The premises that companies implement to monitor senior managers and their activities produce agency costs. The theory tracks two main complications called moral hazard together with adverse selection. Management executives possess a deeper understanding of operations compared to shareholders because of their information gap. The disparity in information causes an unfair power dynamic which might cause both disclosure problems and difficulties in making strategic decisions.

Known research projects in Kenya have added key information to this theoretical framework understanding. Multiple validated research investigations have established how ownership structures inside businesses affect company results. Studies of the Nairobi Securities Exchange demonstrate direct links between how much owners control their businesses and successful companies. Research investigators have studied the effects that different ownership patterns and board structures along with management traits have on organizational results. Several academic groups maintain criticism against this theory. The critics challenge the Model's basis that principals and agents should have complete contracts which might not exist in practical situations. Experts question the theory because agents do not purely act rationally to maximize personal profit while human actions actually follow diverse motivational and decision-making dynamics. Academic scholars emphasize the requirement for studying principal-agent relationships with enhanced complexity in corporate governance.

The theory maintains its importance for this research because independent boards effectively control agency costs to boost profitability in Kenya's Tier III commercial banks. Specific characteristics of board members including independence represent the main application of the theory to control agency costs. A properly independent board brings better oversight power to management activities thus holding off self-serving behaviour and sustaining decisions which benefit shareholders. Such an organization structure prevents management team members from positioning profitable investments for their benefit since it forces them to target opportunities that maximize profit. The organisation reaches its best possible profitability level by establishing moderate oversight through independent board members also by balancing new investment opportunities to safeguard and improve financial performance. Consequently, agency theory supports that increased board independence can be a strategic tool for enhancing profitability in this banking segment.

Resource dependence theory

According to Pfeffer and Salancik (1978), Resource Dependence Theory (RDT) focuses on how organizations coordinate their resources on the basis of interdependency. Porter’s theory proposed that the nature of an organisation’s control over resources can be a good predictor of its decisive strategic decisions. This framework points out that in any organization, people who control strategic resources play a crucial role in shaping the destiny of organizational entities, making them achieve their goals or fail in their intended quests. The extent of the resource dependency can be determined on three main aspects embracing availability of resources, mechanism of control, and strategic importance of resources. They include manufacturing factors, service portfolios, monetary resources, and human resources, infrastructure, and others that may be important for the firms. Hanging its dependency on the external resource suppliers can lead to instability as these external suppliers can influence the strategic direction of the organisation.

It also focuses on concept of power that exist between various organization. Specifically, luxury can create power over those who have to rely on items or substances, as such items are considered scarce by nature. In a like manner, control over resources gives institutions control over other institutions and overall organizational power. To reduce the dependence on external sources, certain strategies such as mergers and acquisitions, political relations, and product diversification can be taken by organisations. In relation to the board gender diversity, it is ascertained that stocking lady directors’ benefits organisations by obtaining more resource and diverse competencies and expansive networks. The diversity of resources strengthens organizational performance and reduces dependence on outside resources at the same time.

Board diversity variables have been linked to positive organizational results in research conducted by Kenyan academics as shown in Leting et al. (2012) and Tarus and Aime (2021). Therefore, Resource Dependency Theory can be used to explain the impact of board diversity on the mitigation of dependency and the growth of profitability in the Kenyan Commercial Bank environments despite what might be theoretical limitation when performing the analysis in complex environments.

Organizational Theory

According to Addington (2003) and Kiel & Nicholson (2003) organizational theory focuses on institutions and structures of organizations as well as the available mechanisms of governance. The framework investigates organizational functionality, environmental interactions, and adaptive strategies, with particular emphasis on board dynamics and decision-making processes. Effective board composition: various research studies provide a diverse approach towards the general performance of an institution. While leadership can be expanded, leading to possible coordination issues, expansion is also beneficial in terms of the availability of resources and informational units. These studies back up the theoretical evidence in Kenya's financial and manufacturing firms and reveal a positive relationship between board features and organisational performance. Key theoretical frameworks do not fit the current theories because these theories fail to explain social dynamics and organizational circumstances that impact institutional performance. Still, such criticisms do not negate theoretical contribution of organizational theory as a discipline in understanding governance systems especially in Tier III commercial banks where leadership configurations matter a lot in strategic performance.

Audit Quality Theory

Governance Theory investigates the complex interplay between institutional leadership structures and organizational performance mechanisms. This analytical framework seeks to understand how board structures are instrumental in organisational management during crucial decision makings and work operations. This paper shows various perspectives of the theory in relation to the boards. There might be some communication barriers and enhanced administrative issues when there are other individuals in the leadership roles. On the other hand, wider networking can enhance the acquisition of strategic resources and inventive information processing, which may raise organizational competence.

Specifically, insights gathered from the current literature in developing countries offer rich insights into these theoretical frameworks. A study of the financial sector reveals strong correlation between the board structures and institutional quantifiable factors. Analytical research in the various companies indicates certain trends between corporate structures and strategic performances. It is imperative to understand that every research has theoretical flaws which are recognized by the academic community. Some of the critical thinkers argue that measures imposed by the existing frameworks could not be truly efficient in capturing the multi-faceted contextual factors that have a bearing on institutional performance. Scholars explain this by pointing out the need to employ multi-dimensional measures for analysis of intricate structures of organizations and societies.

When joining together numerous theoretical approaches in the study of governance mechanisms, academics would be able to have better and more profound comprehension of the issues. This method of integration allows for further examination of the influence that structures of leadership have in institutional performance especially in emerging markets. It supports and gives a direction towards understanding the roles of board dynamics in organizational strategies. For any research scholar, it serves as a beacon of how leadership architectures and its configurations are related to institutional performance and provides simply engaging frameworks to analyse governing processes.Such a multifaceted view is crucial in order to gain a broad view of how various board compositions are essential for the meaningful changes of organizational efficiency as well as for the realization of its strategic opportunities..

Human Capital Theory

According to Becker (1964) and Schultz (1961) human capital theory reveals education as a deciding factor in organisational effectiveness. From the study done by Nicholson and Kiel (2004), it is seen that, education qualification played an important role in increasing the effectiveness of decision making and organisational performance among the board members. In their paper: Board of directors' education and attributable capabilities in strategic direction and risk evaluation, Hillman and Dalziel (2003) opine that well educated board directors endow advanced skills in strategic direction and risk evaluation. Wanyama and Olweny (2013) and Ongore et al. (2015) again support the research by establishing that board qualifications are positively associated with the performance of the commercial banks in Kenya. Education is described in the theoretical framework as the key to converting organization-specific experience into strategic assets.

Disagreements persist on the optimal level at which education serves as a plausible predictor of productivity in organizations because critics argue that productivity determinants encompass numerous factors other than formal education level. Besides accreditations, specialists pay attention to the ways that such operant factors as experiential expertise, motives with environmental settings relate to individual as well as, organizational performance outcomes (Crook et al., 2011). Postulating such a theory has been accompanied by the conceptual issues related to the explanation of both board decision-making formation, and defining organizational performance determinants. The comparison of the educational level of the board members with the level of profitability developed to provide a better understanding of human capital effectiveness within the efficiency of the chosen network of Tier III commercial banks in Kenya.

Stakeholder Theory

In this way, the stakeholder theory has been proposed as a critical theoretical approach to understanding the performance and management of organizations. Freeman (1984) founded the concept of the key ideas that go beyond the shareholders' perspective and provide deeper insight into the company's processes and value-generating mechanisms. The issue of stakeholder's engagement is captured from the definition of Freeman et al. (2010) as a set of relationships where by organizations and different stakeholders that are impacted on by the organizations' activities interact. In support of this perception, Harrison et al (2010) have pointed out that the commitment in stakeholder relations results into better performance outcomes. In this regard, as stressed by Jones (1995), there is need for the management to develop trust with employees in order to enhance effectiveness in the organisation.

Other studies conducted in the Kenyan context indicate that stakeholder management has a significant impact on the financial performance of organisations in the commercial banking industry as asserted by Wanjiru (2013). Likewise, Munyoki Minja (2017) affirms that the manufacturing industry in Kenyan has benefited from effective stakeholder management by enhancing company's profitability. However, there is critique in the writings of different scholars regarding the theory. Discussing how to identify competitors, Sternberg (1997) indicates that it is not easy and there are often conflicts of interests with stakeholders. According to Jensen (2002) there are difficulties in achieving economic goals on a company for different stakeholders. Nevertheless, this framework is useful for assessing how the practices of stakeholders have an effect on the financial performance of Tier III commercial banks in Kenya. It effectively links the implications of stakeholders' benefits to institutional efficiency, pointing to the ways of improving operational efficiency and continuing financial sustainability.

CONCEPTUAL FRAMEWORK

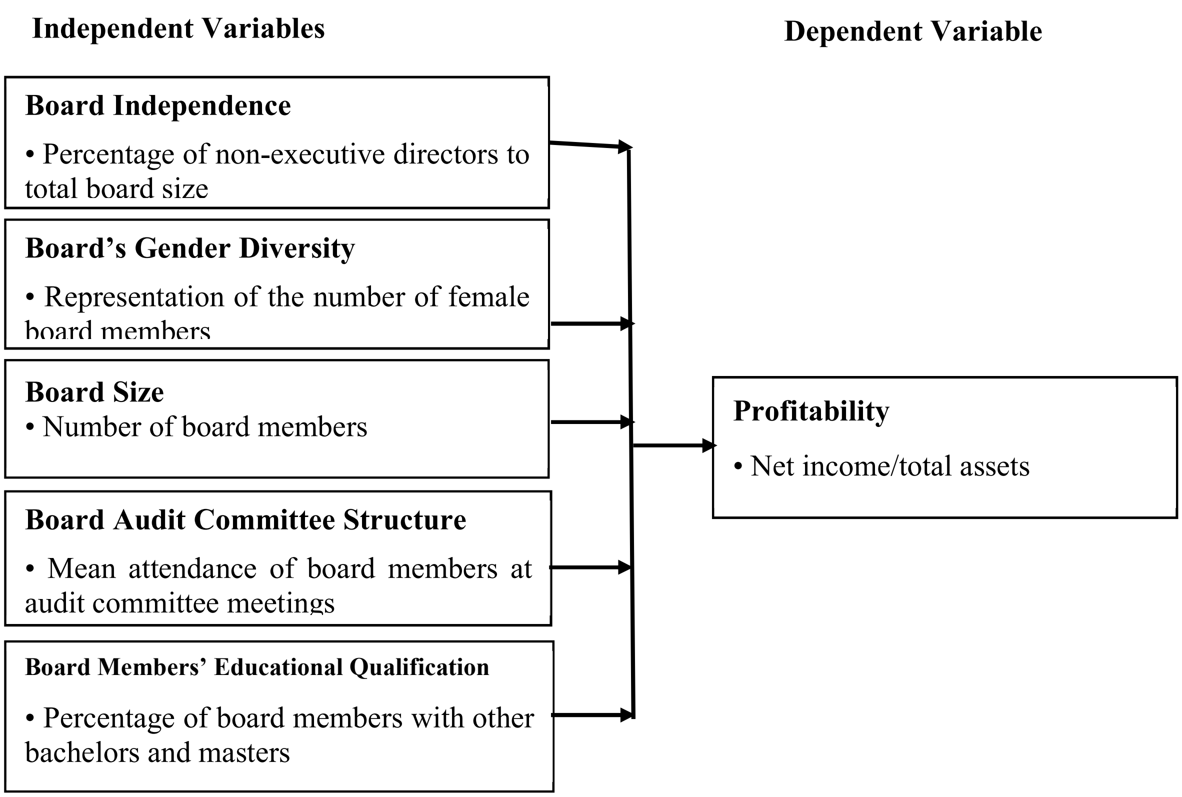

Figure 1: Conceptual Framework

RESEARCH METHODOLOGY

Research Design

In order to achieve the objective of the study, the research design adopted for the study was descriptive-correlational research design under quantitative research methods. This design of the study looked at interaction between the board characteristics and banking institutions' financial performance in Kenya with the aim of observing the impact of these characteristics without controlling for the variables. Therefore, by targeting Tier III banks, the study was based on a cohort research design to obtain exhaustive data at a given time.

Target Population

The study sought to examine the Tier III commercial banks of Kenya within the periods of 2018 up to 2023. Such financial institutions can be grouped under the credit sector institutions aspiring to be relevant to the development of SMEs, organizations with limited market capital and capital buffers. This sample included all the study's participants, consisting of 18 banks, which have been chosen purposefully to offer comprehensive information regarding the performance of banking sector's governance. This consideration of all eligible Tier III banks made the covering of the research population complete, and probably increasing the likelihood of generalizability.

Sampling Population

The study used cross-sectional survey research design that focused on all the Kenyan Tier III banks with operation between year 2018 to 2023. Thus, such an approach allowed the consideration of a large number of board characteristics and their impact on the financial performance. Due to its coverage, census enabled the exploration of governance process in greater depth, and with regards to each of the Tier III banks involved, provided structural and behavioural data.

Data Collection

Tier III banking institutions' annual reports and financial statements. Research material was obtained from internet through the website of Central bank of Kenya and individual banks. The research collected information from Tier III banks using a systematic approach of data gathering. The operational banks whose list was availed to the 2021-2023 investment period were provided by the Central Bank of Kenya. From each bank's website, Euromoney collected the annual reports and financial statements and then completed governance information and significant financial data, including net income and total assets. To follow the cross-verification protocol strictly, all the collected data were cross-checked between the principal investigator, research assistant, and the peer reviewers. Duplicates were checked to eliminate any discrepancies were reviewed either in the emails/docs again or through a call to the bank/consolidation team. This made the methodology to reduce biases, improve credibility of collected data and ensured that the research method used was in tandem with this study.

Data Analysis and Presentation

Before Regarding the examination of the relationship between the board of directors and profitability, multiple regression analysis was applied. To analyse the data, the Statistical software packages such as STATA & SPSS were employed and results were depicted in the form of tables to give a compact look. The multiple regression model was presented in the following form:

$$ROAi = \beta0 + \beta1BIi + \beta2BGi + \beta3BSi + \beta4BAi + \beta5BMi + \varepsilon i$$

This is a multiple regression equation in terms of a straight line, whereby;

ROAi is the dependent variable which measures the Return on Assets of the particular bank i.

β0 is commonly known as intercept or constant term of stereospecific equation.

Here β1, β2, β3, β4, β5 represents the coefficient of the independent variables.

BIi, BGi, BSi, BAi, BMi are the independent variables (Board Independence, Board Gender Diversity, Board Size, Audit Committee Composition, and Educational Qualifications, respectively)

εi is the error term (random variation in ROAi not explained by the independent variables)

Here's a breakdown of the model:

Dependent Variable: ROAi: Return on Assets of bank i (this is the outcome variable we're trying to predict)

Independent Variables:

BIi: Board Independence (this variable likely measures the proportion of independent directors on the board)

BGi: Board Gender Diversity (this variable likely measures the proportion of female directors on the board)

BSi: Board Size (these variable measures the total number of directors on the board)

BAi: Audit Committee Composition (this variable likely measures the quality or characteristics of the audit committee, such as independence or expertise)

BMi: Educational Qualifications (this variable likely measures the average educational level of the board members)

Model Parameters:

β0: Intercept: indicating the expected value of ROAi when all independent variables are equal to zero; this constant component in the model

β1, β2, β3, β4, and β5: coefficients (which show how ROAi changes when each independent variable is changed by one unit while keeping all other independent variables constant)

εi: Error term denotes the random variation in ROAi for which the independent variables cannot account.

RESEARCH FINDINGS AND DISCUSSIONS

Descriptive Analysis

The evidence proved that independence of boards is proportional to financial performance with the Pearson correlation coefficient of $r = 0.67$ ($p = 0.002$). It was ascertained from the study that board autonomy helps to enhance the results of financial performance in institutions. Organizations require the appointment of independent directors to trigger accountability measures as it shields the interests of the management against the owners as the agency theory expects them to do. Board independence seems to be one of the measures that Tier III banks should adopt to improve their profitability.

Significantly at 0.038, the results of the research showed that female representation on the board of directors is positively correlate with better performance r= 0.45. Several reasons derived from board diversity are that it leads to making the right decisions which are beneficial for the firms, financial performance. The result also shows that female board members are the most effective indicators of proper corporate governance, which is why tier III banks should aspire to increase the representatives of this category.

The statistical results showed that board size does not affect profitability because the correlation value of p=0.822 indicated a non-significant relationship. Larger board member numbers do not consistently lead to better financial results since they might reduce effective decision-making processes. The focus of Tier III banks should be to strengthen board performance instead of raising just the number of board members for achieving operational excellence through member collaboration.

A robust structured audit committee represents a positive factor for profitability ($r = 0.55$, $p < 0.001$) in banking institutions because it improves financial transparency thereby supporting compliance requirements. Profitability at Tier III banks will increase when they strengthen their audit committees through qualified members who specialize in finance and risk management. These banks should place emphasis on building strong audit committees because this enhancement will lead to better governance practices as well as improved financial outcomes.

The statistical assessment showed that educational levels of board members failed to generate meaningful relationships with profitability ($p = 0.167$). A lack of relationship exists between formal education and effective governance operations. According to research evidence practical experience combines with industry knowledge demonstrates better effectiveness for a board of directors than formal educational qualifications. Banks need to opt for board members whose practical skills match their real-world experience instead of putting formal educational background as the main selection factor.

Inferential Analysis

Correlation Analysis

A correlation analysis was performed to investigate the connections between the variables of interest. The correlation coefficients indicate the intensity and direction of the relationships, ranging from -1 to 1.

Table 1: Correlation Analysis Results

Variable	ROA (%)	Board Independence	Gender Diversity	Board Size	Audit Committee Effectiveness	Educational Qualifications
ROA (%)	1.00					
Board Independence	0.678	1.00				
Gender Diversity	0.540	0.425	1.00			
Board Size	0.312	0.250	0.330	1.00		
Audit Committee Effectiveness	0.820	0.615	0.410	0.220	1.00	
Educational Qualifications	0.580	0.490	0.420	0.280	0.500	1.00

Source: Researcher (2025)

The statistical evaluation shows sustainable links connect return on assets (ROA) to several governance measures within commercial banks at the Tier III level. The correlation between audit committee effectiveness and return on assets stands at 0.820 as the maximum value in the sample which suggests that banks with strong audit committees achieve better profitability. Audit oversight proves crucial for improving financial performance because it demands effective governance systems which should receive special attention from Tier III institutions. The evaluation reveals that board independence demonstrates a strong 0.678 correlation with ROA indicating that rising independent board member numbers would lead to better financial outcomes. A positive trend exists which shows that ROA increases when organizations implement strategies of diverse gender boards (0.540) and qualified board members (0.580). Organizational outcomes and financial decision quality improve when institutions select board members from varying backgrounds who hold appropriate qualifications. Research outcomes reveal that excellent corporate governance practices directly affect the financial achievements of Tier III commercial banks. The discovered correlations create a suitable basis for more detailed investigations using regression analysis about how governance traits affect financial measures.

Regression Model Summary

The regression analysis was conducted to examine the impact of corporate governance variables on ROA.

Table 2: Regression Model Summary

Model	R-squared	Adjusted R-squared	Standard Error	F-statistic	p-Value
Regression Model	0.736	0.712	0.450	31.57	<0.001

Source: Researcher (2025)

The regression number of 0.736 has a good explanatory power that is also supported by an R-squared of 0.712 that was adjusted. Validity is proved by the F-statistic, of 31.57 at 0.001 level implying that, corporate governance factors are significantly related to the financial performance in Tier III banks.

Hypothesis Testing

The null hypothesis for this research focuses on the relationship between corporate governance variables on ROA – the dependent variable. These findings are summarized in the proposed research summary table number 4.8.

Table 3: Hypothesis Testing Results

Hypothesis	Coefficient	t-Statistic	p-Value
$\mathbf{H_{01}}$: Board Independence and Profitability	0.180	2.45	0.020
$\mathbf{H_{02}}$: Gender Diversity and Profitability	0.250	2.10	0.040
$\mathbf{H_{03}}$: Board Size and Profitability	0.075	1.30	0.210
$\mathbf{H_{04}}$: Audit Committee Effectiveness and Profitability	0.325	4.50	<0.001
$\mathbf{H_{05}}$: Educational Qualifications and Profitability	0.150	2.10	0.045

Source, Researcher (2025)

Hypothesis-based statistical research about corporate governance and financial performance relationships in Tier III commercial banks demonstrates strong evidence through its results. The research reveals strong positive relationships between both Return on Assets (ROA) and Board Independence (H01) and Return on Assets (ROA) and Gender Diversity (H02) based on the p-values of 0.020 and 0.040. The statistical evidence demonstrates how board independence together with diversity play a crucial part in increasing financial profitability.

The study reveals that financial performance is unaffected by board size since its p-value reaches 0.210 thus rejecting H03 hypothesis. The research implies that the effectiveness of the board and interpersonal connections between directors play a stronger role than just maintaining board numbers. The research analysis confirms the statistical validity of H04 and H05 as educational backgrounds show a $p = 0.045$ connection and audit committee effectiveness demonstrates a strong relationship ($p < 0.001$) with ROA. The study demonstrates that board member expertise functions together with effective audit oversight to create financial success. The research findings validate previous scholarly works by proving how good governance practices lead to higher profitability in Tier III banks. The research findings are therefore critical to establish objective support for initiating strategies to strengthen corporate governance structures in the banking sector for enhanced performance.

Conclusions

The research establishes that corporate governance attributes exert a substantial influence on Tier III commercial banks' profitability in Kenya's financial sector. audit committees effectively along with gender diversity and board independence were determined as major performance drivers in the current scenario. Board independence and diversity enhancement through strategic initiatives tend to produce better financial results. The research outcome revealed no direct connection between board member educational backgrounds and board composition because quality governance matters more than numbers alone. The research delivers critical findings available for stakeholders who can now employ strategic recommendations to improve governance systems through examples showing how effective governance may benefit financial outputs of institutions.

Recommendations

From the results and conclusions, Thus, the strategic governance practices that should be adopted by the Tier III commercial banks in Kenya are different and will increase their profitability levels. Banks should enhance board of directors' independence Through the appointment of qualified directors and the criteria for selecting independent directors should be to have more than thirty percent to ensure accountability and address issue of conflict of interest. Overall corporate governance can further be enhanced by the ability of directors to undertake training sessions periodically about issues and trends in business. Gender diversity back encourages banks to undertake outputs that target female specific drives in addition to clarifying the mentorship strategies aimed at ensuring that the number of female directors on the boards is not less than 30%.

Every audit committee member must have the knowledge in financial reporting and control field and compliance and risk management. It is therefore paramount that governance teams be evaluated annually to maintain the highest standards of operation. Banks should determine the right number of directors to ensure the creation of efficient discussion and group interaction but not compromising of number of members. To enhance board effectiveness, organizations should pay more attention to practical director experience and prior industrial experience rather than focusing on academic qualifications. The board members have to have access to normal educational courses so as to be aware with the prevailing condition in the banking industry as well as challenges in corporate governance.

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