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BOARD INDEPENDENCE, SOCIAL CAPITAL AND COMPETITIVE ADVANTAGE OF COMMERCIAL BANKS IN KENYA

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ABSTRACT

Competitive advantage is achieved when an organization's activities lead to superior profitability compared to its rivals. In Kenya, while some commercial banks have managed to gain a competitive edge, others have struggled with financial instability, often attributed to governance issues like insufficient board independence. This study explores whether social capital mediates the relationship between board independence and competitive advantage. Utilizing board independence as the independent variable, competitive advantage as the dependent variable, and social capital as the mediator, the research employed descriptive and correlational designs. The study targeted forty-two commercial banks in Kenya, surveying heads of corporate departments. Data collection was conducted via a census survey using a well-tested questionnaire, with reliability confirmed by a Cronbach alpha coefficient of 0.70. SPSS software facilitated the analysis, combining descriptive and inferential statistics. Results indicated a statistically significant relationship between board independence ($\beta = 0.152$, $t = 3.287$, $p = 0.000$) and competitive advantage. Additionally, social capital significantly mediated this relationship (indirect effect = 0.316; LLCI = 0.236; ULCI = 0.402). The findings suggest that enhancing board independence and social capital are crucial for Kenyan banks aiming to strengthen their competitive position.

***Key Words**: Competitive advantage,Board Independence, Social Capital.*

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BACKGROUND OF THE STUDY

Achieving competitive advantage is fundamental for firms to excel in profitability and other performance metrics. Globally, competitive advantage is associated with factors like market share, cost leadership, product quality, and customer loyalty (Porter, 2022; Barney, 2023). Effective corporate governance, particularly strong board independence, plays a pivotal role in maintaining competitive advantage. Independent boards help ensure unbiased decision-making and reduce conflicts of interest, leading to improved organizational performance (Hermalin & Weisbach, 2023).

In developed countries, the impact of board independence on competitive advantage is well-documented. For example, in the United States, firms with more independent boards demonstrate better financial performance and increased shareholder value (Yermack, 2022). Similarly, European studies show that board independence enhances organizational outcomes and competitive positioning (Fama & Jensen, 2022).

In the African context, research highlights that board independence positively affects financial performance and competitiveness. In Kenya, the banking sector has faced significant challenges due to governance issues. The Central Bank of Kenya reported a rise in distressed banks from nine in 2021 to thirteen in 2022, indicating persistent governance problems (CBK, 2022). Studies such as those by Mutua et al. (2022) and Wambua & Ngugi (2023) have emphasized the need for stronger governance practices, including independent boards, to improve the competitive stance of Kenyan banks.

Statement of the Problem

Achieving competitive advantage is crucial for firms to outperform their rivals in profitability and other key performance metrics. The Kenyan commercial banking sector has encountered significant financial instability, with distressed banks increasing by 44% from nine in 2021 to thirteen in 2022 (CBK, 2022). This trend underscores persistent governance challenges, particularly concerning board independence. Although board independence is recognized as vital for effective governance, its impact on competitive advantage in Kenyan banks remains unclear. Previous studies provide mixed results: while some indicate a positive correlation (Al-Manaseer et al., 2022; Nyarige, 2022), others report inconclusive findings (Mbai et al., 2022; Oketch et al., 2023). Additionally, the role of social capital as a mediator in this relationship has not been thoroughly explored. Wang et al. (2023) suggest that social capital may significantly influence how board independence affects competitive advantage, but empirical evidence in the Kenyan context is limited. This study addressed this gap by examining the mediating effect of social capital on the relationship between board independence and competitive advantage among Kenyan commercial banks.

Research Objective

To determine the mediating effect of social capital on the relationship between board independence and competitive advantage of commercial banks in Kenya.

Research Hypotheses

H_0: Social capital does not mediate the relationship between board independence and competitive advantage of commercial banks in Kenya.

LITERATURE REVIEW

Agency Theory

Agency theory, introduced by Jensen and Meckling (1976), addresses conflicts between management (agents) and shareholders (principals). It posits that agency conflicts arise because management makes decisions while shareholders bear the associated risks. Fama (2022) argued that independent boards can mitigate these conflicts by ensuring unbiased decision-making and reducing conflicts of interest.

The agency theory is relevant to this study as it underpins the investigation into board independence and its impact on competitive advantage. According to agency theory, independent boards are crucial for resolving

conflicts of interest and enhancing governance, which are essential for achieving competitive advantage. The theory supports the hypothesis that stronger board independence may lead to better financial performance and competitive positioning.

Critics argue that the control mechanisms proposed by agency theory can be costly and may interfere with strategic decision-making, potentially impacting other stakeholders' interests (Segrestin & Hatchuel, 2023). Despite these criticisms, the theory remains a useful framework for understanding the role of board independence in corporate governance and its influence on competitive advantage.

Conceptual Framework

In keeping with Kasomo (2006), the conceptual framework for this research comprised board independence, social capital and competitive advantage of commercial banks in Kenya as shown in Figure 1.

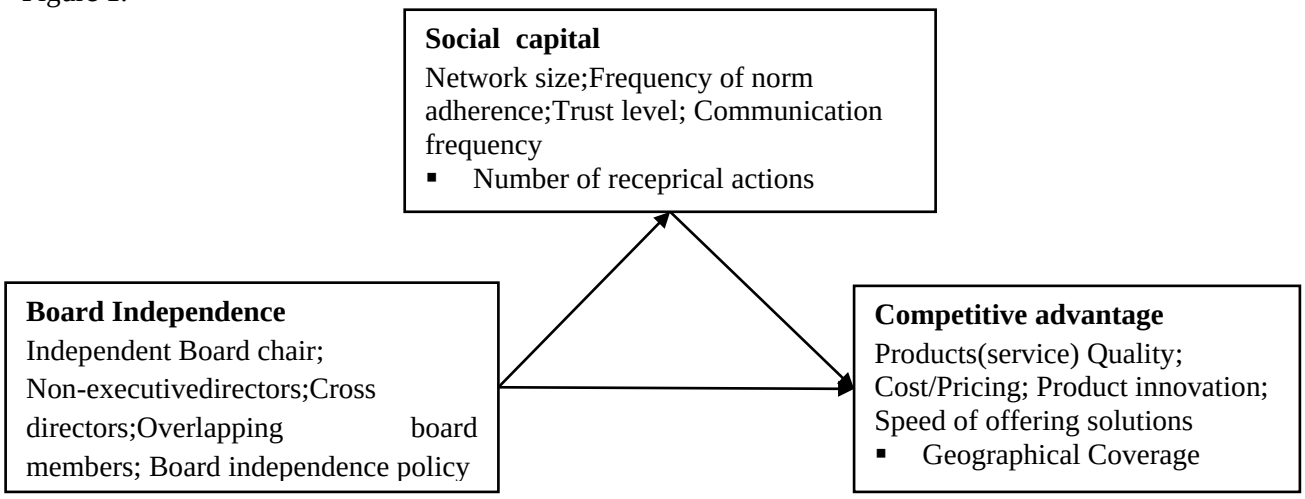

Figure 1: Conceptual Framework

Empirical Review of Board Independence and Competitive Advantage

Al-Manaseer et al. (2023) examined the impact of corporate governance on competitive advantage using data from 20 Jordanian banks listed on the Amman Stock Exchange for the period 2015 to 2020. The study utilized panel data methodology and Ordinary Least Squares (OLS) estimation. Competitive advantage was measured using proxies such as profit margin (PM), earnings per share (EPS), return on equity (ROE), and return on assets (ROA). Independent variables included board size, board independence, CEO status, foreign ownership, and bank size. The findings indicated a significant positive effect of board independence and foreign ownership on competitive advantage proxies, suggesting that increased board independence enhances a bank's competitive positioning.

Nyarige (2023) focused on the influence of corporate governance practices on competitive advantage within Kenyan commercial banks. This study covered ten commercial banks listed on the Nairobi Stock Exchange (NSE) from 2015 to 2020. Key variables included board size, board meetings, board independence, and executive compensation, with Tobin's Q ratio serving as the proxy for competitive advantage. The study identified a positive relationship between board independence and market competitive advantage, although it noted that focusing solely on NSE-listed banks might limit the generalizability of the findings.

Mbai, Kinyua, and Muhoho (2022) explored the impact of board independence on the performance of specific organizations in Kenya. Utilizing primary data from structured questionnaires and secondary data from published reports, the study investigated Machakos Water and Sewerage Company. Despite a rigorous data

collection process, the findings on the impact of board independence on overall company performance were inconclusive, potentially due to the narrow focus on a single sector, which may affect the applicability of the results to other industries.

Oketch, Kilika, and Kinyua (2024) analyzed the effect of top management team cognitive independence on the performance of independent regulatory agencies in Kenya. The research employed structured questionnaires and utilized both descriptive and inferential statistical analyses. The study concluded that cognitive characteristics of the top management team significantly impact organizational performance. However, the lack of a comprehensive definition and elaboration of all cognitive characteristics presented limitations, indicating a need for further research to clarify these aspects.

METHODOLOGY

Research Design: This study adopted a descriptive and correlational research design. Descriptive research involves observing and describing the behavior of subjects, while correlational research aims to establish causal relationships between variables (Saunders et al., 2022).

Sampling And Sampling Technique: This study used census method to collect data which involved collecting data from all the banks. All licenced commercial banks were surveyed by the study. The study questionnaires were filled by the senior manager in charge of corporate affairs at each bank's headquarters, a risk compliance officer, a member of the internal audit team in each bank, the company secretary and three board members as well-defined group of individuals that were considered as the respondents . These respondents were choosen based on the presumed indepth knowledge of the subject matter at hand. From the 42 banks, 294 respondents were expected to participate in the study.

Research Instruments: Structured questionnaire was used as a primary data collection instrument in collecting information on the variables. The questionnaires was self- administered. According to Cooper and Schindler (2003), self-administered questionnaires are advantageous as they enable the researcher to contact participants who might otherwise be inaccessible.

Data Processing and Analysis: Before commencement of analysis, the completed questionnaires were edited to ensure completeness and consistency. The questionnaires were then coded and checked for any errors and omissions. Descriptive statistics were done to summarize the data in terms of percentages per item, minimum and maximum scores per item, mean and standard deviation. Inferential statistics involving correlation and regression analysis was done using Statistical Package for Social Sciences (SPSS) version 23(with path macro). The multiple linear regression model that was used to explain the relationship between the dependent and independent variables (direct effect) and took the form;

$$\mathbf{Y = \beta_{01} + \beta_1 X_1 + \varepsilon}$$ **………………………….. Equation 1**

Where,
Y represents competitive advantage
X_1 represents board independence
ε represents error component
β_0 represents Y-Intercepts(constant)
β_1 represents the model coefficient of the independent variable.

In order to test the mediating effect of Social Capital, the four-step regression method was used, following the approach initially proposed by Baron and Kenny (1986). The Hayes (2023) Process Macro Model 4 was employed to test the mediation hypothesis. The procedure outlined by MacKinnon (2023) was utilized for mediation analysis.

FINDINGS AND DISCUSSION

Descriptive Statistics of the Variables

This section illustrates descriptive findings and discussions based on the objectives of the study. The findings were presented in form of Mean and Standard Deviations. The responses were in line with a 5 Point Likert-Scale ranging from: - Strongly Disagree = 1, Disagree = 2 Neutral = 3, Agree = 4, and Strongly Agree = 5.

Board Independence

The study analyzed the views of the respondents in respect to Board Independence and competitive advantage. Table 1 shows the results of the analysis.

Table 1: Distribution of Responses for Board Independence on Competitive Advantage

Statements	N	SA (%)	A (%)	N (%)	D (%)	SD (%)	Min	Max	Mean	Std. Dev
The presence of an independent Chair is actioned in this bank on the Board to enhance the effectiveness of corporate governance practices.	234	43.2 (101)	52.6 (123)	3.4 (8)	0.4 (1)	0.4 (1)	1	5	4.38	0.618
This is one of the few banks that has promoted a non-executive Board chair to encourage impartial decision-making and accountability.	234	26.5(62)	59.4 (139)	11.1 (26)	2.1 (5)	0.9 (2)	1	5	4.09	0.730
The bank has always promoted a higher proportion of non-executive directors on the Board to contribute to better oversight of management actions.	234	31.2(73)	48.3 (113)	15.8 (37)	4.7 (11)	0	2	5	4.06	0.811
The inclusion of cross directors from other sectors enriches discussions with diverse viewpoints on industry challenges.	234	42.7(100)	50.4 (118)	6.4 (15)	0.4 (1)	0	2	5	4.35	0.620
The bank has a high number of overlapping board members across different organizations.	234	25.6 (60)	34.6 (81)	29.1 (68)	9.4 (22)	1.3 (3)	1	5	3.74	0.987

From Table 1 above, the findings show that the respondents agreed (Mean = 4.38; Std Dev =0.618) with the statement that the independent board chair is actioned by the bank. Respondents also agreed (Mean = 4.09; Std Dev =0.730) on the statement that the proportion of non-executive directors encourages impartiality. The findings further indicate (Mean = 4.21; Std Dev = .894) that majority of our board members sit on boards of multiple companies. In addition, respondents concurred (Mean = 4.06; Std Dev =0.811) that the Bank Board has adopted governance that promotes a higher percentage of non executive directors. Finally, the study

indicates that the respondents agreed (Mean = 3.74; Std Dev =0.987) that the Bank has an overlapping board membership with other organizations. These findings are supported by a research by Oketch, Kilika and Kinyua (2020) who conducted a study on the effect of top management team cognitive characteristics on performance of independent regulatory agencies in Kenya. From their research, the study concluded that top management team's cognitive characteristics significantly affect organizational performance of the independent regulatory agencies.

Social Capital

The study further sought to determine the respondents' level of agreement with the various statements on Social Capital. Table 2 shows the findings.

Table 2: Distribution of responses for Social Capital

Statements.	N	SA (%)	A (%)	N (%)	D (%)	SD (%)	Min	Max	Mean	Std. Dev
The bank has one of the largest network sizes which enhances the bank's access to diverse resources and opportunities.	234	65.0 (152)	20.1 (47)	6.8 (16)	6.0 (14)	2.1 (5)	1	5	4.40	0.998
The bank has a 100% compliance to social norms within the banking industry on a regular basis to strengthen the bank's social reputation.	234	54.7 (128)	38.5 (90)	6.0 (14)	0.9 (2)	0	2	5	4.47	0.649
The bank has high levels of trust within its social network as noted from operational data and this positively influence collaboration and cooperation.	234	62.4 (146)	27.8 (65)	7.7 (18)	2.1 (5)	0	2	5	4.54	0.700
There are mechanisms within the bank for maintaining regular communication within the bank's social network that fosters knowledge sharing and mutual support.	234	60.7 (142)	32.1 (75)	5.6 (13)	1.7 (4)	0	2	5	4.43	0.605
The frequency of reciprocal actions is monitored and evaluated frequently within the network as it contributes to a sustainable cycle of support and reciprocity.	234	49.6 (116)	31.6 (74)	7.3 (17)	7.3 (17)	4.3 (10)	2	5	4.40	0.681

The results in Table 2 indicate that respondents strongly agreed (Mean = 4.40; Std Dev = 0.998) with the statement that the bank has one of the highest networks that enhances its access to resources.

Competitive Advantage

The study also sought to determine the respondent's level of agreement with statements on competitive advantage of Kenyan banks. Table 3 shows the findings.

Table 3: Descriptive statistics for Competitive Advantage

Statements.	N	SA (%)	A (%)	N (%)	D (%)	SD (%)	Min	Max	Mean	Std. Dev
The superior quality of our products/services as reported in industry surveys gives us a distinct edge over competitors in the market.	234	64.1 (150)	29.1 (68)	5.6 (13)	1.3 (3)	0	2	5	4.56	0.661
Our cost/pricing strategy allows us to offer competitive rates ensuring we are always profitable for the last 10 years.	234	59.0 (138)	30.3 (71)	6.4 (15)	4.3 (10)	0	2	5	4.44	0.796
Consistent product innovation ensures that we stay ahead in meeting evolving customer needs and preferences as indicated by consistent growing customer numbers in the last 10 years.	234	62.4 (146)	27.8 (65)	7.7 (18)	2.1 (5)	0	2	5	4.50	0.731
Our ability to rapidly offer solutions sets us apart, enabling us to address customer challenges in a timely manner which is why we operate in most towns that other banks don't operate.	234	60.7 (142)	32.1 (75)	5.6 (13)	1.7 (4)	0	2	5	4.52	0.682
Our wide geographical coverage enhances our reach and accessibility to over 80% of Kenya, giving us a competitive advantage.	234	49.6 (116)	31.6 (74)	7.3 (17)	7.3 (17)	4.3 (10)	1	5	4.15	1.107

From Table 3 above, the findings show that the respondents strongly agreed (Mean = 4.56; Std Dev =.661) with the statement that the bank offers the highest quality of products gives it distinct edge over competitors. Respondents also strongly agreed (Mean = 4.44; Std Dev =0.796) on the statement that the low bank charges have enabled the bank to be highly profitable over the last ten years. The findings further indicate (Mean = 4.50; Std Dev = .731) that the bank offers the most innovative products amongst banks in Kenya. In addition, respondents concurred with (Mean = 4.52; Std Dev =.682) that the bank offers rapid banking solutions to customers in Kenya. Finally, the study indicates that the respondents agreed (Mean = 4.15; Std Dev = 1.107) that the bank has invested in a wide reliable distribution network.

Reliability Test Results

This study assessed the internal consistency of the research questionnaire. The results of analysis are shown in Table 4.

Table 4: Reliability of the Research Questionnaire

Variables	Cronbach's Alpha	Test Items
Board Independence	0.814	5
Social Capital	0.857	5
Competitive Advantage	0.907	5

The results in Table 4 indicated that competitive advantage had the highest Cronbach's alpha coefficient (0.907), with 5 test items. Social capital had the second highest Cronbach's alpha coefficient (0.857), with 5 test items. Board Independence had the third highest Cronbach's alpha coefficient (0.814), with 5 test items. This implies that the research questionnaire met the reliability threshold as all the three constructs had Cronbach's alpha coefficients greater than 0.7.

Correlation between variables is a measure of how the variables are related (Johnson & Lee, 2023). The bivariate Pearson correlation indicates whether a statistically significant linear relationship exists between two continuous variables. If the correlation is positive, it means both variables are moving in the same direction. A negative correlation implies that when one variable increases, the other variable decreases (Chen & Patel, 2023). The correlation results are depicted in Table 5.

Table 5: Correlation results

		CA	BI	SC
CA	Pearson Correlation	1		
	Sig. (2-tailed)			
BI	Pearson Correlation	.574**	1	
	Sig. (2-tailed)	.000		
SC	Pearson Correlation	0.708**	.0.569**	1
	Sig. (2-tailed)	.000	.000	
	N	**227**	**227**	**227**

Where; CA- Competitive Advantage**, BI-** Board Independence**, SC-** Social Capital.

Table 5 shows that the correlation coefficients between the independent and dependent variables ranged between 0.574 for board independence (p=0.000) and 0.708 for social capital (p=0.000). The results from Table 4.5 indicate that there is a positive and statistically significant correlation between Board Independence and Competitive Advantage (r=0.574, p=0.000) at the 0.01 level of significance. This implies that board independence moderately correlates with the competitive advantage of commercial banks in Kenya. The findings of this study align with recent research by Karanja and Otieno (2023), who investigated the impact of board independence on the competitive advantage of commercial banks in Kenya. The results in Table 4.5 also indicate a positive and statistically significant strong correlation between social capital and competitive advantage (r=0.708, p=0.000) at the 0.01 level of significance. This implies that social capital has a strong correlation with the competitive advantage of commercial banks in Kenya.

Analysis of Variance (ANOVA) for the Regression Models

ANOVA tests whether the regression model is generally a good fit for the data. It is also known as the test for goodness fit. From the study, one ANOVA test was performed; for the independent variable. The results obtained are presented in Table 6.

Table 6: ANOVA of the Variable

Model		Sum of squares	df	Mean square	F	Sig.
1	**Regression**	125.551	1	31.838	105.338	0.000
	Residual	62.636	225	0.282		
	Total	188.186	226			

a. Dependent variable: Competitive advantage

b. Predictors (constant). Board independence.

The Table 6 shows ANOVA output for the effect of board independence on competitive advantage. ANOVA results gave F statistic of 105.338 and a p value of 0.000. The p-value obtained is less than 0.05 which is a clear indication that board independence significantly predicts competitive advantage of commercial banks in Kenya. This demonstrates that the regression model 1 is statistically significant at 95% level of significance considering that the p- values were less than 0.05. It is evident that the independent variable significantly predict the dependent variable, which depicts a goodness of fit of the regression model for the data.

Regression Models

Multiple regression analysis was conducted in order to determine the relationship between Competitive advantage and independent variable (Board Independence).

OLS Model for independent variable (Board Independence) and competitive advantage is:

Competitive Advantage = 0.009 + 0.152(Board Independence) ……**Eq 2**

Test of significance of the regression coefficients

Table 7 shows the regression coefficients of the variables and their significance.

Table 7: Significance of regression coefficients

Model		Unstandardized Coefficients		Standardized Coefficents		
		B	**Std. Error**	**Beta**	**t**	**sig**
1	**(Constant)**	.009	.035		.263	.793
	Board Independence	.152	.046	.160	3.287	.000

a. Dependent Variable: Competitive advantage

Table 4.7 indicates that the relationship between Board Independence and Competitive Advantage was positive and statistically significant ($\beta = 0.152$, $t=3.287$, $p = 0.001$). The β value of 0.152 implies for every unit change in Board Independence, competitive advantage changes by 0.152. The null hypothesis that states that Board Independence has no significant effect on Competitive Advantage was rejected at 0.05 significance level. The study therefore concludes that Board Independence has a statistically significant effect on Competitive Advantage of Commercial banks in Kenya.

Mediating Effect of Social Capital on the relationship between board independence and competitive advantage

Table 8 shows the results of the relationship between direct effect of board independence on competitive advantage on one hand, total effect of board independence in the presence of the mediator and consequently the effect of social capital as a mediator (indirect effect on the relationship between board independence and competitive advantage).

Table 8: Effect of Board Independence on Competitive Advantage

Direct Effect of Board Independence on Competitive Advantage						
	Effect	se	t	p	LLCI	ULCI
Model 1	.220	.051	4.297	.000	.119	.321

Total Effect of Board Independence on Competitive Advantage in the Presence of Social Capital					
Effect	se	t	p	LLCI	ULCI
Model 2	**.536**	.052	10.263	.000	.433	.639

Mediating (Indirect Effect) of Social Capital on the Relationship between Board Independence and Competitive Advantage				
Effect	BootSE	BootLLCI	BootULCI	
Social capital	.316	.042	.236	.402

The results of multiple regression analysis using Hayes (2022) PROCESS Macro version 4.0, as shown in Table 8 from the data without outliers, found that board independence had a significant direct effect on competitive advantage with β = .220, t = 4.297 (p = .000). The total effect using the data without outliers (direct + indirect effect) = .536, implying that the two paths contribute to the total effect, hence giving rise to a partial mediation. Finally, applying Zhao et al. (2022) steps discussed previously on mediation to the present study findings, the study found the mean indirect effect from the bias-corrected percentile bootstrap analysis as positive and significant from the data M = .316, SE = .042, 95% CI = [.236, .402], which was significant with both CI being non-zero. From the above results, there is evidence that the confidence intervals for the indirect effect do not straddle a zero in between, which supports the presence of a mediation effect (Memon, Cheah, Ramayah, Ting, & Chuah, 2022). Hence, the study concludes that social capital mediates the relationship between board independence and competitive advantage.

Hypotheses Testing

In this study, t-test was used to test for individual significance of the coefficients under the null hypothesis for the direct effects. The test was done at 95% level of confidence (α=0.05), critical value t=1.96. The null hypothesis was rejected when the t-calculated was strictly greater than the t-tabulated. Mediating effect was determined using the upper and lower confidence intervals (LLCI and ULLC). For mediating effect to be significant, the mediating effect coefficient should be non zero (should not straddle the zero point).
The results of hypothesis testing were as follows:

H_0:Social capital has no mediating effect on the relationship between Board Independence and Competitive Advantage of Commercial Banks in Kenya.

The test was done at 95% level of confidence (α=0.05), critical value t=1.96. T-test statistic was used to test for the significance of ***Board Independence***. From **Model 1** in Table 4.8, the t -value obtained was greater than 1.96 hence the study concludes that Board Independence has significant effect on competitive advantage of commercial banks in Kenya; the study found the mean indirect effect from the bias-corrected percentile bias bootstrap analysis as positive and significant from the data M= **.316**, SE =.042, 95% CI= [.236,.402] which was significant with both CI being none zero. From the above results, there is evidence that the confidence intervals for the indirect effect does not straddle a zero in between, which supports the presence of mediation effect hence **Hypothesis H0** is rejected by the study.

CONCLUSIONS AND RECOMMENDATIONS

The objective of the study was to determine the relationship between board independence and competitive advantage on one hand, and the effect of social capital as a mediator on this relationship on the other hand. The study found that board independence has a positive significant relationship with competitive advantage. The study also concludes that social capital has a significant mediating effect on the relationship between board independence and competitive advantage.

The study found that board independence has a positive significant relationship with competitive advantage. The study also concludes that social capital has a significant mediating effect on the relationship between board independence and competitive advantage. The study recommends that commercial banks should simultaneously ensure it puts in place independent boards that has significant social capital if they are to achieve substantial competitive advantage.

Suggested Areas for Further Research:

The study assessed the mediating effect social capital on the relationship between board independence and competitive advantage of commercial banks in Kenya. However, other sectors such as insurance, education, mining, healthcare, security were not studied. This limits generalization of study findings to these important sectors. Other studies are thus recommended in order to supplement the findings of this study and provide a corroboration of the findings of this study. The study did not include microfinance banks. Therefore, it is recommended that other studies delve into this. The study examined social capital as a mediator on the relationship between board independence and competitive advantage of commercial banks in Kenya. It is recommended that another study be carried out to find out the moderating effect of social capital on the relationship between board independence and competitive advantage.

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