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THE INFLUENCE OF BOARD STRUCTURE ON PERFORMANCE OF COMPANIES LISTED AT THE NAIROBI SECURITIES EXCHANGE

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Abstract

Boardroom squabbles and business failures have been witnessed throughout the world on the corporate stage. Kenya has not been immune to the surge in corporate scandals and bankruptcy that has been sweeping the world. Essentially, the idea is that a governance problem is actually a crisis on the part of the board of directors. The bulk of these companies have failed due to a fall in shareholder value, which has been has got blame on the board of directors. The study's goal was to see how the board structure affected the performance of companies traded at the Nairobi Security Exchange. For this investigation, both primary and secondary data were acquired. The information gathered from the respondents was gathered through the use of a structured questionnaire. In addition, information was gathered from publicly available financial statements and reports for NSE-listed companies as of December 2019. simple linear regression analysis was employed to evaluate the hypothesis. The findings revealed that board structure of companies listed on the NSE has a direct and significant influence on the performance of those companies. This work has made a contribution to the agency theory and a better comprehension of the performance of companies listed on the NSE, and it has served as a reference for subsequent research. It is recommended that replication of this study should be done in other contexts like state corporations and the results be compared for generalization purposes as well as policy formulations. Future research should also focus on longitudinal approaches, this is more likely to provide additional insights into the dynamic aspects of the board structure and firms' performance than cross-sectional studies.

Key Words: Board Structure, Performance, Nairobi Securities Exchange

Introduction

The board structure of an organization has a beneficial influence on the success of the company; as a result, companies must choose which sort of board structure is ideal for their particular firm. Within the company, insiders who must be overseen by the board are common. Additionally, the selecting outside persons to serve on the board is selected or guided by inner management. The board chairman serves as the company's president and chief executive officer (Denis & MConnell, 2003). The board size, the ratio of external directors from within, the existence of multiple CEOs, and the presence of several board committees all contribute to the board's structure. Contemporary researchers have focused on understanding how board structure, as an indication of corporate governance, affects business growth. The premise is founded on the notion that corporate governance has the potential to influence firm performance. It also acknowledges structured boards' contributions to shareholder value maximization, capital generation, investor rights protection, and company success.

Excellent firm performance maintains the organization afloat and improves the company's strategy for the future (Hoskisson et al., 1994). The efficiency, effectiveness, financial viability, and significance of an institution are all factors in its performance. According to the NSE report (2019), company performance has been beset by problems, with the performance of numerous asset classes exhibiting a significant link with developing global macro-economic issues characterized by heightened political and economic changes. While the firms follow the Capital Markets Authority's (CMA) broad governance requirements, how each company implements these general principles may have a distinct impact on its success. Mandala (2018) argues under the management-owner conflict model that agency conflict is frequently represented in management's self-interest. This study's conceptualization is supported by Agency theory (Jensen & Meckling, 1976). The agency conflict is the main paradigm of the agency theory, which is an anchoring theory in this study. It is based on the association amongst the business's owner and the managers who runs the firm on behalf of the principle.

Literature Review

This paper reviewed literature on board structure and firm performance. the review captured both theoretical and empirical reviews.

Board Structure

The internal pattern of connections, power, and communications at the board level of a company is referred to as the organization's board structure (Mandala, 2018). According to Chandler (1962) board structure is a formal facet of a framework indicating a specific, impersonal activities, rules and authority relationships. Darko, Aribi and Uzonwanne (2016) sees board structure not only as a unit but also a wide dimension including arrangements at institutional level, cultural and legal phenomenon determining what is achieved under whose mandate, controls and managing involved risks. The

components that determine how boards are created include board composition, board tenure, board size, board diversity, audit committees, CEO duality, and multiple directorships. The size of an organization's board significantly impacts its effectiveness (Yermack, 1996; Hermalin & Weisbach, 2001).

According to Fauzi and Locke (2012), in order for performance to be realized, the board structure must be aligned with and complementary to external governance mechanisms. This instills trust in shareholders, allowing them to dedicate their resources and energy to financing the firm's operations. As a result, through the board structure, company activities may be held responsible, fair, and transparent, potentially leading to improved firm performance (Kolk, 2003). This study operationalized board structure by board size, multiple directorships, audit committees, and CEO duality.

Firm Performance

Firm performance refers to whether organizational resources are being used to achieve the corporate objectives. According to Ricardo and Warde (2001), performance is a firm's capacity to utilize strengths, overcome weaknesses, neutralize threats, and seize opportunities. The term "performance" relates to the activity, the result of the effort, and the success of the output in comparison to some standard (Neely, 2004). As a result, performance may be defined as a combination of characteristics that explain the process of creating different types of outcomes (Kaplan & Norton, 1992). According to Awino et al.

(2011) combination of different measures of performance by a firm is an effective way of measuring overall performance.

Awino (2011) argues that for old financial measures to be relevant and valid there must be a balance with contemporary, intangible measures related to external orientation. The current study therefore takes into consideration the performance aspect as an important goal of any organization with the presumption that better corporate governance practices may influence firm performance. This research operationalizes business performance to incorporate non-financial viewpoint; customer service, internal business process, learning and development, company social obligation and environmental. Financial metric is gross return on assets (ROA).

Relationship Between Board Structure and Firm Performance

The nature of board influences performance of firms in different ways. Board size impacts corporate performance in two ways: First, a large board provides access to a wide range of experience and connections to the external environment; and second, a large board size slows down the decision-making process. There is a trade-off between these two competing aspects of the influence of boards structure on company performances. The process of reorganizing shareholding has favorable performance repercussions since it is a reasonable choice made by the company's owners to align the quantity of their stock holdings with the company's strategy (Thomsen & Pedersen, 2000). Kirkpatrick (2009) established that boards are given higher roles in forging a way to

make sure that firms perform with the expectations given to them by the owners and all the people with stakes in the firm. According to Adams et al. (2010) boards affirms that the right direction is achieved to enhance and also ensures the returns of shareholders is achieved with overall expected performance achieved as planned in the objectives and also according to the goals. This thus calls for skilled directors for the share like market and returns to shareholders to be achieved.

According to Gurusamy (2017), sizes of the boards have significant and positive association with both financial performance metrics (ROA and ROE), but had an inverse and negligible association with Tobin's Q for manufacturing businesses registered on the Bombay Stock Exchange. Carpenter and Westphal (2001) contended that decisions making lies mostly on individual's qualifications which means that if individuals on the board are qualified or well experienced, they are likely to implement well the monitoring role. Board composition, according to Hermalin and Weisbach (2001) has no relationship with company success, while board size has a negative relation to corporate performance. Mang'unyi (2011) found a difference significantly concerning governance structure and performance aspects within banks in kenya with recommendations that promotion of governance issues at corporate level is key to investors attraction especially the potential ones to foster performance aspects. According to Kamaara et al. (2013) the structure of the board of directors and the performance of Commercial State Corporations in Kenya, was shown to be a significant predictor of performance. Apart from the independent impact of board research specialty on dividends yields. Letting et al. (2012) established that board diversity had a statistically non-significant influence on financial performances. Manini and Abdillahi (2015) discovered that the size of the audit committee, diversity linked with gender, and the amount of capital in the bank had no significant impact on, or rather affect, earnings for Kenyan commercial banks.

Research Methodology

This study was quantitative, thus was anchored on the positivist philosophy approach. Positivism allows quantitative analysis as well as testing of hypotheses. The research design used in this study was a descriptive cross-sectional one. The research looked at all 66 firms that traded on the NSE throughout the time period of the study. The research was founded on both primary and secondary data. Primary data was gathered using structured questionnaires, while secondary data (return on assets -ROA) was gathered from financial reports of participating companies. To investigate the existence of a direct association between board structures and business performances amongst firms listed on the NSE, a simple linear regression analysis was performed. Correlations, P-values, R2, the F test, and the t test were all used to analyze the data.

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Results

Principal component analysis was used in measuring and extracting factors Principal component was utilized in measuring and extracting those factors in clear measurement criteria in the investigation. The objective was to condense large data into fewer and meaningful factors. Factor extraction was based on Eigen $\geq$ 1. the Results are presented in Tables 1 and 2.

Table 1: Total Variance Explained for Board Structure

Component	Initial Eigenvalues			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
Board Size	14.449	57.794	57.794	6.049	24.197	24.197
CEO Duality	1.574	6.295	64.089	5.875	23.501	47.699
Multiple Directorship	1.39	5.561	69.65	4.248	16.991	64.689
Audit Committees	1.315	5.258	74.908	2.555	10.219	74.908
Board Composition	1.267	4.675	79.583	2.326	9.875	79.583

Extraction Method: Principal Component Analysis.

As shown in Table 1, board structure was reduced into four factors using eigen value>1. The five factors accounted for 79.583 percent cumulative variance. Five factors were board size, CEO Duality, multiple directorship, audit committees and board composition.

Table 2: Total Variance Explained for Firm Performance.

Component	Initial Eigenvalues			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
Customer Focus	3.005	44.843	44.843	7.342	25.316	25.316
Internal Process	2.898	9.992	54.835	4.162	14.351	39.667
Learning and Growth	2.236	7.792	62.626	3.376	11.64	51.307
Social	1.829	6.307	68.934	2.788	9.615	60.922
Environmental	1.201	4.141	73.075	2.559	8.826	69.747

Extraction Method: Principal Component Analysis.

As shown in Table 2, non-financial performance was reduced into five factors using eigen value>1. The five factors accounted for 73.075 percent cumulative variance. Five factors were; internal process, environmental, learning and growth, customer focus and social.

Hypothesis Testing

The study was founded on the hypotheses that;

H_{01}: Board structure has no significant effect on performance among companies listed at NSE.

The tests were carried out with a 95% confidence level (=0.05). The results were interpreted using R^2 (goodness of fit), F-test (overall significance), t- test (individual significance) and p-values (reject or fail to reject Ho). The results that gave p-value<0.05 supported rejection of null hypothesis while results that gave p-value>0.05 led to failure to reject hypothesis.

Table 3: Relationship between Board structure and Non-Financial Performance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	F Change	df1	df2	Sig. F Change
					Change Statistics				
1	.471[a]	.222	.205	.78534	.222	13.146	1	46	.001

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8.108	1	8.108	13.146	.001[b]
	Residual	28.371	46	.617		
	Total	36.479	47			

Coefficients[a]

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.	95.0% Confidence Interval for B Lower Bound	Upper Bound
1	(Constant)	2.054	.577		3.562	.001	.893	3.215
	Board Structure	.587	.162	.471	3.626	.001	.261	.914

a. Dependent Variable: Non-Financial

b. Predictors: (Constant), Board Structure

The findings indicated that correlation coefficient between board structure and non-financial performance was R = 0.471. This means that board structure is moderately related with non-financial performance. Coefficient of determination R^2 = 0.22 shows that 22.2% of changes in non-financial performances are accounted for by the variations in board structure leaving 77.8 percent explained by factors not considered in this model. Analysis of variance (F = 13.146, P-value = 0.001<0.05) confirmed that the model is overall significant.

The results further indicated that board structure was statistically significant (β = 0.471, P-value = 0.001<0.05). Thus, the hypothesis that boards structures do not have significant effects on performances among companies listed at NSE was rejected. The predictive model of non-financial performance on board structure was of the form;

NFP = 2.054 + 0.471BS

Where NFP is Non-Financial Performance and BS is Board Structure

Table 4: Relationship between Board Structure and Financial Performance

					Change Statistics				
Model Summary									
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	F Change	df1	df2	Sig. F Change
1	.419[a]	.176	.158	1.03615	.176	9.808	1	46	.003

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	10.530	1	10.530	9.808	.003[b]
	Residual	49.386	46	1.074		
	Total	59.917	47			

Coefficients[a]								
		Unstandardized Coefficients		Standardized Coefficients			95.0% Confidence Interval for B	
Model		B	Std. Error	Beta	t	Sig.	Lower Bound	Upper Bound
1	(Constant)	.622	.761		.818	.418	-.909	2.154
	Board Structure	.669	.214	.419	3.132	.003	.239	1.100

a. Dependent Variable: Financial (ROA)

b. Predictors: (Constant), Board Structure

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The findings indicated that correlation coefficient between board structure and non-financial performance was R = 0.419. This means that board structure is moderately related with financial performance. Coefficient of determination R^2 = 0.176 shows that 17.6 per cent variations in financial performances are accounted for by the changes in board structure leaving 82.4 percent unexplained. Analysis of variance (F = 9.808, P-value = 0.003<0.05) confirmed that the model is overall significant.

The results further indicated that board structure was statistically significant (β = 0.419, P-value = 0.003<0.05). Thus, the hypothesis that board structure do not have significant impacts on business performances among companies at NSE was rejected. Beta coefficient for board structure suggest that for every one unit increase in boards structures, financial performances (ROA) of organizations traded at NSE increases by 0.419 units holding other factors constant. the predictive model of financial performance (ROA) on board structure was of the form;

FP (ROA)= 0.662 + 0.419 BS

Where FP is Financial Performance and BS is Board Structure

Conclusion

According to the findings, the board structure of firms traded at the Nairobi securities exchange has a direct and considerable impacts on their performances. The study adds to the agency theory by emphasizing the functions of board of directors who are entrusted by the shareholders to select and recruit managers who possess the required characteristics to manage and maximize shareholders' interest. The results further uphold that there is need to institute structural mechanisms and systems that check on the behaviour of the agent.

Recommendations

The study recommends that replication of this study should be done in other contexts like state corporations and the results be compared for generalization purposes as well as policy formulations. Future studies should hence concentrate on longitudinal techniques, despite the fact that they are expensive, complex, and time-consuming. Cross-sectional research are less likely to give new insights into the dynamic features of board composition and company performance. Although the current research focuses on a single informant, it is advised that numerous respondents from each business be used to produce more reliable data. Multiple responders from different departments (marketing, finance) and management levels might be selected.

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