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INFLUENCE OF BOARD SIZE ON THE FINANCIAL PERFORMANCE OF WATER COMPANIES UNDER LAKE VICTORIA SOUTH WATER SERVICES BOARD

Cherotich, M.,[1*] & Tibbs, C. Y.[2] Kirui, C.[3]

[1*] MBA (Finance) Scholar, School of Business, Kenyatta University [KU], Nairobi, Kenya
[2,3] Ph.D, Lecturer, Department of Business Administration, School of Business, Kenyatta University [KU], Kenya

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ABSTRACT

The interest and focus in the modern corporate governance practices, especially on matters accountability received much attention following the high-profile collapses of mega firms in the recent past due to accounting fraud. This study aimed at establishing the influence of board size on the financial performance of water companies under Lake Victoria South Water Services Board for the period 2011-2015. Causal study design and a census was preferred since the number of water companies in the nine urban based water service providers within the Lake Victoria South Water Services Board was few. Data was collected using questionnaires conveyed to the respondents through drop and pick technique and was analyzed through descriptive and inferential statistics. Regression analysis aided in the establishment of the relationship and variation between the study variables, and results presented in tables. The study established that there was a significant and positive relationship between board size and financial performance at 95% confidence level. The study recommended that water companies in Kenya should carefully consider the right size of their boards that would steer them to the realization of objectives while meeting the needs of various stakeholders and stabilized operations and performance of the firms.

Key Words: *Board Members, Board Executive, Non-executive, Financial Performance*

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INTRODUCTION

Academicians, regulators and governments will most likely focus on the corporate governance systems at the height of every financial crisis in order to increase the investors' confidence which will in turn attract investments. An effective corporate governance structure is one that promotes transparent as well as efficient markets, adheres to the rule of law and vividly stipulates the separation of responsibilities among the various regulatory, enforcement and supervisory authorities. Aguilera and Jack son (2010) stipulated that corporate governance helps in balancing the interests and responsibilities among all company's stakeholders. A corporate governance system refers to the set of structures and processes used to guide the firm's business.

The corporate governance system's core objective should be to strive to maximize shareholders' wealth. Bairathi (2009) expounded that corporate governance entails the management of an entity with a fair, efficient as well as a transparent administration aimed at achieving well-defined goals. In other words, corporate governance is a system which includes structures, operations and controls in an entity with an objective of attaining long term strategic goals to satisfy the various stakeholders including the shareholders, creditors, employees, suppliers and customers while abiding by the legal and regulatory dictates, and also meeting the local community and environmental needs. When executed under a good system, the corporate governance leads to the development of legal, commercial and institutional structures. In addition, it delineates the boundaries within which various corporate duties are handled. Good and working corporate governance systems in the underdeveloped and developing economies are crucial for the success of the local companies and foreign investors pursuing the great opportunities offered by such economies.

The Kenyan water sector has undergone major reforms in the bid to ensure that the service delivery is efficient and sustainable. These reforms resulted in the 2002 enactment of Water Act that introduced a new institutional structure and framework to govern water and sanitation operations in Kenya. The Act led to the establishment of the Water Services Regulatory Board (WASREB) that is mandated to set rules and enforce the necessary standards to guide the sector in ensuring that consumers are protected and efficiently, cost effectively as well as sustainably access services (Nyaboke, Arasa, & Ombui, 2013). This has seen the water services providers adopt the corporate governance guidelines. Some companies have been successful while in others, its implementation has been met with a lot of resistance.

According to Lee-Kuen, Sok-Gee, and Zainudin (2017) financial performance of an firm is exhibited using metrics such as the profits, earnings, and the appreciation in value of the share price. In addition, financial performance can be assessed by how well a corporation uses assets at its disposal in the course of the core business activities to generate revenues. Additionally, financial performance indicates the overall financial health of a firm over a given time period, and which can be used to compare it with the performance of firms in the same industry. In the corporate governance literature, performance is measured through accounting ratios that include the return on capital employed (ROCE), return on assets (ROA), and return on equity (ROE) (Yawson, 2006). Similarly, apart from solely relying on the accounting based methods, alternative approaches such as the economic value added approach are used to assess shareholders value by determining the profitability of an entity after the total cost of capital is accounted for. Other metrics used by a profit making organization to measure its financial performance are "capital adequacy, asset quality, management, earnings and liquidity" popularly called the CAMEL Model.

According to Bhagat and Bolton (2008) a sound corporate governance system cautions an entity from vulnerabilities to possible financial crisis. The argument has always been given that the a company's governance structure influences its ability to respond and address factors that may have an effect on its financial performance (Nicholson & Kiel, 2007). On this note, it is stated that well governed companies significantly post good performance and thus, good corporate governance remains crucial for financial performance of any firm. According to Nicholson and Kiel (2007), a well-functioning corporate governance structure acts as a cornerstone for investment attraction, raising finances and strengthen the base for a company's financial performance. The author further posited that a good corporate governance structure adds value to corporations through wider access to funds, reduced cost of capital, favorable financial performance as well as better treatment of all stakeholders.

Statement of the problem

Water is one of the basic needs and every household, especially those in the urban areas should be connected. Judging by its demand, one expects that the urban based water companies should be performing well financially but this is not the case. According to Carroll and Shabana (2010), studies done on corporate governance in organizations point to the conclusion that corporations that embrace good corporate governance practices outperformed those that do not. This has proved to be true especially in Kenya where we have seen recent corporate failures involving big companies like the collapse of Nakumatt supermarkets, the Nyaga stock brokers, Kenya railways, Uchumi supermarkets and the near collapse of Kenya airways. Most failures in companies are attributed to bad corporate governance system. The size of the board affect the performance of most entities as they guarantee a firm control on the top management without compromising on efficiency.

Good corporate governance structures are important to corporations as they enhance better performance (Campbell, 2007). Kamonjo (2014) study focused on corporate governance practices and their effects on Saccos' financial performance. Fredrick (2013) analysed the effect of corporate governance practices adoption on the financial performance of public sector related saccos located in Nairobi North District. Similar studies have been done by Ahmed (2010) on print media houses in Kenya, and Ngulumbu (2013) on listed companies on the Nairobi Securities Exchange. However, no studies on board size have been done focusing on private utility services, like water firms under Lake Victoria South Water Services Board (LVSWSB). Therefore, this study's focus was on the association between board size and financial performance of water firms under LVSWSB.

Objectives of the study

The aim of the study was to investigate the influence of board size on financial performance of water companies under Lake Victoria South Water Services Board.

Research hypothesis

Ho_1: There is no significant effect of board size on the financial performance of water companies under Lake Victoria South Water Services Board.

LITERATURE REVIEW

Theoretical review of literature

Stewardship theory

The theory can be traced to the field of psychology and sociology. A steward is the party that protects and maximizes the wealth of shareholders through the firm's performance. Stewards are the managers and company executives working for the owners to multiply their wealth and make profits. The theory stresses the role of the top managements as being stewards and, therefore, harmonizing their goals with the organizational goals. The managers are viewed as inherently seeking to do the right things to earn good profits and maximize shareholders' wealth. The executive and managers y do not necessarily commit themselves to work for their own interest, but because they have a strong feeling of duty to the firm. The theory further points out that the stewards get satisfied and motivated when they attain corporate goals and success. Stewardship theory also asserts that even when left alone, the managers act as responsible stewards of the resources under their control, which is the opposite of the agency theory that argues that managers may disregard shareholders' interest and instead act in their own self interests. It specifies some mechanisms to reduce agency loss such as tying executive compensation, benefits and managers' incentive schemes to the company's performance to align their financial interests and motivate them to perform better (Jaskiewicz, & Klein, 2007).

This theory clearly outlines the views and goals of a steward to those of the water companies at large. In so doing, the desires of the steward acting for the institution are not hindered resulting to empowering and offering maximum independence that is built on trust. This in return would enhance the water companies' financial and operational performance.

Empirical review of literature

Haniffa and Hudaib (2006) noted that there is no ideal board size but it should be an odd number to avoid a stalemate. According to Ketokivi and Mahoney (2017), among the duties of directors is to protect shareholders' interest. Maranga (2015)'s study focused on the effect of corporate governance on the financial performance of SMEs in Kenya as of December 2013 in Nairobi County. She looked at the board size, CEO duality, number of boards, size of sub-committees and age of the SME. The construct for performance measuring was the return on assets (ROA) ratio, and using descriptive research design. Her findings were that a positive link between corporate governance and financial performance existed among the selected SMEs and recommended that the government should provide incentives to help implement corporate governance system and financial monitoring of managers and boards subcommittees. Abdul Rahman and Haneem Mohamed Ali (2006) however, concluded that a smaller board size may be devoid of expertise, experience as well as wise decision that would otherwise be present in the case of more members.

Relating to the association between the board size and performance of a company, there are two different schools of thoughts. Muhammad (2018) noted that according to the first one, a smaller size of board contributes more towards the firm's success. The second school of thought according to Coles, Daniel and Naveen (2008) of is the view that a large board size improves an entity's performance. Given the complexity of business environment and the organizational culture, Pieper and Klein (2007) and Jaskiewicz and Klein (2007) noted that a large board size is good as it supports and advises the management more effectively as is has the capacity to gather much more information. In addition, a larger board is better since it has a wide range of expertise and diversity necessary for better decision making because it is difficult for an influential executive officer to dominate.

However, the supporters of the first school of thought such as Abor and Biekpe (2007) are of the opinion that a large board is linked to less effectiveness and may easily be controlled by the executive. In the case of a small board, the chance of free riding is reduced, and the accountability of every director is increased. Empirical studies such as one by Harford, Mansi and Maxwell (2012) focusing on the U.S. industrial firms established that the market values corporations with smaller boards as they appear to be highly profitable. The result from Coles, Daniel and Naveen (2008)'s study of small and midsize Finnish firms revealed a negative statistical relation between the board sizes and their profitability.

Theoretically and in general, García-Meca, Garcia-Sanchez and Martínez-Ferrero (2015) noted that the association between the size of the board and firm's performance remains inconclusive. In reference to the agency theory, larger board sizes may lead to increased managerial costs, which in turn adversely affects company's profitability (Yawson, 2006). The managerial costs will increase when the large board raises its expenses like the annual remuneration, bonuses and travel allowances among others. Consequently, this move by the board may lead to a surge in agency costs. De Andres and Vallelado (2008) added that the large size of board may affect its communication and coordination, and negatively affect firm's performance.

Using the resource dependence theory, the board size positively affects on financial performance. A large board may improve firms' financial performance as crucial resources that include finance and business contracts are more easily secured (Haniffa, & Hudaib, 2006). The case for larger boards was also supported by Yawson (2006) who noted that such firms could attract more qualified members, and who could improve decisions made. Also, larger boards may improve firm's performance as it can be used to establish effective board sub-committees. According to Ntim and Soobaroyen (2013a) large boards are also an indication that the various stakeholders are well represented in the board.

Empirical relationship between board size and firm financial performance

The number of studies focusing on the association between the size of the board and the financial performance in emerging economies are limited. The studies so far conducted from developing countries have given mixed results: positive, negative or no significant relationships. Using 347 Malaysian listed companies in their study, Haniffa and Hudaib (2006) established that the board size had a positive relationship with ROA. Jackling and Johl (2009)'s study found that Indian companies with large boards posted better performance since they had wider access to finances.

On contrary, Mashayekhi and Bazaz (2008) examined 240 Iranian companies for 2005 and 2006 and established that larger boards impacted negatively on the value of these firms. Specifically, large boards were associated with lower EPS ROE and ROA. Similar results were obtained by Sanda, Mikailu, and Garba (2010) who noted that larger boards in the 93 selected companies in the Nigerian stock market between 1996 and 1999 impacted negatively on their performance. In a study on 318 Chinese listed firms by Muhammad (2018) revealed that the board size was negatively related with ROE. Contrary to the above cases, a study by on 81 suspended listed firms in South Africa between 1999 and 2005 found no significant association between the board size and performance of these entities.

Conceptual framework

Independent Variables		Dependent Variables
Board size ▪ Number of board members ▪ Executive/ non-executive	→	**Financial Performance** ▪ Profits ▪ Total revenue

Figure 1: Conceptual Framework

Source: Researcher (2017)

METHODOLOGY

The study adopted a causal research design, which was aimed at exploring the relationships or cause and effect between variables of the phenomenon under study. According to Cooper and Schindler (2003) causal research design aims at learning how one variable leads to variations in another. Therefore, this design fitted this study as the researcher sought to establish and explain the association among variables. As noted by Ngechu

(2004) population refers to a set of people, households, group of things, elements and events that are being investigated. The target population of the study was 44 employees in the 9 companies under Lake Victoria South Water Services Board as at 30th June 2016. On sample size, the researcher used a census approach that required a survey to be done on all the members of a target population. The study obtained the data from the primary as well as the secondary sources. The primary data was obtained with the help of questionnaires. On data analysis, the study involved both quantitative and qualitative data. The financial performance of water companies for the period of review was analyzed using profitability measures.

RESULTS

From the results in Table 1, 86.6% of the respondents agreed that a smaller board size was associated with firm's financial success while 13.3% disagreed. 90% of the respondents agreed that a large board size was able to collect much more information useful for better firm's performance while 10% disagreed. 26.6% of the respondents agreed that a large board size improved the performance of a firm while 43.3% disagreed, 30% of the respondents were neutral.

Table 1: Board size

		Strongly Agree	Agree	Neutral	Disagree	Strongly disagree
1.	Large board supports and advices the management more effectively thus enhancing financial performance.	12 (40%)	7 (23.3%)	7 (23.3%)	4 (13.3%)	0
2.	Large board size is able to collect much more information useful for better firm's performance	10 (33.3%)	17 (56.7%)	3 (10%)	0	0
3.	Smaller board sizes greatly leads to the success of a firm	20 (66.7%)	6 (20.0%)	4 (13.3%)	0	0
4.	Larger boards bring forth a range of expertise necessary for better decisions and barring dominance by a powerful CEO, and in turn lead to better corporate performance	5 (16.7%)	11 (36.7%)	14 (46.7%)	0	0
5.	Large boards seem less effective and easily controlled by the CEO while smaller boards are more effective in reducing the opportunities for free riding by some board members and increase their participation in the decision–making process.	20 (66.7%)	3 (10.0%)	3 (10.0%)	4 (13.3%)	0
6.	A large board size improves the performance of a firm	4 (13.3%)	4 (13.3%)	9 (30.0%)	13 (43.3%)	0

Source: Field data (2017)

Inferential statistics

Under this sub-section, the study focused on the correlation analysis and regression analysis to establish the relationship between the study variables.

Relationship between board size and financial performance

Results in Table 2 showed the correlation between board size and financial performance of water companies under LVSWSB. The findings were of essence in answering the second objective, that was, to assess the effect of board size on financial performance of water companies under LVSWSB.

Table 2: Relationship between board size and financial performance

			Financial performance	Board size
Spearman's rho	Financial performance	Correlation Coefficient		
		Sig. (2-tailed)	1	
		N		
	Board size	Correlation Coefficient	.413**	
		Sig. (2-tailed)	.000	1
		N	44	

**. Correlation is significant at 0.01 level (2-tailed).

Source: Field data (2017)

Table 2 results indicated at 99% confidence level, a positive and significant association between board size and financial performance exists ($r=0.413$, $p=0.000$ and $p<0.01$). The results revealed that board size improved financial performance. Past studies' results findings supported this assertion that board size and financial performance are positively and significantly correlated (Jaskiewicz, & Klein, 2007).

Regression analysis of board size and financial performance

Table 3 presented the model summary results where The R-Squired was 0.130 implying that 13% of the variability in financial performance of water firms was explained by the board size. Further results revealed that the correlation coefficient (r) was 0.360 (36%) implying that there was a positive relationship between board size and financial performance thus concurring with Jaskiewicz and Klein (2007) who established a positive interaction between board size and company's financial performance.

From the ANOVA regression results, it was established that the board size was significant ($F = 43.954$, $p=0.000$ as it is $<p=0.01$). These results also showed that the board size and financial performance had a satisfactory goodness of fit between them. Therefore, using the regression coefficients, the simple linear equation took the form: $Y=2.383+0.346X_3 +e$.

Table 3: Regression results of board size and financial performance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.360[a]	.130	.125	.65238

a. Predictors: (Chalevas), Board size

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	18.197	1	18.197	43.954	.000[b]
	Residual	42.896	42	.414		
	Total	61.093	43			

a. Dependent Variable: Financial performance

b. Predictors: (Chalevas), Board size

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Chalevas)	2.383	.276		8.550	.000
	Board size	.346	.077	.376	4.451	.000

a. Dependent Variable: Financial performance

Source: Field data (2017)

Beta of 0.346 implied that for each 0.346 units of board size use led to a corresponding 1 unit rise financial performance of water services firms under LVNWSB. It was also observed in Table 3 that the board size strategy was statistically significant ($p=0.000$ and $p<0.05$) in offering an explanation of financial performance of water firms. The study was consistent with Yawson (2006)'s studies that established that a positive and significant interaction existed between the board size and financial performance. The beta value was also important in testing the hypothesis, "HO_1: There is no significant effect of board size on financial performance". Since the beta value, $0.346 \neq 0$, and $p = 0.000 < 0.05$, this study rejected the hypothesis and made a conclusion that the board size and financial performance of water firms were positive and statistically significant.

CONCLUSION

The study aimed at examining the effect of board size on financial performance of water firms under LVSWSB and was guided by the null hypothesis, Ho1: There is no significant effect of board size on financial performance of water companies under LVSWSB. The results revealed that at 99% confidence interval, positive and significant relationship between board size and financial performance existed. These findings were further supported by regression analysis, where it was established that board composition predicted financial performance. Consequently, the study reject the null hypothesis since the beta coefficient was not zero, and at 95% confidence level concluded that that there was a positive and significant relationship between board size and financial performance. From the ANOVA regression results, it was established that the board size was significant.

This study concluded that board size and financial performance of firms under LVSWSB were significant and positively related.

RECOMMENDATIONS

On the basis of the findings and conclusion of this study, the research recommended that Water companies in Kenya should carefully consider the right size of their boards that would steer them to the realization of objectives while meeting the needs of various stakeholders.

Recommendations for further research

Further research can be done in the same area but data be collected for a longer period of time, which may be a five year period or a ten year period with an aim of testing if time can bring stability to the governance index. It was also suggested that a study can be done to determine firm level corporate governance in predicting the market value of private companies. Finally, a study can be done to compare corporate governance indices between developed and emerging markets.

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