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Influence of Board Attributes on the Performance of State Owned Enterprises in Kenya

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Abstract:

This study sought to assess the influence of board attributes on the performance of state owned enterprises in Kenya applying an integrated analytical framework. The population of the study was the 130 state owned enterprises that had participated in performance contracting over the five year period 2010 to 2015 in Kenya. A sample of 97 state owned corporation was selected. The main instrument of primary data collection was self-administered semi-structured questionnaire, administered on a stratified sample comprising senior managers. Secondary data was collected from the State Corporations Advisory Committee Secretariat as well as from company secretaries of selected corporations. Descriptive statistics of means and standard deviation of were calculated. Regression analysis established that board structure and board operating environment had statistically significant influence on performance of state owned enterprises in Kenya. However, board demographics did not statistically significantly influence performance of state owned enterprises. The study recommends that board attributes that support performance be adopted and considered in development of new codes for governance.

Keywords: Board attributes, board structure, board operating environment, board demographics, performance

1. Introduction

The board of directors, considered the most critical internal governance mechanism, has received increased interest in literature and is deemed to have the responsibility of monitoring and controlling the top management team (Hitt, Ireland & Hoskinsson, 2009). Board studies have largely been anchored on agency theory, stewardship theory, resource dependence theory, stakeholder theory, institutional theory (Namoga, 2011). The value of these theories in understanding the contribution of board of directors in corporate governance, specifically in attempting to provide explanations as to how board structure and board demographics influence board performance and ultimately the performance of organizations is important. Prior studies on boards have adopted two methodological approaches- direct and process approach (Namoga, 2011).

The direct approach assumes that key board attributes such as size and composition have a direct effect on performance of organizations (Daily & Dalton, 1994) while the process approach proffers the collection and analysis of data on board processes to improve understanding of what boards do and behave and not just how they should look (Balta, 2008, Namoga, 2011; Zahra & Peace, 1989).

There is a prevailing assumption that effective board role is a requirement for good organizational performance as it positively influences organization performance (Ongore, 2008; Kiel & Nicholson, 2003). Boards are generally viewed to perform three critical roles that include monitoring and control role, service role and strategic role (Zahra & Pearce, 1989) and these roles are anchored on the board theories (Maassen, 1999) and do actually overlap. The capacity of boards to perform their roles is likely to be influenced by board structure and board demographics as well as other factors such as how they utilize and manage information and stakeholders (Daily & Dalton, 1992; Fama & Jensen, 1983; Hermalin & Weisbach, 2003; Kiel & Nicholson, 2003).

Existing literature on corporate governance and performance studies has mainly relied on accounting - based financial indicators, market based indicators or a combination of both. Van Ness, Miesing and Kang (2009) in a meta-analytical review found that corporate performance has largely been measured using one category of measurement such as accounting, market or Tobin's q and that an application of two or three measures was seldom. In SOEs studies, performance may be best captured by examination of efficiency and effectiveness indicators (Ochieng, 2016).

1.1. Statement of the Problem Statement

State owned enterprises contribute significantly to the Kenyan economy in terms of not only offering products and service to the citizens of Kenya but also by offering employment (Koigi, 2011). These enterprises account for about 20% of the wage employment in the public sector (Kenya National Bureau of Statistics, 2006) and approximately 11% of the Kenya's GDP (Centre for Governance and Development, 2005). Despite these critical investments, the state of governance of state owned enterprises and their performance has been decried as suboptimal (Mwaura, 2007; World Bank, 2007) and persistent calls have been made to reform the corporate governance regime of Kenyan state owned corporations (Kisero, 2012).

1.2. Research Questions

- To find out the influence of board structure on performance of State Owned Enterprises (SOEs) in Kenya
- To establish the influence of board operating environment on the performance of State Owned Enterprises (SOEs) in Kenya
- To determine the influence of board demographics on performance of State Owned Enterprises (SOEs) in Kenya

2. Literature Review

2.1. Theoretical Review

The stewardship theory view directors as the stewards of the organizations and acting in the best interest of the owners. Its underlying assumption is that managers are good stewards of the firm (Donaldson, 1990; Barney, 1991). The steward theory thus focuses on mutual trust between the principals and steward and has implications on the managerial control systems, especially with regards to information sharing mechanisms to address the information asymmetry problem. Bathula (2008) links superior performance of a firm to having more inside directors as they understand the firm better than outsiders and can thus make superior decisions. This argument is also supported by Kiel and Nicholson (2003) who contend that having a majority inside directors makes decision making efficient and effective. Stewardship perspective argues that there is no motivational problem on the side of management and that governance structure should be designed to facilitate high organizational performance rather than bonding management to corporate and shareholder interests (Donaldson & Davis, 1991).

Proponents of steward theory therefore contend that situations where the chief executive officer and the chairman of the board are the same, facilitates a better working environment for management with less complex structure and monitoring routines, and ultimately improved performance. This theory is therefore relevant to this study, applied in a liberalist perspective in defining the roles of the boards in a normative manner based on the assumption that the directors who have delegated authority exercise stewardship and that the operating environment is created and enhanced in such a manner that there is extrinsic motivation.

2.2. Empirical Review

The board plays a major role in protecting the interests of the shareholders/owners of an organization (Fama & Jensen, 1983). The board is ordinarily elected by the owners to act on their behalf and in turn monitors the top management and ratifies key decisions. The structure of the board of directors, which includes board leadership, board composition and board size in delivering the above role, is recognized especially in agency theory. The focus on board leadership has been on CEO duality, where the CEO is the Chairperson of the board as well as the separation between the duties of chairperson and CEO. As demonstrated in the review of the corporate governance theories, there are varying arguments on the same depending on the underpinning theory- agency theory, stakeholder theory, resource dependency theory, stewardship theory.

According to OECD (2015) board of directors do need relevant and timely information for them to play their role effectively and thus contribute significantly to the performance of organization. Information access capability vary amongst board members depending on whether the board members are independent or not; and also between the board members and the organization's managers. Contribution may be enhanced through provision of access to information by improving access to key managers within the organization. Environmental impact to the success of board of directors has been acknowledged to have significance (Keramati. et.al. 2016). Notably, environment varies by the extent of unpredictability and unexpected change (Mbo, 2017) and as such the information uncertainty and resource dependence are critical considerations. The process of perceiving and interpreting information from the environment sources is deemed complex and uncertain (Ludvigsen, 2010) and the decision makers background do affect impact the direction that the organizations strategically takes. This necessitates the case for co-alignment between the environmental dimensions and strategic orientations

Demographics are considered in the context of diversity. In the view of stakeholder theory, the demographics should be wide enough to accommodate different stakeholders' interests adequately. However, such diversity must be tempered with the shareholders interest. Prior studies on demographics have yielded inconsistent results (Balta, 2008; Ongore, 2008) owing to examination of different characteristics and application of varying measures of performance. Recently there has been increasing interest in gender equality in organizational life (Namoga, 2011) but evidence to support the effects of women participation in boards is limited.

Strategic role of the board assumes that the boards are critical in providing guidance to management in formulation and implementation of strategies (Mulili, 2012) by applying their professional expertise throughout the strategy decision making process (Koech, 2018). In this case boards are expected to review, evaluate and analyze propose changes to strategies (Zahra & Pearce, 1989) applying their broad range of experience (Kiel & Nicholson, 2003). The strategic activities of boards are best captured by Zahra and Pearce (1989) as: provision of advice to the CEO and management; refinement of strategic plans; initiation of own analysis or suggestions for alternatives; probing of managerial assumptions about the organization and environment; and ensuring alignment on strategic direction.

3. Methodology

The study utilized descriptive cross sectional survey design. Cross sectional design takes a snapshot of a population at a point in time and thus allowing conclusions about phenomena across a wide population to be drawn through data collection and testing of relationships (Cooper & Schindler, 2010). According to the report of the Taskforce on Corporations Reforms (2013) the actual number of state owned enterprises is 187. The Taskforce recommended reclassification of the state owned enterprises into five categories namely purely commercial agencies, agencies with strategic function, regulatory agencies, executive agencies and research institutions, public universities, tertiary education and training. This study target population was 130 state owned enterprises that were in existence for a period of at least five years prior to 2012 and had participated in the performance contracting exercise (Office of the Prime Minister, 2012). Applying Krejcie and Morgan formula the sample size was 97 corporations. The study applied stratified sampling to establish the number of respondents in each class. Krejcie and Morgan (1970) formulae as follows:

$$S = \frac{X^2NP(1 - P)}{d^2(N - 1) + X^2P(1 - P)}$$

Where S = required sample size

X^2 = the table value of chi-square for 1 degree of freedom at the desired confidence level (3.841).

N = the population Size

E= precision level at 0.05

N= sample proportion of success

P= the population proportion (assumed to be .50 since this would provide the maximum sample size).

d= the degree of accuracy expressed as a proportion (.05).

Category	Sampling Frame	Sample
Public Universities	7	5
Training and Research Corporations	11	8
Service Corporations	22	17
Tertiary Education and Training Corporations	6	4
Regulatory	29	21
Commercial /Manufacturing	33	25
Financial	22	17
Total	130	97

Table 1: Sample Size

3.1. Data Collection Procedure

The study utilized both primary and secondary data. Primary data based on issues derived from review of extant literature as well interviews with experts, was collected using a semi structured questionnaire. The questionnaire was structured to gather the following: general information regarding the state enterprises, the board structure, board demographics, board role, and board operating environment, as well as institution's performance. Data collected was sorted, coded then entered and analyzed using IBM Statistical Package for the Social Sciences (SPSS) version 23.

4. Findings and Discussions

The data that was analyzed in this study was received from 61(81%) of the targeted 97 organizations hence considered an effective response rate. The response rate compares favorably with similar studies on organization performance. Koech (2018), Letting (2011) and Ongore (2008) achieved a response rate of 70 percent, 85 percent and 87.5 percent respectively. The study indicated that majority of the state owned corporations that is 37.7% were established over 50 years ago, 31.1% of the corporations were established between 41 to 50 years ago, 14.8% of the corporations were established between 31to 40 years ago, 9.8% of the corporations were established between 21 to 30 years ago and lastly, 6.6% of the corporations were established less than 20 years ago. The study also revealed that 39.3% of the responding state corporations were commercial/manufacturing, 21.3% were service corporations, 19.7% were regulatory services, 16.4% were financial and

lastly 3.3% were public universities.

4.1. Descriptive Statistics

4.1.1. Board Structure

The minimum board size of the state owned enterprises was 5 while the maximum board size was 14. The total number of the board members was 626. The findings indicate that the average number of board members was 10 which is slightly higher than the recommended number of 9 board members as per the State Advisory Committee (2015) Code of Good Governance popularly known as Mwongozo. The findings revealed that the number of executive directors from all the state owned enterprises were 121 (19.33%). The minimum number of the executive directors was 1 and the maximum number was 3. The average number of executive board members was 2. The findings revealed that the total number of external board members categorized as independent was 176 (28.12%) in the 61 state owned enterprises. The minimum number of board members categorized as independent was 2 and the maximum number of board members categorized as board independent was 5. The findings indicate that a total of 151(24.12%) of the board members had served as politicians before. The minimum number of board members who had served as politicians in state owned enterprises was 1 and the maximum number was 4. In terms of interlocking directors, the study established that the minimum number of directors who sit in more than one board is 1 and the maximum number of directors who sit in more than one board are 4. The total number of board of directors who sit in more than one board in all the state-owned enterprises are 153 (24.44%). Therefore, on average close to 3 board members sit in more than one board.

4.1.2. Board Operating Environment

A Likert scale was used to establish the influence of board operating environment on performance of the state corporations in Kenya. With regard to board culture, the study found out that board meetings and the board members respect each other views (mean = 4.00 and SD = 0.641). Most meetings were held in a timely manner (mean = 3.96 and SD = 0.577) and that new members were taken through an induction on procedures and rules of the board (mean =3.98 and SD = 0.78). In terms of keeping time in full board and committee meetings, the findings were positive (mean = 3.94 and SD = 0.898). The study revealed that board chairman dominated board meetings (mean = 3.79 and SD = 0.898); the board members received the annual calendar of events for the board (mean = 4.20 and SD = 0.78) as well as monthly briefings from management regarding matters that are important to the organization performance (mean =4.13 and SD = 0.857)

In terms of the formal independence of the board, the study established that organizations had a clear governance structure (mean = 4.03 and S.D = 0.721) and most board members had not been employed by the organization within the last five years (mean= 4.09 and SD = 0.433). The board members accessed the organization database with ease (mean= 4.17 and S.D = 0.61). Further, the board members declared conflict of interest where there was a possibility of such occurrence (mean=3.86 and SD = 0.821) and the fixed term of office for non-executive directors was observed (mean = 4.18 and SD = 0.76).

4.1.3. Board Demographics

The study examined data on board demographic characteristics including age, tenure, education background, gender diversity, public service background and political background. The study revealed that the age of most board members of the state corporations surveyed was between 40-50 years (37.3%). Followed by 23.6% of the board members were between 30-49 years, 25.1% of the board members were between 50- 60 years, 11% of the board members were between 60- 70 years, 1.9% were above 70 years and lastly, 1.1% were below 30 years.

In terms of gender diversity, the study established that the minimum number of women in the board was 2 and the maximum number of women in the board was 6. The total number of women in the board for all the 61 state corporations was 229. Therefore, 36.5% of all the board members of state owned enterprises were women. This is in conformity with the recommendation by the State Corporation Advisory Committee's Code of Governance for the threshold of having at least a third of either gender included in the board of public entities.

The results on education background indicate that only a paltry 7.7 % of the board members had PhD qualifications with most board members 58.0% having at least a Bachelor and 34.3% having a Master degree qualification. This finding resonates with prior studies that considered education qualification of board members. For instance, letting (2011) noted that at least 29% of board members of listed companies had a Master degree while Balta (2008) noted that 46% and 15% of Greek board members of listed companies had at least a Master degree and PhD qualifications respectively.

In terms of educational specializations, the study established that majority of the board members that is 16.1 % had specialized in Business Administration, followed by 16% in Finance, 13.3% in Human Resource, 11.6% in Social Sciences, 11.2% in Accounting, 10% in Marketing, 9.7% in Operations, 4.2 % in Legal, 3.5% in Sciences, 3.2% in Health Sciences and the least was 1.1% in the Engineering specialization. It is apparent that board members who have background of specialization in business, finance and accounting are the majority in state owned enterprises. This is consistent with the findings by Letting (2011) and Ongore. et. al. (2011).

The findings of the study revealed that 58.4% of the board members had served for tenure of between 2 and 3 years, 30.6% of the board members had tenure of less than 1 year while 11% of the board members had served for over 3 years. This implied that board members had accumulated experience serving within the organizations selected. The study noted that majority of the board members that is 56.2% had public service background while 43.8% did not have public service background. This implied that most of the board members in the state owned enterprises have worked in government ministries, departments and agencies before.

4.2. Inferential Statistics

Table presents the regression model on board attributes and Return on Assets. As presented in the table, the coefficient of determination R square is 0.173 and R is 0.417. The coefficient of determination indicates that 17.3% of the variation on Return on Asset is influenced by board attributes that is board structure, operating and board environment, board demographics and board role

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.417 ^a	.173	.114	.65304

Table 2: Model Summary for Board Attributes and Return on Assets

a. Predictors: (Constant), Board Role, Board Demographics, Board Structure, Operating and Board Environment

The results of ANOVA test in table 4.59 show that the F value is 2.091 with a significance of p value = 0.001 which is less than 0.05, meaning that null hypothesis was rejected and concluded that there is a significant relationship between board attributes and ROA.

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.941	3	.235	2.091	.001 ^b
	Residual	2.103	19	.110		
	Total	3.044	23			

Table 3: Analysis of Variance for Board Attributes and Return on Assets

A. Dependent Variable: Return on Assets

B. Predictors: (Constant), Board Demographics, Board Structure, Operating and Board Environment

The data findings show that the β value of board structure was 0.230 and is significant at p value (0.000) since it is less than the level of significance of (0.05). This therefore implies that board structure is a good predictor and it has significant influence on return on sale. The board structure has no influence on return on asset of state owned corporations.

The β value of operating and board environment was 0.151 and is significant at p value (0.001) since it is less than the level of significance of (0.05). This therefore implies that operating and board environment is a good predictor and it has a significant influence on return on asset. The study rejects the null hypothesis operating and board environment has no influence on return on asset of state owned corporations.

The β value of board demographics was 0.124 and not significant at p value (0.014) since it is less than the level of significance of (0.05). This therefore implies that board demographics is a good predictor and it has a significant influence on return on asset.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.136	.091		1.495	.092
	Board structure	.230	.071	.498	3.239	.000
	Operating and board environment	.151	.054	.247	2.796	.001
	Board demographics	.124	.061	.334	2.032	.014

Table 4: Coefficient Table for Board Attributes and Return on Assets

5. Conclusion

This study establishes that board structure had the largest effect on return on asset. This study shows that one unit change in board structure results in 0.230 units increase on return on asset for state owned corporations. Board operating environment followed with a coefficient 0.151 and lastly board demographics with 0.124. This study concludes that board role, board structure, board operating environment and board demographics all have a positive effect on return on assets.

6. Recommendation

The results about the board attributes and performance relationships have implications for investors, shareholders and regulators. The results reveal that board structure has significant influence on the performance of state owned corporations in Kenya. The results recommend the board of state owned corporations to combine all the three board attributes to improve on performance.

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