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Effect of Board Structure on Financial Performance of Large Agricultural Companies in Trans Nzoia County, Kenya

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Abstract: **The aim of the study was to establish the effect of board structure on financial performance of large agricultural firms in Trans Nzoia County, Kenya. The study was guided by the following specific objective: To determine the effect of board structure on financial performance of large agricultural companies in Trans Nzoia County. The study adopted a descriptive research design that was quantitative in nature. The target population was the 184 the managers and supervisors of agricultural seed companies in Trans Nzoia County, Kenya. The sample size was 123. The study attained a response rate of 65%. Both descriptive and inferential statistics were used to analyze data. A close-ended questionnaire was used to collect primary data while secondary data was obtained from the financial statements of the firms. Reliability of the tool was tested using Cronbach's alpha coefficient while content validity was confirmed using experts. Factor analysis was done to determine the construct validity of the variables of interest. The results (β= .266, p<.05) suggested that board structure has a positive significant effect on financial. It was therefore concluded that board structure as a corporate governance practices positively affected the financial performance of the agricultural seed firms in Trans Nzoia County, Kenya. Therefore the study recommends that the shareholders' should not only reduce their firms' board sizes but the focus should shift from the size of the board to the quality of the agricultural seed firms' board of directors.**

Keywords: **Corporate governance practice, Financial Performance & Governance.**

1. INTRODUCTION

The global financial landscape is changing rapidly; economies and financial systems are undergoing traumatic years. Globalization and technology have continuing speed, financial arenas are becoming more open with new products and services being invented and regulators everywhere are scrambling to assess the changes and master the turbulence (Sandeep *et al,* 2002). Financial performance refers to the degree to which financial objectives being or has been accomplished. It is the process of measuring the results of a firm's policies and operations in monetary terms. It is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. The most popular measures of financial performance are return on equity (ROE) and return on assets (ROA). The ROE measures accounting earnings for a period per dollar of shareholders' equity invested. It is a product of the profit margin and the asset turnover. ROA doesn't distinguish between capital raised from shareholders and that raised from creditors. The financial performance analysis identifies the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the balance sheet and profit and loss account (Al-Hussein *et al,* 2009).

According to Bebchuk (2004) well-governed firms are expected to be more profitable. Poorly governed firms are expected to be less profitable. Claessens *et al.* (2002) posits that better corporate governance framework benefits firms through greater access to financing, lower cost of capital, better financial performance and more favourable treatment of all stakeholders. The weak corporate governance does not only lead to poor firm financial performance and risky financing patterns, but are also conducive for macroeconomic crises. Good corporate governance is important for increasing investor confidence and market liquidity (Donaldson, 2003).

Parker (2007) paradigm of the separation of shareholder ownership and management's control explained that agency problem occurs when the principal (Shareholders) lacks the necessary power/information to monitor and control the agent (manager) and when the compensation of the principal and the agent is not aligned. Good corporate governance shields a firm from vulnerability to future financial distress (Bhagat & Jefferis, 2002).

The argument has been advanced time and time again that the governance structure of any corporate entity affects the firm's ability to respond to external factors that have some bearing on its financial performance (Donaldson, 2003). In this regard, it has been noted that well governed firms largely perform better and that good corporate governance is of essence to firm's financial performance. Demsetz & Villalonga (2002) indicated that a well-functioning corporate governance system helps a firm to attract investment, raise funds and strengthen the foundation for firm financial performance.

The governance structure of any corporate entity affects the firm's ability to respond to external factors that have some bearing on its performance. In this regard, it has been noted that well - governed firms largely perform better and that good corporate governance is of essence to firms (Berglof & Von Thadden, 1999). The concept is gradually becoming a top of policy agenda in the African continent like in Ghana and South Africa. Indeed, it is believed that the Asian crisis and the seemingly poor performance of the corporate sector in Africa have made the concept of corporate governance resurface in the development debate. Corporate governance deals with ways in which suppliers of finance to corporations assure themselves of getting a return on their investment (Shleifer & Vishny, 1997).

Statement of the Problem:

Issues of corporate governance have been an inherent weakness in most agricultural firms. According to McDonald (2007), good governance enables efficient and effective service delivery, and it also ensures high levels of accountability and transparency. These challenges top the list of problem areas in the manufacturing and processing, and the main cause is problems around corporate governance. At the most basic level a corporate governance problem arises whenever an outside investor wishes to exercise control differently from the manager in charge of the firm. Most research on corporate governance has been concerned with the resolution of this collective action problem. In a nutshell, the fundamental issue concerning governance by shareholders today seems to be how to regulate large or active shareholders so as to obtain the right balance between managerial discretion and small shareholder protection. Corporate governance is about the organization of a company by taking into account the outcome of a good corporate governance practice in an accountable board of directors who ensures that the investors' interests are not jeopardized. The accountability and transparency component of corporate governance would help companies gain shareholders' and investors' trust. These stakeholders need assurance that the company will be run both honestly and cleverly. Variables such as board activity in terms of board size, board composition, meetings of the board and CEO compensation all had an impact on performance for listed manufacturing firms (Gathura, 2007). Agricultural seed companies in Trans Nzoia County have been posting poor financial results in the recent past. However there is scanty literature on the effects of corporate governance on the financial performance of agricultural seed companies. The studies done on relationship between corporate governance and financial performance have posted contradictory results. More so there is little known about the effects of board structure practices on financial performance in a developing nation like Kenya. Hence this study sought to fill this gap by assessing the effect of board structure on financial performance of large agricultural companies in Trans Nzoia County, Kenya

Research Objective:

The specific objective of the study was: To determine the effect of board structure on financial performance of large agricultural companies in Trans Nzoia County.

Research Hypotheses:

H_0: Board Structure has no significant effect on financial performance of large agricultural companies in Trans Nzoia County.

2. LITERATURE REVIEW

Direct monitoring by the shareholders is governed through the board of directors who were elected by shareholders. The board of directors is the ultimate decision making organ of the company. The board plays a major role in the corporate governance frame work and is mainly responsible for monitoring managerial performance and achieving an adequate return for shareholders. The board also acts as an intermediary between the principals (shareholders) and the agents. (Managers) ensuring that capital is directed to the right purpose (OECD report 2004). The Kenya Capital Markets Authority (2002) defines the role of the board of directors as identifying the corporate business opportunities as well as principal risks in its operating environment including the implementation of appropriate measures to manage such risks or anticipated changes impacting on the corporate business. Prasad (2006) noted that board structure distinguishes between those directors who hold management positions in the company and those who do not. Those with management positions are referred to as inside directors. The top person in the board is known as the chairman. He could be an executive or non-executive of the company. If the CEO happens to be a director on the board, then he is an executive director. Prasad (2006) identified other dimensions of board structure such as the number and types of board committees, committee's membership, flow of information of information among these committees and pattern of committee membership.

The board of directors is the highest body of a company that is responsible for managing the firm and its operation. It plays a vital role in shorter decision regarding the shorter investments. Kamau and Basweti (2013) found there is a positive correlation between the board size and the financial performance. Larger board size may find it difficult in arriving at a consensus in decision which can ultimately affect the quality of corporate governance. Larger bards allows firms to bring diverse and vital resources on the board that can make the board decision making effective and efficient, directly or indirectly meeting challenges in the globalized business environment.

The size of the board can add to the diversity of perspectives, proving greater choices among solutions and more decision criteria to achieve the shorter goals and objectives. The board size and the financial performance efficiently ensure that the shorter objectives are achieved. Size of the board is recognized as one of the unique features of board dynamics with considerable but strategic impact on the board independence as well as the overall quality of corporate governance (Jensen & Meckling 1976).

The size of the board is vital to achieving the board effectiveness and improved firm performance especially from resource dependency perspective which place more emphasis on the board ability to co-opt limited and scares resource from various external links. Board size affects the quality of deliberation among members and ability of board to arrive at optimal corporate decisions. The accounts payable period, accounts receivable period are components of the financial performance which can be affected by the board's decision. There is near consensus in the conceptual literature that effective boards are composed of greater proportions of outside directors. A preference of outsider dominated boards is largely grounded in agency theory. Agency theory is control based theory in that managers by virtue of their firm specific knowledge and managerial expertise are believed to gain an advantage over firm owners who are largely removed from the operational aspects of the firm. The potential for this conflict of interest or battle for control necessitates monitoring mechanism designed to protect shareholders as owners of the firm (Jensen & Ruback 1983).

An examination of fortune 500 corporations, Kesner (1987) found a positive and significant relationship between proportion on inside directors and returns to investors, the earlier work on corporate governance reported a positive association between inside directors and firm performance. Additionally, there is a stream of research which has found no relationship between board composition and firm performance. In the face of ownership and control dispersion, outside non-executive directors are more reliable and also effective in representing shareholders interest.

Kesner (1987) argued that non-executive directors are much more likely to oppose to corporate strategy they believe is not in the best interest of shareholders. The board monitoring and control function becomes difficult with insider dominated board since they cannot provide appropriate monitoring against itself. The independent outside director brings to bear the much needed neutrality and objectivity in the board discuss. Corporate governance plays an important role in controlling the management of financial performance by formulating sound policies. The roles of CEO duality help in maintaining an appropriate level of financial performance in the organization (Gill & Biger, 2013). CEO tenure also helps in improving financial performance management. The dual-responsibility, CEOs serve the interests of the management

team and one way to protect the team's position is to hold excessive corporate liquidity. In addition, the CEO together with the board of directors formulates policies, including policy related to financial performance management.

According to the Agency theorists, CEO Duality creates imbalance in corporate power distribution as heavy concentration of management and control resides with one-person which tend to jeopardized board effectiveness (Deloof 2003). This imbalance makes it inevitably difficult for the corporate board to provide appropriate monitoring or even institute punitive measure against erring CEO due to absence of independence. The integrity of information available to board is compromised with CEO duality due to asymmetric as CEO determines what kinds of information are brought to board attention. Agency theorists thus, argued that the separation of the two positions will reduce the agency cost and promote corporate transparency and accountability. Hence this study hypothesized that:

H_0: Board Structure has no significant effect on financial performance of large agricultural companies in Trans Nzoia County.

3. RESEARCH METHODOLOGY

The study was descriptive in nature and was quantitatively conducted. Jacobs & Razarich (1996) define survey research method as a technique in which detailed information concerning a social phenomenon is gathered by posing questions to respondents. The outcome of such investigation makes it possible to find explanation of social phenomenon in question. This type of design was most appropriate in investigating the influence of board composition on financial performance of agricultural seed companies in Trans Nzoia County.

In this study, the target population comprised of all the managers and supervisors at the agricultural seed companies in Trans Nzoia County, Kenya. This included the top managers, middle, level managers and supervisors. There are two agricultural seed companies in Trans Nzoia County namely: Kenya Seed and Western Seed Company. Kenya seed has a total of 102 managers and supervisors in the four levels while Western Seed has 82 giving a target population of 184 managers and supervisors. The managers and supervisors were chosen as the target population for the perceived knowledge of matters of corporate governance.

The sample size of this study was based on Krejcie, *et al*. (1998), statistical table for determining sample size from a population. This gave a sample size of 123. Stratified Random Sampling and then simple random sampling was used. This method involves a process of stratification of segregation of the population in homogenous groups (groups with the same characteristics). This was then followed by random selection of the subjects from each stratum. The population was stratified in four strata: Top level managers, middle level managers, operation managers, and supervisors. This ensured that a sample was a representative of the population hence ensured that validity was attained.

The main instrument of data collection was a close-ended questionnaire. This ensured quantitative e information was captured for each objective. The questionnaires were preferred in the study because all the respondents were literate. Also, being a descriptive study, the questionnaires facilitated efficiency in collecting information from the respondents.

4. FINDINGS AND DISCUSSIONS

Out of the targeted 123 respondents who were given the questionnaire 80 completed the questionnaire. This gave a overall response rate of 65%. The respondents were required to provide information about their gender, age, and Education. The gender distribution of the survey respondents was 30.0% female and 70% male. The age distribution for the managers was 8% were in the age bracket 20-30, 20% age bracket 31-40, 40% age bracket 41-50, and 12% were above 50 years old. Thus majority of the managers were in the age bracket 41-50 (40%). The educational level for the managers indicated that 12% had postgraduate qualification, 40% had degree level, 20% had diploma level and 8% certificate level education. The majority had degree level of education (40%) It indicates that the firms employ majority of the managers with degree level of education. For management experience 8% had below 3 years, 20% had 4-7 years, 40% had 8-10 years, while 12 % had above 10 years. Cronbach's alpha reliability test was used to determine the internal consistency of the question items that measured the variable of interest for this study. Sekeran (2000) benchmark of Cronbach's coefficient value of greater than 0.7 indicates the tool was reliable to measure the variables. The results for board structure 7-items gave a value of .896.Correlation Analysis.

Correlation analysis was done to determine relationships between the study variables. Pearson product moment correlation coefficient was used. This test was done as a precursor to regression analysis so as to determine whether the variables were related linearly related. The results showed a significant positive correlation between financial performance and board structure (r = .589, *p*=0.000) that was statistically significant at 95% confidence level.

Hypothesis (H_{01}) stated that board structure has no significant effect on financial performance of large agricultural companies in Trans Nzoia County. The results (β= .266, p<.05) suggested that board structure has a positive significant effect on financial. Hence hypothesis H_{01} was not supported.

Hence the estimated model took the form:

$Y = .548 + .266X_1$

Where:

Y=Financial Performance

X_1 = Board Structures

Table.1: Regression Results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.548	.172		3.191	.002		
	Board Structure	.266	.054	.327	4.931	.000	.837	1.195

Source: Survey data (2016)

Values of unstandardized registration coefficients, with standard errors in parenthesis while *p <0.05 indicates the value is significant at 95%.

5. CONCLUSION

It can therefore be concluded that board structure internal audit, and shareholder's interest as corporate governance practices positively affected the financial performance of the agricultural seed firms in Trans Nzoia County, Kenya. From the findings, the study established that board structure as a corporate governance practice positively affected the financial performance of the agricultural companies in Trans Nzoia, Kenya. Therefore the study recommends that the shareholders of the agricultural companies in Trans Nzoia, Kenya should strive to create an optimal board structure that comprises of representatives of all the crucial stakeholders in the various subcommittees of the board.

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