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SECTION B:

ENTREPRENUERSHIP AND INNOVATIVE BUSSINESS ,

BOARD SIZE AND FINANCIAL PERFORMANCE OF HOUSING FINANCE BANK, UGANDA

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Abstract

The study was carried out to establish the relationship between board size and financial performance of commercial banks in Uganda, with Housing finance bank as a case study. The study was cross-sectional combined with analytical survey design as well as descriptive methods to interpret the findings. Besides, both qualitative and quantitative methods were also adopted. A sample of 59 staff of Housing finance bank were selected. Both census and simple random sampling methods were used to select the respondents for the study because of their involvement in corporate governance issues within the bank. Semi-structured self-administered questionnaires and interview guids were employed to collect data. The regression result showed that about 36% of the variations in financial performance of Housing finance bank is explained

by corporate board size, board. Thus, the study therefore recommends that Housing finance bank need to assess board's ability to monitor management as most members have their own companies to run and have little or no time to perform a better overseer function. The researcher would recommend to Housing finance bank manangement to adhere to principles of corporate governance and choose a small board of directors not above ten in number.

Background of the study

As the existing research shows, the main function of the board of directors is to supervise managers and provide advice to maximize the wealth of shareholders[1]. Existing financial literature studies the effects of various characteristics of corporate boards on the recommendations and supervisory functions of the board of directors. To improve the efficiency of the board of directors, it is important to study the relationship between the size of the board of directors and corporate performance. The research on the relationship between board size and corporate performance is based on agency theory and resource dependence theory. Specifically, the former assumes that small boards are more effective in maximizing shareholder wealth. Based on agency theory, communication costs, coordination costs and free-riding problems caused by agency problems. A smaller board of directors can reduce these costs, better weigh the pros and cons of agency issues, and ultimately achieve the goal of improving the efficiency of the board. However, based on the resource dependence theory, previous studies support the positive correlation between the board size and corporate performance [2]. In order to study the relationship between corporate board size and corporate performance, this paper selects 372 companies in the US S&P 500 from 2013 to 2017 for empirical research. In addition to studying the relationship between board size and corporate performance, it also pays attention to the Odd-even effect of corporate board members.

Theoretical Review

This study was guided by the agency and stakeholder theories. The agency theory focused on problems relating to separation of ownership and control. Proponents of the principal agency theory Jensen and Meckling (1976) asserts that; the theory involves a contract between agent (director) who knows more about the entity/corporation and the Principle (shareholder) it is assumed that the agent will not always have the interests of the shareholder at heart. The agency theory presumes, opportunism on the part of the agent and enforced compliance are not nationally bounded, but instead represent a supranational lens for evaluating corporate governance issues.

Lubatkin (2005:pp. 867-888). Today well known agency problems resulting from separation of ownership from management still prevail in firms worldwide. Recent research suggests that firms tend to have poor performance when they have greater agency problems. An efficient governance structure is believed to be one of the most important means by which agency problems may be alleviated. The elements of corporate governance addressed in literature include ownership structure, the board of directors' composition board size and sometimes CEO reputation. The composition of boards of directors varies according to differences in ownership structure Eldenburg et al., (2004), the composition of the board is what determines the level of monitoring the CEO (Weisbach, 1987) and the size of the board is inversely related to company value as companies with large boards tend to use their assets less efficiently and earn less profit (Yermack, 1996).

Although Agency theory addresses manager principle interest divergence additional theories are needed to explain what if anything causes the interests of principle agent to be aligned. The stewardship theory has been touted as a means to defining relationships based upon behavioural premises (Donaldson & Davis, 1989; 1991). The stewardship theory situations in which managers are not motivated by individual goals but rather are stewards whose motives are aligned with objectives of their principles. From the legal perspective the exponents of this theory say directors need to recognize the interests of customers, employees, suppliers and other legitimate shareholders but under the law their first responsibility is to shareholders.

Besides, the Stakeholder Theory on the other hand, has been advanced for its descriptive accuracy, instrumental power and normative validity. Although these constructs are inter related they are distinct. "If the unity of the corporate body is real then there is reality and not simply legal fiction in the proposition that the managers of the unit are fiduciaries for it and not merely for its individual members that they are… trustees for an institution (with multiple constituents) rather than attorney for the stockholders" (Dodd,1932). One group of scholars view the stakeholder theory as a potential foundation for growth of social science based research and another views it as an umbrella term describing a class narrative accounts, each based on its own moral principles. The proponents of this theory however argue that managers should make decisions so as to take into account the interests of stakeholders. The rationale behind is to create a maximum value maximization- a major object of governance of firms.

Conclusively, running of companies is a dynamic task and each theory advanced has a contribution it makes in corporate governance but what comes out strongly is the recognition that in business there is a relationship between managers and business owners, it is for that case that this research will focus on the principle agent theory. Under such hypotheses, adequate governance structures are required for allowing owners to monitor and control managers Jensen and Meckling (1976), Berle and Means (1932/1991); Shleifer & Vishny (1997). The point of reference in this model of corporate governance is the market. However at present the Agency Theory dominates the theoretical discussions on corporate governance but does not quite cover all aspects. In contrast the stewardship theory presumes that managers are inherently good stewards of corporations and can be trusted to work diligently to attain high levels of corporate profits and shareholder return. Ironically this presumption leads to ultimate conclusion that boards of directors are redundant and That stakeholder advisory boards are sufficient.

Statement of the Problem

The commercial banking sector has been dogged by multiple corporate governance malfeasance that led to the closure of several banks in the recent past. Greenland bank, international credit bank (ICB) run by the Kato family, and National Chamber of Commerce all had problems with governance and flaunting business ethics. However the banking sector since the late 2000's has seen a spur in financial growth with an influx of foreign owned banks entering the market this has contributed to improvement in customer service and increased competition.

Although Housing finance bank has experienced growth in its operations in the previous years since its inception in 1967, existing data shows that it has been experiencing discrepancies in its financial performance over these years. Issues relating to transparent control, responsible corporate boards, shareholder rights, accountability, and timely disclosure of useful information are still inefficient. Besides, Housing finance bank still faces ineffective corporate governance structures which have led to decline in achieving its annual financial performance targets with its profitability ratio falling from 50% to 20% in the period from 2019 to 2023 (Housing Finance Bank Annual Financial Report, 2023). Therefore, this study intends to investigate whether corporate governance in place is the major cause of discrepancies in the existing financial performance trends exhibited by Housing finance bank.

Purpose of the Study

The study aimed at examining the relationship between corporate governance and financial performance of commercial banks in Uganda.

The study was guided by the following Objectives

i) To examine the relationship between board size and financial performance of Housing finance bank;

ii) To examine the relationship between board composition and financial performance of Housing finance bank;

1.5 Research Questions

i) What is the relationship between board size and financial performance of Housing finance bank?

ii) What is the relationship between board composition and financial performance of Housing finance bank?

1.6 Hypotheses

H1: Board size a significant positive relationship with financial performance of commercial banks;

H2: Board composition has a positive relationship with financial performance of commercial Banks;

Literature review

Board Size and Financial Performance

Based on agency theory, researchers believe that the relationship between board size and company performance is negative. A larger board will have more agency costs, and as the board becomes larger, issues such as coordination and communication costs will increase (Mak and Kusnadi 2005) It makes sense to consider the factors that affect the board of directors and discover whether the relationship between board size and company value should be positive or negative. Based on the resource dependence theory, the relationship between board size and corporate governance is positive (Eldenburg et al, 2004).The reason for support is that a larger board of directors can ensure that more non-executive directors can better supervise managers, while a larger board of directors will include more professionals from different fields. High-quality boards from different backgrounds can make better decisions for the board.

Jensen (1993) argues that as board size increases, board's ability to monitor management decreases as most members have their own companies to run and have little or no time to perform a better overseer function. Similarly, Hermalin and Weisbach (2003) argue that consensus among economic literature is that large boards will weaken a company's performance. Empirical studies on board size seem to suggest a similar conclusion that a negative relationship exists between large board size and firm performance. The notion widely held is that substantive discussion on major issues is insufficient and the board decision can easily be hijacked by those with self-interest. Mak and Yalanto (2003), using a sample study from Malaysia/Singapore study, found that company performance is highest when board size is small in size. Sanda et al., (2003), in a Nigerian study seems to agree that small boards contribute to a better performance as coordination and decision making becomes less lengthy and less time consuming. Lastly Mak and Kusnadi (2005) also affirm that small boards have a positive relation with high performance. In all these findings there is a consensus by the respondents that large boards point to a weak corporate governance structure 22(37.3%) and particularly limiting the number of board members will generally improve performance of banks 30(50.8%) by the majority of respondents. These arguments suggest that large boards will affect performance of banks.

Research Design

The research adopted a cross- sectional survey research design to gather data from a rather large pool of respondents (Olsen & George 2004). The study adopted both qualitative and quantitative methods in order to increase viability and the strength of the report, Patton (2001) advocates the

use of triangulation by stating "triangulation strengthens a study by combining methods. However, the idea of combining methods has been challenged by Barbour (1998). She argues while mixing paradigms can be possible but mixing methods within one paradigm, such as qualitative research, is problematic since each method within the qualitative paradigm has its own assumption in "terms of theoretical frameworks we bring to bear on our research" (p. 353).

Findings

Descriptive Statistics for Board Size and Financial Performance

Descriptive statistics were used to analyse the impact of boar size on financial performance. Data on the impact of board size on financial performance was collected based on the respondents' understanding of corporate governance in the bank. The data was presented in table form below 1 below.

Table 1: Descriptive Statistics for Board Size

Statement on Board Size	**Percentage Responses (%**					**Mean**	**Std dev**
	SA	**A**	**N**	**D**	**SD**		
Board members understand their responsibilities	26 (44.1%)	24 (40.7%)	4 (6.8%)	2 (3.3%)	3 (5.1%)	**1.5**	**.61**

Board and sub committee meetings are conducted regularly	27 (45.7%)	19 (32.2%)	5 (8.5%)	4 (6.8%)	4 (6.8%)	**1.9**	**1.21**
Corporate governance of banks needs special attention	23 (39.1%)	21 (35.6%)	6 (10.1%)	6 (10.1%)	3 (5.1%)	**1.6**	**.66**
Board size contributes greatly to firm value	15 (25.4%)	10 (17%)	3 (5.1%)	22 (37.3%)	9 (15.2%)	**1.7**	**.55**
Small boards are beneficial to high performance	23 (39.1%)	8 (13.5%)	13 (22.1%)	10 (16.9%)	5 (8.4%)	**2.3**	**1.24**
Limiting board size improves performance of the bank	15 (25.4%)	30 (50.8%)	3 (5.1%)	7 (11.9%)	4 (6.8%)	**2.3**	**1.24**
A large board is a characteristic of weak corporate governance	14 (23.8%)	22 (37.3%)	8 (13.6%)	9 (15.2%)	6 (10.1%)	**2.4**	**1.11**
Board size increase affects monitoring of management	14 (23.8%)	28 (47.4%)	8 (13.6%)	4 (6.8%)	5 (8.4%)	**2.2**	**1.16**

Source: Primary data

Findings from table 1 above, indicated that 26 (44.1%) constituted the majority of the respondents who strongly agreed that Board members understand their responsibilities, 24 (40.7%) agreed, 4 (6.8%) were not sure, 2 (3.3%) of the respondents disagreed while 3 (5.1%) strongly disagreed. Since majority of the board members understand their responsibilities, the implication is that services offered are properly tailored to meet the customer needs hence meeting their financial requirements and as well making a strong customer base since there is a saying which states that "a satisfied customer buys again".

Furthermore, majority (27, 45.7%) of the respondents strongly agreed that Board and sub committee meetings are conducted regularly, 19 (32.2%) agreed, 5 (8.5%) of the respondents were not sure while 4 (6.8%) disagreed and strongly disagreed respectively. The implication here is that this enables them to discuss issues and merge ideas with those of the directors and that of their subordinates for the proper functioning of the bank.

The study findings also indicate that 23 (39.1%) of the respondents who were the majority strongly agreed that Corporate governance of banks needs special attention, this was followed by 21 (35.6%) of the respondents who strongly agreed, 6 (10.1%) were not sure and disagreed respectively while 3 (5.1%) strongly disagreed. 22 (37.3%) of the respondents constituting the majority disagreed that Board size contributes greatly to firm value, 15 (25.4%) of the respondents agreed, 10 (17%) agreed, 9 (15.2%) strongly disagreed while 3 (5.1%) were not sure. Study findings indicate that 22 (37.3%) agreed that a large board is a characteristic of weak corporate governance, 14 (23.8%) agreed, 8 (13.6%) were not sure, 9 (15.2%) disagreed while 6 (10.1%) strongly disagreed. Majority of the respondents agreed with the assertion and thus could negatively affect performance. A key informant had this to say:

"Large boards point to a weak corporate governance structure and if performance is to be improved in the banking sector then the owners of such banks have to limit on the number of board members, this will boost their performance".

More so, the study findings also indicate that majority (23, 39.1%) strongly agreed that Small boards are beneficial to high performance, 13 (22.1%) of the respondents were not sure, 10 (16.9%) disagreed, 8 (13.5%) agreed while 5 (8.4%) strongly disagreed. In analysis, the study found out that qualitative data that was obtained during the study was in line with quantitative data. One the respondent said that; "*That bank's performance is highest when board size is small in size".*

Further analysis from the results also indicated that 30 (50.8%) of the respondents constituting the majority agreed that Limiting board size improves performance of the bank, 15 (25.4%) strongly agreed, 15 (25.4%) disagreed, 4 (6.8%) of the respondents strongly disagreed while only 3 (5.1%) of the people interviewed were not sure.

Correlation Analysis

The relationships between study variables are established by running a correlation analysis and since the study had relationship objectives, the relationship between the study variables of corporate governance components of board size, board composition, CEO reputation, and ownership structures on financial performance were established using Pearson's correlation. The results of the correlation analysis are indicated in table 2 below.

Table 2: Showing the Relationship between Study Variables **correlation between board size and financial performance of Housing Finance Bank, Uganda.**

Variable		**Board size**	**Financial Performance**
Board Size	Pearson Correlation	1	**.453****
	Sig. (2tailed)		0.000
	N	59	59
Financial Performance	Pearson Correlation	**.453****	1
	Sig. (2tailed)	0.000	
	N	59	59
**. Correlation is significant at the 0.01 level (2-tailed).			

Relationship between Board Size and Financial Performance

The Pearson coefficient ($r = \mathbf{0.453^{**}}$, $p = 0.00<0.01$) shows that there is a positive association between board size and financial performance of Housing Finance bank. . The correlation results showed that board size is a significant predicator of financial performance. This implied that a larger board size with more members leads to better financial performance.

Null hypothesis:

Ho: Board size has no significant positive relationship with financial performance.

The hypothesis was tested using Pearson's coefficient of rank correlation and the results are shown in table 2. It shows that there is a significant positive relationship between board size and financial performance of Housing finance bank (r = 0.453**, p = 0.00<0.01). Since the correlation was found to be significant, the null hypothesis (Ho) was rejected and the alternate hypothesis (H1) which recognizes the existence of significant relationship between board size and financial performance was accepted as summarized.

Recommendations and Conclusion

The study recommends that there is always need to assess board's ability to monitor management as most members have their own companies to run and have little or no time to perform a better overseer function. The researcher would recommend to Housing finance bank management to adhere to principles of corporate governance and choose a small board of directors not above ten in number.

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ELECTRONIC PAYMENT SYSTEMS AND PERFORMANCE OF COMMERCIAL BANKS IN UGANDA: A CASE OF EQUITY BANK, NDEEBA BRANCH

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