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CORPORATE GOVERNANCE, MANAGERIAL COMPETENCES, ACCOUNTABILITY AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN UGANDA

Mwesigwa, Rogers

Faculty of Entrepreneurship and Business Administration
Makerere University Business School, Uganda
mwesiro@yahoo.com

Nasiima, Sentrine
Human Resource Management, Makerere University Business School, Uganda

Suubi, Suzan
Accounting and finance, Makerere University, Uganda

Abstract

The purpose of this study was to determine whether in Uganda, corporate governance, accountability and managerial competences are related with the financial performance of commercial banks. The motivation for this study was the poor performance of commercial banks in Uganda despite the number of interventions put in place. This study adopted a cross sectional and quantitative design where 25 commercial banks operating in Uganda were considered for the study. The study provides evidence that corporate governance, accountability, managerial competences significantly relate to financial performance of commercial banks in Uganda. However corporate governance was observed to be the most significant predictor of financial performance. The study recommends that corporate governance mechanisms should be put in place to enable the efficient and effective management of banks in Uganda in order to improve performance. The study contributes to dearth of existing literature on financial performance - largely focuses on corporate governance, accountability, managerial competences separately using Uganda's experience.

Keywords: Corporate governance, Financial performance, Accountability, Commercial banks, Managerial competence, Uganda

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INTRODUCTION

Firms with better systems of management continue to attain organizational objectives and goals than those that do not have (OECD, 2004; Nkundabanyanga, Ntayi, Ahianzu and Ssejjaka, 2014). Bradley (2004); Adams and Mehran (2003), argues that organizations with better systems and procedures are important for firms' performance. Better policies and procedures have been recognized as a significant factor in improving financial performance of organizations (Nkundabanyanga et al, 2014). More so, Gompers et al. (2003) argues that if an organization pays attention in having and following systems, then it will be in position to generate better returns to its shareholders. Experiential studies from elsewhere support this view that improved organizational governance result into better organizational performance (MacAvoy and Millstein, 2003). Dittmar and Mahrt-Smith (2007) also noted that better managed firms generate almost double returns than poorly managed ones. According to Jensen (1986); La Porta et al. (2002), shareholders noted that with improved corporate governance, organizations resources will be put to good use instead of being misappropriated by the managers of the firm. Furthermore, Kyereboah-Coleman and Biekpe (2006) observed also that poorly governed firms have more sustainability issues than better managed ones.

In Africa various studies have been undertaken as regards to corporate governance and firm performance eg. Sanda, Aminu and Garba., et al. (2005), Kyereboah-Coleman and Biekpe (2006), none of the studies specifically addresses the impact of corporate governance, accountability, managerial competences on banks financial performance in Uganda. Nevertheless, the relationship between corporate governance, managerial competence, accountability and their influence on the financial performance of commercial banks in developing countries like Uganda has received minimum research attention (Matama, 2005). Thus, study linking corporate governance and financial performance of commercial banks in Uganda was necessary where reports have shown that many commercial banks have failed to perform above average in terms of profitability in order to sustain their stay in business For example, in September 1998 and May 1999 four Ugandan banks were closed for imprudent banking practices (Habyarimana, 2003) and poor internal governance (Bank of Uganda, 1999; Brownbridge, 1998). In addition National Bank of commerce and Global Trust Bank were closed recently to protect depositors interest and maintain financial stability (Kasekende, 2014) This concern has also been highlighted by (Kasita and Emojong, 2010; Among, 2009; Kasekende, 2014) who observed that there are consistent reports of commercial banks financially performing poorly and this has often led to some of these banks closing business operations.

The purpose of this paper therefore, was to determine whether corporate governance, accountability and managerial competences influence financial performance of commercial

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banks in Uganda. The significance of this paper lies in its benefit to its stakeholders. The paper exemplifies the necessity of commercial banks to put in place corporate governance mechanisms in order to ensure that banks are managed responsibly, effectively, efficiently so as to remain financially viable.

This paper is structured into five sections: The first section is a brief introduction, the second section is literature review and development hypothesis; the third is research methodology, fourth is analysis and presentation of findings, and the fifth is a discussion, conclusions, research limitations and suggested areas for further research.

LITERATURE REVIEW

Corporate governance and firm performance

Different studies elsewhere have been carried out on corporate governance and firm performance. For example, the Organization of Economic Development (OECD) has long endorsed good corporate governance because of its association with firm performance (OECD, 2004). Selvaggi and Upton (2008) examined the correlation between good corporate governance and organizational performance and found a strong relationship between good corporate governance and superior company performance. Black et al. (2003) found that significantly better corporate governance scores were associated with higher firm value and security prices for Korea Stock Exchange firms. Brown et al. (2004), also found that better governed firms were more lucrative than poorly governed ones. Sanda et al. (2005) while investigating corporate governance and firm performance in Nigeria found out that corporate governance is a strong predictor of firm performance. Kyereboah-Coleman (2007) also found that corporate governance highly influences firm performance. More so, in Uganda, Matama (2005) noted that Commercial banks failures have been linked to self-inflicted causes resulting from bank owners. Most of these studies evaluated corporate governance in terms of structure, composition and conformance, transparency, trust and disclosure. In our study however, corporate governance was evaluated in terms of board Independence, board size and Ceo Powers as shown below;

Independence of the board: Brown et al. (2004) found that organizations with independent boards generate ideas freely to make decisions than organizations where boards are easily influenced. John and Senbet (1998) observed that any organization with more non-executive or outsiders is seen as having more board independence than the one with few outsiders. They noted that empirical results have been inconclusive when it comes to firm performance. Hermalin and Weisbach (1988) posted that shareholders continue to change inside directors who are familiar with the firm’s activities in order to have better monitoring of the organization.

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On the other hand, outside directors act as professional referees to guarantee that consistent actions are taken for the betterment of the organization (Fama, 1980). This view was supported by Hermalin and Weisbach (1988) who noted that outsiders play a big role in protecting shareholders' interest through effective decision control. Shivdasani (2004) observed that outside directors easily take a corrective action like change of management and strategies when there is poor performance unlike inside directors. Firms also choose to add outsider directors following periods of performance decline in order to provide new ideas, to add to the pool of knowledge or to show stakeholders that operations are now under control (Pearce II and Zahra, 1992). According to Lynall et al., (2003), outside directors have more control, possess better abilities and experience in contributing to the strategic decision making of the organization.
Different studies therefore, suggest that outside directors accomplish their tasks effectively in order to protect their reputations and avoid associations with firms that could damage their reputations (Fama and Jensen, 1983). Conversely, outside directors will always avoid serving as directors for poorly performing firms because of the potential stigma that could be transferred to them (Lester, 2008). It is on this basis that above, we hypothesize that;

H1a: Independence of directors positively influences financial performance

Board size: Researchers agree that there is no best size for a board of directors. While there is some dispute regarding the effect of board size on firm performance (Alexander et al., 1993; Yermack, 1996), evidence suggests that larger boards are preferable for smaller firms and this has an impact on organizational performance (Dalton et al., 1999). According to Jensen (1983), a well-functioning board should have a maximum of seven or eight members to function effectively. Larger boards tend to provide an increased pool of expertise, greater management oversight, access to wider range of contracts and resources (Goodstein et al., 1994; Psaros, 2009). However, smaller boards are more likely to reach agreement and also allow members to engage in genuine debate and interaction (Firstenberg and Malkiel, 1994). However, Forbes and Milliken (1999), Yawson (2006), Pye (2000) and Mak and Kusnadi (2005) found that larger boards suffer from higher agency problems because they are difficult to coordinate and have difficulty making value maximizing strategic decisions. More so, it has been argued that larger boards of directors possess a pool of expertise as compared to smaller boards (Dalton et al., 1999). Jensen (1993) however, argued that as board size increases, boards' ability to monitor management decreases due to a greater ability to dodge and an increase in decision-making time. Pearce II and Zahra's (1992) also revealed that poor performance is positively associated with smaller boards and Gilson (1990) reported that only 46 percent of outside directors remained on the board of firms following a bankruptcy or debt restructuring. This finding is

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consistent to D'Aveni (1990) who found that most managers leave a firm shortly before bankruptcy in order to avoid damaging their status.

Hermalin and Weisbach (2003) reasoned that there is a probability that larger boards can be less effective than small boards. When boards consist of too many members, agency problems may increase, as some board members may tag along as free-riders. Lipton and Lorsch (1992) suggested a restriction on the number of directors on a board to seven or eight, as numbers beyond that it would be difficult for the Chief Executive Officer to control. A large board could also result in less important discussions, since expressing opinions within a big group is usually time consuming and difficult and frequently results in a lack of cohesiveness on the board (Lipton and Lorsch, 1992). More so, the problem of coordination surpasses the benefits of having more directors and when a board becomes too big, it often moves into a more symbolic role, rather than fulfilling its intended function as part of the management (Jensen, 1993). However, Brown et al. (2004) suggested that limiting board size leads to better organizational performance as the increased monitoring benefits of larger boards were outweighed by poorer communication and decision making. On the other hand, very small boards lack the advantage of having the spread of expert advice and opinion around the table that is found in larger boards. Furthermore, according to Dalton and Dalton (2005), larger boards are more likely to be related with an increase in board diversity in terms of experience, skills, gender and nationality. It is on the basis of evidence reviewed above, we hypothesize that;

H1b: Board size positively influences firm performance

CEO power: Adams et al. (2005) posted that CEO's who are powerful can easily implement changes in an organization as compared to powerless CEOs. However, it is also possible for poorly performing firms to appoint powerful CEOs if the they are viewed as excelling in developing and implementing the strategies needed to turn a firm around. Consistent with agency theory, powerful CEOs have an option to pursue objectives which are varying with organizational performance (Harjoto and Jo, 2008). Stewardship theory (Donaldson and Davis, 1990; Muth and Donaldson, 1998), asserts that CEO power may be ideal for firm value and performance because of the leadership styles employed. However, (Jensen and Meckling, 1976) suggested that CEO power is not perfect for firm value and performance because it could compromise the board's necessary monitoring role. It is on the basis of evidence reviewed above that, we hypothesize that:

H1c. CEO power positively influences financial performance

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Accountability and financial performance

Earlier studies have studied the influence of accountability on financial performance (Khanna et al., 2004) especially on levels of disclosure. As owners of the company, the shareholders choose managers to run the organizations on their behalf. This means that managers are accountable to the shareholders (Tirole, 2006). These managers in essence should carry out the day to day activities of the organization and protect the interests the organization on behalf of their shareholders (OECD, 2004). This was supported by the agency theory; which highlighted accountability to shareholders as an important instrument for supporting stakeholders' interests (Healy et al., 1999; Hermanson, 2000; Bushman and Smith, 2001; Healy and Palepu, 2001). Disclosure and transparency which were seen as measures of accountability are important in that they are the both foundations to protecting shareholders' rights and building shareholders confidence in the business. This was supported by Khanna et al. (2004) who examined disclosure practices of organizations and found an relationship between disclosure and firm performance. According to Khanna et al (2004), firms with high levels of corporate disclosure are highly trusted by shareholders and perform better than firms with low levels of disclosure. The reason is that banks with high levels of corporate disclosure may attract more investors than others. It is on this basis of above, we hypothesize that;

H2: Accountability positively influences financial performance

Managerial competences and financial performance

Managerial competences have long been considered significant for effective management and organizational performance. Managers who have and properly deployed these competences produce superior performance in a job than managers who do not have. It is reasonable, therefore, to conclude that managers who display these competences have positive effects on the performance of their organizations. This was supported by Boyatzis, (1982) who recognized that managerial competences influence decision making in an organization. Therefore, the development of managerial competences should take priority in achieving organizational performance. Developing effective managerial competences to deal with specific challenges and problems of the organization is one of the urgent needs of many organizations in the global competitive and rapid changing of technology environment. The dynamic business environment requires managerial competencies to achieve strategic organizational goals since competencies were observed as significant tool of achieving a competitive advantage (Martina, et al, 2012). Jennings and Beaver (1997), posted that managerial competencies provide a sound basis for an improved financial performance. It is on this basis that, we hypothesize that:

H3: Managerial competences positively influences financial performance

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METHODOLOGY

This study adopted a cross sectional and quantitative research design. The study population comprised of 25 commercial banks in Uganda (Bank of Uganda, 2012). Simple random sampling was also employed to select managers and banking assistants and purposive sampling technique was used to ensure that more Board of Directors and CEO's from commercial banks were considered for the study.

Primary data were collected using self-administered questionnaires to get the opinions of respondents following the recommended guidelines (Churchill, 1979). The questionnaires were pre tested before being administered to respondents. This tool was chosen because it was quicker in getting data from the respondents (Bakkabulindi, 2004). Content Validity Index (CVI) was used to obtain the validity of the instrument.

The questionnaire was assessed to confirm that the scale items are meaningful; the statements are generally understandable and capture the issues under study. Cronbach's coefficient alpha was used to determine the reliability of the questionnaire (Cronbach, 1951) and to assess for the internal consistence of the scales used. The Cronbach alpha coefficient of above 0.7 for individual test variables were accepted meaning the instrument is reliable (Nunnally, 1978).

We used a five point Likert scale ranging from strongly disagree "1" to strongly agree "5" to develop the tool. This scale would enable respondents to show the degree or extent to which they had adopted the practice described in the item. Corporate governance was measured basing on the scales developed by (Gabrielsson and Huse, 2002; Gabrielsson and Winlund, 2000; Lynall et al., 2003) and modified to include Board size, independent of the board and Ceo power. Managerial Competences was measured basing on the scales developed by Martin and Staines (1994) and Caglino and Spina (2002) and we modified them to include scales unique to Ugandan environment. Accountability was measured basing on the scales developed by Day and Klein (1987). Financial performance was measured basing on the scales developed by Demsetz and Villalonga (2001), Fich and Shivdasani (2006), Thomsen et al. (2006) and Hoskisson et al. (1993).

We carried out a correlation analysis to establish the direction and strength of the association of study variables and a hierarchical regression to determine the variance in the dependent variable that is explained by independent variables.

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ANALYSIS AND FINDINGS

The study covered 24 commercial banks (84%) and majority of the respondents were got from Stanbic bank (9.1%). This was followed by Equity and Development Finance Company of Uganda Bank Limited (DFCU) with 8.6%. Tropical bank followed with 8.0%, Housing Finance and Centenary with 6.3% while few of the respondents were got from Cairo International Bank with 1.7%. Overall, majority of the respondents were bank managers (53.8%) while the least respondents were CEO (3.8%) implying that information was got from people who are directly involved in the day to day management of banks in Uganda.

In order to initially discern the relationship between corporate governance, accountability, managerial competences and financial performance, the Pearson (r) correlation coefficient was employed to execute this as shown below;

Table 1. Spearman's Correlation Matrix table

	1	2	3	4	5	6	7	8
Board composition-1	1.000							
CEO powers 2	.259**	1.000						
Independence of directors-3	.321**	.421**	1.000					
Board size-4	.183**	.261**	.345**	1.000				
Corporate Governance-5	.390**	.616**	.718**	.702**	1.000			
Accountability-6	.245**	.355**	.315**	.245**	.452**	1.000		
Managerial competences-7	.274**	.225**	.261**	.244**	.299**	.332**	1.000	
Financial performance-8	.379**	.548**	.478**	.309**	.498**	.357**	.439**	1.000

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

Results from the above table shows that there is a substantial relationship between Corporate governance and accountability ($r = 0.452$, $p<0.01$). This finding means that when corporate governance improves, it leads to improvement in accountability implying that corporate governance is highly associated with accountability. In addition, the components of corporate governance i.e. Board composition, CEO Powers, independence of directors and Board size were all positively relate to accountability with the following parameters ($r = 0.245^{**}$, $p<0.01$), ($r = 0.355^{**}$, $p<0.01$), ($r = 0.315^{**}$, $p<0.01$) and ($r = 0.245^{**}$, $p<0.01$), respectively. This implies that good governance is highly associated with providing accountability to the stakeholders.

Results further show a significant relationship between Corporate governance and managerial competences ($r = 0.299$, $p<0.01$). This means that managerial competences improve when there is good corporate governance. Findings also show that the components of corporate governance i.e. Board composition, CEO Powers, independence of directors and

Board size were positively relate to management competences with the following parameters (r = 0.274**, p<0.01), (r = 0.255**, p<0.01), (r = 0.261**, p<0.01) and (r = 0.244**, p<0.01), respectively. This implies that good organizational governance is highly associated with better management competences.

Finally, we post a positive relationship between corporate governance and financial performance (r = 0.498**, p<0.01). This means that corporate governance is highly associated with financial performance of commercial banks and implying that hypothesis 1abc was supported. The results further show that the components of Corporate governance i.e. Board composition, CEO Powers, independence of directors and Board size were all positively related to financial performance with the following parameters (r = 0.369**, p<0.01), (r = 0.540**, p<0.01), (r = 0.468**, p<0.01) and (r = 0.301**, p<0.01) respectively implying that when corporate governance improves, it leads to an improvement in banks financial performance.

We also carried out multiple regression analysis to determine explanatory power of corporate governance, accountability, managerial competences on the financial performance of commercial banks in Uganda.

Table 2. Multiple Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	**(Constant)**	1.404	.292		4.815	.000
	Corporate governance	.289	.062	.355	4.683	.000
	Accountability	.064	.056	.087	1.143	.255
	Managerial competence	.280	.063	.317	4.415	.000

R = .592 Std. Error of the Estimate = .427 Sig = 0.000
R Square = .351 Adjusted R Square = .338 F = 26.502
a. Dependent Variable: financial performance

The model seen in table 2 above explains 33.8% (Adjusted R Square 0.338) of the observed variance in financial performance. Corporate governance was observed to be the most significant predictor of financial performance (Beta 0.355, sig = 0.000). Managerial competences was also observed to be the substantial predictor of financial performance (Beta 0.317, Sig = 0.00). Accountability was found not be a major predicator of financial performance (Beta 0.087, Sig = 0.255). Findings further reveal that the regression model was significant (F change = 26.502, Sig = 0.000). The results above implies that when Corporate governance, accountability and managerial competences if well managed can improve financial performance by 33.8% (Adjusted R Square = 0.338).

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DISCUSSIONS

Findings indicate that corporate governance significantly relate with financial performance of commercial banks as seen in Table 1. The above result is in line with Matama (2005), who found out that Corporate Governance has a strong influence, on the general financial performance of Commercial banks in Uganda. It is also consistent with Masibo (2005) who posted a positive direct and indirect link between Board Governance and Firm Performance through Board Effectiveness of the listed companies in Uganda. Findings are also consistent with Brown et al. (2004), who found that better governed firms are more profitable, more valuable than poorly governed firms and offer better returns to their shareholders. Findings are also consistent with Gilson (1990), who posted that smaller organizations deliberately reduce the number of outside directors in an effort to cut costs and improve firm performance.

It is also in line (Jensen, 1993; Hermalin and Weisbach, 2003) who argued that larger boards can be less effective than small boards because larger boards increase agency problems which affect financial performance. In addition, Jensen (1993) posted that with larger boards, the problem of coordination offsets the advantages of having more directors. When a board becomes too big, it plays more of symbolic role, rather than fulfilling its intended purpose. This finding contradicts the above in that small boards lack the benefit of having the different alternatives from where the best decision can be made (Dalton and Dalton, 2005).

Findings further reveal that there was a significant relationship between corporate governance, managerial competences and financial performance as seen in Table 1. This is consistent with Amit and Schoemaker (1993), who posted that firm performance, depends on how well managerial decisions about resources particularly and how it is managed generally. A firm may achieve better performance not just because it has resources (Penrose, 1959; Enders, 2004), but the quality of management is an important driver of firm performance. Enders (2004) also reported that differences in firm performance result from management quality. He argues that it is the management competences can therefore be used as a means to explain these differences.

Findings reveal that there was a significant relationship between corporate governance, accountability and financial performance. This is consistent with Tirole (2006) who argued that shareholders elect the directors to oversee the operation and performance of the business on their behalf. The directors are accountable to the body of shareholders that elect them. It is also consistent with Carse (2000) who posted the failure of a bank will affect not only its own shareholders, but also on other stakeholders. Bushman and Smith (2001), also stated that the availability of information is critical to resource allocation decisions and financial performance. They concluded that it is only through full and complete disclosure and transparent

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management practices can shareholders feel confident that the firm to which they have given their funds is being operated with their best interests in mind. Findings are also in line with Hauswald (2009), who stated that although the information gathering activities of the board and the acquirer are substitute instruments for increasing firm value, the firm's disclosure policy is complementary to the acquirer's screening activity. Greater transparency encourages more external scrutiny and, hence, a more active takeover market whereas more internal monitoring reduces the incentives for an acquirer to screen. It is also consistent with Khanna et al. (2004), who said that poor performance in the past can affect the degrees of corporate disclosure. Therefore, commercial banks should disclose more relevant information to its stakeholders in order to improve corporate image.

CONCLUSION & RECOMMENDATIONS

We conclude that corporate governance, accountability, managerial competences visa a vis financial performance in Uganda does not differ materially from previous studies elsewhere. The study established a significant positive relationship between corporate governance, accountability, managerial competences and financial performance of commercial banks in Uganda. Among the studied variables, corporate governance was found to be a vital tool for improving organizational performance by keeping the integrity of commercial banks. The efficient use of firm resources depends on the decisions taken by the management team. A well-managed organization encourages domestic and foreign investment which in turn increases financial performance in the long run. Commercial banks that are managed properly operate at low costs and this has an influence on its financial performance in the long run.

In light of the above research findings in Table 1 and 2, the following recommendations were made; corporate governance mechanisms should be put in place to guarantee commercial banks manage resources effectively and utilize its resources efficiently. This will help shareholders to be cautious about preventing multiple interests by directors. Organizational principles and values should be adhered to if commercial banks are to achieve financial performance. Commercial banks management should ensure that there is proper accountability to its stakeholders for the continuity of the firm. Banks should have transparent accounting standards, bolstered by internal and external audits of financial statements. Managerial competences should be emphasized by commercial banks in order to improve performance. Commercial banks should build and create awareness among the different stakeholders by disclosing of all the relevant information.

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LIMITATIONS OF THE STUDY

The study concentrated on corporate governance, accountability, managerial competences and financial performance a case of commercial banks in Uganda. A further study needs to be carried out on how to improve financial performance of other companies' not necessarily commercial banks. This is necessary because some managers in Ugandan companies do not know that corporate governance is worth of value to the organization and are even not acquitted with what it needs to have the relationships alright. A longitudinal research design will be preferred in future since it involves repeated observations of the same variables over a long period of time.

The model shown in Table 2 above explains only 48.5% of the variance in financial performance of commercial banks in Uganda is concerned, future research should be directed at establishing other factors that could explain the remaining 51.5%. Lastly, this study was quantitative in nature; therefore qualitative research approach should be carried out in future to get more information.

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