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Abstract

The purpose-The paper seeks to compare the corporate board size and the financial performance of private companies in Uganda.

Methodology-The paper adopted a positivist paradigm besides a cross-sectional study design. Researchers gathered quantitative data from 394 companies in Western and Central Uganda. An open questionnaire was administered to board members and executives from companies. Pearson correlation and standard regression techniques were used for data analysis.

Findings-A significant positive relationship between the performance of the firm and the board size among private companies was established from the findings.

Unique Contribution to Practice and Policy-This study will provide a precise and direct understanding of the relationship between board size and performance.

The practical implications-The study recommends that private companies should recruit large boards of directors due to their diversified skills and connections that increase firm value.

Research limitations-The study falls short of examining the influence of other characteristics of the board, such as composition, and leadership structure, on financial performance but solely concentrates on the board size. Besides, it was cross-sectional and generalized all private companies without considering industry-specific factors that could have changed the results.

Originality/value-This is the first study that focuses on exploring the comparison between the corporate board size and the financial performance of private companies in Uganda.

Keywords: *Financial Performance, Board Size, Private Companies.*

INTRODUCTION

Board size refers to the total number of directors of a firm inclusive of the chief executive officer (CEO) and chairman (Akbar, 2017). According to Adams and Ferriera (2017), the corporate board has a cardinal function of monitoring and advising management; thus, it is a vibrant instrument for aligning decisions of management and shareholders in an organization (Wisler, 2018). With the increased competition in the contemporary business environment, the efficiency of corporate boards in shielding stakeholders has become crucial continually. On the other hand, financial performance is a measure of how effective a firm can make use of assets to generate revenue over a given period (Kerzner, 2017). Additionally, as opined by Duru et al., (2016), the board also enhances a firm's financial performance as it controls the Chief executive officer's operations, promotes the firm's image, and maintains a healthy rapport between management and stakeholders hence upholding organizational values. A large board therefore is enriched with diverse knowledge and expertise since it has more members. Conversely, an increase in board size escalates deficiencies in coordination hence deflating the board's efficiency in controlling and monitoring agents (Lipton and Lorsch, 2016). Furthermore, a large board size undermines its capacity to disapprove or critique the executive and to assess firm performance objectively. Kerzner (2017) posits that where board members are more than seven or eight, they increase the cost of monitoring the executive hence becoming ineffective.

The agency theory advocates that the director's free-riding problem increases with a large board size, which consequently becomes more detached from the administration processes (Sakawa and Watanabel, 2018). The CEO has a higher probability of controlling large boards as compared to the board chairman taking control of and monitoring management. It leaves leeway for the managers to focus on their interest at the expense of that of the shareholders hence resulting in increased problems at the agency and therefore lowering the performance of the firm. Sakawa and Watanabel (2018) further assert that with an increase in the board size, reaching consensus becomes a challenge for board members due to the enormous variety of ideas and opinions. As a result, large boards are slower as well as less efficient in decision making, which renders them inefficient in controlling and monitoring management. All these will escalate the principal-agent conflict, hence negatively affecting a firm's financial performance. Besides, Ahmed et al., (2016), maintain that adopting and formulating new ideas and consenting on varied opinions is improbable in large boards, leading to less enhancement of the board`s role in providing management with positive intentions as well as contributions. Consequently, the Board conflicts mean that it is members are more unlikely to meet the shareholders` interests hence increasing the firm problem.

According to Paniagua et al. (2018), a debate about the ideal board size exists. As such, there is no specific method that may be useful in defining the number of board directors. While some studies advocate for smaller boards, others find boards with more members beneficial. Mehrotra (2016) recommends that the optimal board should have between eight to ten members, with a similar number of directors both at the executive as well as non-executive positions. Kerzner (2017), asserts that the ideal board size ought to be about seven to eight directors. According to McGaffigan (2017), the ideal board size ranges from 6 to 15 members and is perfect for enhancing agency performance. Lorsch and Lipton (2016) suggest that the board size, ranging from eight to ten directors, is ideal for communication as well as coordination. A board with more than ten

members will experience challenges for directors to indicate their ideas and opinions. As reported by Yermack (2016), inconsistencies and poor communication are known features of large boards, and these stifle the ability of members' to efficiently monitor the executive. This causes higher agency costs and problems, resulting to lower agency functions. Furthermore, a large board causes free-riding by directors and is also associated with high distribution costs and conflicts amongst directors. These problems, therefore, escalate agency conflicts hence negatively affecting a firm's performance.

Contrary to the above, Muttakin et al. (2018), posits that smaller boards are characterized by the domination of CEOs, which gives them a leeway to override board decisions which serve their selfish interests. Consequently, this stifles the agency's financial performance, thus intensifying firm problems. Consistent with the resource dependency theory, large boards improve a company's ability to co-opt the harsh conditions, which in turn improves the performance of a firm (Appiah, and Amon (2017). Furthermore, the resource dependency theory asserts that the active, as well as divergent unity of large boards, promotes performance by standing firm against severe economic conditions (Appiah,and Amon,(2017).The deficit in connections amongst smaller boards undermines their capability to get credit facilities. In a related case, large boards can effectively perform their strategic roles hence alleviating agency conflicts. According to Manzaneque et al. (2016), such efforts are critical during periods of financial distress. Moreso, in such scenarios, a deficit of diversity characterized by smaller boards amplifies uncertainty regarding strategic growth (Frijns et al., 2016). Consequently, this boosts agency crisis and negatively affects performance in a firm with a smaller board size (Frijns et al.,(2016).

The above debate portrays an inconclusive position as on how the board size relates to financial performance, especially from the perspective of private companies in Uganda. Therefore, this paper aimed at examining the association between financial performance as well as the board size of private limited companies in Uganda. It demonstrates the necessity for private limited companies to put in place governance mechanisms to guarantee that the board manages private limited companies effectively if they are to remain financially feasible.

This study is hence expected to benefit stakeholders in various ways. First, Private Limited Companies in Uganda will have a more precise and direct understanding of the relationship between board size and performance that will be useful for companies' success. Additionally, Buttice et al. (2017) had earlier observed that the relationship between financial success and the board size is paramount in any private company. Secondly, Private Limited Companies will understand how corporate board size influences firm performance about resource allocation. Moreso, this research is one of the few to focus on Uganda and the first one to focus on establishing the relationship between board size and financial performance of private limited companies in Uganda. It thus offers a novel perspective. This paper is organized into five sections. The first section is a brief overview of the research and the contribution of the study. It is followed by a literature review and hypotheses in the second section to discuss the theoretical background of the research and previous studies on Board size and financial performance. The third section is to discuss the source of data, research methodology, and framework. The fourth section concentrates on the discussion of results. Finally, the fifth section concludes and gives study implications, study limitations, and recommendations for areas for future research.

LITERATURE REVIEW

Previous studies by Terjesen et al.,(2016); Estély and Nisar (2016), Ahmadi et al., (2018); Hudaib and Haniffa, (2016); Pechersky,(2016).; Yawson, (2016) find that huge boards give more extensive backgrounds, communications skills diversity, business contacts as well as experience outside the firm. Garg and Eisenhardt (2017), observe that with a large board, directors can exchange highly competent counsels, and there is a high possibility of creating connections with various external parties. Additionally, Chong et al. (2018), postulates that big boards also have a significant role in enhancing outputs of decisions due to the exchange of ideas. As a result, it provides management with fresh opinions and ideas that lead to better firm performance.

Empirical evidence concerning the relationship between board size and financial performance bears mixed results. Hamdan et al. (2017) established a negative relationship between financial success and board size. They also found out that if the number of board members increased, the equity of firms reduced. However, this context could not be generalized to be applied to all companies since it is not a linear reaction. Hamdan et al. (2017) concluded that unlike large firms, small and medium-sized firms are the ones that were negatively affected. While investigating 452 large public firms in the US, Yermack (2016) established a negative association between a company's financial success and its board size. Yermack observed an increase in incremental costs arising from increasing the board size. He thus, concludes that a firm can yield a superior market value with a small board. He further affirms that firms are valued more by considering diverse independent variables such as; growth opportunities, board composition, firm age, and diversification. Yermack noted that none of these predictor variables changed the outcome that smaller boards are better than big ones in enhancing a company's financial performance. Smaller corporate boards are more successful compared to the large ones, as confirmed by inefficiency when the board size increases, which emanates from impediments in coordination as well as processes (Akbar et al., 2017; Haniffa and Hudaib, 2016; Lipton and Lorsch 2016). Conversely, as focused on large firms, Yermack's (2016) findings may not be generalized to smaller firms with different cultural environments.

Isik, and Ince (2016), while studying eight hundred and seventy-nine small and also medium-sized firms in Finland, establish a negative association between financial success and board size. Similarly, various studies (Cheng et al., 2018) conclude that firms with small boards face lower agency costs hence achieving better financial performance. On the contrary, other researchers established a positive impact by large boards on a company's financial wellbeing. For instance, Almandoz and Tilcsik (2016) find that whenever the board size expands, the market exhibits a favorable response. From their studies, they observe that big boards can easily monitor firms with mild financial performance, given their diverse experience and skills. While studying a sampled number of private Limited Firms, Vu et al. (2018) establish a positive relationship between financial success and the board size. The results of their study indicate that unlike smaller boards, large boards easily access external environments that offer better chances of having more extensive resources for raw materials and finance. This coincides with the theory of resource dependence, which proposes that a large board can give better access to a company's outside environment, which in turn enhances the securing of significant resources (e.g., finance and raw materials) hence reducing doubts (Duru et al.,2016). Besides, Haniffa and Hudaib (2016) establish a good association between a firm's financial performance and its board size using ROA. This

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finding is contrary to their prior discovery of a negative association between the two, where they made use of Tobin' s Q as a measure of success financially. In the latter, outcomes agree with Vu et al. (2018). Such divergence arises from perceptions of management and investors on giant boards in the context of the notion that a big board improves familiarity of a business environment. Fundamentally, Haniffa and Hudaib (2016) observed that a broader knowledge base characterized by a significant board size increases informed economic decisions hence reducing principal-agent conflicts.

Furthermore, while investigating 72 private Limited Companies in Zimbabwe for the period 2012 to 2014, Mangena and Tauringana (2017) established a good correlation between the financial performance of a firm and its board size. They confirmed that even when using inflation-adjusted data, their study results remained unchanged. This depicts a critical role a large board can play in effectively monitoring management in the uncertain political and economic atmosphere hence enhancing the financial success of a company. On the contrary, Chang (2017), Mangena and Chamisa (2018); and Joslin and Müller (2016), conclude that there is no relationship between the financial success of a firm and the size of its board. As a result of the mixed opinions as pointed out above, it is affirmed that there is no agreement as to whether small or large boards are more suitable in monitoring firm performance hence leading to the hypothesis below.

H_1*: *There is a positive association between the firm`s success and its board size.

METHODOLOGY

The study adopted the positivist paradigm and cross-sectional research design, utilizing quantitative data. The survey covered a population of 30,000 private limited companies. This returned a sample of 394 private companies determined using a formula by Yamane (1973) as shown;

$$n = \frac{\mathrm{N}}{1 + \mathrm{N}(e)^2}$$

Whereby e = standard error of estimate (5%), n = sample size, and N= population

Companies were categorized by sector and selected using simple random sampling from each sector. The study covered companies in western and central Uganda. These are the main business areas of Uganda, comprising 80% of private companies in Uganda (Financial Sector Deepening, 2015). Questionnaires were administered to auditors, board members, accountants, and CEOs owing to their participation in the governance of private limited companies as Companies Act of Uganda, 2012.

The board size represented the number of board directors. This has consistency with works done by Ashwin (2016), Duru t al. (2016), who used it as a dimension of corporate governance. The study used profitability (ROA, ROE, and Net profit margin), solvency liquidity, and financial effectiveness (operating expense ratio and asset turnover ratio) to gauge the financial performance. Those ratios were obtained from financial reports of firms of 2019. Data was cleaned and aggregated using the name of the company as the breaking variable. Frequency distributions were generated to explore missing values, which were found to be below one percent. Thus, they were considered trivial to bias the results hence being replaced with the mean (Field, 2006). Diagnostic tests of independence of error, normality, linearity, and homoscedasticity were conducted, and the

data met the assumptions of linear regression, thus assuring the legitimacy of results (Osborne,2017). Consequently, the study applied Pearson correlation and regression techniques for data analysis in establishing the relationship between the financial success of a firm and the size of its board. The structural model below depicts how board size influences the financial success of private companies in Uganda.

$$FP = \beta_0 + \beta_1 BSIZE + e$$

where FP is Financial performance, β_0 is a constant, β_1BSIZE is coefficient of board size and e is the error term.

RESULTS

Sample Characteristics

Characteristics of private limited companies encompassed their location, sector, and board size, as shown in tables 1,2, and 3.

Table 1: Location of Private Limited Companies

	Frequency	Percent	Cumulative Percent
Western Region	119	30.2	30.2
Central Region	275	69.8	100.0
Total	394	100.0	

Source: Primary Data

Table 2: Sector of Private Limited Companies

	Frequency	Percent	Cumulative Percent
Agriculture	62	15.7	15.7
Industry	139	35.3	51.0
Services	193	49.0	100.0
Total	394	100.0	

Source: Primary Data

Table 3: Distribution of Frequency by Board Size

	Frequency	Percent	Cumulative Percent
Below 5 Members	281	71.3	71.3
5-10 Members	92	23.4	94.7
10-15 Members	19	4.8	99.5
Above 15 Members	2	.5	100.0
Total	394	100.0	

Source: Primary Data

The majority (68.9%) of the companies were in Central Uganda, compared to 32.2% in Western Uganda (Table 1). This implies that private companies in Uganda mainly function in Kampala city. Besides, a substantial proportion (49%) of companies belong to the service sector, with a significant (35%) in the industry sector and 15.3% in agriculture (Table 2). This implies that most private companies in Uganda operate in the service sector. Furthermore, results show that the majority (71%) of the private limited companies had boards below five members, 23% between 5 and 10 members compared to 5% with boards above ten members (Table 3). This means that most companies had small boards contrary to best practices of corporate governance.

Pearson correlation and Regression Analyses

Table 4: Regression Analysis

(a) Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.339	.115	.113	.38324

(b) ANOVA

Model.		Sum of Square	Df	Mean Square	F	Sig.
1	Regression	7.474	1	7.474	50.888	.000
	Residual	57.574	392	.147		
	Total	65.048	393			

(c) Coefficients

		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	T	Sig.
1	(Constant)	2.294	.048		47.999	.000
	BDSIZE	.232	.032	.339	7.134	.000

Source: Primary Data

Results presented in Table 4(a) revealed a vital positive association between the board size of the firms and financial performance (r =.34, p<.01). This suggests that having many board members is related to a high financial performance of a company. This is because large boards are characterized by the diversity of skill as well as the experience of the members, and thus increasing the financial performance of a company. Consistent with the above results, the regression results in table 4(c) revealed that board size (B=0.23, p<.001) was a significant predictor of the financial performance, accounting for 12 percent (Table 4(a)) of the variation of the financial success of the private limited firms. Consequently, from the findings above, it can be inferred that the hypothesis

that a desirable relationship exists between financial success and the board size (H1) was supported.

DISCUSSION OF RESULTS

As described above, the board size was gauged using the number of board members in private limited firms. Results (Table 3) indicate that most (71%) of the companies had a board size of fewer than five members, 23% between 5 and 10 members compared to a mild 5% with boards above ten members. These results contradict the Cadbury Committee (2010), which suggests an optimum board size ranging from eight to ten members. Kerzner (2017) asserts that the ideal board size should be about seven or eight directors. Additionally, McGaffigan (2017) proposes that the right board size ought to range between six to fifteen members for enhancing the performance of the firm. Lipton and Lorsch (2016) contend that eight or nine directors are optimal board size for communication as well as coordination.

In Uganda, the financial institutions' Act 2004 (part vii) requires companies to have not less than five board members. Besides, section 19 of the Uganda capital markets guidelines (2003) state that "the board size should not be too large to undermine an interactive discussion or too small that the inclusion of wider expertise and skills to improve board effectiveness will be comprised." The current practice among private limited companies in Uganda as regards board size is also inconsistent with findings of this study where it has been established from the results that large boards are positively related to the high performance of firms financially. This partly explains poor financial results among private limited companies in Uganda.

The board size being among the constructs of corporate governance explains the disparities in the financial success of privately-owned limited companies. It was derived with a proposition that a positive association exists between a firm's financial success and its board size (H1). The correlation analysis outcomes (Table 4) revealed a strong and positive association between a firm`s financial success and the board size. This implies that a significant board results in the superior financial success of a company. These results support the views of Adams and Ferriera (2017) and Eisenberg (2017), who note that many directors on the board lead to is crucial in monitoring and advising management; thus, it is considered a vital mechanism for aligning interests of stakeholders and management in an organization. Additionally, as posited by Duru Et al. (2016), a large board enhances a firm's performance as it controls the CEO's operations, promotes the firm's image, and maintains a good rapport between stakeholders and management hence encouraging the organization's culture. Johnson(2017) and Jiang (2018), further confirm that a large board is desired since it enhances the consideration of varied board members with diverse areas of knowledge and expertise that enhance the financial success of an entity.

Empirically, the results above mirror the findings from several researchers (Chatterjee,2017; Mandala,2018; Nas,2016; Haniffa and Hudaib, 2016; Yawson, 2016). They established that smaller boards are characterized by the domination of CEOs, which gives them a leeway to override board decisions for their selfish interests, therefore escalating agency problems, and stifling a firm's financial performance. Furthermore, against the agency theory, the theory of resource dependency assumes that large boards enhance a company's ability to co-opt a harsh environment hence improving its performance (Bommaraju et al.,2019; Wakaisuka-Isingoma,2016). Similarly, this theory congruently confirms that the effects, as well as divergent unity of big boards, promote

performance by withstanding a severe economic environment. This is because the deficit in connections amongst small boards undermines their capability to get credit facilities (Bommaraju et al., 2019; Wakaisuka-Isingoma,2016). In a related case, large boards can effectively perform their strategic roles hence alleviating agency conflicts. This is critical during periods of financial distress because, in such scenarios, a deficit of diversity characterized by smaller boards amplifies uncertainty regarding strategic growth (Duru et al.,2016). Consequently, this boosts the agency crisis and negatively affects performance in a firm(s)with smaller board sizes.

CONCLUSION

Conclusively, the significant positive impact of the board size on financial success affirms a linear relationship; thus, supporting the hypothesis (H1). The proposed model shows substantial and positive results for the relationship between financial success and the board size. However, given that the study results contradict some empirical findings in the existing literature, which have reported a negative association between financial success and board size, the outcomes of this study should be applied with caution in other countries. These findings should only be used in the context of private limited private companies in Uganda.

STUDY IMPLICATIONS

Theoretical Implication

The study has refuted the theory of agency and confirmed the underpinnings of the theory of resource dependency. Contrary to agency theory, this study points out that expanding the board size is positively related to the financial success of a firm. This is according to the theory of resource dependency, which suggests that due to their linkage and diversity, large boards enhance a company`s capability to co-opt the harsh situations hence improving its financial performance.

Managerial Implication

The study has heightened an understanding of how the board size influences the financial success of an entity, thus promoting the efforts of private limited companies to advance their performance by selecting a diversified and large number of board members. Thus management can recommend their shareholders to accept large boards for diversity and linkage. Management and shareholders of private companies need to appreciate that large boards enhance a company’s capability to co-opt an unfavorable environment hence improving the financial success of a company. Managers must recognize that the active and divergent unity of big boards promotes company performance by transcending the severe economic environment.

RECOMMENDATION

For the growth of private limited companies, the study recommends the expansion of board size positively for board diversity and to achieve financial success. Additionally, the study also advocates for a viable board mix that increases firm value. This will bridge the deficit in connections and expertise that is a characteristic of smaller boards, hence increasing the financial wellbeing of companies. The study also recommends that private limited companies ensure diversity in their board for skills and experience.

STUDY LIMITATION

The study only examined the impact of the board size on the financial success of limited firms. This contradicts the academic debate that designates the board of directors as a dynamic structure with multifaceted characteristics influencing its effectiveness. Therefore, the legitimacy of the study results is limited; thus, findings should be applied with caution. Additionally, a cross-sectional design adopted by the study limits the understanding of the relationship between the variables over time for more reliable conclusions. Despite the above limitations, the present study findings have given a crucial understanding of the association between board size and financial success that can be utilized to increase the success of private limited firms in Uganda.

AREAS FOR FURTHER RESEARCH

Future studies should develop hypotheses based on multiple traits of the directors on the board for a more comprehensive impact analysis on characteristics of the board on a firm`s success. Besides, future researchers can investigate the relationship from a longitudinal point of view rather than a cross-sectional design that was applied in this study. This could correct changes in the data concerning the time element.

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