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## **The Mediating Effect of Managerial Competencies in the Relationship between Corporate Governance and Financial Performance of Companies in Uganda: A Multi- Theoretic Approach**

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# The Mediating Effect of Managerial Competencies in the Relationship between Corporate Governance and Financial Performance of Companies in Uganda: A Multi-Theoretic Approach

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## Abstract

**Purpose:** The dwindling financial performance of companies has attracted enormous attention globally for many years, and corporate governance remains a matter of public and academic debate. This study aimed to establish the mediating role of managerial competencies in the relationship between corporate governance and the financial performance of companies in Uganda.

**Materials and Methods:** The study applied a positivist paradigm and a cross-sectional design. Data were obtained from a sample of 394 private companies drawn from central and western Uganda. Companies were stratified by region, sectors, and subsectors; and then selected using simple random sampling from each stratum. A structured questionnaire was distributed to board members, Chief Executive Officers, accountants, Internal Auditors, and managers who were selected purposively. Principle

Component Analysis and varimax rotation were employed for data extraction and reduction. The hierarchical regression technique was employed for data analysis.

**Findings:** The study results confirmed managerial competencies to be a partial mediator, of the relationship between corporate governance and financial performance of companies in Uganda.

**Implications to Theory, Practice and Policy:** Building on a multi-theoretical approach, the study advocates for the revision of corporate governance and recommends private companies prioritize managerial competencies in their recruitment processes and training programs to enhance their financial performance.

**Keywords:** *Corporate Governance, Managerial Competencies, Financial Performance*

## 1.0 INTRODUCTION

There is an ever-increasing debate on the dare financial performance of companies across the globe. The discussion was prompted by the collapse of many companies such as WorldCom, Enrol, and Arthur Andersen, the Asian financial crisis in the 1990s, the U.S Savings and Loans crisis in the 1980s, and other financial scandals worldwide, which have resulted in constant demand for improved corporate governance, making it a significant concern (Baydoun *et al.*, 2013 and; Dzingai and Fakoya, 2017). Whereas every company's target is sound financial performance, private companies in developing economies face challenges of poor performance (Akisimire, 2016). In Uganda, there have been cases of poor financial performance with private limited companies suffering the most. For instance, by the close of trading in June 2017, NIC Holdings Ltd had faced a decline in its ROA and ROE by 9.59% and 19.68%; UMEME by 75.78% and 74.16%; Uganda Clays Ltd by 9.51% and 0.49 among others respectively (<http://crestedcapital.com/equity-market/company-reports/2017-2/>). In 2015, Uchumi Uganda closed due to consistently registering losses year to year (Akisimire, 2016). Besides, there is a high mortality rate of companies in Uganda, with 90% of them operating for less than 20 years due to poor financial performance (Private Sector Foundation, 2014). As a result of all these scandals, governments and private sector organizations around the world have made various efforts to promote good governance in both the private and public sectors hence leading to the emergence of numerous governance guidelines and codes (Braga-Alves and Shastri, 2011; Price et al, 2011).

Corporate governance is a set of relationships between the company's management, its board, shareholders, and other stakeholders (OECD, 2013). High-quality governance is indispensable for improving the performance of organizations, improving the investment atmosphere, and enabling investors' rights. It enhances economic development as it contributes to economic growth and financial stability by reinforcing market confidence, financial market integrity, and economic efficiency (OECD, 2013). Corporate governance has attracted significant consideration in scholarly research with extant studies (Dzingai and Fakoya, 2017 and Muriithi, 2011) on corporate governance and financial performance predicting a positive association. Garcia-Ramos and Garcia-Olalla (2011) in their study on the family-ownership structure and board of director's effectiveness among European firms indicate that firms with efficient corporate governance enjoy a lower cost of capital and lower operating expenses, which in turn improves their profitability.

The preceding discussion and theoretical underpinnings suggest that managerial competencies mediate the relationship between corporate governance and financial performance. As noted by Khurana (2011), the board of directors should select competent Chief Executive Officers (CEOs) with skills as a top priority for their firms to gain a competitive advantage. A competent management team will utilize their expertise to predict the future and prepare the company for any change. It is further urged that corporate managers often use their knowledge, skills, and expertise to pursue superior financial performance and maximize firm value for the stakeholders (Williamson, 2011 and Stulz, 2010). Therefore, firms can utilize corporate governance to control discretionary managerial decisions hence achieving better financial performance (Miller, 2011; Myers, 2010). It is imperative to note that an independent board is an essential factor in monitoring the actions of the company managers. It is, therefore, central for board members to ensure proper management of the company through efficient recruitment processes (Chtourou et al, 2011). From the above debate, it can be deduced that managerial competencies act as a conduit in the association between corporate governance and financial performance. This assertion rhymes with

observations of Xie et al (2003) and Chtourou *et al.* (2011) who noted that a board of directors without a management team with suitable competencies in finance and accounting may be able to control business processes but may not control workers' knowledge and expertise in manipulating earnings and the likely risk implications.

The agency and upper echelons theoretical underpinnings support a debate that managerial competencies mediate the corporate governance-financial performance connection. The agency theory advocates that shareholders appoint managers and delegate to them authority to run the business on their behalf. The theory further suggests that the board does not directly implement strategies and decisions in organizations but rather works through management to influence financial performance (Fama and Jensen, 2011). Besides, Byukusenge et al (2016) concluded that with the increase in size and type of private companies, corporate governance no longer stands out as a sufficient factor in improving the entity's financial performance. Orobia et al (2020) posited that for the sustainability of business performance, managerial competencies need to be well utilized by the board not only effectively but also innovatively. The forgoing debate points to managerial competencies as a critical factor in mediating the relationship between corporate governance and financial performance. The above debate posits that the board does not directly implement strategies and decisions in organizations but rather works through management to influence the financial performance of organizations. This concurs with Agrawal and Chadha (2005), who indicated that the probability of earnings manipulation is low for firms with a competent board and a management team who know accounting and finance. Besides, Byukusenge et al (2016) concluded that with an increase in private companies in size and type, corporate governance no longer stands out as a sufficient factor in improving the entity's financial performance. Byukusenge and colleagues argued that for the sustainability of business performance, managerial competencies need to be well utilized by the board not only effectively but also innovatively. This points to managerial competencies as a critical factor in mediating the relationship between corporate governance and financial performance.

Despite the theoretical assertions and a vibrant debate highlighting the mediating role managerial competencies play in the connection between corporate governance and financial performance, empirical evidence is still limited. In the context of private limited companies, studies have either focused on large organizations from developed economies, a single industry in multi-sectoral economies, or only direct relationships hence rendering their conclusions uncertain. While examining the role of corporate governance on Savings, credit, and cooperative societies in Uganda, Ssekakubo et al (2014) confirmed the mediating role of managerial competencies in the relationship leaving other sectors untouched. Their findings concurred with the conclusions of Mwesigwa et al (2014) in their study on the relationship between corporate governance, managerial competencies, accountability, and financial performance of commercial banks in Uganda. Despite the above findings, still, little is still done to test the mediating effect of managerial competencies in the association between corporate governance and firm financial performance among private limited companies.

Notwithstanding the ever-expanding number of studies addressing the association between corporate governance and firm financial performance in the contemporary business world, a few have explored the mediating role of managerial competencies in such relationships (Klein, 2012; Carcello and Neal, 2010). As noted by Jose (2008), a study that does not address the mediating mechanism ends up with facts but with an incomplete understanding of the relationship. Besides, Bennet (2010) notes that a study that fails to consider the possibility of a mediator effect may miss

more justifications for an outcome. Bennet adds that by exploring the mediating effect of variables in the relationship, one can spell out the nature of the relationship and the extent to which the mediating variable influences the connection between the independent and dependent variables. Besides, as noted by Weir and Laing (2010), testing the mediation effect increases confidence in causal relationship claims. Thus, the mediating effect of managerial competencies on the relationship between corporate governance and the financial performance of private companies in Uganda is still an elusive matter that needs to be addressed. This study, therefore, established the mediating effect of managerial competencies in the relationship between corporate governance and firm financial performance hence the following hypothesis;

H<sub>1</sub>: Managerial competencies mediate the relationship between corporate governance and firm Financial performance.

## **2.0 MATERIALS AND METHODS**

### **Philosophical Orientation, Study Design, Study Population, Sample Size, Sampling Techniques and Data Collection Method**

The study employed a positivist paradigm, collecting quantitative data through scientific procedures for the generalization of results (Zuckweiler, Rosacker, & Hayes, 2016). A cross-sectional study design was followed, to detect patterns between variables (Bell, Bryman, & Harley, 2018). The study population comprised 30,000 private limited companies in Uganda (Uganda Bureau of Statistics, 2016), the study surveyed 394 companies determined using a formula by Yamane, (1973). Emphasis was on Western and Central Uganda since 80% of private companies are located there (Uganda Bureau of Statistics, 2016). Private limited companies were categorized using stratified sampling with companies categorized by region and sector. Firms were selected from each district and sector using a simple random sampling technique (Standage, Duda, & Ntoumanis, 2006). The researcher used a self-administered questionnaire for collecting data from board members, accountants, internal auditors, managing directors, and general managers. All companies returned questionnaires, thus achieving a response rate of 100%.

### **Measurement of Variables**

The present study explored corporate governance based on various dimensions including Board Size (the number of directors on the board) (Lawal, 2012; Nicholson and Kiel, 2013), leadership Structure (separate leadership and CEO duality) (Ujunwa, 2012; Haniffa and Hudaib, 2016), audit committee independence (the proportion of independent members on the audit committee in a firm) (Ghabayen, 2012 and Hamdan et al, 2013). The study further included board Composition (in terms of the number of non-executive directors against the total number of directors on the board in limited companies (Kiel and Nicholson, 2013; Heenetigala and Armstrong, 2011), and Stakeholder Management (transparency and accountability), all (Hillman and Keim, 2011). On the other hand, managerial competencies constituted knowledge, skills, and abilities (Orobia et al, 2020; Kerr and Werther, 2018). Furthermore, the study used profitability (ROA, ROE, net profit margin), liquidity (current ratio), solvency (Debt to equity ratio), and financial efficiency (asset turnover ratio and operating expense ratio) to measure financial performance. Financial ratios were determined from the financial reports of companies (Haat et al, 2018; Imam and Malik, 2017).

## Data Analysis

After data cleaning (for missing values and outliers) and exploratory factor analysis, the compressed data were subjected to further statistical tests to ascertain their conformity to parametric assumptions. Podsakoff *et al.* (2012) noted that before parametric analytical techniques are adopted, data should be checked for compliance with parametric assumptions. The study, therefore, tested for normality, linearity, homogeneity of variance, independence of errors, and multicollinearity and all met the minimum requirements as recommended by Tabachnick and Fidell (2001). Hierarchical multiple regression was used in testing the relationship between variables thus, testing the study hypothesis (Tabachnick, Fidell, & Ullman, 2007). Baron and Kenny (1986) posit that, for a mediation test to be reliably conducted; 1) the independent and dependent variables should be strongly associated, 2) the predictor variable should significantly influence the mediating variable, 3) the mediating variable should substantially influence the dependent and, 4) the effect of the independent variable on the dependent variable should reduce when the mediating variable is introduced in the model. These assumptions were checked and confirmed through regression analysis (Baron and Kenny, 1986; Field, 2006). Hierarchical regression analysis aided the study in systematically identifying the contribution of each variable in explaining the predictive power of the model. Furthermore, the study used an additional criterion of bootstrapping in the AMOS program version 22 to ascertain the effect size and statistical significance of the mediation (Tabachnick and Fidell, 2001).

The following regression equations were therefore specified to test the mediation effect of managerial competencies (Jose, 2008).

$$MComp = b_0 + b_1 CorpGov + e \dots \dots \dots i$$

$$FP = b_0 + b_1 CorpGov + e \dots \dots \dots ii$$

$$FP = b_0 + b_1 CorpGov + b_2 Mcomp + e \dots \dots \dots iii$$

Where Mcomp= managerial competences; CorpGov= corporate Governance; FP= financial performance;  $b_0$ = Constant;  $b_{1\&2}$ = beta coefficients; e = error term

## 3.0 FINDINGS

### Demographic Characteristics

A significant proportion (49%) of companies operated in the service sector, with a substantial (35%) in the industry sector and 15.3% in agriculture. A substantial portion (35.5%) of companies had operated for a period between five and ten years, 31% above 15 years, 21% less than five years with a mild proportion (11.9%) having operated for a period between 10 and 15 years. The majority (68.9%) of these companies were in Central Uganda, compared to 32.2% in Western Uganda. Furthermore, 38.6% of the participants were Accountants, 33.8% managers, 15.5% managing Directors, and 7.8% board members compared to Auditors (4.3%). This means that the study covered personnel in charge of decision-making and critical operations of companies, thus providing accurate responses. A significant proportion (41.6%) of respondents had spent 3 to 5 years in their positions, 26.4% had spent between 6 to 8 years, 19.5% up to 2 years with a marginal 12.7% having spent 10% years and above in their positions. This implies that most respondents were highly experienced and with broad knowledge about operations, thus being able to provide more reliable responses.

### Regression Results, Testing for the Mediating Effect

Following the recommendations of Jose (2008), on confirming the association between study variables and; in line with the study purpose, this study explored the mechanism through which corporate governance influenced the financial performance of private limited companies by testing the mediating effect of managerial competences in the relationship. Thus, hypothesis that “*Managerial competencies mediate the relationship between corporate governance and firm Financial performance*” was tested.

The results of the hierarchical regression analysis for the mediation test are presented in Table 1.

**Table 1: Hierarchical Regression Results for Mediation of Managerial Competences**

Predictor	Dependent Variables								
	Managerial Competence			Financial Performance					
	Model 1			Model 2			Model 3		
	Unstandardized Coefficients		Standardized Coefficients	Unstandardized Coefficients		Standardized Coefficients	Unstandardized Coefficients		Standardized Coefficients
B	SE	Beta	B	SE	Beta	B	SE	Beta	
(Constant)	27.36	1.50		1.17	0.10		0.90	0.13	
Corporate Governance	0.21	0.01	0.76***	0.01	0.00	0.60***	0.01	0.00	0.46***
Managerial Competences							0.01	0.00	0.18**

Note: \*\*\*  $p < .001$ , \*\*  $p < .01$ ,  $N = 394$

Source: Primary Data

The hierarchical regression analysis (Table 1) revealed that corporate governance significantly influenced managerial competencies ( $\beta = .76$ ,  $p < .001$ ) in model 1. In model 2, the influence of corporate governance on financial performance ignoring managerial competencies (mediator) was significant with a coefficient of ( $\beta = .60$ ,  $p < .001$ ). While controlling for corporate governance, managerial competencies were found to have a considerable influence on financial performance, given a beta coefficient of ( $\beta = .18$ ,  $p < .01$ ). Additionally, with an introduction of the mediator (managerial competencies) in model 3, the influence of corporate governance on financial performance decreased dramatically from ( $\beta = .60$ ,  $p < .001$ ) to ( $\beta = .46$ ,  $p < .001$ ). However, it remained highly significant, thus confirming partial mediation (Jose, 2013). From these results, a ratio index given by  $[(.60 - .46) / .60] * 100$  indicated that 23% of the influence of corporate governance on financial performance was explained through managerial competencies and 87% of the effect was direct (Jose, 2013).

These results, therefore, indicated conformity to mediation assumptions by Baron and Kenny (1986) and supported the hypothesis that “managerial competencies mediate the relationship between corporate governance and firm financial performance of private limited companies” (H1). This means that whereas corporate governance can influence financial performance, a company can achieve greater performance if the board of directors works with a competent management team that will aid the implementation of policies and strategies, hence improving financial performance.

## Discussion

### **The Mediating Effect of Managerial Competencies in the Relationship between Corporate Governance and Financial Performance**

To establish the mechanism through which corporate governance influences financial performance among private limited companies in Uganda, the study investigated the mediating role of managerial competencies in the relationship between corporate governance and financial performance among private limited companies. Jose (2008) noted that a study that does not address the mediating mechanism ends up with facts but with an incomplete understanding of the relationship. It was hypothesized that managerial competencies mediate the relationship between corporate governance and firm financial performance (H1). Results in Table 1 (model 3) indicated that the effect of corporate governance on financial performance reduced albeit remained significant with the introduction of managerial competencies (the mediating variable) in the model compared to its main effect. Given that all mediation conditions, as suggested by Baron and Kenny (1986), were met, it confirms that managerial competencies partially mediate the relationship between corporate governance and the financial performance of private limited companies in Uganda, thus supporting hypothesis H1. This conceptually implies that since the board of directors does not engage in daily operations and direct implementation of decisions, they work through management to influence the financial performance of companies.

The study results coincide with the conclusions of Byukusenge et al (2016) who posited that with the growth of the private sector, corporate governance no longer stands out as a sufficient factor in stimulating the financial performance of companies. Byukusenge et al argued that for the sustainability of business performance, managerial competencies need to be well utilized by the board not only effectively but also innovatively. These study results further agree with the empirical conclusions of Miller (2011), Myers (2010). They argued that firms should utilize corporate governance mechanisms to enhance managerial competences and decision making if they are to achieve higher financial performance. They recognize that managerial competencies are a conduit between corporate governance and the financial performance of an organization. Additionally, the results link well with the agency and upper echelons theoretical underpinnings, which suggest that the board can choose competent managers whose education and experience form the knowledge and skill base. These competences positively predict receptivity to innovation since they translate into solutions that are more creative hence improving the company's financial performance. Central to the above results, although managerial competences weaken the main effect of corporate governance, the fact that the direct effect of corporate governance remained statistically significant even after the inclusion of the mediator implies that corporate governance remains a substantial determinant of the financial performance of private companies of Uganda (Jose, 2013).

## **4.0 CONCLUSION AND RECOMMENDATIONS**

### **Conclusion**

In a related case, the study established that managerial competencies play a mediating role in the relationship between corporate governance and financial performance. It was observed that managerial competencies weaken the influence of corporate governance hence indicating partial mediation. This study, therefore, underscores managerial competencies as being critical to the



effective execution of business processes and the attainment of superior financial performance for companies. It can be deduced that private limited companies that will survive competition are only those that can attract highly competent individuals who will refine their strategic direction, thus improving their financial performance. However, the significant direct effect of corporate governance on financial performance demonstrates that despite the existence of managerial competencies, corporate governance still plays a critical role in influencing the financial performance of an entity though it is not sufficient without managerial competencies.

### **Theoretical Implication**

Empirical findings from this study revealed that the financial performance of private limited companies in Uganda is explained by corporate governance through managerial competencies. This implies that theoretically, financial performance can be explained by integrating constructs from agency theory and upper echelons theory. In line with the upper echelons theory, the study established a significant association between managerial competencies and the financial performance of private limited companies. It was established that in private limited companies, executives act based on their personalized interpretations of the strategic situations they face. These interpretations are a function of their experiences, values, and personalities, thus supporting the theory. The misperception of the echelons' contribution to financial performance has, therefore, been addressed in the present study. In a related case, from the perspective of agency and upper echelons theories, the study findings revealed that managerial competencies partially mediate the relationship between corporate governance and the financial performance of private limited companies in Uganda.

### **Managerial Implication**

Furthermore, the study has brought out the inevitable role managerial competencies play in explaining the corporate governance-financial performance relationship in entities. Thus, besides investment in physical capital, private limited companies should invest in human resources. They should invest in programs aimed at improving the skills of workers, and attract and retain highly competent managers who will change their strategic direction, thus ensuring a sustainable competitive advantage.

### **Policy Implication**

The findings of this study have important policy implications for the country and the region at large. This study argues that regulations relating to corporate governance should be reviewed. For instance, a model should be developed for private limited companies in Uganda, depicting the dimensions of corporate governance and managerial competencies conceptualized in this study. Moreover, the variables and their association in this study have been conceptualized and confirmed based on study findings, international systems, and practices of corporate governance.

### **Recommendation**

From the upper echelons theoretical perspective, given the mediating role of managerial competencies that has been confirmed in this study, private companies in Uganda should have robust recruitment processes aimed at identifying and retaining highly competent staff. These processes should go beyond just professional competencies. As it is deep-rooted by the study findings, organizational outcomes, strategic choices, and performance levels are partially predicted by managerial background characteristics such as knowledge, skills, and abilities.

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