THE EFFECT OF BOARD SIZE ON FIRM FINANCIAL PERFORMANCE OF LISTED FIRMS IN NAIROBI SECURITY EXCHANGE

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ABSTRACT

The study sought to establish the effect of board size on the performance of listed firms in Nairobi security exchange. It was guided by agency theory, upper enchlon theory which captured the board's monitoring role. The study used exploratory research design. The study employed panel approach for a period covering ten years from 2006-2015. The target population comprised of all 68 listed firms in Nairobi Securities Exchange. The study used secondary data which was obtained from annual reports and NSE bulletins. Data was analyzed using both descriptive and inferential statistics. Specifically, multiple regression was used to test the hypothesis. The study found a significant positive effect of board size on firm financial performance.

Keywords: Board size, financial performance, security exchange.

Introduction

Financial performance is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. Rahman and Haniffa (2006) reasoned that financial performance of a firm can be used to determine its operating performance that means that the firm's performance is in quantifiable metrics.

Board size is also viewed as a proxy to measure the diversity of the knowledge pool and the availability of resources provided by the board from the perspective of resource dependence theory. Boards in unlisted firms can potentially complement a management team's knowledge base (Gabrielsson and Huse, 2005; Minichilli *et al.,* 2009). A larger board is more likely to have a wider range of skills, knowledge, and expertise which, in turn may contribute to both its monitoring and service roles (Corbetta and Salvato, 2004). Moreover a large board may counter the weight of a CEO (Maere *et al.,* 2014).

According to agency theory, the main argument in favor of a larger board of directors is that the increase in the number of members raises their disciplinary control over the CEO

(Brédart, 2014). Jensen (1993) confirmed that the smaller board size is more correlated with the quality of monitoring. Lipton and Lorsch (1992) also stated that the board might become less effective in monitoring management when its size increases. They recommended that board membership should be between eight and nine persons, and any additional benefits that can be gained from the increased monitoring by additional membership will offset the costs linked with slow decision making.

Empirical evidence on the effect of board size on firm performance provided mixed results. While, Ahmadu et al. (2005), Chan and Li (2008), De Andres et al. (2005) and Mustafa (2006) found that larger boards are associated with poorer performance, Beiner et al. (2004), Bhagat and Black (2002) and Limpaphayom & Connelly (2006) found no significant association between board size and firm performance.

The board of directors is one of the central institutions to ensure firms act in the interest of their stakeholders and mitigate the agency problem between management and shareholders (Fama and Jensen, 1983). Therefore, the board plays a significant role in ensuring that the firms' financial performance is sound. Therefore, this study will seek to find out the effect of board size on firm financial performance in the listed firms in Nairobi Security Exchange (NSE).

METHODOLOGY

This study used exploratory research design. The emphasis of exploratory studies is to study a situation or problem in order to establish whether causal relationships exist between variables. This design is suited to this study as it used secondary data on all variables and relationships between variables was interrogated without making any attempt to influence the variables.

Panel data was used in this study. Panel data entails studying of a particular subject within multiple sites, periodically observed over a defined time frame (Gujrati, 2003). In this study balanced panel data was used in which each cross section unit has same number of observations.

The target population comprised of all firms listed in Nairobi Securities Exchange (NSE) in Kenya. The total number of listed firms in Nairobi securities exchange at the end of 2015 is 68 (NSE handbook, 2015). The target population consists of 68 companies for the period 2006- 2015. However, listed firms to be included in the study are those that were trading on the NSE during the period, and therefore firms that were listed after 2006 and those were delisted or deregistered during the period of study was excluded from this study.

The panel data was collected from the yearly financial reports of the companies. The annual reports from the NSE and CMA, and downloads of other journals from the company websites was also used.

Secondary data was used in this study which was derived from secondary sources including journals, Nairobi Securities Market reports, Capital Market Authority reports, the specific company annual reports and their websites.

Data Analysis

The research employed both descriptive statistics and inferential statistics. Descriptive statistics provided simple summaries about the sample and the observations were made. This often involves summarizing the central nature of variables, it also comprised the spread or range of scores, as well as the average difference each score is from the mean. Descriptive statistics include measures of skewness, and kurtosis to indicate how asymmetric or lopsided, and how peaked or heavy-tailed, respectively is a distribution of scores. Thus, descriptive statistics summarize basic characteristics of a distribution such as central tendency and standard deviations.

Inferential statistics was concerned with making predictions or inferences about the population from observations and analyses of a sample. It allows generalization beyond the sample data to a larger population. To address the issue of generalization, Chi-square was used to tell the probability that the results of the analysis on the sample were a representation of the population that the sample represented.

RESULTS AND DISCUSSIONS

The sample comprised of firms listed in Nairobi Securities Exchange. Secondary data was collected for a period of ten years from 2006 to 2015. Twenty-five firms were removed from the analysis as a result of incomplete data. The final sample comprised of 43 firms making a total of 430 observations.

Descriptive Statistics

The means and standard deviations of the variables in the study are presented in the table below.

	Mean	Std. Deviation	N
ROA	1.106250	0.361890	430
Profitability	Profitability	0.614836	430
Financial Leverage	0.409281	0.198333	430
Board Size	8.765625	2.314884	2.314884

Inferential Statistics

Research findings showed that board size had correlation coefficients of estimate which was on $\beta 1 = -0.005$ (p-value = 0.0084) which is less than $\alpha = 0.05$) implying that we reject the idea stating that there is no significant effect between board size and firm performance.

CONCLUSION AND RECOMMENDATION

The findings seem to suggest that greater emphasis need to be taken by firms to have larger board size which is argued and found in this study to have a positive implication on firm performance. Future research could also explore on board characteristics and firm performance by using different research method.

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