# Corporate Board Leadership Structure and Financial Performance: The Stewardship And Agency Theoretical Perspectives Of Private Limited Firms In Uganda

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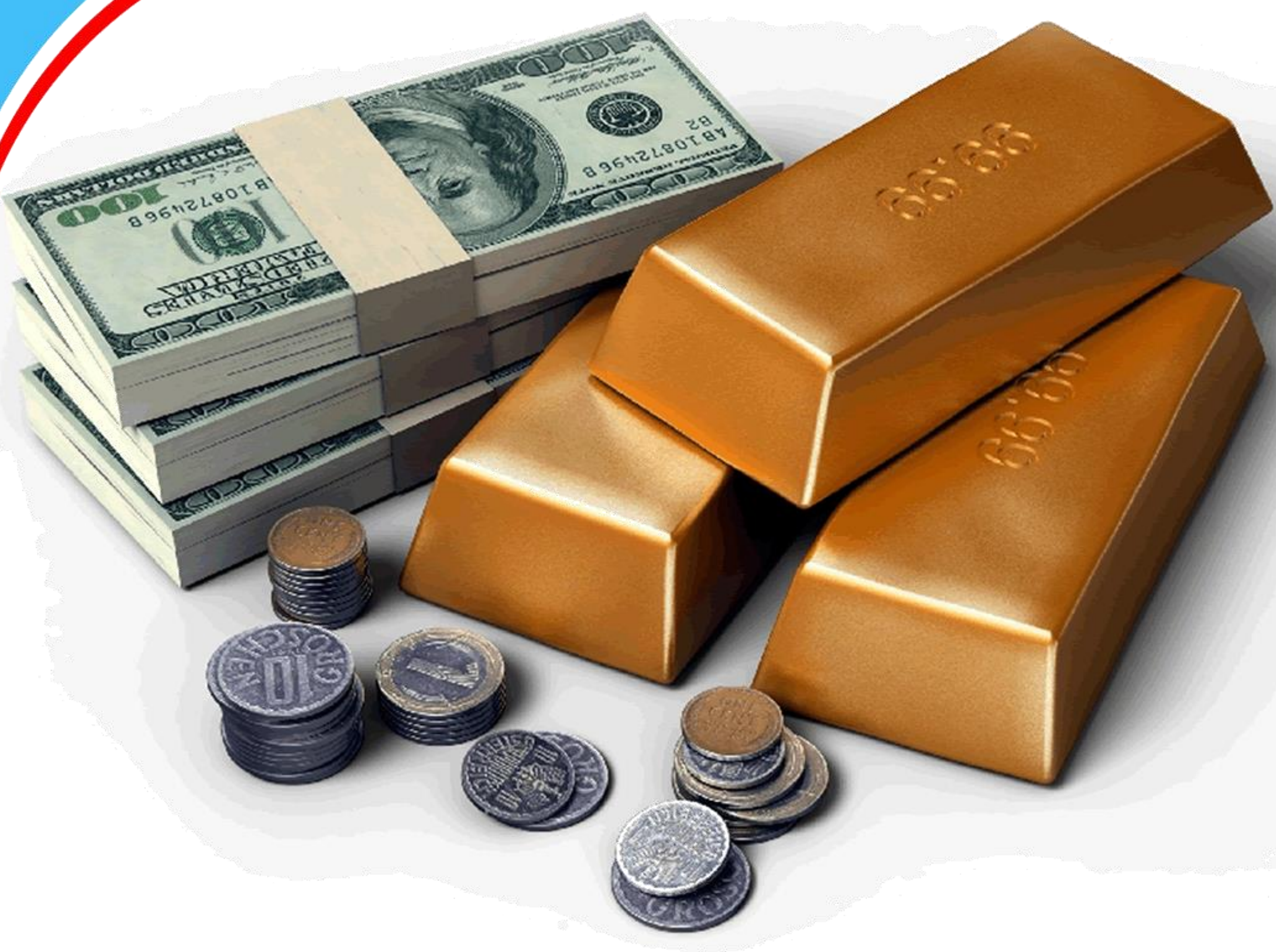

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# Corporate Board Leadership Structure and Financial Performance: The Stewardship And Agency Theoretical Perspectives Of Private Limited Firms In Uganda

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**Abstract**

**Purpose:** This study aimed to establish the association between the board leadership structure and the financial performance of private limited companies in Uganda.

**Methodology:** The study adopted a positivist paradigm and a cross-sectional design. 394 private companies were sampled from Central and Western Uganda. Quantitative data were collected from board members, accountants, auditors, and CEOs using a self-administered structured questionnaire. Pearson correlation and standard regression analyses were conducted for data analysis.

**Findings:** The study established a positive relationship between a separate leadership structure and the financial performance of private companies. Separate leadership was confirmed as a recipe for private companies' financial success, accounting for 7% of the variance. The study also revealed that CEO duality was common amongst most private limited companies in Uganda.

**Unique Contribution to Practice and Policy**: The study calls for a re-examination of the current policy on governance to make the corporate governance code obligatory to all firms and not just the listed entities. Regulators ought to reinforce their monitoring approach to effect adherence to the governance code.

**Keywords:** *Separate Leadership, Financial Performance, Private Limited Companies*

## 1.0 INTRODUCTION

Policymakers, investors, and researchers have greatly appreciated the board of directors' role in improving companies' financial performance (Osazevbaru & Imasuen, 2022; Ozbek & Boyd, 2020). This emanates from the poor financial performance that has caused the early demise of private companies in developing and developed economies (Song & Kang, 2019). Several international companies, such as Marilyn Lynch and JP Morgan collapsed as a result of poor financial performance (Ghabayen, 2012). Like other regions, East Africa is facing challenges in the private sector where 70% of private companies collapse within 24 months due to poor financial performance, and Uganda tops countries with the highest rate (30%) of failing businesses (Orobia et al, 2020). Despite Government efforts to cushion private entities against financial shocks through subsidized lending, Uganda witnessed large-scale corporate failures where international and indigenous companies have since collapsed consequent to poor financial performance (Mugisha et al, 2020). The poor financial performance of private companies is likely to have drastic effects on the country's economic development if not checked.

Extant literature suggests that the financial performance of companies is associated with their board leadership structure (Chiraphol et al, 2021 & Asogwa et al, 2019). Corporate board leadership structure resides in the possibility of the CEO and board's chairman being the same individual or otherwise (Osazevbaru & Imasuen, 2022; Krause, 2017). On the other hand, financial performance refers to how well a firm fulfills its financial goals compared with its competitors (Yu et al, 2019). Empirically, there have been numerous attempts at validating either agency theory or stewardship theory as the finest way to conduct governance in companies with inconclusive findings (Lohde et al, 2021; Torfing & Bentzen, 2020). This study therefore examined stewardship and agency theories in comprehending the relationship between corporate board leadership structure and financial performance. The agency theory as coined by Jansen and Meckling in 1976 supports the separation of the roles of the CEO and the board chairman, which renders the board more autonomous from the management, leading to better monitoring and improved financial performance (Vitolla et al, 2020 & Guerrero et al., 2017). In contrast, the stewardship theory as advanced by Donaldson and Davis in 1991 (Torfing & Bentzen, 2020) is opposed to the separation of leadership and suggests that flawless management is achieved from the CEO duality leadership style (Merendino et al., 2018). It further expounds that whenever the decision-making process, as well as responsibilities, are left to the discretion of one person, valuable insights, and an understanding of the firm operations, are easily achieved (Sarim, 2020). This, in turn, improves decision-making and cuts agency costs, producing a desirable impact on its financial performance (Richards, 2017; Proctor, 2018; Shollo & Galliers, 2016; Miller, 2020).

On the contrary, the Agency theory emphasizes that the board chairperson is mandated with the entire supervision of the board, organizing and coordinating board meetings, authorizing remuneration of the CEO, and monitoring and recruiting the executive (Miller, 2020). Unlike the CEO, whose chief responsibility is to oversee the firm to effect the board decisions, policies, and strategies, the laxity by the executive arises in serving shareholders' interests. Therefore, apportioning all these roles to a single individual escalates the challenges as the efficacy of monitoring the executive will be diluted (O'Leary, 2020). Smith et al. (2018) reinforced this assertion by maintaining that CEO duality tightens one's grip over control of all members while dwindling the powers of the board on the other hand. As such, this precipitates a supremacy battle between the principal and agent as the capability of the director to achieve the role of monitoring is immensely impeded, which plummets the company's financial performance. Ehikioya (2018), and Lipton and Lorsch (2016) advocated for separate leadership in enhancing board independence by ensuring checks and balances over the executive. Segregation of duties restricts management from pursuing selfish gains to the disadvantage of shareholders. Morais et al. (2019) asserted that the separation of leadership detaches the monitoring responsibility of non-executive directors from the decision-control function of the executive. From the above debate, it can be observed that the literature on the relationship between board leadership and financial performance is still elusive and replete with mixed findings.

This study, therefore, addresses whether the board leadership structure influences the financial performance of private limited firms in Uganda. In so doing, it contributes to the literature by explicitly examining board composition. A more frequent setting has also been used to analyze the context of multiple board leadership prescriptions. By investigating whether board leadership structure can influence financial performance, this paper offers more empirical evidence relevant to private limited companies in developing economies, specifically Uganda. This paper is organized as follows: The first section focuses on the introduction of the study. The second part entails the literature review and hypothesis development. The third section presents the methodology. The fourth section presents the study's empirical results through a detailed statistics description. The fifth section discusses the study results from which conclusions and recommendations are drawn.

## 2.0 LITERATURE REVIEW

### Theoretical Review

Numerous fundamental theories underlie corporate governance, and these include; the agency and stewardship theories. This section, therefore, entails details of agency and stewardship theoretical underpinnings on account of financial performance among private limited companies in Uganda.

### Agency Theory

The agency theory was first explored by Adam Smith in the $18^{th}$ century and later by Ross in 1973 with the first detailed description by Jensen and Meckling in 1976, Fama and Jensen in 1983, and Williamson in 1987 (Moloi et al, 2020). These were followed by Aghion and Bolton in 1992 and later, Hart in 1995 (Cuevas-Rodriguez *et al*., 2012). This theory assumes that shareholders appoint managers and delegate to them authority to run the business on their behalf (Al-Najjar, 2014 & Jensen, 2014). The contract between the owners (principals) and the managers or directors (agents), defines the agency relationship between two parties and shareholders expect managers to act and make decisions in the owners' interests (Cuevas-Rodriguez *et al*., 2012). However, managers may not necessarily always make decisions in the best interests of shareholders. The Agency theory, therefore, aims at determining the most cost-effective governance method for tackling any possible agency issues (Moloi et al, 2020). The theory suggests that the separation of the positions of chairman and Chief Executive Officer (CEO) leads to higher performance. The chairman remunerates the chief executive officer and supervises the board; thus, an assumption of these roles by one person results in a dilution of the effectiveness of monitoring the CEO hence increasing the agency problem (Jensen, 2014).

In a nutshell, the agency theory applies to this study more than not as it emphasizes strong corporate governance mechanisms such as separate leadership structure which is the focus of this study. This is because private limited companies operate in complex environments thus their financial performance has a bearing on the strength of their governance structures (Davis et al 2011). However, although agency theory advocates for the separation of power, Weir et al (2014) suggest that efficient management is an output of the principle of the unity of command, hence advocating for CEO duality. Moreover, Roberts and Dowling (2012) contended that when responsibilities and decisions are constrained to one person, there is greater understanding and knowledge of the firm's operations and better decisions, which will reduce the agency problem and thereby enhance financial performance.

### Stewardship Theory

Donaldson and Davis introduced this theory in 1989 as a normative alternative to Agency theory (Karns, 2011). It assumes that the executive manager is a steward of the business with behaviors and objectives consistent with those of the owners. The theory assumes that integrity, justice, and respect are core values of a firm and serve as a foundation for management's actions in all decisions. Management makes decisions based on the perception of what is best for the group than an individual. They are assumed to feel obligated to account for and disclose information to all stakeholders to improve corporate performance (OECD, 2015). Stewardship theorists, therefore, build structures that empower and facilitate the management, believing that it is not necessary to develop control or monitoring mechanisms since management has the same intrinsic values as the owners (Davis et al, 2013). The theory holds that efficient and effective management is an output of the principle of unity of command; thus, it advocates for CEO duality. In this perspective, when one person takes responsibility and decisions, there is a greater understanding and knowledge of the firm's operations. Such duality reduces the agency problem and thereby enhances financial performance (Dalton and Rechner, 2010). This argument rests on the premise that managers who identify with their organizations and are highly committed to their organizational values are more likely to serve corporate ends (Karns, 2011).

Notwithstanding its suggestions, the stewardship theory is criticized on several grounds. The theory falls short for advocating for CEO duality. Yet, according to the existing literature and agency theoretical underpinnings, CEO duality increases one's control over all members and shrinks the power of the board; thus, expanding the agency problem since the effectiveness of monitoring the executive will be diluted. The theory also suggests that managers act as stewards focusing on organizational goals than personal interests. However, it does not clarify whether there is a limit to the behavior of the steward. In the case of private companies, profits must be generated; hence, the pro-organizational conduct of a steward does not mean they do not have survival needs. Furthermore, the theory holds that since directors are trusted and expected to act in the best interest of the company and owners, there is no need for mechanisms of monitoring and control. However, given the history of corporate scandals and failures the world over like in Enron and Worldcom, the practical application of such a theory can only be tested in this study.

## Empirical Review

### Separate Leadership and Financial Performance

Numerous empirical studies endeavored to establish whether financial performance and board leadership structure are connected, but their findings were inconsistent. Singh and Delios (2017) interrogated the correlation of the Indian firm's financial success to their governance structures. They discovered that it is harmful to collapse the roles of the chairman and the CEO into one person. Similarly, Ozbek and Boyd (2020), Song and Kang (2019), Nguyen and Chau (2020), and Njenga (2018) established that CEO duality is a harmful ingredient for any firm that is focused on the achievement of sound financial performance. However, Park et al. (2018) studied 500 Fortune companies and affirmed that CEO duality facilitates a firm's financial performance by circumventing unwarranted bureaucracy, quickening decision-making, and timely attainment of financial performance. Krause (2017) noted a significant positive correlation between combining the roles of the CEO and board chairman. Moreover, a study by Agyei-Boapeah (2018) established that a separate leadership structure hardly affects the market value. Haniffa and Hudaib (2016) also investigated the financial performance- connection to the governance structure of 347 privately-owned organizations listed on the Stock Exchange in Kuala Lumpur. Their results established that separate leadership is not associated with the firm's performance. Additionally, Cheng et al. (2018) contended that their empirical findings did not indicate a statistically significant association between a firm's financial success and CEO duality. Additionally, Mukyala et al (2020) studied the relationship between Corporate Governance and Firm Value for companies listed on the Nairobi stock exchange and observed a positive association.

From the debate, the evaluation of the empirical research yielded valuable facts about the connection between the firm's performance and its board leadership structure (Chuang et al., 2016). Moreover, the detachment of chairman roles from the CEOs renders the directors more practical assessment of the functionality of the management since the agency costs are consequently lowered, as well as the emphasis on accountability and corporate transparency (Liu & Zhang, 2017). Accordingly, in Uganda's context, a separate leadership structure is considered a crucial mechanism of governance to bolster the company's financial performance (Capital Markets Corporate governance guidelines, 2003). Nonetheless, besides mixed opinions characterized by previous studies, they gave more preference to companies in developed economies than those in developing countries like Uganda, thus presenting scanty information about such companies. Moreover, the agency and stewardship theoretical underpinnings present conflicting views, providing no immediate solution. Therefore, to test the above arguments in the context of Uganda's private limited companies, the hypothesis below was proposed:

**$H_{01}$:** There is a positive correlation between Separate leadership and financial

## 3.0 METHODOLOGY

### *Research Paradigm, Research Design, Population, Sample Size, And Sample Selection*

A positivist paradigm and cross-sectional design were adopted to achieve the study objective. Quantitative data were collected from 394 private limited companies. These were derived from a population of 30,000 private limited companies in Uganda (Financial Sector Deepening, 2015) using the following formula by Yamane (1973).

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

Where N= population, n = sample size, and e = standard error of estimate (5%). Companies were stratified by sector and then selected from each sector using a simple random sampling technique. Researchers employed a structured questionnaire to collect data from board members, CEOs, Accountants, and Auditors who were selected purposively. These were found by other researchers (Amedu & Bashir, 2017; Dulewicz, 2018; Bell et al., 2018; Suprianto, 2017) to be the most reliable participants in corporate governance studies, providing reliable information in the present study.

### Measurement of Study Variables

The leadership structure of the Corporate board is generally applied as a dummy variable in various studies on the governance of corporates (Liao et al., 2018; Hajer & Anis, 2018; Schmiedel et al., 2019; Yusoff & Alhaji, 2012). Consequently, the researcher applied it as a dummy variable with separate leadership assigned code '1' and code '0' for CEO duality. Furthermore, the study measured financial performance as the average of accounting-based measures that included profitability (ROA, ROE, and net profit margin), liquidity, and solvency. These approaches have been used in other studies (Imam & Malik, 2017; Haat et al, 2018; Jovanović et al., 2017; Solomon, 2018) and proved to be accurate measures of financial performance.

### Data Analysis

Data were cleaned by addressing missing values and outliers following the guidelines of Pallant (2020). Besides, parametric assumptions of homogeneity of variance, normality, and the independence of errors, were confirmed before data analysis (Chakraborti & Sparks, 2020). Consequently, using SPSS version 20, Regression and Pearson correlation analysis techniques were adopted for data analysis. These analysis techniques were preferred due to their robust predictive power, guaranteeing the results' reliability and validity (Varoquaux, 2018). A linear regression model to empirically test the study hypothesis was estimated, as shown below;

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

where, FP = Financial performance, $\beta_0$ constant, $\beta_1$LSTRUCTURE coefficient of leadership structure, and $e$ = error term.

## 4.0 FINDINGS

### Descriptive Statistics

Results in Tables 1 to 5 indicate frequency distributions of private limited companies by asset base, years of operation, location, sector, and leadership structure, respectively.

**Table 1: Asset Base of Private Limited Companies**

| | Frequency | Valid Percent | Cumulative Percent |
|---|---|---|---|
| Below Ugx 500m | 196 | 49.7 | 49.7 |
| Ugx 500- Ugx 1bn | 84 | 21.3 | 71.1 |
| Ugx 1bn- Ugx 1.5bn | 36 | 9.1 | 80.2 |
| Ugx 1.5bn- Ugx 2bn | 11 | 2.8 | 83 |
| Above Ugx 2bn | 67 | 17 | 100 |
| **Total** | **394** | **100** | |

*Source: Primary Data*

**Table 2: Years of Operation of Private Limited Companies**

| | Frequency | Valid Percent | Cumulative Percent |
|---|---|---|---|
| Below 5 Years | 83 | 21.1 | 21.1 |
| 5-10 years | 141 | 35.8 | 56.9 |
| 10-15 Years | 47 | 11.9 | 68.8 |
| Above 15 Years | 123 | 31.2 | 100.0 |
| **Total** | **394** | **100.0** | |

*Source: Primary Data*

**Table 3: 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 4: 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 5: Frequency Distribution by Leadership Structure**

| | Frequency | Percent | Cumulative Percent |
|---|---|---|---|
| CEO Duality | 218 | 55.3 | 55.3 |
| Separate Leadership | 176 | 44.7 | 100.0 |
| **Total** | **394** | **100.0** | |

*Source: Primary Data*

From the detailed results above, 49% of private limited companies had an asset base below Ugx 500 million, 21% had assets between Ugx 500 million and 1 billion, with a slight proportion (17%) having assets above 2 billion (Table 1). 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 (Table 2). The majority (68.9%) of these companies were in Central Uganda, compared to 32.2% in Western Uganda (Table 3). A significant proportion (49%) of private limited companies that participated in the study operated in the service sector, with a substantial (35%) in the industry sector and 15.3% in agriculture (Table 4). Besides, it was observed that most private firms had not separated the board chairman and CEO's responsibilities and those of the chairman of the board, with the majority (55.3%) practicing CEO duality compared to 44.7% that had a separate leadership structure (Table 5). These results mean that most private companies had the CEO overriding board decisions.

**Table 6: Results of Pearson Correlation and Regression Analyses**

**a) Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | 0.269 | .072 | .070 | .39234 |

**b) ANOVA**

| Model | | Sum of Squares | Df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 4.708 | 1 | 4.708 | 30.583 | .000 |
| | Residual | 60.340 | 392 | .154 | | |
| | **Total** | **65.048** | **393** | | | |

**c) Coefficients**

| | | Unstandardized Coefficients | | Standardized Coefficients | | |
|---|---|---|---|---|---|---|
| **Model** | | **B** | **Std. Error** | **Beta** | **t** | **Sig.** |
| 1 | (Constant) | 2.288 | .061 | | 37.615 | .000 |
| | Separate Leadership | .220 | .040 | .269 | 5.530 | .000 |

*Source: Primary Data*

Results (Table 6a) indicated that a separate leadership structure had a positive relationship with financial performance (*r* =.27, *p*<.01). Consequently, the regression results (Table 6) illustrate that separate leadership bore a palpable good effect on the financial success of private limited companies. It was discovered that separate leadership (*B*= 0.22, $p < 0.05$) predicted 7% ($R^2$= 0.72) of the variation in the financial success of private limited companies. This shows that separating the CEO's roles from those of the board chairperson improves the financial performance of a company. This is true because, with a separate leadership structure, one will check the performance of the other, reducing conflict of interest and agency problems hence sound financial performance of the firm. These results supported the hypothesis that "separate leadership positively associates with financial performance" (H1). These results indicate that for every positive unit change in a separate leadership structure, financial performance will improve by 0.22 units, representing 7% of the total variance. This means that other factors beyond the scope of this study explain the remaining 93% of the disparity in the financial performance of private limited companies.

**Discussion of Results**

The board leadership structure was measured in terms of whether the CEO's responsibilities were separate from those of the board chairperson among the private limited firms. Results (Table 5) indicated that most (55%) of private companies in Uganda practiced CEO duality. This shows that the duties of the board chair, as well as the CEO, were fused to be carried out by performed by one person. This implies that most of the private limited companies in Uganda did not comply with the Companies Act (2012), corporate governance guidelines by Capital Markets Authority (2003), and the financial institutions' Act (2004), which require a separate leadership structure.

Furthermore, results contradict the agency theory and assertions of Ehikioya (2018); Lipton and Lorsch (2016); Solomon (2018); Kamruzzaman (2019), who recommend separate leadership in enhancing board independence since it will ensure checks and balances over the executive. This restricts management from pursuing selfish interests to the disadvantage of shareholders. According to the above, Oh and Cheng (2016) asserted that the CEO's duality increases one's control of overall board members and shrinks its powers. This eventually hinders the ability of the director to carry out their monitoring role, thus increasing the rivalry between an agent and the principal hence affecting firm performance negatively. Besides the above prepositions, the study established that a separate board leadership structure positively impacts the financial performance of private limited companies in Uganda (Table 6).

**Separate Leadership and Financial Performance**

From the context of the agency theory, it was hypothesized that separate leadership was associated with financial performance. Consequently, correlation results (table 6a) revealed a significant positive association between separate leadership and financial performance. This indicates that segregating the duties of the CEO from those of the board chairman boosts financial success in an organization, supporting hypothesis H1. Katmon (2019) and Rono (2018) supported this finding as they asserted that CEO duality increases one's control over all members and shrinks the power of the board, which eventually hinders the ability of the director to carry out their monitoring duty. This increases the conflict between the agent and the principal, negatively affecting the financial performance of a firm. Moreover, Ehikioya (2018), Lipton and Lorsch (2016), and Levrau et al. (2016) recommend separate leadership in enhancing board independence since it ensures checks and balances over the executive and therefore, this restricts management from pursuing selfish interests to the disadvantage of shareholders. This is also consistent with Broye et al. (2018), who maintain that a separate board leadership structure dictates the boundary between the role of monitoring NEDs and the decision-control function of the executive.

The above results show consistency with other studies (Finkelstein, 2018; Rigtering, 2019; Robert, 2017; Brayo, 2016) that found separate leadership to have a crucial link to financial performance. Results from this study are further reinforced by the agency theory, which highlights the board chairman's critical role in overseeing the entire board, unlike the CEO, that ordinarily oversees the firm and is mandated to implement company policies and strategies. Thus, assigning all these roles to an individual escalates the agency problem as the effectiveness of monitoring the executive will be diluted (Komolafe, 2020). Accordingly, in the context of Uganda, a separate leadership structure is considered a vital mechanism of governance for boosting company financial performance (Companies Act of Uganda, 2012).

**5.0 CONCLUSION AND RECOMMENDATION**

From the discovery made in this study, it is quickly inferred that a separate board leadership structure has a significant positive effect on the financial performance of private limited companies in Uganda. Consequently, from the study's findings, it can be realized that when corporate governance among private limited companies is viewed as having CEO responsibilities separate from those of the board chairperson, it undoubtedly results in greater financial success. It is thus worth perceiving that corporate governance ought to be implemented in the sense that there is no CEO-free riding. However, the model's predictive power of a mild 7% suggests that private companies in Uganda should ensure that their corporate governance dynamics are defined by more than just the separation of powers. As such, they should uphold all governance mechanisms to ensure a consensus on matters that can impede their financial performance. Nevertheless, theoretical and empirical evidence in this study has exhibited that a firm financial performance can be enhanced sustainably by embracing separate leadership as a strong pillar of corporate governance.

**Study Limitations and Areas For Future Research**

Despite its enormous contribution to the body of knowledge, this study is not without limitations. The findings were limited to only internal stakeholders, such as top management and board members. First, this limited the opinions that could have come from other stakeholders like customers, regulatory and tax bodies, and the general public, which could have improved the validity of the results. Therefore, researchers could engage all stakeholders to comprehensively analyze stakeholders' perceptions of the private limited firm's financial performance. Second, using only a positivist approach exposed the study findings to methods bias. Thus, future researchers could apply a critical realism approach to thoroughly examine how the Board leadership structure and financial performance are associated. Nevertheless, despite the above limitations, this study deep-rooted the relationship between board leadership structure and the financial performance of private limited companies, thereby serving its purpose.

**Theoretical and Policy Implications**

First, this study has confirmed the presumption of agency theory by establishing a positive association between a separate leadership structure and financial performance, as opposed to the stewardship theory. This study has therefore recognized that when the board chairman and CEO roles are separated, it hiders the CEO from pursuing selfish gains to the disadvantage of shareholders. Furthermore, the results deep-rooted in this study provide a guide for policymakers regarding the effectiveness of corporate boards by separating the responsibilities of the CEO and the board chairman. This will help regulators companies in Uganda, such as the Uganda Registration Services Beaural (URSB), to strengthen the existing corporate governance mechanisms among private limited companies, improving their financial performance.

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