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BOARD SIZE AND TAX PLANNING AMONG MANUFACTURING AND ALLIED FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE, KENYA

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Abstract: **The manufacturing and allied sector in Kenya has been growing at a slower rate than the economy and the Gross Domestic Product has been deteriorating with time. From the year 2010, the sector has witnessed some large manufacturing firms either relocating or restructuring their operations owing to heavy taxation and unfavorable operating environment. Taxes represent a significant cost to firms; it affects a firm's profitability and almost all financing decisions hence actions designed for reducing corporate tax burden through tax planning are regarded highly. The separation of ownership from control in public listed companies means that tax planning occurs within agency framework. Board of directors play an important role in ensuring shareholders' wealth maximization which is greatly influenced by tax costs. Despite the Manufacturing sector registering stagnation and declining profits for the last five years, there is reawakened stake in the sector through the Big 4 Agenda which seeks to increase the Gross Domestic Product input of the sector to fifteen percent by 2022. The specific objective of the study was to determine the influence of board size on tax planning by manufacturing and allied firms listed at the Nairobi Securities Exchange, Kenya. Kenya. The study was anchored on agency theory and causal research design was adopted. The target population were the nine firms listed at the manufacturing and allied sector and secondary data was obtained from the audited financial reports. The study findings showed that board size had insignificant effect (β=0.0020, p=0.274) on tax planning among manufacturing and allied firms listed at the Nairobi Securities Exchange at 5 percent significance level. The study recommends that the board size of manufacturing and allied firms listed at the Nairobi Securities Exchange should not be large as this results into bureaucratic conditions.**

Keywords: **Agency Theory, Board Size, Tax Planning, Manufacturing and Allied Firms, Nairobi Securities Exchange.**

1. INTRODUCTION

1.1 Introduction and Background

Tax is a significant cost for corporations, therefore companies are more and more inventing means to bring down expenses, sustain more profits for investment opportunities and increase their values. Part of the approaches to execute these objectives, tax planning represents a major activity that takes a colossal part of management's time and resources. Tax planning does not suggest anything illegitimate; even in complex cases, the tribunals have always determined that there is nothing unusual with minimizing tax expenses if it complies with the tax laws and on this account it beats all odds for one to pay additional taxes beyond what is charged by the authority. Tax planning in first world countries is prevalent and transformed into a fully developed profession, with clear specialization and orientation. In particular, at least 60% and 85% of the firms in the USA and Japan respectively appoint a tax agent to help optimize tax expenditure.

In Kenya, a report by PWC (2014) showed that almost all public companies in Kenya have a tax department or are engaging professionals in taxation and tax matters with the overall responsibility of minimizing a company's overall tax liability and that firms such as Safaricom Plc and Kenya Breweries limited have been able to report higher profitability as a result of strategic tax planning. Moreover, in the Bata Shoe Company Vs KRA (2014), the court ruled that *"considering payment of tax is a coerced obligation dictated by decree, a taxpayer is not constrained to pay a single coin in excess of what is due to the taxman and the taxman, on the other hand, is permitted to collect up to the last coin that is due from a taxpayer".*

The survival and success of manufacturing and allied sector is very critical to the general public, KAM (2018) opines that there are strategies to assist fix up the sector by 2022 in addition to accelerating GDP from 8.4% to 15%. Taxation and tax policy of any economy has a major implication on the growth and economic development. Moreover, in most corporate organizations, tax ideologies and practices are executed and supervised by the board of directors as part of their fiduciary responsibility. According to Oyenike et al. (2016), the credibility of financial information for tax obligation rests with the board of directors. They evaluate the various loopholes available to minimize tax payments as well as to remain competitive among the peers in the same industry.

1.2 Statement of the Problem

The manufacturing and allied sector in Kenya is currently made up of 9 firms, the sector's development has been very sluggish as compared to the economy and GDP has been sinking with time Wamoiri, (2019). Between 2010-2020, some large manufacturing firms have either relocated or restructured their operations due to heavy taxation and unfavorable operating environment. Most recently, the government introduced WHVAT, incidentally the inability of KRA to refund VAT to corporate entities has resulted to suffer cash-flow problems. VAT credits due to the manufacturing sector stood at Sh24.3 billion as at June 2018. This is further complicated by bureaucratic rules for tax refunds potentially making it more difficult to get a refund, (KAM, 2018).

Subsequent studies have reveled tax planning among Kenyan companies, for example, Osebe et al., (2019) established that the mean ETR for listed firms in Kenya is 24.7% against the statutory tax rate of 30% which can be attributed to the ability of these firms to strategically manage their tax expense and consequently lower their tax rate. Firms that exploit the loopholes in tax laws generally have lower ETR, which benefit the firm through cash savings which affords it the freedom to invest in lucrative projects, therefore enhancing the value of the firm. The separation of proprietorship and management in the manufacturing and allied sector, implies that tax planning occurs with agency framework and subsequently a scrutiny on the influence of the board of directors on reducing managerial opportunism linked with tax planning. This study sought to assess the effect of board size on tax planning among manufacturing and allied firms listed on the Nairobi Securities Exchange, Kenya

1.3 Objective of the Study

The study sought to investigate the influence of board size on tax planning by Manufacturing and Allied Firms Listed at the Nairobi Securities Exchange, Kenya.

1.4 Research Hypothesis

H_0: Board size has no influence on effective tax rates among Manufacturing and Allied Firms Listed at the Nairobi Securities Exchange, Kenya

2. LITERATURE REVIEW

2.1 Theoretical Review

Agency theory was fathered by Jensen and Meckling (1976) they hypothized that an agency relationship ensues where individual(s), the principal, enters into a contract with another individual(s), the agent, to effectuate assignments such as decision making. Managers serve as representatives of shareholders who delegate obligation to a 3rd person in a corporate structure. According to this theory, the separation of proprietorship from management causes divergence of interest betwixt the shareholders and the management.

Agency theory guided this study by helping to understand the agency framework in corporate tax planning and proposing ways in order to reduce problems arising from such framework. Tax minimization decisions are made by managers who act on behalf of the shareholders; conflicts between shareholders' and management might occur because the executives responsible for tax effective decisions are more likely to opportunistic and redirect benefits realized from tax optimization for their benefit (Putri et al., 2017). Moreover, tax minimization is rather a risky activity which if not properly implemented could lead to additional costs borne by the firm, including, the risk of being audited, tax fines, and loss of corporation reputation. This implies that management cannot be relied upon, thereby demanding for the application of corporate governance mechanisms such as strict monitoring and advisory.

According to agency theory, the board of directors performs a critical function in reducing managerial opportunism consequently contributing to shareholders' wealth maximization. The board of directors, which is mandated to assign and ensure efficient use of necessary resources, enhance productivity, and ameliorate shareholder wealth, plays a key function in determining tax optimization strategies of a firm. Moreover, in most corporate organizations, tax ideologies and practices are executed and supervised by the board of directors as part of their fiduciary responsibility. When corporate entities fail or suffer reputational loss, boards are held accountable because they are directly answerable. The efficacy of the board to adequately oversee the executives is influenced by its size (Jensen, 1993). The numbers of board members affect a firm's administration guidelines. Smaller boards are considered effective for strengthening tax reduction practices, while large board memberships have demonstrated inefficiencies.

2.2 Empirical Review

In a public company, where the management is delegated to the board of directors, the number of directors is the utmost determinant of the success of its function. Smaller boards have been praised for ease in decision making; however, they have been castigated for making low quality decisions due to limited variety of skills. On the other hand, big boards of directors can benefit from a large pool of practical knowledge, professionalism, and expertise of its members. Therefore, they can positively influence strategic decisions such as tax decisions, having a wider outlook about the operating environment and different interpretation of tax laws.

Ribeiro *et al*. (2015) considered the contribution of firm characteristics and corporate governance attributes in explaining ETRs employing data from 704 nonfinancial companies quoted on the LSE covering duration from 2011 to 2013 and concluded that a larger amount of board members contributes to higher ETRs. This study was based in UK, a developed country with more elaborate governance mechanisms and high market capitalization. This research was based in Kenya, an emerging market with different capital market laws as compared to UK. Equally the study was limited by short sample period, the present research covered a period of 2010 to 2019.

Armstrong et al. (2015) studied the nexus linking Corporate Governance mechanisms and tax avoidance. The study sampled all companies listed on Compustat covering the period 2007 to 2011. The study indicated that firm with bigger board size have the advantage of higher cash flows through the minimization of effective tax rate, besides such firm strives to heighten tax avoidance as it does not carry any uncertainty as regards investment. Based on quantile regression, the conclusions of the study indicated that number of board members having significant work on tax planning and avoidance by firms. The study however did not consider diagnostics tests before inferential analyses.

Pratama (2017) conducted a study among listed Indonesian companies. The study was based on regression methods and concluded a significant negative relationship between the number of board members and effective tax rates implying the higher the number of directors, the lower the tax expense tax rate. He attributes this to difficulty in arriving at a consensus thus allowing management to take decisions that benefit themselves. The study apart from being based on listed Indonesian firms, firm size, and its moderating impact on the relationship linking board size and tax planning was not examined which stood as an objective in the study.

Dirk and Johanes (2017) studied Corporate Governance mechanisms influences tax minimization in Germany. Regression discontinuity plan was applied in the study, the difference in governance framework due to value-weighted structure the market capitalization-based indexes. Their study results showed a significant discontinuity in the corporate governance characteristics level in the level at the cutoff. Largest MDAX corporations exhibited stronger governance characteristics in relation to the smallest DAX businesses. The study revealed that board size significantly contributes to effective tax rate of firms. This present thesis centered on manufacturing and allied enterprises trading at the NSE. Additionally, panel regression analyses were applied where the underling requirements were met.

Kang'ara (2019) studied the consequence of governance on tax planning for 11 commercial and service businesses trading in NSE, Kenya. The study period was 2014 to 2018 (5years) where secondary panel data was applied. The variables considered were board size, number of meetings, independence of the team, managerial ownership (portion of management shares), return on equity and bond financing. ETR was applied to proxy tax planning. The study adopted descriptive research design and analysis based on multiple regression methods. Findings indicated a R-Square of 0.605. The analysis of variance (ANOVA) provided a p-value of 0.000. Based on the regression output, board size revealed a negative but significant effect on tax planning. Unlike the previous studies which isolated diagnostics tests, various pre- and post-estimation tests for panel regression analysis were in the current undertaken to ensure the data was adequate for inferential analyses.

Chytis et al. (2020) examined corporate governance effects on tax planning at the same time the financial crisis period. The research concentrated on quoted firms on the Athens exchange, assessing how corporate governance attributes affect firms' tax in the time of inauspicious conditions due to the economic crisis. The period between the years 2011 to 2015 was covered based on fifty (55) non-financial listed firms were sampled. It was acknowledged board size having a negative but considerable effect on tax planning of listed firms in Greece. The study notably centered on public companies on the Athens stock whereas this thesis looked at listed firms in Kenya.

2.3 Conceptual Framework

Conceptual framework shows visible disposition of the relationship between research variables, board size measured by the number of persons in the board was proposed to have underlying effect on tax planning of listed firms, as such making it the independent variables. Tax planning as measured by effective tax rate serves as the dependent variable of the study.

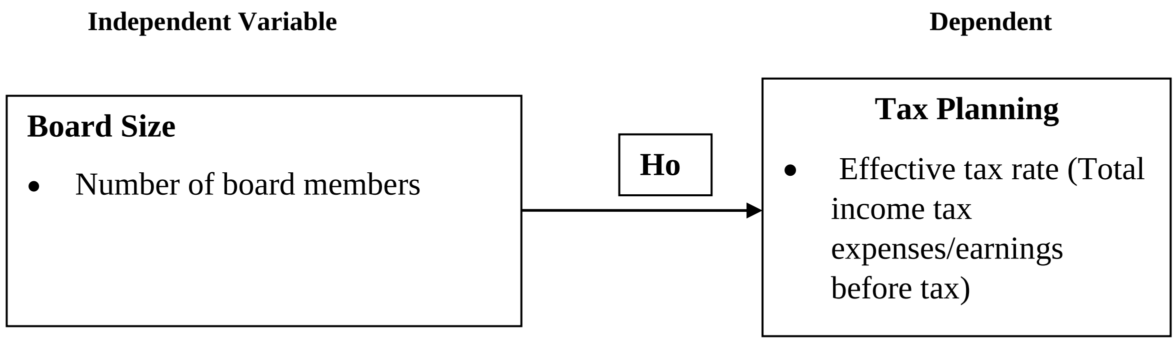

Figure 2.1: Conceptual Framework

Source: Researcher (2022)

3. RESEARCH DESIGN

3.1 Research Design

In line with the assertion by Kothari (2011), research design refers to the outline adopted in a research enquiry which spans from the process of data collections, measurements and as well as analyses of data. According to Mugenda and Mugenda (2013), research design is therefore regarded as the blueprint to an investigation which is used for purposes of answers to questions in research. The study used causal research design which is employed in studies which endeavor to ascertain the cause-and-effect linkages of research variables. The investigation aimed to evaluate the relationship between board size and tax planning among the manufacturing and allied firms listed at the NSE in Kenya.

3.2 Target Population and Sampling Design

Target population is the number of firms or people in totality that a research study seeks to cover and make inferences from. The study's population consisted of nine (9) identified Manufacturing and Allied corporations. The financial statements of these listed firms from 2010 t0 2019 served as the unit of analysis for the proposed study, and the accounting information of these listed firms served as the unit of observation. The study applied a census approach so as to cover all the nine manufacturing and allied companies listed at NSE, Kenya, therefore enhancing the reliability and validity of the research.

4. DATA ANALYSIS AND DISCUSSIONS

4.1 Data Analysis and Discussions

This section presents the results from the panel regression analysis on the effect of board size on tax planning among manufacturing and allied firms listed at the Nairobi Securities Exchange, Kenya. The results are contained in Table 1.

Table 1: Panel Regression Results

Tax Planning	Coef.	Std. Err.	Z	P>|z|	[95% Conf.	Interval]
Board Size	0.0020	0.0029	0.73	0.485	0.0045	0.0087
cons	0.0771	0.0379	2.03	0.076	-0.0103	0.1645
R^2	0.9997					
F (8, 8)	2.07					
Prob> F	0.0000					

Source: Study Data (2021)

In Table 1 above had an F statistics value of 2.07 and a corresponding p-value of 0.0000 which indicates significance. In view of the results, bank size had a coefficient of (β=0.0020. Therefore, board size had insignificant effect on tax planning among the manufacturing and allied firms listed at the NSE, Kenya. This positive effect indicates that a unit increase in board size increases tax planning of the firms under the study by 0.002

H_0: Board size has no significant influence on tax planning among Manufacturing and Allied Firms Listed at the Nairobi Securities Exchange, Kenya

The study looked into the impact of board size on tax planning by the under study firms. According to the study, board size has no significant impact on tax planning, as stated at the 0.05 significance level. A probability of 0.274 was found, showing that board size had no significant impact on tax planning, at the 0.05 significance level. This result can be linked to the huge tax board's bureaucratic nature, which decreases the efficacy and efficiency of tax planning. This could be attributed to huge boards having a sluggish decision-making process, which has an impact on the firms' tax planning system. Board size had positive and insignificant leverage on tax planning by manufacturing companies listed in NSE, Kenya according to the regression outcomes. Bureaucratic conditions among firms can result to insignificant influence on tax planning in manufacturing and allied companies in Kenya, listed in NSE.

5. CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion and Recommendations

This study deduced that board size had an insignificant positive effect on tax planning among manufacturing and allied firms listed at the NSE, Kenya. In spite of the vast tax policy effectiveness put through by manufacturing and allied firms, their large number slows down the effectiveness of the tax policies due to bureaucratic conditions. The study recommends that manufacturing and allied firms should have a board size that is very efficient in decision making, specifically in strategic matters such as tax planning.

5.2 Contribution to Knowledge

The study contributes to the existing body of knowledge in various ways. The study contributes to literature on the effect of board size on Tax Planning among the Manufacturing and Allied Firms listed at the Nairobi Securities Exchange, Kenya. The study results contribute to knowledge as it formulated and successfully tested the null hypothesis which stated that board size has no significant effect on Tax planning.

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