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EFFECT OF BOARD NATIONALITY, SKILLS AND TENURE ON PERFORMANCE OF NON-FINANCIAL FIRMS LISTED AT NAIROBI SECURITIES EXCHANGE, KENYA

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Abstract: **Board diversity is very important to the creation of new ideas and knowledge necessary to enhance firm performance. As such many companies have taken measures to diversify their boards by having best mix of culture, professional skills, among other characteristics in order to build their capacity and to make them effective. Therefore, this study seeks to investigate the effect of board diversity effectiveness on financial performance of firm listed at NSE, Kenya. The study was conducted using explanatory research design. All the non-financial firms listed at NSE with full data for the period between 2012 and 2017 were selected purposively. This procedure resulted into the selection of 33 out of 40 firms. Secondary data was analyzed using descriptive statistics such as means, minimum, maximum, and standard deviation. Regression analysis was used to establish the effect of board diversity on firm performance. The study revealed that there exist a strong positive and significant correlation between board diversity and firm performance that is increase in diversity resulted in higher sales turnover. The study also established a statistically significant effect of board diversity on firm performance. This implied that board diversity not only influences firm performance but also brought on board various skills, experience and deeper insight into the firms operations owing to their background and recommends that shareholders of listed companies in Kenya shoulder consider board skills, nationality, and tenure among other attributes when appointing board member. Moreover, the findings of this study forms a basis for future research in this area by interested researchers.**

Keywords: **companies, professional skills, shareholders, nationality, firm performance.**

1. INTRODUCTION

The board of directors is the supreme decision making organ within an organization. It plays important role in approving major firm strategic and financial decisions such as mergers and acquisitions, capital structure, dividend policy and monitoring the CEO performance (Makhlouf et al 2017). Boards also act as an intermediary between owners and management. On the other hand, when corporate governance mechanisms are weak, board inefficiency could be costly to the company and even to the society as a whole. Therefore, the existence of the effective board of directors is important for the proper functioning of firm and in enhancing firm value (Ujunwa, 2012; Veronica, 2016; Makhlouf, *et al,* 2017; Hassan and Miller, 2017).

As such it's therefore a requirement for every public listed companies in Kenya to be headed by an effective board to offer strategic guidance, lead and control the company and be accountable to its shareholders. The board should compose of balance of executive directors and non-executive directors of diverse skills or expertise in order to ensure that no individual dominate the board's decision making process.

In Kenya, majority of the board members are usually a mix of various attributes such as age, education, corporate experience, skills, and gender among other characteristics (Hassan & Miller, 2017). They are usually male dominated as the appointments are done in a closed door networks whereby the serving directors introduces their counter parts before their terms expires (Ekadah and Mboya, 2012). Such board's appointments are detrimental to the future sustainability of the firm as the most of the board members may not be qualified to serve effectively as board member due to lack of certain attributes. This process of appointment has caused more harm than benefits to the firm due to the collapse of firms such as Worldcom and Enron among others in the recent past. In Kenya for instance the recent issue of corruption and mismanagement of firms under the oversight of the board of directors has raised more questions than answers on the effectiveness of company's board. However, the study seeks to establish the effect of board diversity effectiveness on firm performance in Kenya.

Board Diversity and Firm Performance:

In corporate finance board diversity is one of the most researchable subject which has resulted into mixed outcome. The boards of directors with diverse characteristics are able to understand the dynamic of the business operating environment to a further extent, as more diverse teams provide a broad range of knowledge, information and resources as to their homogeneous counter parts. However, diversity can also come at a cost because of increased group conflicts and reduced workforce cohesion which negatively affect boardroom performance (Hassan & Miller, 2017). As such, some of the board diversity construct that influences firm performance are; nationality, skills, and tenure.

Board nationality:

Firms benefit when board of directors has members from different nationalities (Estelyi and Nisar, 2016). It's a valuable source of information about institutions behaviors and norms because knowing how a foreign director might behave in a given situation might create a better understanding of cultural variations and on how these variations impact upon firm decisions. This knowledge may also provide essential resources to the firm such as expertise and ties to external networks and resources. On the other hand because of increasing globalization and business operations worldwide requires firms to have knowledge of international markets as well as experience with different regulatory regimes. This attributes are argued to be crucial knowledge to have within a firm (Homan, 2017).

The increased exposure of internationalization by foreign nationals on the board reduces the potential for managerial entrenchments and subsequently has the potential to increase firm performance. This is because directors from different nationality background may help in product promotion, geographic diversification as they are to meet the needs of a diverse set of stakeholders. As such, board of directors from different countries increases firm performance (Hasan, 2015).

Previous studies have produced mixed result on the effect of board diversity on firm performance. Nationality differences occur because of social economic conditions, culture and personality (Estelyi and Nisar, 2016). Non-locals directors are able to understand the needs of stakeholders and the market in which the firm operates. Foreign nationals can cause increased activity within the board based on increased levels of board meeting attendance, committee assignments and corporate governance. The result of Estelyi and Nisar, 2016 indicates a positive significant relationship between nationality diversity and firm performance while Mugambi, 2018, found that nationality causes a great effect on the decision making. This is due to the fact that foreign national bring foreign values, personality attributes, among others (Kaczmarek, 2009). Ujunwa, 2012 also found out that board nationality have a positive effect on firm performance. Alternatively, Osiregbemhe, 2017 found no significant relationship between nationality diversity and firm performance and conclude that if the proportion of foreign directors are important to the success of the firm then it can be achieved without an impact on firm performance.

Board skills:

The board of directors is viewed as one of the most important structure of corporate governance. As such they are responsible for the proper functioning of the organization on behalf of owners (Akpan and Amran, 2014). The shareholders therefore should ensure that the composition of the board is staffed with people of high integrity, well talented and educated that would not allow their investment to be wasted. The wider the talented pool from which board members have been selected, the more capable the board should be (Grosvold et al., 2007). The presence of expertise in finance, law, strategic and management in corporate entities has effect on firm performance. It follows that professional skills of the board members is very important for decision making which consequently affect firm performance. Mohamud *et al.* (2017) suggested that formal education allows individuals to gain knowledge and skills, and earn credentials valued by others in the business community while Carcello *et.al*.(2006) noted that repetition to exposure and the extensive effects of experience increases the knowledge and skills of experts.

Recent studies carried out have shown mixed results on the effect of board skill on firm performance. For instance Gray and Nowland, (2015) found that diversity of expertise on board had no overall impact on firm performance as measured by return on asset. On the other hand, Guner *et al*, (2008) investigated the presence of financial expertise on boards and resulting increased external funding but found that it does not necessarily benefit shareholders. While Balogh, (2016) examined diversity expertise on boards and its link to shareholders' values and found a strong relationship between board skills and firm performance.

Board Tenure:

This is the period within which a member may serve on board. Therefore, the issue of board tenure has remained unresolved and continues to attract attention from scholars and practitioners. Governance experts have expressed concern on long tenured directors. A short tenured board may face less significant governance problems because of inexperienced directors. They may also have less complete understanding of firm business operations which may limit their ability to monitor and control the firms operations than long tenured board (Huang & Hilary, 2017). Studies carried out in recent past on the effect of board tenure have shown mixes result. According to Hamacher, 2015, it was found that experienced directors add value to the board. The study by Awinja, 2017 concluded that board members with high number of years of experience in various industries have a broader understanding of the industry. The chief executive paper, 2016, narrated that longer board tenure had a positive effect on firm performance though the trend reverse downward as the number of years increases up to a certain point. This finding was consistent with Huang & Hilary, 2017 who found that diversity on team performance has a positive effect when groups are too jaded. The findings suggest that greater diversity helps mitigates the oversight problems when the board tenure is long.

2. RESEARCH METHODOLOGY

Target population:

The study targeted annual financial reports of all non-financial firms listed at the NSE for the period between 2012 and 2017 (NSE, 2018). They were chosen for the study as the researcher believed that the study population gave an overview of the situation of capital structure as it was on the ground among non-financial firms listed at the NSE. They were also targeted because it was easier to access their Audited financial reports through the NSE and Capital Market Authority (CMA) for the purposes of data collection and analysis. The reasons for using these sectors were to ensure that all industries in non-financial sectors were included.

Research Design:

The research adopted explanatory research design. The design was ideal for the study as it entailed extracting data from financial reports and analyzing it in order to establish causal relationship between the independent and dependent variables.

Measurement of the study variables:

Table 1: Measurement of Operational Variables

Variables	Operational Definition	Indicators
Turnover ratio	Total sales for the period Scaled down by one million To total assets	Total sales for the period Total Assets
Board Skills	Number of board members With postgraduate qualification	Postgraduate Qualification
Nationality	Number of foreign director's On board	Board members other than Kenyan
Board Tenure	The number of years a member Serves on board	Total number of years

Source: Author, 2018

Data Analysis:

The study utilized descriptive and inferential statistics to analyze the collected data. Descriptive statistical tools such as mean, standard deviation, minimum and maximum were applied to describe relevant information about each variable. Inferential statistical tools such as; F-tests, analysis of variance (ANOVA), Spearman correlations regression analysis were used in the study. Spearman correlation was used to give direction and magnitude of the relationship between board diversity and firm performances. The regression analysis was suitable for the study since the study seek to establish the relationship between board skills, nationality and term limit on firm performance. Therefore the study adopted the following regression model.

$Y = \alpha 0 + \beta 1NA\ \beta 3BS + \beta 4TL + \beta 6BR + uit$

Where;

β1NA : Nationality β2BS : Board Skills β3TL : Term limit

3. RESULTS AND DISCUSSION

Descriptive Statistics:

The firm performance explained by total revenue to total assets shows that non-financial firms listed at NSE had a minimum and a maximum of 0.25 and 1.20 respectively with a mean of 0.6053 and standard deviation of 0.25489. This suggests that over 60% of firms performance are influenced by board diversity in Kenya. The board skills indicates a minimum of 0.11 and a maximum of 0.67 with a mean of 0.5027 and standard deviation of 0.22477.The nationality of board members shows a minimum and maximum of 0.43 and 1.00 respectively with a mean of 0.7957 and standard deviation of 0.20471. The board tenure on the other hand varies from 7 years to 14 years with a mean of 9.0333 and standard deviation of 2.55266. The mean of 9 indicates that the average number of years a member can serve on boards of listed firms in Kenya before retirement.

Table 2: Descriptive statistics

Description	Minimum Statistics	Maximum Statistics	Mean Statistics	Std Error	Std deviation Statistic
Turnover ratio	0.25	1.20	0.6053	0.04654	0.25489
Board skills	0.11	0.67	0.5027	0.04104	0.22477
Nationality	0.43	1.00	0.7957	0.03738	0.20471
Term limit	7.00	14.00	9.0333	0.46605	2.55266

Source; Research Data, (2012 – 2017)

Inferential Analyses:

Relationship among the study variables

Table 3: Spearman Correlation

	TN	BS	NA	BR	TI
TN	1				
BS	0.594^{**}(0.001)	1			
NA	0.394^{*}(0.031)	0.634^{**} (0.000)	1		
TI	0.356(0.056)	0.458^{*}(0.011)	0.775^{**}(0.000)	-0.173(0.362)	1

**Correlation is significant at the 0.01 level (2-tailed)
*Correlation is significant at 0.05 level (2-tailed)
LIST WISE N= 216

Source: Research Data (2012 – 2017)

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The result of correlation analysis reveal a moderate, positive and significant correlation between board skills and turnover ratio as r = 0.594, P = 0.001. This implied that board skills predict significant and positive relationship with sales turnover. The study found that there exist a weak, positive and significant correlation between board nationality and sales turnover as r =0.394, P = 0.031. The implication of this is that an increase in the number of foreign directors on board would significantly and positively increase level of sales turnover in non-financial firms listed at NSE, Kenya.

Effect of board diversity on firm performance

The study set to test the null hypothesis $\mathbf{H_{OI}}$ that stated; Board diversity does not affect performance of firms listed at NSE, Kenya. Multiple regression analysis was conducted to test the formulated hypothesis. The output from the analysis is as shown in table 4 below.

Table 4: Relationship between board diversity and firm performance

Goodness of fit analysis					
R	R Square	Adjusted R^2	Std Error of the estimate	Durbin Watson	
0.640^a	0.409	0.341	0.20690	1.499	
Overall significance; ANOVA (F-Test)					
	Sum of squares	df	mean Square	F	Sig.
Regression	0.771	3	0.57	6.005	0.003^b
Residual	1.113	26	0.043		
Total	1.884	29			
Individual Significance (T-Test)					
Variables	B	Std Error	Beta	t	Sig
(Constant)	0.086	0.169		0.507	0.616
Board Skills	0.545	0.182	0.481	2.996	0.006
Nationality	0.633	0.236	0.508	2.683	0.013
Term limit	-0.029	0.020	-0.286	-1.455	0.158
Dependent variable; sales turnover					
Predictors; (Constant), board skills, nationality, term limit					

Source; Researcher data, (2012 – 2017)

The output from the analysis shows that board diversity had a significant impact on firm performance in Kenya as its p-values (0.003 < 0.05). Additionally, the regression also shows a statistically significant positive association between board diversity and firm performance (β1 = 0.771, p-values 0.003) which is less than α (0.003 < 0.05).

The regression model is significant since it explain certain portion of variation in sales turnover. From table 4 the result shows R square value of 0.409, which implies that about 41% of variance in firm performance, is due to variation in board diversity with adjusted R Square of 0.341.

4. CONCLUSION BASED ON THE FINDINGS

The study found that board tenure does not affect firm performance and conclude that the period a member serves on board does not influence or result in increase in firm performance as measured by sales turnover. On the other hand, the regression model also revealed that board tenure did not predict any significant changes in sales turnover since their statistical coefficients were insignificant. Thus, a decrease in the board tenure would not significantly result into a decrease in financial performance of firms listed at NSE, Kenya.

Nationality of the board was found to have a statistical significant relationship with firm performance as measured by total sales to total assets and conclude that an increase in the number of non-local directors on board would result into a higher sales turnover of` non-financial firms listed at NSE, Kenya. This therefore implied that constituting board with members from different nationality could lead to achievement of higher returns.

Further the study concluded that board composition should comprise of members of diverse skills from various academic disciplines. This is due to the fact that a diverse board in terms of skills enhances the board capacity leading to improved performance.

Listed companies are therefore encouraged to have diversity on their board of directors not only because of their influence on firm performance but because of their effectiveness in decision making on policy related issues. Diversity in the board of directors would represent the face of company shareholders, customers and employees. The diverse board brings various skills, experiences and deeper insight in the firms operations. It also helps in marketing the firms product and rebranding especially when the board is composed of people from diverse nationality, skills and term limit. This will lead to improved quality in decision making and minimizes conflict among board members.

5. RECOMMENDATIONS OF THE STUDY

The study recommends that shareholders of listed firms should consider appointing board of directors with diverse skills in accounting, law, human resource and strategic management among other disciplines. This is informed by the results that there exist a strong statistically significant and a positive correlation between board diversity and firm performance in non-financial firms listed at NSE, Kenya.

The study recommends that the companies in Kenya should consider nationality and regional balance in appointing board members. This is because the research established that nationality diversity significantly predicted a positive return on sales turnover and that more appointment of non-locals on corporate boards would result into a higher financial return in non-financial firms listed at NSE, Kenya.

Further the study also suggested that government through the capital market authority and shareholders should develop a policy framework to improve board diversity by increasing the fraction of non-locals directors on board to enhance financial returns on listed companies. Thus, the higher the proportion of foreign directors on board of listed firms would result into increase in sales turnover.

Suggestion for further Research

The study was based on secondary data which was collected from published financial statement of listed companies. This method of data collection limited the amount of the information to be collected on board diversity. Thus future research should complement the existing method of data collection with questionnaire and scheduled interview with senior management and employees of these firms in order to obtain accurate and credible information on board diversity construct and on how they impact on firm performance.

Additionally, the study relied heavily on observable board characteristics and therefore recommends that future researchers could study other non observable variables such as personality traits, ethical beliefs and integrity of board members in order to verify their effect on firm performance in Kenya.

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