

CORPORATE GOVERNANCE AND PERFORMANCE OF FINANCIAL INSTITUTIONS

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Abstract

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The role of banking and insurance as an animated component of any economy has been widely recognized in the evolution of literature (Shrutikeerti & Amlan, 2017). The financial liberalization efforts taken by various developing economies had the central bearing on their financial institutions (Shrutikeerti & Amlan, 2016). The development of insurance and banking sectors play an important role in stimulating financial development and consequently the growth of the economy. Enhancing firm performance predicted through ownership structure, information disclosure, financial transparency and board profile safeguards reputation, yields effective risk management systems and yet helps firms achieve their business objectives. The study employed a sample of 103 financial institutions and adopted a descriptive cross-sectional survey design with a Pearson correlation coefficient. Reliability, validity and exploratory factor analysis with principal components and Cronbach's alpha as well as hierarchical regression was reasonable for analysis but also directed using the Partial Least Square (PLS) modelling which was helpful in attesting the measurement and structural models appropriate for the performance of financial institutions. Reveal a statistically significant and positive relationship between corporate governance and firm performance. PLS modelling assented the structural and measurement models and recognized that corporate governance is statistically significant and predict firm performance through its different constructs of information disclosure, financial transparency, and ownership structure and board profile. Equally, firm performance demonstrated that management efficiency, earnings quality, asset quality, capital adequacy and liquidity were key dimensions. The study was cross-sectional and a longitudinal study is necessary to understand the dynamics of corporate governance and firm performance over a period of time. The results extend the understanding of the role of corporate governance in promoting firm performance in financial institutions. Additionally, the results add evidence to the growing body of research focusing on interdisciplinary aspects as well as the relationship between corporate governance and firm performance. Overall, there is a significant positive relationship between corporate governance and firm performance.

Keywords: Corporate Governance, Firm Performance, Financial Institutions, Uganda

1. INTRODUCTION

In this paper, we study the association between corporate governance and firm performance of financial institutions. Viably, no other set of firms

has been as closely examined in the earlier few years as financial institutions. Since the financial crisis in 2008, a number of papers and policies have been proposed, debated, and endorsed on virtually every aspect of banking and finance. The substance of this

attention certainly springs from the crisis, which became a dominant reminder of the importance of the financial system in any economy, as a healthy economy cannot be existent without a well-functioning financial system. Sub-Saharan Africa has experienced a strong economic growth over the last decade though with most of the countries being hit by a number of shocks like the sharp decline in commodity prices, tighter financing conditions and severe drought in East Africa, Uganda not an exception (Background to the Budget, 2016). There is growing evidence that corporate governance is creating steadiness between economic, social, individual and communal goals while encouraging the efficient use of resources, accountability, the use of power and stewardship and at the same time, aligning the interests of individuals, corporations and society (Bhagat & Bolton, 2008; Hartono et al., 2013). Broadly, the paper investigates circumstances under which firm performance is predicted through the Capital adequacy, Asset quality, Management efficiency, Earnings quality and Liquidity (CAMEL). It is doubtless a success to the materialistic presumption that the CAMEL model is a significant tool that assesses the relative financial strength of financial institutions and suggests necessary measures to improve their weaknesses (Prasad & Ravinder, 2012; Srinivasan & Saminathan, 2016; Sushendra & Parvesh, 2013; Wakaisuka-Isingoma et al., 2016). So when, corporate governance practices increase the company's value (Bauer et al., 2008) profitability and achievement of value maximization become the pursuit of productive activities that would improve the overall quality of firm performance (Stiglitz & Guzman, 2016). This manifested profitability and value maximization is recognized as a driver and ability to achieve its objectives in terms of revenues and profits for the creation of firm performance. Hence, with the increased competition and the high demand for profitability by institutions, the financial institutions are now moving towards an economic-oriented model (CAMEL) departing from the social approach that has been followed for decades (Prasad & Ravinder, 2012; Srinivasan & Saminathan, 2016).

The study concentrates on commercial banks, Micro Finance Institutions (MFIs) and insurance companies. This was because these financial institutions serve as the backbone to the financial sector that facilitates the proper utilization of financial resources of an economy. Ragothaman and Gollakota (2009) argue that the financial system is exposed to a variety of risks that are growing more complex day by day. Therefore, financial intermediation activities are operating in a rapidly innovating industry that urges them to create more specialized financial services to better satisfy the changing needs of their customers. It is apparent that no sector in the economy can flourish without the support and service of the financial sector. Besides, it is important to note that the nation should be reinforced with national and regional capacities, socio-economic policies and structures through political views and commitments, manpower, capacity and skills as well as legislative and institutional frameworks for managing a robust financial sector (Background to the Budget, 2016).

In the same thinking, commercial banks are involved in the practice and need of banking system for sectoral development as well as the process of increasing wealth of the economy particularly the capital goods used to raise productivity. Also,

insurance in Africa has a disgraceful performance on a global stage without South Africa in the act. In addition, the insurance density for the billion people living in this region was only US\$16.5 per capita (KPMG, 2014). But also, Uganda's penetration ratio (gross value of insurance premium/GDP) was only 0.66 percent of the population, compared to its East African counterparts, Tanzania 2.3 percent, Rwanda 1 percent while Kenya has the leading penetration at 3.8 percent (KPMG, 2014). In addition, the rate of growth of insurance in Africa has remained weak (Crawford, Russignan & Kumar, 2018) and still below the global threshold as indicated in the East African region with insurance penetration ratios of Kenya 2.83 percent, Rwanda 1.74 percent, Uganda 0.77 percent and Tanzania with 0.68 (OECD, 2018).

This is not a surprise especially when most of the Africans are still beset in meeting their basic food and ordinary needs: therefore insurance is still a long way for the majority of Africans, Uganda inclusive. Still, there is a lack of reliable information to assess people's affluence as well as shallow markets that are important in raising money to capitalize on insurance companies. But also, important aspects of the regulatory framework like a capital requirement, audit requirement and dilution of ownership are still low as far as Uganda's security exchange is concerned and yet central for initial public offers (Capital Markets Authority, 2017; Kironde, 2015; Njenga, 2011). These may be attributable to the performance of insurance companies in developing countries. Furthermore, Quayes and Tanweer (2013) proclaim that over the past three decades, MFIs have steadily increased their credit disbursement. As well, Carlton et al. (2001) contend that the fascination with microfinance is derived from the fact that the provision of financial services could contribute to poverty reduction and yet, permit the test of sustainability at the same time. However, in Uganda, the MFIs are growing in size and operation but there is a great concern of lack of regulations. These may lead to weak governance and management as well as inappropriate reporting mechanisms which eventually affect their performance (Association of Micro Finance Institutions in Uganda-AMFIU, 2013).

This study shows a predictive power of 67.6 percent of corporate governance predicting the performance of financial institutions. This, therefore, proposes that ownership structure, information disclosure, financial transparency and board profile enhance performance through capital adequacy, asset quality, management efficiency, earnings quality and liquidity of financial institutions. Equally, a few studies, including (Ahsan, 2016; Bank of Uganda, 2010; Frederick, 2014) have looked at the CAMEL model of financial institutions though in another perspective. Frederick (2014) for example, looked at factors affecting commercial banks with an emphasis on domestic commercial banks. Around the region, Moyo, Nandwa, Oduor and Simpasa (2014) looked at financial sector reforms, competition and banking systems stability in Sub-Saharan Africa. Their findings reveal that as a result of financial liberalization and the CAMEL-type bank-specific factors, there is increased competition in the banking sector which enhance financial stability. Ahsan (2016) studied selected Islamic banks in Bangladesh using secondary data from 2007 to 2014 and concluded that all the banks rated strongly in all aspects of the CAMEL model.

It is pertinent to note that the above studies are reviewing commercial banks, addressing different variables and hitherto leaving out other financial institutions, which this study attempts to address.

This hence suggests the relevance of this study especially at the time when a number of financial institutions are closing down in Uganda (Bank of Uganda, 2017). But still, financial institutions recorded overall year-to-date profits of UGX 1.0 billion during 2015, which reflect a substantial drop in profitability of 80.0 percent below the profits of UGX 5.0 billion earned during 2014. The net after-tax profits declined from UGX 17.7 billion in 2014 to UGX 12.2 billion in 2015. Subsequently, the yearly ROA and ROE ratios declined to 3.2 percent and 10.4 percent from 5.6 percent and 20.3 percent, respectively (Background to the Budget, 2016). Therefore, the requisite to find a relationship between corporate governance and firm performance of financial institutions. The rest of the paper is structured as follows: the following section is literature review and hypotheses development, next is methodology, findings, discussion and finally conclusion.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1. Theoretical review

Agency theory established by Jensen and Meckling in 1976 emphasizes strategic management and business applicability. Many firms are not run by the people who own them, thus the separation of ownership and control (Berle & Means, 1932) leading to a conflict of interest – Agency theory. The agency theory positions that in modern corporations in which share ownership is widely held, managerial actions depart from those required to maximise shareholders' returns (Noriza & Norzalina, 2007). In the same thinking, managers of firms typically act as agents of the owners and are given the mandate to manage the firm for the owners' advantage (Eriotis et al., 2007). However, managers are most concerned with the accomplishment of their own targets which may contrast from the boosting of the firm value aiming at the maximization of the owners' benefit. In line with the agency theory, the study attempts to find out if the financial institutions have mechanisms that entail processes and structures (ownership structure, financial transparency, information disclosure and board profile) that facilitate the creation of value as well as the governance structures that promote better management and prudent allocation of resources. It is pertinent that the influence of agency theory as far as attaining authority to manage the firm through supervision, control and monitoring is crucial and therefore its relevance to this study.

3. EMPIRICAL REVIEW

3.1. Corporate governance

Corporate governance is known to be the system by which companies are directed and controlled (Cadbury, 1992) and therefore deals with the duties and responsibilities of a company's board of directors to successfully lead the company, and their relationship with its stakeholder groups. Corporate governance is important to any economy given what

accrues to it: first, its systems are increasingly being seen as a necessity for both social and economic development in developing economies, like Uganda (Wanyama et al., 2013); and second, its good practices enhance firm performance through healthier management and prudent allocation of firms' resources (Mobius, 2002; Tsifora & Aleftheriadou, 2007). But still, the corporate governance practices recommended should be interpreted and applied in a way that is fitting for the firm and also the sector in which it operates. In this study, corporate governance is measured using ownership structure, information disclosure, financial transparency and board profile (Barako et al., 2006; Bodaghi & Ahmadpour, 2010).

Ownership structure of the firm plays a vital role in issues of corporate governance since these practices try to align the relationship between shareholders and managers (Desender et al., 2013). The literature on ownership and performance present inconsistent findings for example; Yudaeva et al. (2003) assert that firms with foreign ownership are more productive than domestic ones. In the same thinking, Choi and Hassan (2005) reason that the level of foreign ownership is positively associated with a bank's return but negatively with the bank's risk. Still, Nguyen, Locke and Reddy (2015) posit that there is a positive effect of ownership concentration on performance. On the other hand, Zeitun (2014) finds that institutional and foreign ownership have no impact of the firm performance. Broadly, highly concentrated ownership promotes monitoring of the actions of managers-positively affects firm performance (Almudehki & Zeitun; Nguyen et al., 2015). And therefore, the type of ownership structure is part of agency theory and is equally important for corporate governance. For example: firm's ownership structure promotes voting rights, firm's ownership structure promotes capital rights and firm's ownership structure promotes managerial rights.

Information disclosure and financial transparency are critical given the fact that they translate the firm's performance through enhanced returns as a result of timely and accurate disclosure (Edogbanya & Kamardin, 2016). Information disclosure is making information accessible to interested and affected parties in a manner that is understandable to them (Akhtaruddin, 2005). Crowther (2000) traced an archaeology of corporate reporting which shows that, over time, the amount of information provided, first to shareholders, then to potential investors than to other stakeholders has gradually increased, as firms recognize the benefits in providing increased disclosure. The detail of the information to be provided should be descriptive and guided by materiality which enables the stakeholders to make an informed assessment of the quality of the firms' governance (King VI Report, 2016). Equally, there is a need to disclose against outcomes so that the user is able to draw implications from the descriptions given.

Sullivan (2005) contended that the question of performance of financial institutions is an essential component of transparency. Preparation of annual financial statements carries the responsibility of presenting them so that they provide an accurate picture of the financial results in a manner that can be defended in terms of the credible framework. This is crucial given the fact that the banking sector presents unique challenges for corporate

governance- the scope for conflicts between insiders and outsiders is bigger than in any other industries because of information asymmetry in their statements for financial statement (Tumusiime-Mutebile, 2016). Likewise, financial transparency which involves the extent to which investors having timely, meaningful, reliable and ready access to any required financial information about a company, is equally key (Wanyama et al., 2013).

Board profile is important from the agency theory perspective in the sense that it enables the institution to engage in opportunistic activities because of their dominance (Sunil & Santanu, 2012). Boards also seek to protect shareholders' interest in a competitive environment while maintaining managerial accountability to attain good firm performance (Demsetz & Villalonga, 2001). The study considered board profile to be: number of independent directors verses executive directors, the financial institution clearly defined by their terms of authority and responsibility, CEO's performance being monitored and appraised satisfactorily, and the CEO being supported by counsel from the board of directors. Hence, it is amenable that financial institutions should clearly define their authority and responsibilities which ultimately results in a system of internal controls that are regularly tested to ensure effectiveness. The weakness of corporate governance is perhaps the most important factor blamed for the corporate failure consequences from the economics and corporate crises. There is much that can be done to improve the integrity of financial institutions' reporting through greater accountability and disclosure, the restoration of resources devoted to audit function, audit quality and better corporate governance policies passed by the board members (Saudagaran, 2003). Therefore, firms should execute their governance roles and responsibilities, adapt the stakeholder-inclusive approach in order to balance the needs, interests and expectations of substantial stakeholders in the best interest of the firm over time (King VI Report, 2016).

3.2. Firm performance

Performance is the act of measuring the firm's efficiency, effectiveness and transforming its complex reality in organized symbols that can be related and transmitted under the same circumstances with the aim of managing its corporate and functional strategies (Koufopoulos, et al., 2008). Samina and Ayub (2013) add that firm performance is how well a firm can use its assets as a primary mode of business to generate revenues and profit. To this effect, there may be factors, which need to be considered while differentiating the performance of financial institutions. Therefore, to evaluate this performance, the study employs the CAMEL model, which measures the performance of financial institutions from each of the important parameters like capital adequacy, assets quality, management efficiency, earning quality and liquidity since they can adequately assess the soundness and performance of financial institutions (Bank of Uganda, 2010; Prasad & Ravinder, 2012). CAMEL rating criteria is a concise and obligatory tool that ensures a financial institution's healthy conditions by reviewing its different aspects based on a variety of information sources like financial statements, funding sources, macroeconomic data, budget and

cash flow (Reddy & Prasad, 2011). But equally, the CAMEL analysis approach is beneficial as it is an internationally standardized rating that provides flexibility between on-site and off-site examination, hence, a central model in assessing financial institutions' performance. As well, financial institutions should employ the CAMEL model rating on a periodic basis in order to withstand business variations and susceptibility to external stimuluses.

Tesfation (2016) argues that capital adequacy is the amount of own fund that acts as a buffer and available to support the institution in case of a financial shock. It reflects the overall financial condition of financial institutions and the ability of management to meet the need of additional capital. It is normally judged basing on Capital Adequacy Ratios (CAR) that show the internal strength of the financial institution to withstand losses during the crisis. The study considers advance to assets ratio, as a proxy for capital adequacy, appropriate given the fact that it indicates a financial institution's aggressiveness to lend out money, which ultimately results in better profitability (Godlewski, 2003). The study reveals a weight of 0.154 of capital adequacy which is just slightly above the threshold of 12 percent. Financial institutions in Uganda shall at all times maintain a core capital of not less than 8 percent and a total capital of not less than 12 percent of the total risk-adjusted assets plus risk-adjusted off-balance sheet items (FIA, 2004). Bank of Uganda (2017) reports that the banking sector in Uganda is sound and stable with adequate capital and liquidity buffers; for example industry's aggregate tier one capital adequacy ratio and total capital adequacy ratio increased from 19 percent to 21.4 percent and from 21.7 percent to 23 percent in 2016 and 2017 respectively (Bank of Uganda, 2017). However, it is important to note that the above scenario is only for commercial banks and not taking into consideration micro finance institutions and insurance companies.

Assets quality is an imperative parameter that gauges the strength of financial institutions. Largely, the prime reason behind measuring the assets quality is to ascertain the component of non-performing assets as a percentage of the total assets (Halaj, 2008). The study is considering net non-performing assets to net advances, as a proxy of asset quality. The ratio is likewise sound since it discloses the efficiency of financial institutions in assessing the credit risk and recovering the debts. Findings reveal a weight of 0.182 of asset quality that it contributed to firm performance. Deprived asset quality could lead to bank failure since it tends to detect, measure, monitor and regulate credit risk but could be deteriorated by the bad and doubtful claims. In addition, the policy in approving loans could not be favourable, as well as high increase in non-performing loans instigating the risk of loan losses derived from the delinquent loans. Recently, in Uganda, asset quality deteriorated with the ratio of non-performing loans (NPL) to total gross loans rising from 4.1 percent to 5.3 percent (Bank of Uganda, 2015) then to 10.5 percent (Bank of Uganda, 2016) and 8.3 percent (June 2016) to 6.2 percent (June 2017) - the drop in NPLs within this period was attributed to two major factors: the closure of Crane Bank, whose NPLs contributed to 46.9 percent of industry-wide NPLs by the end of December 2016; and significant write-offs by banks which peaked in

the quarter to March 2017 (Bank of Uganda, 2017). Thus, there is a need to carry out asset quality assessment by performing credit risk management and evaluating the quality of the loan portfolio.

Management efficiency is the capability of the board of directors and management to identify, measure and control the risks of the institution's activities as it ensures the safe, sound and efficient operations in compliance with the law applicable and regulations. Grier (2007) argues that management should have clear strategies and goals in directing the institution's domestic and international business, monitor the collection of financial ratios as far as management strategies are concerned. The study uses total advances to total deposits, as the proxy for management efficiency, since it measures the efficiency and ability of the financial institution's management in converting the deposits available (excluding equity) with the financial institution into high earning advances (Gupta, 2008). The study shows that a weight of 0.477 came from management efficiency (actually the biggest contributor to performance). This demonstrates that financial institutions' top management in Uganda is able to handle the risks involved as well as managing advances *visa viz* deposits to the financial institutions.

The quality of earnings determines the financial institutions' profitability and explains its sustainability and growth in earnings in future. Net profit to average assets has been adopted to measure earnings quality since it measures the return on assets employed or the efficiency in utilization of assets (Said, 2003). Bank of Uganda (2017) shows that the aggregate net after-tax earnings dropped by 16.7 percent from June 2016 to June 2017: generally due to increased costs through provisioning for bad debts. Liquidity is another important factor of financial institutions since it focuses on proper care to hedge the liquidity risk, at the same time ensuring good percentage of funds that are invested in high return generating activities, so that it is in a position to generate profit with provision of liquidity to the depositors (Prasad & Ravinder, 2012). For example, in Uganda, Bank of Uganda (2016) shows that credit institutions recorded an overall drop in profitability of 80 percent, and a net after profit from 17.7 percent to 12.2 percent. Still, aggregated income statement for micro-finance deposit-taking institutions to show fluctuations in percentages ranging from 4.6, 4.3, 10.1, 11.6, 10.4, 17.7 and 14.7 ranging from 2009 to 2015 (Bank of Uganda, 2015), which is a threat in sustainability and growth of financial institutions in the future. Equally, Bank of Uganda (2017) shows that the aggregate net after-tax earnings dropped by 16.7 percent from June 2016 to June 2017: generally due to increased costs through provisioning for bad debts. Therefore, liquid assets to total deposits need to be revised since it measures the liquidity available of the total deposits of the financial institution and subsequently the overall liquidity position of the financial institution.

3.3. Ownership structure and firm performance

The relationship between ownership structure and firm performance dates far back from (Berle & Means, 1932; Jensen & Meckling, 1976; Fama & Jensen, 1983). Ownership structure as a mechanism

of corporate governance is believed to facilitate increased efficiency of a firm and therefore firm performance. Barako et al. (2006) describe ownership structure as a governance characteristic which influences firm performance. Corporate boards have the authority to make, or at least approve all significant decisions including decisions about investment policy, management compensation policy and board governance itself. It is dependable that board members with appropriate stock ownership should have the incentive to provide effective monitoring and oversight of important corporate decisions and hence implying that board ownership can be a good proxy for overall good governance (Mehran & Mollineaux, 2012). Arshad and Safdar (2009) reveal that corporate governance and ownership structure have important implications on firm performance.

In the same vein, Schleifer and Vishny (1997) argue that large owners are capable of monitoring and controlling management and thereby contributing to a better firm performance. This would denote that shareholders owning a large share of the company's equity shall earn more incentives as a duty to monitor as well as influence decision making since they may be more affected by the actions of management and partly benefiting more from their own monitoring effort than the shareholders owning a small portion of company's equity. To this effect, the more insider ownership could increase firm performance since there is better alignment of managerial and shareholder interests (Jensen & Meckling, 1976) but still, will act to maximise firm and shareholder value because of their own interests (Dennis & McConelle, 2003). Thus, *H1: There is a positive relationship between ownership structure and firm performance.*

3.4. Information disclosure and firm performance

Abdur (2011) asserts that one major feature of corporate disclosure is that a firm will provide information to enable the society, investors and suppliers to make specific decisions. However, the decision to disclose or not to disclose certain information is influenced by a variety of factors such as the presence of independent non-executive directors, audit committees, board leadership structure and board size. Eng and Mak (2003) argued that quality of corporate disclosure is associated with firm performance. Corporate financial disclosure is categorized into voluntary and mandatory. Voluntary disclosure is the information in excess of mandatory disclosure (Kun et al., 2008). It is the information available to the stakeholders at the discretion of the corporation's management while mandatory disclosure information requirements are laid down by statute and professional regulations. They added that quality and credible disclosure is fundamental in predicting firm performance. Information disclosure is a critical component of reviewing and improving the corporate governance of financial institutions, however, it is also pertinent to hinge on the source of information, information disclosed, and under what economic conditions the information is disclosed. Therefore, *H2: There is a positive relationship between information disclosure and firm performance.*

3.5. Financial transparency and firm performance

Transparency is one of the major indicators of the good practice of corporate governance in an economy (Simon & Wong, 2001). The following statements were used to measure financial transparency; up-dated financial facts on the firm's insiders are publically accessible, firms publish their business reports including reports of external auditor in compliance with the laws, bylaws and financial regulations. In addition, firms that have transparent strategies create systems in which all the stakeholders of the corporation attempt to ensure that firm managers adopt mechanisms that safeguard stakeholder interests and thereby improving firm performance (Ahmadu, et al., 2005). Haat et al. (2008) asserted that the lack of sound corporate governance and transparency in disclosing information by companies was the major reason for the financial crisis in East Asia. The Asian financial crisis, as well as the accounting and corporate scandals in the United States, have drawn consideration for the need for better corporate governance (Haat et al., 2008).

Wanjau, Muturi and Ngumi (2018), Adiloglu, Gungor and Yuce (2018) reason that financial transparency would entail full disclosure of the financial information to reduce information asymmetry within and among firms. Financial transparency as a system of corporate governance is grounded on the good financial reporting in unification with accounting standards and regulatory requirements (Fung, 2014). Financial transparency prompts disclosure and in the same vein, aid shareholders in the maximization of their goal since any illegitimate detection is properly observed to limit the top managers' discretion of their interests. Hence, *H3: There is a positive relationship between financial transparency and firm performance.*

3.6. Board profile and firm performance

Board profile is yet another construct of corporate governance. Number of non-executive director verses executive directors, and Chief Executive Officer (CEO) duality, the institutions are clearly defined in terms of lines of authority and responsibility; have been considered as the indicators of board profile in the study. CEO duality is regarded as an important aspect of corporate governance where the same person does not perform both the role of the CEO and the chairman of the board of directors (Sunil & Santanu, 2012). Duality gives a good understanding and knowledge of firms operating environment and the separation of the role of the chief executive officer from that of the chairperson. This is likely to create transparency and therefore enhance firm performance. In addition, Adeyemi and Fagbemi (2010) revealed that ownership by independent directors has the possibility of increasing firm performance. Denis and Sarin (1998) reported that firms that substantially increased the proportion of independent directors had above average firm performance. The board profile seemingly mirrors the environmental constraints faced by firms, giving some credence to the proposition that firms strategically select board members as a means to

reduce uncertainty and yet supplements top management with vital advice and counsel (Lester, Hillman et al., 2008). Consequently, *H4: There is a positive relationship between board profile and firm performance.*

4. METHODOLOGY

4.1. Design and population

The study was based on 103 financial institutions and adopted a descriptive cross-sectional survey and correlational, with an interest in financial institutions in Uganda. The population was 106 financial institutions but 103 actually responded (commercial banks, 11; MFIs, 71; insurance companies, 21) representing 97.2 percent of the population. The data used to calculate the CAMEL model ratios was got from the audited financial statements of the financial institutions. This was derived from an average of three consecutive years' data (2013, 2014 and 2015) - taken as a point in time and recorded on the basis of the required ratios of CAMEL, which was then related to the primary data set of corporate governance. Both primary and secondary data were collected from the three financial institutions namely commercial banks, MFIs and insurance companies (just a segment of the financial institutions) which belong to the service sector contributing 52.3 percent to Gross Domestic Product of the economy (Bank of Uganda, 2018). In addition, there is an increasing recognition that financial sector development is a top priority to sustain economic growth in developing countries, particularly among the more successful reformers, such as Uganda.

4.2. Reliability, validity and analysis

Reliability, validity and exploratory factor analysis with principal components and Cronbach's alpha were used to examine the validity and reliability of the scales as measures of the study constructs. Cronbach and Shavelson (2004) contend that the Alpha can take any value from zero (no internal consistency) to one (complete internal consistency) with 0.7 as the acceptable limit.

In order to use the parametric tests or tools of analysis, the study variables were subjected to diagnostic tests on the assumptions of Ordinary Least Square (OLS) (Tabachnick & Fidell, 2007). These included normality, multicollinearity and homogeneity (homoscedastic). Statistical analysis, which uses linear regression assumes that the data is linear. Correlation, regression and F-tests analyses among others are used based on the assumption that data is normally distributed, that there is no multicollinearity and that data is homoscedastic. Normality tests allow for inferences about the population, lack of multicollinearity ensures the stability of results whereas homogeneity certifies that standard errors are not over or underestimated.

Equally, convergent validity using the principal components for each variable was extracted by means of a principal component analysis using varimax rotation method. Factor loadings that were below 0.5 coefficients were withdrawn to avoid extracting factors with weak

loadings. Hierarchical regression was used as an appropriate tool for analysis when variance on a dependent variable is being explained by independent variables that are correlated with each other (Pedhazur, 1997). In addition, structural equation modelling specifically using XLSTAT 2016 with PLS modelling was helpful in endorsing the measurement and structural models suitable for financial institutions' performance. The advent of Structural Equation Modelling (SEM) with Partial Least Square Modelling (PLS) using latent variables has changed the nature of research. The PLS has achieved an increasingly popular role in empirical research since it represents a responsibility of distinctive methodological features of both the structural model and coefficient paths as well as authenticating instruments and testing relationships between constructs (Henseler et al., 2009). PLS-SEM desirability was adopted given the fact that it allows researchers to estimate very complex models with many constructs and indicator variables especially if the prediction is the goal of analysis. But still, PLS allows for much flexibility in terms of data requirements and

specification of the relationships between constructs and indicators (Sarstedt, Ringle, & Hair, 2017).

5. FINDINGS

We used exploratory factor analysis to explain the variance in the observed variables in terms of underlying latent factors (Habing, 2003). This is done given the fact that factor analysis intends to pick out those factors that measure the ability and traits relating to the construct that is intended to be measured (Field, 2009). To this effect, factor analysis has offered not only the possibility of gaining a clear view of the data but also the leeway of using the output in subsequent analyses (Field 2000; Rietveld & Van-Hout, 1993). On the other hand, performance in terms of the CAMEL model was analysed from secondary data from the financial statements of different financial institutions: and therefore was not tested for exploratory factor analysis. Below is the Table 1 showing the rotated component matrix of corporate governance.

Table 1. Rotated component matrix on corporate governance

Statements	Component			
	Board Profile	Financial Transparency	Information Disclosure	Ownership Structure
The number of independent directors is more than the executive directors	.784			
The CEO is supported by counsel from the Board of Directors (BoD)	.655			
CEO's performance is monitored and appraised satisfactorily	.629			
The institution is clearly defined in terms of lines of authority and responsibility	.587			
The Chief Executive Officer (CEO) is only responsible for that post	.521			
Updated financial facts on the firm's insiders is publically accessible		.815		
Firm publishes its business reports including the report of the external auditor in compliance with the laws, by-laws, and financial regulations		.711		
Information that has been disclosed is only mandatory			.710	
Firm has a clearly defined and publically accessible disclosure policy which defines principles, rules and procedures of reporting to shareholders, relevant authorities, public, and other interested parties			.666	
Firm publishes its annual reports and information concerning its business operations			.539	
Firms ownership structure promotes voting rights				.793
Firms ownership structure promotes capital rights				.707
Firms ownership structure promotes managerial rights				.768
Eigen value	2.242	2.013	1.668	1.632
% of variance	18.683	16.777	13.903	13.598
Cumulative % of variance	18.683	35.460	49.363	62.960

Note: Determinant = 0.045

The communality coefficients of the principal component analysis are all above 0.5 with determinant of 0.045 (> 0.000), implying that all items relate well in measuring corporate governance. Likewise, four factors namely ownership structure, information disclosure, financial transparency and board profile have been extracted and explain 62.96 percent with a Kaiser-Meyer-Olkin measure of sampling adequacy of 0.631 of corporate governance.

From the study with the help of rotated component matrix, the following statements were extracted to measure ownership structure: ownership structure of the firm has mechanisms that entail processes and structures which facilitate the creation of value; the institution is clearly defined in terms of lines of authority and responsibility; the governance structure of the firm

promotes better management and prudent allocation of resources.

The study hinged on the following statements to explain information disclosure: information that has been disclosed is only mandatory; the firm has a clearly defined and publically accessible disclosure policy which defines principles, rules and procedures of reporting to shareholders, relevant authorities, public, and other interested parties and; the firm publishes its annual reports and information concerning its business operations.

Financial transparency was explained by such statements as updated financial facts on the firm's insiders is publically accessible; the firm publishes its business reports including the report of the external auditor in compliance with the laws, by-laws, and financial regulations. Board profile was clarified by statements like the number of

independent directors is more than the executive directors; CEO is supported by counsel from the Board of Directors (BoD) and CEO's performance is monitored and appraised satisfactorily.

6. DESCRIPTIVE STATISTICS

Table 2 displays the descriptive statistics in respect to corporate governance (ownership structure, information disclosure, financial transparency and board profile). Information disclosure has the highest mean (3.5340), followed by financial transparency (3.2573), then ownership structure (2.8398) and lastly, board profile (2.5146). Nevertheless, there were more variations in

information disclosure, then ownership structure, financial transparency and then board profile. Coefficient of variation exhibits that ownership structure was most risky, followed by information disclosure then financial transparency and board profile. The mean of financial institutions in terms of firm performance is 2.00, with a standard deviation of 0.828 and covariance of variation of 41 percent. Generally, the degree of variability in the distribution shows that performance of financial institutions is riskier than any of the constructs of corporate governance. But still, Cronbach's alpha for corporate governance is 0.78, whereas firm performance is secondary data using firms' financial statements.

Table 2. Descriptive statistics for corporate governance

Study variables	Mean	Standard. Deviation	Coefficient of variation (Percent)
	Statistic	Statistic	Statistic
Ownership structure	2.8398	.97068	34.18128
Information disclosure	3.5340	1.09200	30.89983
Financial transparency	3.2573	.96219	29.5395
Board profile	2.5146	.71214	28.32021
Corporate governance	3.0364	.93425	30.76844
Firm performance	2.0000	.828	41.4

7. CORRELATION ANALYSIS RESULTS

There was a significant positive relationship between corporate governance and firm performance ($r = .466, p < .01$). Firm performance had significant positive relationships with constructs of corporate governance, ownership structure ($r = .290, p < 0.01$),

information disclosure ($r = .252, p < 0.05$), financial transparency ($r = .406, p < 0.01$), however not significant with board profile ($r = .100, p > 0.05$) as shown in Table 3 below. This implied that performance of financial institutions was enhanced through ownership structure, information disclosure and financial transparency.

Table 3. Correlations of study variables

	1	2	3	4	5	6
Ownership Structure (1)	1					
Financial Transparency(2)	.136	1				
Information Disclosure (3)	.149	.092	1			
Board Profile (4)	.152	.141	.147	1		
Corporate Governance (5)	.616**	.581**	.642**	.519**	1	
Firm Performance (6)	.290**	.252*	.406**	.100	.466**	1

Note: * Correlation is significant at the 0.05 level (2-tailed).

** Correlation is significant at the 0.01 level (2-tailed).

7.1. Analysis of variables

Hierarchical regression analysis was used to determine the relationship between corporate governance and firm performance. The regression indicates that corporate governance has a significant relationship with firm performance and the relative strength of different independent variables' effects on firm performance.

The regression analysis reveals that ownership structure ($F = 9.279, B = .226, p < 0.05$) with firm performance indicate a significant positive relationship and therefore a significant predictor of firm performance. The regression analysis model is, therefore, $FP = 1.357 + .226OS$ implying that if the ownership structure is enhanced by one unit, firm performance increases by 0.226 units.

Equally, the regression analysis discloses that information disclosure ($F = 19.94, B = .282, p < 0.05$) with firm performance shows a significant positive relationship. This finding, therefore, indicates that information disclosure is a significant predictor of firm performance. Information disclosure predicted

16 percent of firm performance implying that 16 percent of the change in firm performance was explained by information disclosure. The regression analysis model of: $FP = \beta_0 + \beta_1 ID + \varepsilon$ is therefore presented as: $FP = 1.005 + .282ID$. If information disclosure is enhanced by one unit, firm performance will increase by 0.282 units and therefore supporting hypothesis two (H_2) which states that there is a positive relationship between information disclosure and firm performance; where $ID =$ Information disclosure.

The regression analysis of financial transparency ($F = 6.86, B = .199, p < 0.05$) significantly and positively displays a relationship to firm performance. This finding indicates that financial transparency is a significant predictor of firm performance. Financial transparency predicted 5 percent of firm performance suggesting that 5 percent of the change in firm performance is explained by financial transparency. The regression analysis model of: $FP = \beta_0 + \beta_1 FT + \varepsilon$ is therefore presented as: $FP = 1.353 + .199FT$. If financial transparency is enhanced by one unit, firm performance will increase by 0.199 units implying

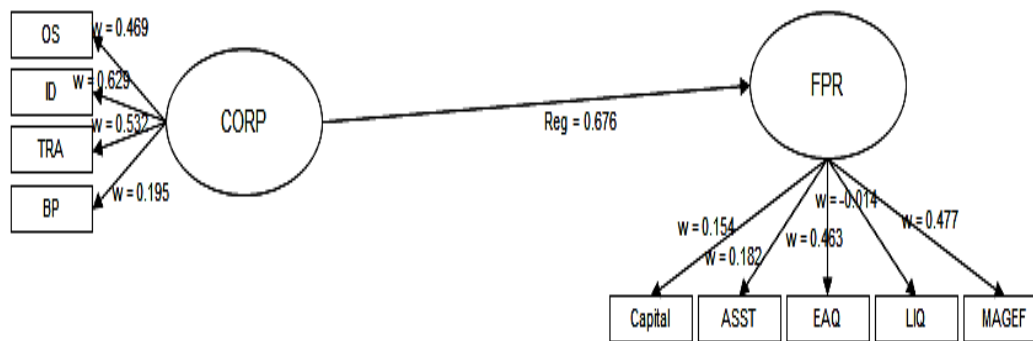
that hypothesis three (*H3*) which states that there is a positive relationship between financial transparency and firm performance is similarly supported; where *FT* = Financial transparency.

In the same vein, the regression analysis of board profile ($F= 1.02$, $B = .106$, $p>.05$) to firm performance indicates that there is no significant relationship between board profile and firm performance. This finding demonstrates that board profile does not bring any variation in firm performance. The regression analysis model of $FP = \beta_0 + \beta_1 BD + \varepsilon$ is therefore presented as $FP = 1.733 + .106BD$ but not significant, inferring that hypothesis four (*H4*) which states that there is a positive relationship between board profile and firm performance is not supported.

Structural equation modelling using Partial Least Square (PLS) modelling was further tested to consent the structural and measurement models. It

was recognized that corporate governance is statistically significant and predict firm performance ($Reg = 0.676$, $p<.05$). Accordingly the different constructs of corporate governance also show that ownership structure ($w= 0.469$), information disclosure ($w= 0.629$), financial transparency ($w= 0.532$) and board profile ($w= 0.195$) predict firm performance. Information disclosure displayed the highest weight, followed by financial transparency, then ownership structure and lastly, board profile. Much as the regression analysis did not take on board profile as a predictor of firm performance, the PLS did - is a superior model. Equally, firm performance demonstrated that capital adequacy ($w= 0.154$), asset quality ($w= 0.182$), earnings quality ($w= 0.463$), management efficiency ($w= 0.477$), and liquidity ($w= 0.014$) were key dimensions of firm performance in their revealed respective weights.

Figure 1. A structural model of corporate governance and firm performance using PLSM



8. DISCUSSION

There is a significant positive relationship between corporate governance and firm performance. Firm performance has significant positive relationships with constructs of corporate governance including ownership structure, information disclosure, financial transparency and board profile. This implies that ownership structure, information disclosure, financial transparency and board profile enhance performance through capital adequacy, asset quality, management efficiency, earnings quality and liquidity of financial institutions. Consequently, ownership structure in terms of promoting voting, capital as well as managerial rights is reasoned fundamental. So, the firm with value-creation mechanisms and processes, better management, and its support of prudent allocation of resources are significantly identified as critical. In addition, financial institutions, have managed to promote the number of independent directors being more than the executive directors, the CEO is supported by counsel from the Board of Directors (BoD), CEO's performance is monitored and appraised satisfactorily and the institution is clearly defined in terms of lines of authority and responsibility and as a result improves their firm performance. This presents a new trend of financial institutions adherence to corporate governance guidelines.

In Uganda, the 2012 Companies Act provides the primary framework for governance of companies

and equally introduces a code of corporate governance which is voluntary for private companies and mandatory for newly public companies. Kiryabwire (2014) argues that the legal and regulatory framework of corporate governance in Uganda is a hybrid that comprehends mandatory standards (banking standards) and voluntary standards (guidelines on corporate governance). But also, the financial institutions in Uganda could have got a lesson from the world "big" companies that collapsed like: Barings bank in the United Kingdom in 1995, Enron in 2001, WorldCom in USA in 2002, financial scandals of Royal Ahold - a Dutch transnational retail group in 2003, Telecom Italia in Italy, Deutsche bank in Germany, Kookmin bank in South Korea, Tokyo Electron in Japan in the far East, Vimplecom - a Russian telecommunications, Petrobras - a Brazilian petrochemical giant and SABMiller - once world's leading brewer in emerging markets in South Africa.

In line with the findings, Bhagat and Bolton (2008) accomplished that ownership of board members, and CEO-chair separation is significantly and positively correlated with firm performance. Corporate boards have the power to make, or at least approve all important decisions including decisions about investment policy, and corporate governance itself. It is credible that board members with appropriate stock ownership will have the incentive to provide effective monitoring and oversight of important corporate decisions. The

board of directors is an important mechanism for over-seeing management behaviour, resulting in better corporate accountability and disclosure. The proportion of non-executive directors on the board is seen as a key indicator of the independence of the board from management. In the same thinking, Bhagat and Bolton affirm that firms that introduced corporate governance systems are characterized by high profitability.

In addition, Bodaghi and Ahmadpour (2010) found that corporate governance variables like ownership structure play an important role in the determination of the financial mix of the firms (financial performance). Nonetheless, it is pertinent to note that ownership structures differ across firms because of the differences in the circumstances facing firms, particularly in regard to scale of economies, regulations and the environment stability in which these firms operate (Demsetz & Villalonga, 2001). Fitriya and Locke (2012) investigated the role of board structure and the effect of ownership structures on firm performance and revealed that board of directors, board committees, and managerial ownership have a positive and significant impact on firm performance. Nevertheless, non-executive directors, female directors on the board and blockholder ownership did not have any significant relationship on firm performance.

Additionally, financial institutions disclosed both mandatory and voluntary information as well as having clearly defined and publically accessible disclosure policies which defined principles, rules and procedures of reporting to shareholders, relevant authorities, public, plus other interested parties. Publication of firms' annual financial reports as well as information concerning their business operations improved the firm performance of financial institutions. Financial disclosure has a positive impact on the performance of a company in terms of capital adequacy, asset quality, management efficiency, earnings quality and liquidity (Francis, Nanda, & Olsson, 2008; Miller, 2002) and this is further supported by (Francis et al., 2008) who posit that the earnings quality are positively correlated with the level of a firm's disclosure. Furthermore, Quayes and Tanweer (2013) demonstrate that better disclosure has a positive impact on the financial performance of a company. In the same thinking, several regulatory reforms were instituted in financial year 2016/17 with the view to improve the soundness and stability of the financial system. The amendments enclosed compliance with insurance core principles, risk-based supervision but also harmonized with the East Africa corporation requirements as well as international best practices (Background to the Budget, 2017). But still, European Corporate Governance Institute (2015) states that enhanced disclosure norms, performance evaluation of boards, introduction of financial controls, enhancing the protection for minority shareholders, a better framework of regulation would strengthen the foundations of corporate governance.

Financial transparency in terms of updated financial facts about the financial institutions is publically accessed. The publications of the business reports including the reports of the external auditor in compliance with the laws, by-laws, and financial regulations enrich firm performance. Sullivan (2005) contend that the question of transparency of

financial institutions is an essential component of performance. Preparation of annual financial statements carries the responsibility of presenting them so that they provide an accurate picture of the financial results in a manner that can be defended in terms of the credible framework. The best defence to criticism is through open and transparent disclosure since it eliminates the risk of the incredibly damaging consequences that occur when it is revealed that disclosures have been less than total. It is difficult to overstate the importance of the role of transparency in ensuring the maintenance of financial institutions independence and discharging its accountability obligations. Hence, the importance of transparent reporting practices extends beyond narrow institutional interests because they make an important contribution to establishing the credibility of a nation's financial system. As economies evolve and seek to establish their positions in the international marketplace, the national reporting framework becomes important to an expanded group of users. For most transition economies, Uganda inclusive, the accounting profession and the standard-setting framework in terms of market-based disclosures are still evolving which creates potential problems for the production of internationally credible financial reports.

Nevertheless, correlation and regression results from the study revealed that the board profile had no significant relationship with firm performance, but the partial least square results held a significant relationship. This could be attributed to nature, rules governing an environment where these boards operate. Nkundabanyanga and Ahianzu (2012) argued that there are no empirically confirmed measures of board role performance in Ugandan service firms that would act as benchmarks for board role performance in the service sector (where financial institutions belong) in spite of their importance to the economy. It is commonly believed that the presence of experts on the board could limit the excessive risks taken by the financial institution's management. Financial experts among a board's independent directors arguably have lower costs in acquiring information about the complexity and associated risks of certain financial transactions and hence are better able to efficiently monitor senior management (Harris & Raviv, 2008). In this regard, a more financially knowledgeable board can recognize risks that will not pay off or which are unsound for the financial stability of the financial institution and advise senior managers to avoid such risks. Largely, Gompers, Ishii and Metrick (2003) deliberated on the impact of corporate governance on firm performance and found that firms with better governance have a better overall performance.

9. CONCLUSION

The main objective of the study is to examine the association between corporate governance and performance of financial institutions. Overall, the PLS results suggest that there is a significant positive relationship between corporate governance and firm performance. In addition, results indicate that ownership structure, information disclosure, financial transparency and board profile predict performance of financial institutions. In order to cope with the intricacy and a blend of risks exposure

to financial system properly, dependable, constructively and sustainably, it is of great importance to evaluate the overall performance of financial institutions by implementing a regulatory financial supervision framework, the CAMEL rating system. This is broad because it assesses and evaluates the performance and the financial soundness of the activities of the financial institutions as well as being a concise and indispensable tool for auditors and regulators.

Limitations to the study include, first, only three types of financial institutions, namely,

commercial banks, insurance companies and MFIs were considered. Second, the study was limited in terms of the period since average of three years (at a particular point in time) was used in the calculation of the CAMEL ratios, otherwise, a longitudinal study could be considered. Despite these limitations, our results are beneficial by providing further evidence on how firm performance of financial institutions is enhanced by the different aspects of corporate governance including ownership structure, information disclosure, financial transparency and board profile.

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