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Impact of Board size on the Financial Performance of the Listed Manufacturing Companies in Nigeria

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Abstract: *The impact of board size on the financial performance of listed manufacturing companies in Nigeria was investigated in this study. The manufacturing sector in Nigeria consists of 74 companies from where 34 companies were purposively selected. The study used both primary and secondary data. Secondary data was extracted from the published financial statement of the selected companies while primary data was collected with the use of questionnaire from the 170 respondents drawn from the selected 34 companies. The result indicates that there is a significant positive linear relationship between board size and financial performance of listed manufacturing companies in Nigeria. The study therefore recommends an increase in board size for the listed manufacturing companies which should be done in line with the complexity and nature of operation of the individual firm.*

Keywords: *Board Size, Financial Performance, Return on Equity, Resources Dependency Theory*

I. Introduction

The twenty first century review of organization activities and performance revealed that companies, businesses, organizations and corporations globally have changed the way they do business. This has been as a result of globalization, economic downturn and internationalization of markets globally. The contemporary business environment has been significantly characterized with uncertainty and risk, eliciting complexity to forecast and control the tangible and intangible elements impacting firm performance (Adams, Hermalin & Weisbach, 2010). Markedly, the good market players must be organizations that capitalize on rule-based systems as opposed to relationship- based systems. As a rejoinder to the external pressures, such entities (Companies, businesses, organizations and corporations) resort to various strategic approaches. The strategic approaches include benchmarking, downsizing, management by Exemption, reengineering operationalization, restructuring and total quality management amongst other strategies aimed at sustaining their competitive edges, upholding performance as well as survivability in the long run (Adams, Hermalin & Weisbach, 2010).

Kuratko and Morris (2009) noted that for such entities to prosper in the turbulent business environment, as well as implement the aforementioned strategic approaches, numerous firms and organizations have integrated corporate board practices in their management. This applies to both public and private organizations. Managenelli and Klein (1994) suggested that well-governed organizations immensely performed better than those that failed to incorporate corporate board. Notably, numerous firms including the International Corporate board Network (ICGN) and the Organization for Economic Corporation and Development (OECD) have over the time established frameworks for corporate board. The framework spells out the composition, tenure of office, appointment procedure of the board as well as the board size.

Shleifer and Vishny (1997) outlined corporate board as the approaches through which finance suppliers of corporations assure themselves of obtaining a return on investment. More elaborately, John and Senbet (2007) articulated corporate board as embedding the mechanisms through which various stakeholders of an organization practice control over corporate insiders and management such that their interest are upheld. The issue of corporate board has drawn significant attention and focus since the 1980s both in practice and academic research. Accordingly, OECD (2004) suggests that corporate board will entail a range of associations between an organization's management. Corporate board will also offer the platform through which the organization's mission and objectives are established, and the means of pursuing them, checking and monitoring organizational performance are developed.

The scandals experienced at global organizations such as Enron, International News Corporation, Lehman Brothers, Parmalat, and WorldCom have positioned the corporate board systems used by modern organizations under close inquiry. In fact, every round of corporate scandals over the years results in fresh rounds of debate and corporate board enhancements. For instance, Berglof and Von Thadden (1999) observed that the Asian Financial crisis of 1997 led to attention on insider trading. Meanwhile, they also note that the Global Financial Meltdown of 2008 elicited the emphasis on the responsibilities of audit committees, executive remuneration and external auditors as well as board independence. Additionally, OECD (2004) observed that

these scandals coupled with the seemingly poor performance of the corporate sector in Africa have elicited impetus to the application of corporate board practices in numerous African countries. Indeed, at the helm of these notable corporate board enhancements and reforms, is a common interest in the effectiveness of board of directors in realizing organizational performance.

The issue of board effectiveness on the other hand led to a debate on what constitutes an appropriate size for a board to be effective. In line with OECD (2004) guideline, Oyerogba, Memba and Riro (2016) posits that a board consisting of 12 members can be considered appropriate. Naddler (2009) however advocated for a smaller board size comprises of 7 members. The line of thought was that although larger board size initially promotes key board functions, there come a time when larger board suffer from coordination and communication problem and thus effectiveness and performance of the organization declines.

In the light of this debate, this study investigates the impact of board size on the financial performance with a particular attention on the manufacturing companies in Nigeria for a period of ten years ranging from 2005 to 2014. This period is considered appropriate considering the fact that it witnessed the significant reform that has taken place in the code of corporate governance in Nigeria. The rest of the paper have been arranged as follow: a review of literature was conducted in section 2. Research methodology adopted was detailed in section 3 while section 4 and 5 took care of data analysis and conclusion respectively.

2.1 Theoretical Review – Resource Dependency Theory

While reviewing the theoretical framework for the significance of board of directors in companies, the resource–dependency theory is of noteworthy value. The board of directors is a resource for the organization (Johnson *et al.* 1996; Hillman *et al.* 2000). In its formulation, Petrose (1959) articulated the importance of unique bundles of resources an organization controls that are of crucial value for the growth and performance of the organization. The resources according to Petrose (1959) include the organization's assets, competences, processes, operations, characteristics, information and knowledge controlled by the organization. Additionally these resources are nurtured and purposed to enhance organization's effectiveness and efficiency (Barney, 1991; Daft, 2006). Thus, from this point of assertion, company's governance structure and the board arrangement (independence, director ownership, size, and diversity) is perceived as a resource, which could add value to the company.

Arguably, the resource-dependency theory presents that companies endeavor to put forth control over their environment through co-opting the resources required to survive (Pfeffer & Salancik, 1978). As such, boards are believed to be a bridge between the firm and the vital resources, which a company requires and derives from the external environment for an enhanced performance. The resource-dependency theorists point out that having outsiders on the board (Non-executive directors) helps foster access to resources; prerequisites for firm performance (Johnson *et al.* 2010). The theory, further, enunciates that independent directors enhance the resource-base of the company. Such resources as noted by Pfeffer and Salancik (1978); Johnson *et al.* (2010) will include access to vital constituents (buyers, public policy decision-makers, suppliers, and social groups) information, skills, and legitimacy.

Hillman *et al.* (2000) affirms that the board of directors serves as boundary spanners as they promote the projections of an organization's business. Hillman et al. for instance, argued that, the external associations and networking that board members will exercise will apparently influence the development of the business positively. Additionally, they noted such links would enhance the organization's long –term projections. As such, Pfeiffer and Salancik (1978) had earlier noted that when a company hires a member/ director to the board, it does so with expectations that this individual will come to come to support the company, associate themselves with the business and its characteristics (strengths, weaknesses, opportunities, and threats), will constructively present the company to others, and even endeavor to aid the business. Additionally Pfeiffer and Salancik (1978) state that hiring outside or non-executive directors to the board could enhance the company's capacity to manage its environmental unforeseen events. Initially, Pfeiffer (1972) had illustrated that considering the size of the board and performing background checks for the non-executive board members were indispensable prerequisites for efficient management of the company's capitation needs and the regulatory environment.

Further, Pearce and Zahra (1992) accentuated the significance of board composition since it allows for resource exchange between the company and its external environment that is always vital for firm performance in the short-run, effective financial performance, and survivability in the long-run. They further noted that having a heightened environmental uncertainty, board size and outside directors in the board was linked with more efficient and effective formulation of strategy and its eventual execution. The aspect was affirmed by Carpenter and Westphal (2001) who illustrated how the social context of external linkages and networking facilitated business operations and prosperity. Indeed, if Pearce and Zahra (1992) were anything to go by, then it is apparent that boards function as a co-operative approach, within which the company associates its external environment to safeguard resources and secure itself against environmental uncertainty.

Also, the resource dependency responsibility of board of directors evaluates the manner in which the BOD and/or BOM facilitates the firm's capacity to attain financial resources (Thompson & McEwen, 1958; Pfeffer, 1972; Mizruchi & Stearns, 1988). Particularly, Mizruchi and Stearns (1988) note that the company having a heightened level of bank debt could engage an individual of the bank to enhance access to the bank's financial resources (funds). Equally, Carpenter and Westphal (2001) observed that the companies hampered with solvency issues were purported to engage representatives of the financial institutions to their respective boards. Such appointments as noted by Carpenter and Westphal (2001) depict that the significance placed on capital as a crucial resource plays a role in the behavior of individual companies. The duo also found a link between companies 'borrowing strategy and the kind of financial representation on the board since such linkage offers both the principal and agent with an opportunity to co-opt each other on a continuous basis.

Intently, scholars have integrated the resource dependency theory to describe the composition of boards, especially, concerning the independence of the board. Previously, Kaplan and Minton (1994) observed that poor financial and stock market performance of an organization time and again results in appointment of financial directors to the board. Additionally, Pearce and Zahra (1992) reported that outsiders are engaged on the board since they bring forth a fresh perspective, particularly, when the firm is not performing well. Substantially, Muth and Donaldson (2010) presented that these linkages between companies' borrowing strategy and the kind of financial representation on the board, anchoring upon the resource dependency theory enhanced performance of the firm.

Evidently, in this study, the resource dependency theory perceives the board as the resource, which not only supersedes its needs for other resources, but also impacts the environment in its favor, and thus enhancing firm performance. Apparently, organizations require resources; resources acquired through networking and associations as well as the efficiency and effectiveness in linking the network gaps, thus determining the quality of organizational performance.

2.2 Empirical Review: Board Size and Financial Performance

Firstly, Yermack (1996) examined a recommendation to limit the size of board of directors. He was motivated to enhance the effectiveness of the board and avail evidence to support the recommendation. Mainly, he hypothesized that firm value depended on the quality of monitoring. As such, Yermack laid his research on a sample of 452 large US public corporations, drawn from the Forbes Magazine top 500 largest US public corporations over the duration 1984-1991. Yermack (1996) indicated that an inverse relationship existed between the board size and firm market value as illustrated by the Tobin's Q technique on board size. This inverse relationship showcased both cross-sectional analyses of the variation between firms and in time series analyses of the variation between individual corporations. Noticeably, Yermack reported that the inverse relationship between board size and the firm value weakens as the size of the board grew, meaning that the increase in incremental costs arose as the boards grew larger from small to medium and medium to large.

Secondly, Guest (2009), while examining the influence of board size on the performance of 2,746 UK listed companies over the period 1981-2002, used secondary data on board size, which was his independent variable and firm performance (dependent variable). He then, integrated the regression technique for analysis of data sourced from 'DataStream'. Conclusively, Guest remarked that the UK business setting offered an interesting institutional environment, since the UK boards engaged insufficiently on their monitoring role, and thus, any negative influence of the larger board size was probable to mirror the malfunction of the board's advisory as opposed to their monitoring role. Additionally, the research also indicated that the board size had a strong negative influence on profitability ratios (particularly, ROA (Return on Assets), share returns, and Tobin's Q. Moreover, the inverse association between board size and performance was heightened for larger firms that had engaged larger boards. Indeed, Guest (2009)in his endeavors supported the assertion that concerns of poor communication and inefficient decision-making challenged the effectiveness of large boards.

Closer home, Muriithi (2004) carried out a study on the relationship between corporate governance mechanisms and firm's performance. His approach entailed an empirical examination of the aforementioned relationship by sampling 44 listed firms with the Nairobi Stock Exchange, Kenya over a five-year review period (1999-2003). For the dependent variables Muriithi (2004) used the Stock Market Returns (RET), Return on Assets (ROA), and Tobin's Q as measures of financial performance. He collected data from secondary sources that entailed the audited financial statements and company annual reports. Then, he emphatically classified the variables into three sets of corporate governance mechanisms, control variables and performance measures, thus, modeling multiple regression equations aimed at assessing the relationship between size and composition of the board and financial performance. From the study, it was apparent that the average size of the board of the listed firms was eight members. However, no significant association was observed between the board size and the Tobin's Q measure. Moreover, Muriithi (2004) reported a positive relationship between board size and RET, indeed, at a confidence level of 0.01%.

Further, Okiro (2006) laid his studies on listed companies with the Nairobi Stock Exchange (NSE), Kenya over a three-year review period (2000-2002). Okiro's endeavor was to establish the influence of the board size, board composition and performance of the firm. The study's sample excluded banks and any other financial institutions owing to these institutions' huge debt structure. Okiro engaged secondary data for the study that was sourced from companies' financial statements, annual reports and NSE materials. For the dependent variable Okiro used the Tobin Q technique as measure of performance, while the control variables were the firm size and firm gearing. Okiro (2006) reported an average board size of 7.18 with a maximum of 15 members and standard deviation (SD) of 2.85. Okiro further established no relationship between size of the board and performance of firms; this was as a result of the multiple liner regression model used to analyze the data.

III. Research Methodology

The purpose of this study was to establish the effect of board size on the firm financial performance of listed manufacturing companies in Nigeria using positivistic approach. Under the positivistic philosophical approach, we set up the hypotheses on the basis of the existing relevant theories. Then these hypotheses were tested and confirmed or disproved by quantitative and statistical methods in order to answer the research objectives and accomplish the research purposes. Remenyi *et. al.,* (2005) claimed that the final result of such research can be applicable through the positivist approach. Positivistic research is generally based on numbers and mathematical equations which and is difficult to alter because it used the quantitative methodology to collect primary data.

The study used both longitudinal and cross sectional survey research design earlier used by Eriksson and Kovalainen, (2008). The longitudinal survey design was justified on the grounds that the data was collected over more than one time period and cross sectional design is justified on grounds that data of different companies was also collected at a defined period. In addition, longitudinal study permitted the arrangement of data in a panel data form (Connaway and Powell, 2010). Similarly, the study population of this research work comprised the entire work force or workers in listed manufacturing companies in Nigeria with total numbers of seventy four (74). The study used 45% of the population as a sample size which was 34 companies according to Mugenda and Mugenda (2012). There are approximately sixty thousand and five hundred and ten (60,510) workers in the listed manufacturing companies from where 170 respondents were drawn. The respondents consisted of the Managing Director, company secretary, Marketing manager, Operations Manager and Production Manager of listed manufacturing Companies. These highly placed personnel are chosen because of their knowledge and involvement in the administration and running of the firm for sound financial performance.

To achieve the study objective, the study used both primary and secondary data. The primary data was collected through the direct responses from the workers of the listed manufacturing companies in order to inquire about the financial performance and board size of the companies through the use of structured questionnaire. Kothari (2014) describes primary data as those which are collected afresh and for the first time by the researcher, and thus original in character. In this study Closed- ended or a structure questionnaire was adopted to generate data in quantitative form for the research. The study also used secondary data which was obtained from the annual financial statements of the sampled companies.

After the data collection, the completed and returned questionnaires were edited for completeness, coded and entries made into Statistical Package for Social Sciences (SPSS version 20). Coding consisted of technical procedures where symbols, which are normally numerals, are given to the raw data in order to transform it into an easily tabulated and counted format (Churchill & Iacobucci, 2002). It assisted the researcher in reducing the replies to a few categories containing information required for analysis. Thus, codes are given to each individual response. This ensured that the data are accurate, consistent with other information, uniformly entered, complete and arranged to simplify coding and tabulation. With data entry, the data collected is captured and stored. The dataset was then subjected to a verification process to verify if the captured data correlates with the data-captured into SPSS. Descriptive statistics was conducted in SPSS version 20. Various statistical analytical approaches were used namely; descriptive and inferential statistics.

IV. Results and Discussion

The main objective of this study is to determine the impact of board size on the financial performance of listed manufacturing companies in Nigeria. The study operationalized board size in terms of the total number of directors on the board of the company. Financial performance on the other hand was operationalized with the use of return on equity. The study adopted the use of both descriptive and inferential statistics in ascertaining this relationship. The descriptive statistics adopted includes, frequencies, percentages, mean and standard deviation while inferential statistics includes correlation and regression analysis. Trend analysis was also conducted on the secondary data as part of the descriptive statistics.

4.1 Descriptive Statistics for Board Size

The study intended to establish whether firms with smaller board size perform better than firms with large board size. The results indicate that 45.9% and 35.8% of the respondents agreed and strongly agreed with the statement respectively while 6.3% and 3.1% strongly disagreed and disagreed with the statement respectively. On whether large board size has a negative impact on the performance of the firm, the result also indicated that majority of the respondents agreed.

The study further sought to establish whether firms dominated with inside directors perform better than firms with lesser inside directors. The findings indicated that 39.0% and 38.4% of the respondents agreed and strongly agreed with the statement respectively. While only 16.4% of the respondents disagreed with the statement. On whether it was better to do away with the services of outside directors because it is an additional cost to the firm and their services are not reflected in the firm performance at all, the result also indicated that majority of the respondent agreed. Finally, the study aimed to find whether a small size board is better and more effective in term of costs savings than large board size, the findings also indicate that majority of the respondents agreed.

These findings imply that the respondents felt that small board is more effective and perform better than large board size. The findings of this study concurs with those of Guest (2009) who examined the influence of board size on the performance of 2,746 UK listed companies over the period 1981-2002.From the study, it was apparent that the average size of the board of the listed firms was eight members. However, no significant association was observed between the board size and the Tobin's Q measure.. Closer home, Muriithi (2004) also carried out a study on the relationship between corporate governance mechanisms and firm's performance. The research indicated that the board size had a strong negative influence on profitability ratios (particularly, ROA (Return on Assets), share returns, and Tobin's Q.

Table 4.1: Descriptive Statistics for Board Size

	Strongly disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std Dev
Firm with smaller board size performs better than firms with large board size	6.3%	3.1%	8.8%	35.8%	45.9%	4.12	1.11
Large board size has a negative impact on the performance of the firm	8.8%	5.7%	5.7%	39.6%	40.3%	3.97	1.22
Firms dominated with inside directors perform better than firms with lesser inside directors	8.2%	8.2%	6.3%	39.0%	38.4%	3.91	1.23
It is better to do away with the services of outside directors because it is an additional cost to the firm and their services are not reflected in the firm performance at all	7.5%	3.8%	5.0%	37.1%	46.5%	4.11	1.16
A small size board is better and more effective in term of costs savings than large board size	6.3%	6.9%	6.9%	40.3%	39.6%	4.00	1.15

4.1.1 Trend Analysis for Board Size

As part of the descriptive statistics, the study further conducted a trend analysis to establish the trend of average board size in manufacturing companies for the period between 2005 and 2014. The findings show that the board size of the manufacturing companies has been fluctuating across time. The average board size for most companies in 2005 was 10 members which increase slightly in 2007 before decreasing again in 2010. Most manufacturing companies have large board size in 2007 and 2013. The results support that of Guest (2009) who examined the influence of board size on the performance. From the result, it was apparent that the average size of the board of the listed firms was eight members.

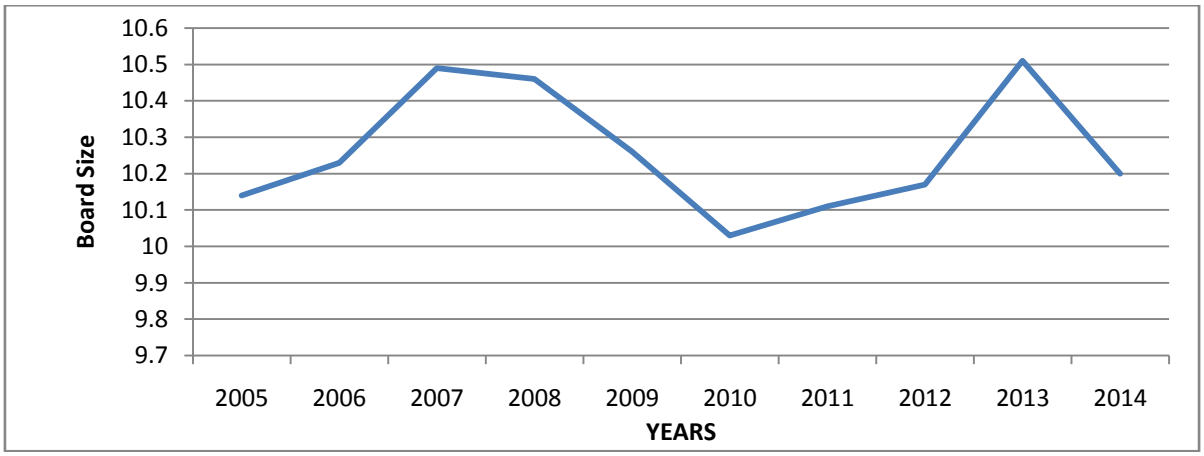

Figure 4.1: Trend Analysis for Board Size

4.2 Correlation Results for Board Size and ROE

In the correlation analysis board size was found to have a strong and significant relationship with return on equity (r=0.406, p=0.000). The findings appear supports the earlier results of Muriithi (2004) who also carried out a study on the relationship between corporate governance mechanisms and firm's performance where a strong relationship was noted between board size and financial performance.

Table 4.2: Correlation Results for Board Size and ROE

		ROE	Board Size
ROE	Pearson Correlation	1	.406**
	Sig. (2-tailed)		0
	N	350	350
Board Size	Pearson Correlation	.406**	1
	Sig. (2-tailed)	0	
	N	350	350
** Correlation is significant at the 0.01 level (2-tailed).			

4.3 Univariate Regression Analysis for Board Size and ROE

From the result of the regression analysis presented in table 2, R-square was 0.164 which implies that board size accounted for 16.4% of the variation in the return on equity while the remaining 84% can be attributed to other variables not captured by this model. The results shows that board size is a good predictor of companies financial performance as indicated by the F-statistics (F=68.706, p=0.000).

Table 4.2: Model Summary for Board Size and ROE

Model Summary	
R	.406a
R Square	0.164
Adjusted R Square	0.162
Std. Error of the Estimate	1.570356

Furthermore, F-test was carried out to test the null hypothesis that there is no relationship between of Board Size and financial performance of listed manufacturing companies in Nigeria. The results of ANOVA test presented in table 3 shows that the F value is 68.706 with a significance of p value = 0.000 which is less than 0.05, meaning that board size is a good predictor variable of financial performance of listed manufacturing companies in Nigeria.

Table 4.3: ANOVA for Board Size and ROE

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	169.430	1	169.430	68.706	.000[b]
	Residual	860.640	349	2.466		
	Total	1030.070	350			
a. Dependent Variable: ROE						
b. Predictors: (Constant), Board Size						

The coefficient β = 0.239is also significantly different from 0 with a p-value= 0.000 which is less than 0.05. The result implies that a unit change in board size will result in 0.239unit change in financial performance. This confirms that there is a significant positive linear relationship between board size and financial

performance of listed manufacturing companies in Nigeria. Therefore, the null hypothesis was rejected at the significance level of 0.05 and study concluded that there is a relationship between board size and financial performance of listed manufacturing companies in Nigeria. The result corroborate those of Anderson et al. (2004); Coles et al. (2008); Guest (2004) that related the board size with enhanced firms' market value. It however disagreed with that of Randoy and Jensen (2004) who reported no significant relationship between board size and performance. Equally, Singh and Davidson (2003) stated that the larger the boards are, then the more an inverse-related outcome with firms' performance was generated.

Table 4.4: Regression Coefficients for Board Size and ROE

	B	Std. Error	Beta	t	Sig.
(Constant)	1.317	0.241		5.455	0.000
Board Size	0.239	0.029	0.406	8.289	0.000
a Dependent Variable: ROE					

V. Conclusion and Recommendations

The main objective of this study was to examine whether board size has significant impact on the financial performance of listed manufacturing companies in Nigeria. The study used both descriptive and inferential analysis to test this relationship. In the correlation analysis board size was found to have a strong and significant relationship with return on equity (r=0.406, p=0.000). The findings of the regression analysis revealed that board size accounted for 16.4% of the variation in the return on equity. The results further showed that board size was a good predictor of companies financial performance as indicated by the F-statistics (F=68.706, p=0.000). This confirms that there is a significant positive linear relationship between board size and financial performance of listed manufacturing companies in Nigeria.

Therefore, the null hypothesis was rejected at the significance level of 0.05 and study concluded that there is a relationship between board size and financial performance of listed manufacturing companies in Nigeria. The study therefore recommends an increase in board size for the listed manufacturing companies which should be done in line with the complexity and nature of operation of the individual firm.

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