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EFFECTS OF CORPORATE GOVERNANCE PRACTICES ON ORGANIZATIONAL PERFORMANCE: A CASE OF COFFEE COOPERATIVE SOCIETIES IN MACHAKOS COUNTY

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ABSTRACT

The study focused on effects of corporate governance practices on organizational performance. Specifically, the study examined the influence of board structure, composition and compensation on the performance of coffee cooperative societies in Machakos County. Using descriptive research design, closed ended questionnaires were administered to the 174 board executive directors and supervisory directors from 29 registered active coffee cooperative societies in Machakos County. Data collected was analyzed using descriptive and inferential techniques and the findings were expressed in means, standard deviations and percentages before being presented in form of tables and figures which were followed by comments and inferences. Overall, the study established that corporate governance positively and significantly influences firm performance. The study found out that board structure, board composition and board compensation had a strong influence on the performance of coffee cooperative societies in Machakos County. In terms of compensation, it was established that recent board members are unstable in contrast to stable longer-tenure members. Likewise, executives' compensations are low and fewer, not based on merit although subject to increment, timely paid as well as no compensation arrears observed. Largely, the study recommended that the boards' structure design should ensure consensus, checking of CEO/COB, bring more expertise and experience. Similarly, boards should appoint younger members for superior technical knowledge, more adaptability, and receptivity, innovative. Further, CEO should be separate from board to avoid conflict of interest and weakening board independence besides increasing non-executives and women on boards. Capacity of inside directors should be enhanced; recent board members should be reduced in favour of maintaining stable longer-tenure members and board membership be anchored on merit. Board compensation should be standard; merit based, promptly paid and subject to increment.

Keywords: *Corporate Governance, Structure, Composition, Compensation, Performance*

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INTRODUCTION

The definition of corporate governance (CG) as the process and structure of the board of directors providing direction, authority, and oversights on behalf of and for the benefit of shareholders and Stakeholders (O'Kelley, Goodman & Sanderson, 2021), demonstrates CG's efficacy and ramifications on organization performance. In the lenses of agency theory, this balancing act between interests of board members, shareholders and the other stakeholders, is best addressed through effective board structure, balanced and competent board composition and board compensation (incentive mechanisms) (Hashed & Almaqtari, 2021).

This ensures transparency and accountability resulting into improved performance reflected in profitability, expansion, stakeholder satisfaction and asset base among others (Lu & Wang, 2021). Unfortunately, this conflict of interest has been mismanaged through inappropriate structure, composition and compensation of boards leading to corporate misconduct (financial scandals and fraud) resulting into poor performance in terms of profitability, investor confidence apathy and corporate failure (Li, 2018).

The flop of Carillion, Patisserie Valerie in 2018, the British Steel, Kier Group plc, Thomas Cook and the British travel firm, in 2019, underscore how misleading audits have been at the heart of corporate failures (Steven, 2019). These came on the heels of other high-profile corporate failures such as Volkswagen, Malaysia Development Berhad (1MDB), German's 2020 Wirecard, Luckin Coffee Dong, Punjab National Bank (PNB) of India, Petrobras and Odebrecht of Brazil, Toshiba of Japan, of Canada in 2016. This financial fraud validates the assertion by Dong, Wang, Zhang and Zhou (2020) that a board composition dominated with internal directors, has higher chances of exhibiting selfishness by failing to probe and understanding their firms' risk management processes and poor management decisions.

Similarly, the latest addition to a long and storied history of corporate fraud is Canada's Valeant Pharmaceuticals and Alberta Motor Association, South Africa's Steinhoff International Holdings NV and KPMG typify what Ofer, Saad, Su and Tallarita (2021) refer to as oversight failure, the inability to combat groupthink and inactivity at the board level. This raises doubt of directors' duties and liabilities and highlights the importance of non-executive training and professional development. Resource dependency theory predicts such scenario where failure of BOD in providing resource access and oversight of resource management as well as offering strategic direction to a firm, undermines firm performance (Glaulier & Underdown, 2001).

Koutoupis (2019) proposed that the board of directors should have executive and non-executive directors, optimum number, mix of the required skills and competencies, optimum gender mix, age distribution, occupation, geographical coverage, ethnicity, academic qualifications as well as individual experience to protect the firm against external threats. In performing this role, members are expected to be independent and monitor the actions of managers as agents of the owners to ensure they are acting in accordance with the owners' interests (Jensen & Meckling 1976).

It is these scandals portraying the relationship between the business managing agent and the owner (principal) of the business to be that of doubt and contending interests, the agency theory predicts and offers the remedy (Jensen & Meckling 1976). These include establishing measures such as controls on the actions of agents, monitoring the actions of agents, financial incentives to encourage agents to act in the interest of the principals, and separation of risk-taking functions from control functions (Altuwaijri & Kalyanaraman, 2016).

Londono, Claessens and Correa (2021), the requirement that directors' remuneration should be linked to performance has not always been observed in the corporate world and examples abound where directors receive excessive pay rises or significant bonuses when their companies are in financial crises and sometimes laying off employees

due to over-domineering CEO-cum-board chair (Zond, 2015).

The cases discussed here, is the iceberg of the long list of firms struggling under effects of poor corporate governance. These sampled fraud cases represent just a glimpse into a much broader global problem and highlighting corporate governance issues that need intense scrutiny (Vig, S., & Datta, 2021). This is placing the issue of corporate governance firmly in the spotlight. To this end, the current study interrogated the board structure, board composition and board compensation and their influence on organizations performance among coffee cooperatives in Machakos County, Kenya.

Statement of the Problem

The unending wave of corporate failures and collapse validates the empirical link between corporate governance and performance (Londono, Claessens & Correa, 2021). Like many countries, many organizations in Kenya share the sickening governance issues. For instance, in a report by the US Department of Agriculture on Kenya's coffee industry identifies poor governance of marketing cooperatives as leading factor in a possible fall in marketed coffee volumes in many counties including Machakos (USDA Foreign Agricultural Service, 2019). The Kenya Coffee Annual Report (2018) warns of declining coffee volumes, delayed payment, milling losses among others in counties with Machakos topping the list. As a result, the International Coffee Organization (ICO) observed cases of farmers in Machakos, Muranga and Kiambu uprooting coffee shifting to less risky enterprises.

Despite stated increasing challenges, until now there are insufficient empirical findings on this issue in Machakos County. Little available local empirical evidence is either both contextually and conceptually remote (Mbogo, 2020; Irungu, 2019, Macharia & Genga, 2019; Bajji, Nkaabu & Rintari, 2019). Most studies are contextually based in developed countries (Lu & Wang, 2021; Hashed & Almaqtari, 2021; O'Kelley, Goodman & Sanderson, 2021; Vig & Datta, 2021; Benvenuto, Avram, Avram & Viola, 2021; Dong, Ofer, Saad, Su, W., & Tallarita, 2021; Wang, Zhang & Zhou, 2020; Steven, 2019). The study, therefore, sought to address the contextual and conceptual gap by examining corporate governance practices on organizational performance of coffee cooperative societies in Machakos County.

Study Objectives

- Determine the effect of board structure on performance of coffee cooperative societies in Machakos County.
- Determine the effect of board composition on performance of coffee cooperative societies Machakos County.
- Determine the effect of board compensation on the performance of coffee cooperative societies in Machakos County.

LITERATURE REVIEW

Studies confirm the fact that aspects of an organization's board structure such as size of the board (Mohammed, Hamdan & Al Mubarak, 2017) board leadership (Adusei, Akomea, Poku & McMillan, 2017), independence (Ouma & Webi, 2017) and board diversity (Steven, 2019), influence performance. However, correlation board structure and corporate performance that still abstruse as contradictory studies reveal (Livnat, Smith, Suslava & Tarlie, 2016; Huang, et al., 2015).

Similarly, board composition and firm performance elicited mixed hence inconclusive viewpoints. Indeed, the success of any firm is predicated on the people sitting on it board. Accordingly, proportion of outside directors (Yasser, Al-Mamun & Rodrigo, 2017), board tenure (Brennan, 2016), directors' expertise and perspectives (Kyereboah-Coleman & Biekpe, 2016) and external directors (Toms, 2017) have a strong bearing on the competitiveness and realization of an organization's desired goals. Ageda (2015) expressed divergent perspective.

Equally, inconsistent debates on the relationship of company performance and board compensation board persists in relation to size (Anwar, Shah & Hasnu, 2016), bonuses (Borlea, Achim & Mare,

2017), merit (Yameen, Farhan &Tabash, 2019), reward, stipend and pay (Scott & Davis, 2015) with Amoll (2017) having contrary opinion. Evidently, contradiction in the findings of the studies aforementioned necessitates further investigation.

METHODOLOGY

A descriptive survey design was adopted. The study targeted 174 board members of the 29 active coffee cooperative society's board comprising chairperson, secretary and treasurer as well as 3 supervisory committee members from each of the 29 cooperatives. Since the population was small, a census approach of selecting the entire population (174) to participate in the study as recommended by McElreath (2020) was adopted. Quantitative and qualitative techniques were utilized in analyzing data with findings presented in form of tables and figures.

FINDINGS

The findings were discussed thematically in tandem with the three key study constructs namely board structure, board composition and board compensation. On board structure, the study established that large boards do not experience conflicts due to difficulty in reaching compromise agreement, bring more expertise, experience and offer a broader array of perspectives and do not reduce CEO/COB dominance respectively. Also established was that those boards with fewer directors (members) possess more coherence as well as simpler in consensus building although they can be easily manipulated by CEO/COB. Likewise, it was observed that large boards are no longer concerned about decisions on strategic issues as well as non-committal in effecting strategic vicissitudes (adjustments). Equally, boards having experienced members who are advanced in age, larger independent as well as social capital gained for many years, results in improved company overall expected business outcomes.

Similarly, the study reported that youthful board demonstrates higher practical expertise, flexible in accepting new ideas or systems are more willing in risking, embrace increased imaginative aptitude, besides displaying higher effectual governance monitoring. Furthermore, it was discovered that the combination of CEO and COB posts creates a conflict of interest, weakens the board, and so jeopardizes independence. Women on corporate boards bring new perspectives and stimulate staff diversity, which leads to improved performance.

In regards to board composition, external directors form majority of the board and non-executive members, as observers, offer independent opinion as they have no conflict of interest. Also revealed was that inside directors might not be ready to oppose the COB's desire and seek risky expansion ambition through unrealistic investment, and that they are competent and reliable advocates of shareholders' interests. Equally found out was that non-executive directors excel in monitoring reports on management and finance, more efficient business/company FICO assessments, and antitakeover modifications (revisions).

In the same way, recently appointed/elected board participants settle on temporary or speculative choices (decisions), imperfect examination (scrutiny), and vulnerable to social influences. However, competency and knowledge are considered requisites for board membership. Correspondingly, longer-tenure participants have been determined to be insulated in opposition to social disengagement and enhance a feel of solidarity, consequently possess ability to assess recommendations of senior company executives.

Concerning board compensation, findings reveal that Board members are not entitled to market rate bonuses and allowances and that remuneration is based on qualification, skill, competence and experience of board members. In the same vein, it was observed that board members are not owed any bonuses and allowances arrears, and there was provision for periodical upward adjustment of compensations. Likewise, board compensations are not inclusive of all standard categories provided by labour regulations and laws just as bonuses and

allowances were timely delivered to board members.

CONCLUSION AND RECOMMENDATIONS

It was concluded that large boards never reach consensus easily, bring more expertise, experience and offer a broader array of perspectives but fail checking CEO/COB dominance. Further, large boards overlook strategic repositioning although older, experienced board members offer independence and social capital. On the contrary, lean boards portray unity; uncontested consensus building although can be easily manipulated by CEO/COB.

In relation to board composition, the study concludes that external directors form a higher proportion of the board and offer independent opinion. Similarly, the investigation reasoned that non-executive director are more competent, better overseers and antitakeover experts. Inside directors never oppose the COB although they are skilled and protect of investors' interests. Further, new board members make temporary, lack scrutiny capacity, and easily compromised. Still, board membership not based on merit, longer-tenure members preferred social interaction and solidarity, capable of scrutinizing top executives' decisions.

On compensation, it was concluded that Board members never earned market rate bonuses and allowances and that remuneration is based on qualification, skill, competence and experience of board members. Alike, board members are not owed any bonuses and allowances arrears, and compensation periodical upward adjustment. Although compensations are paid timely, they miss some standard bonuses and allowances.

Based on the conclusions of the study, there is need to design moderate board structure for easy consensus building. In addition, it is necessary to appoint board members who bring more expertise, experience and offer a broader array of perspectives and be able to check CEO/COB dominance. Further, the study recommends modest boards to foster unity, independence, consensus building, not easily manipulated by CEO/COB and social capital that will not overlook strategic repositioning.

Besides, it is imperative to have more external directors on the board to ensure independence, competence and better oversight and antitakeover capability. Further, it is recommended to have very few new board members to avoid temporary decisions, scrutiny incompetency, and easy compromising. Still, board membership should be based on merit, have balanced tenure in order to scrutinize top executives' decisions.

There is need to streamline compensation through offering market rate bonuses and allowances and that is based on qualification, skill, competence and experience of board members. Alike, board members should not be owed any bonuses and allowances arrears, and compensation be periodically adjusted upward and capture all standard bonuses and allowances.

Suggestion for Future Research

The current study examined key broad issues of cooperate governance board structure, composition and compensation thematic areas. Further exploration, focusing on each of these particular constructs is encouraged. To that end, additional prominence on each of these specific corporate governance practices including board structure, composition and compensation, should be invigorated. Correspondingly, scaling up sample size with more premium on areas with scanty empirical evidence, would contribute massively to this area. Further, employing other research approaches would enhance validity and reliability to make the work more credible.

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