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Corporate governance, firm characteristics, external environment and performance of financial institutions in Uganda: A review of literature

Juliet Wakaisuka-Isingoma[1]*, Josiah Aduda[2], Gituro Wainaina[3] and Cyrus Iraya Mwangi[2]

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*Corresponding author: Juliet Wakaisuka-Isingoma, Faculty of Commerce, Department of Accounting, Makerere University Business School, Kampala, Uganda
E-mail: julietwakaisuka@gmail.com

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Abstract: *Main Objective of the Study*: Examine the relationship among corporate governance, firm characteristics, external environment, and performance of financial institutions in Uganda. *Value of the Study*: The paper is expected to create value to different categories of groups like: the central bank, as a regulatory body; financial institutions that can benchmark with the views of different scholars; the public can make suitable decisions regarding choices where to bank and borrow; the academia in terms of research; and the government in terms of planning, policy formulation, and budgeting for the country. The paper is expected to make significant contributions to theory building by affirming to current theories. The paper made policy recommendations aimed at enhancing firm performance within the sector, given the magnitude of corporate governance, firm characteristics, and the external environment. The paper provided a different perspective of understanding firm performance of financial institutions by integrating, the agency theory, resource dependence theory, transaction cost theory, and the stakeholder theory. *Theoretical Foundation*: Agency theory, transaction cost theory, stakeholder theory, and resource dependency theory.

Subjects: Corporate Finance; Banking; Insurance

Keywords: corporate governance; firm characteristics; external environment; firm performance; financial institutions; Uganda

1. Introduction

Corporate governance is forming a balance between socioeconomic, individual, and communal goals while encouraging the efficient use of resources, accountability, the use of power, and stewardship

ABOUT THE AUTHOR

Juliet Wakaisuka-Isingoma is a lecturer in the Faculty of Commerce, Department of Accounting, Makerere University Business School, Kampala, Uganda. I am a PhD student at the University of Nairobi and awaiting my doctoral defense.

PUBLIC INTEREST STATEMENT

Financial institutions are responsible for distributing financial resources in a planned way to the potential users, including the public. Consequently, they offer credit, manage markets, and pool risks among consumers. Nonetheless, it is imperative to note that clients' (potential user) money is put in the hands of managers who decide how it should be spent. In this regard, therefore, through disclosed audited financial statements, clients should ensure that the financial institutions where they entrust their money should have sound governance mechanisms.

at the same time, aligning the interests of individuals, corporations, and society (Nkundabanyanga, Ahiauzu, Sejjaaka, & Ntayi, 2013; Noriza, 2010; OECD, 2015). Firm characteristics are aspects that are seen as "drivers" to business relations (Eriotis, Vasiliou, & Ventoura-Neokosmidi, 2007). Firm characteristics as accredited by (Dean, Mengüç, & Myers, 2000; Mohd, 2005; Wiklund & Shepherd, 2005) play a role in decreasing agency conflicts and informational gap and therefore essential determinants of firm performance and success. They include firm size, age of the firm, leverage, family control, quality of auditing, and asset structure (Abor, 2008; Adeyemi & Fagbemi, 2010; Dean et al., 2000). Business firms recognize the external environment as opportunities and threats presented by such aspects as sociocultural, legal, political, economic, technological, and infrastructural factors (Abayomi & Oyobami, 2012). However, it is central to note that firm performance does not happen in a vacuum but within a certain environment which has challenges and opportunities (Njanja, Ogutu, & Pellisier, 2012). Firm performance measures the efficiency of an institution and its ability to achieve its objectives in terms of revenues and profits (Ongore & Kusa, 2013). With the increased competition and the high demand for profitability by institutions, the financial sector is now moving toward an economic-oriented model departing from the social approach that has been followed for decades (Prasad & Ravinder, 2012). The study is therefore based on ratios of the variables relating to capital adequacy, assets quality, management efficiency, earnings quality, and liquidity (CAMEL).

Corporate governance practices have been closely associated with the agency theory, stakeholder theory, resource dependency theory (RDT), and transaction cost theory (TCT). Agency theory holds that managers will not act to maximize the returns to shareholders unless appropriate governance structures are implemented by firms to safeguard the interests of shareholders (Jensen & Meckling, 1976). The stakeholder theory states that in a modern day firm, managers are deemed to have an implicit relationship with not only shareholders but also other stakeholders (Kock, Santaló, & Diestre, 2012). RDT states that boards enable firms to minimize dependence or gain resources (Pfeffer, 1972). Kor and Misangyi (2008) contend that RDT is a more successful lens for understanding boards broadly because it emphasizes that external directors enhance the ability of a firm to protect itself against the external environment, reduce uncertainty, or co-opt resources that increase the firm's ability to raise funds or increase its status and recognition. Besides, the TCT is considered as the basic theoretical framework that analyses the relation between the service provider and the customer process, implying that the theory embeds and governs both sides of the process. Transaction costs are the costs of negotiating, monitoring, and enforcing the exchanges between parties to a transaction, and measure the efficiency of a transaction (Bowen, DuCharme, & Shores, 1995).

Uganda's financial system is composed of financial institutions like commercial banks, licensed credit institutions, microfinance deposit-taking institutions (MDIs), licensed credit institutions, microfinance institutions (MFIs), development banks, investment and stock brokerage firms, insurance companies, savings and credit cooperatives (SACCO), and licensed foreign exchange bureaus. Uganda's financial institutions has developed since 1906, when the National bank of India (later Grindlays bank) and then Standard Chartered bank and Uganda Cooperative bank were established (Bategeka & Okumu, 2010). Prior to Uganda's independence in 1962, government-owned institutions dominated most banking in Uganda. In 1966, the Bank of Uganda, that controlled the issue of currency and managed foreign exchange reserves, became the central bank. The financial institutions in Uganda are supervised and regulated by the Bank of Uganda, according to Bank of Uganda Statute 1993. In July 1999, the Bank of Uganda issued a policy statement which classified financial institutions into four tiers: tier IV: financial institutions which are not regulated by Bank of Uganda and are not authorized to take in deposits from the public but may offer collateral or non-collateral loans; tier III: microfinance and deposit-taking institutions (MDIs); tier II: credit institutions; and tier I: commercial banks which are authorized to hold current, savings, and fixed deposit accounts for both retail and corporate in local and international currency. In addition, commercial banks are authorized to transact the business of foreign exchange in all currencies.

Furthermore, the Insurance Regulatory Authority (IRA) was recognized under section 14 of the statute 1996, now the insurance act (chap. 213), laws of Uganda, 2000 which came into effect on the 14th of April, 1996 and began operation in April 1997. The main objective of the authority was to guarantee the effective administration, supervision, regulation, and govern the industry of insurance in Uganda. The insurance sector has existed for some time but not many Ugandans take insurance cover as a priority, with policy holders mostly doing it out of statutory obligation or as a job-related benefit (Kyatusiimire, 2015). IRA is working toward establishing an electronic register which would help insurers scrutinize clients and understand their insurance background before underwriting the requested policy. Given the fact that Uganda is now executing her second National Development Plan (NDP II) intended to boost the economy toward middle-income status by 2020 (Uganda Bureau of Statistics, 2016), performance of insurance in Uganda is important to the economy since this sector is among the sectors expected to spur economic growth and help in the realization of Uganda's vision 2040. Olayungbo and Alkinlo (2016) declare that the upward share of the insurance sector in the aggregate financial sector is fundamentally every developing and developed country has repositioned consideration to the insurance–growth nexus.

In addition, Oling, Rwabizambuga, and Rodriguez (2014) said that MFIs are organizations that offer savings and/or credit facilities to micro- and small-scale business people. MFIs provide financial services to poor people who have difficulties in obtaining these services from most formal institutions because their businesses, saving levels, and credit needs are all small. Although the microfinance industry is committed to educate the public and government about its practices, there has been some concern over the recovery approaches (loans without collateral, group lending, progressive loan structure, immediate repayment arrangements, regular repayment schedules, and collateral substitutes) used by some MFIs (Quayes & Tanweer, 2013). They argued that MFIs may fail to meet the full promise of their mission (reducing poverty) without continuing grants. The sector moved away from credit to other products, but then again a number of major institutions have still remained overwhelmingly loan-driven (Wright & Rippey, 2003). In addition, there is uncertainty in the Ugandan microfinance community that the regulation may be too strict in some areas and may damage the performance of the industry. The review of literature is based on the financial sector given its contribution to the economy. This sector forms approximately 29.6% of the service contribution to GDP, which is approximately US$ 2.1B or 13.5% of total GDP. Services are the fastest growing sector of the economy, contributing 47.1% of total GDP for 2013/2014 fiscal year (Background to the Budget, 2015/2016). Specifically, the review is based on commercial banks, insurance companies, and microfinance institutions.

1.1. Corporate governance

Cadbury (1992) defined corporate governance as the system by which companies are directed and controlled. It is concerned with the duties and responsibilities of a company's board of directors to successfully lead the company, and their relationship with its shareholders and other stakeholder groups (Pass, 2004).Corporate governance is important to any economy, first, given that its systems are increasingly being seen as a pre-requisite for both social and economic development in developing economies like Uganda (Wanyama, Burton, & Helliar, 2013). Second, good corporate governance practices enhance firm performance through better management and prudent allocation of firms' resources (Tsifora & Eleftheriadou, 2007). In this study, corporate governance was operationalized as ownership structure, information disclosure, financial transparency, and board profile (Barako, Hancock, & Izan, 2006; Bodaghi & Ahmadpour, 2010). In this regard, information disclosure and financial transparency have been chosen because these practices translate the firm's performance through enhanced returns as a result of timely and accurate disclosure since information disclosure is making information accessible to interested and affected parties in a manner that is comprehensible to them (Akhtaruddin, 2005). Besides, Matama (2008) pointed out that in Uganda, there is inadequate disclosure evidenced by high level of off-balance sheet items, lack of financial transparency, and ambiguous ownership structure of businesses. Financial transparency looks at the extent to which investors have timely, meaningful, reliable, and ready access to any required financial information about a company (Wanyama et al., 2013). Board profile is also 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).

2. Firm characteristics

Firm characteristics were measured using leverage, asset structure, and quality of auditing (Abor, 2008; Rouf, 2010). Firm characteristics are critical in a developing economy given the fact that majority of the firms are micro, small, and medium enterprises. For example, first, in Uganda's situation, majority of the firms are small and about 70% of firms do not celebrate their 50th birthday (Uganda Bureau of Statistics, 2011). Second, though Uganda is distinguished internationally for its entrepreneurial aptitude and ranked as one of the more entrepreneurial nations not only in Africa, but the world (Briggs, 2009), it is equally perplexing to know that there is an extraordinarily high business failure rate in the nation that is accumulating from small businesses which rarely grow to their full potential (Tushabomwe-Kazooba, 2006). This ultimately has a bearing on firm characteristics and hence affecting firm performance.

Leverage is the ratio of the firm's debts to its assets and therefore forces managers to generate and pay out cash, merely because interest disbursements are compulsory. Respectively, the quality of auditing remains a service provided to an organization intended to facilitate identification of actions for continuous improvement and facilitate evaluation of progress with perfection plans. Audit plays an important role in developing and enhancing the global economy and business firms since the auditors express an opinion on the fairness of financial statements (Al-Khaddash, Nawas, & Ramadan, 2013).

The asset structure of a firm plays a significant role in determining the firm's performance. For some time, researchers have been trying to describe how financial institutions decide about their asset and liability structures in order to optimally meet objectives of shareholders and management (Grzegort, 2013). In this regard, the degree to which the firm's assets are tangible should result in the firm having greater liquidation value (Titman & Wessels, 1988). Hałaj (2008) asserts that firms that invest heavily in tangible assets also have higher financial leverage since they borrow at lower interest rates if their debt is secured with such assets. It is believed that debt may be more readily used if there are durable assets to serve as collateral.

3. External environment

Firm performance does not happen in a vacuum but within a certain environment which has challenges and opportunities. External environment was measured using information technology (IT) and regulations (Bharadwaj, 2000; Nampewo, 2013). Additionally, regulations are important measures in an effort to prevent decision-making that would take inadequate accountability of the public interest. The legal framework is a key element of the corporate governance system of a country because it shows that accountability and transparency cannot be achieved unless there are appropriate rules and regulations in place. It provides legal protection for investors and ensures their ability to exercise their rights (Gul & Tsui, 2004). In the mainstream of modern culture, information technology is considered to be one of the answers to most problems and/or restrictions in business. It is seen as the way that a business can emerge from the past and enter a brighter, more efficient future (Bharadwaj, 2000). IT-related resources serve as potential sources of competitive advantage.

4. Firm performance

Firm performance is how well a firm can use its assets as a primary mode of business to generate revenues and profits (Samina & Ayub, 2013). There is need to deliberate on differentiating firm performance of financial institutions. Therefore, to evaluate their performance, the study based on the CAMEL model, which measures and is appropriate to performance of financial institutions (Prasad & Ravinder, 2012). They contend that capital adequacy is essential for a financial institution to maintain depositors' confidence and prevent the institution from going bankrupt. It reflects the overall financial condition of financial institutions and the ability of management to meet the need of additional capital. The capital adequacy ratio (CAR) is developed to ensure that financial institutions can absorb a reasonable level of losses occurred due to operational losses and determine the capacity of the institution in meeting the losses. CAR includes: debt–equity ratio (D/E) which is the ratio

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indicating the degree of leverage of a financial institution. It indicates how much of the financial institution's business is financed through debt and how much through equity. Advance to assets ratio (Adv/Ast) is the ratio indicating a financial institution's aggressiveness to lend out money, which ultimately results in better profitability (Godlewski, 2003).

Derviz and Podpiera (2008) posit that the quality of assets is an imperative parameter to gauge the strength of financial institutions. Broadly, the primary reason behind measuring the assets quality is to ascertain the component of non-performing assets as a percentage of the total assets. The ratios necessary to assess the assets quality are: net non-performing assets to total assets (NNPAs/TA) which discloses the efficiency of financial institutions in assessing the credit risk and recovering the debts. Net non-performing assets to net advances (NNPAs/NA) is the most standard measure of assets quality measuring the net non-performing assets as a percentage to net advances. Percentage change in net performing assets tracks the movement in net non-performing assets over previous years.

Management efficiency is another critical element of the CAMEL Model. The ratio in this segment involves subjective analysis to measure the efficiency and effectiveness of management. The ratios used to evaluate management efficiency include: total advances to total deposits (TA/TD) which measures the efficiency and ability of the financial institution's management in converting the deposits available with the financial institution, excluding other funds like equity capital, into high earning advances. Profit per employee (PPE) shows the surplus earned per employee resulting from dividing the profit after tax earned by the total number of employees. Return on asset (ROA) is a measure of the profitability expressed by dividing earnings before interest and tax as a percentage of total assets (EBIT/TA) (Gupta, 2008).

The quality of earnings is a very significant criterion that determines the ability of a financial institution to earn consistently. It basically determines its profitability and explains its sustainability and growth in earnings in future. The following ratios explain the quality of income generation: percentage growth in net profit (PAT Growth) which is the percentage change in net profit over the previous years. Net profit to average assets (PAT/AA) which measures return on assets employed or the efficiency in utilization of assets (Said, 2003).

Liquidity is another important factor of financial institutions. Financial institutions should take proper care to hedge the liquidity risk, as well as ensuring that a good percentage of funds are invested in high return generating activities. This would position them to generate profit with provision of liquidity to the depositors. The following ratios can considered when measuring the liquidity: liquid assets to total deposits (LA/TD) measures the liquidity available to the total deposits of the financial institution. Liquid assets to total assets (LA/TA) measures the overall liquidity position of the financial institution (Prasad & Ravinder, 2012).

5. Financial institutions in Uganda

The Bank of Uganda was recognized in May 1966 as the bank of issue, responsible for the functions earlier served by the East African Currency Board in Nairobi. Before Uganda's independence in 1962, government-owned institutions dominated most banking. Uganda commercial bank, which had 50 branches throughout the country, dominated commercial banking and was wholly owned by the government. In addition, the Uganda Development Bank was a state-owned development finance institution, which channeled loans from international sources into Ugandan enterprises and administered most of the development loans made to Uganda. Whereas Uganda had 290 commercial bank branches in 1970, by 1987, there were only 84, of which 58 branches were operated by the government. Subsequently, this number began to increase slowly until in 1989 when the gradual increase in banking activity signaled growing confidence in Uganda's economic recovery. Nevertheless, in the late 1990s, early 2000s, and recently in 2014 (Ministry of Finance, Planning and Economic Development, 2014), the Ugandan banking industry underwent significant restructuring and a number of banks were declared insolvent, taken over by the central bank, and eventually sold or liquidated. Additionally, the insurance sector remains a relatively small part of the financial system, although it is growing in size. Similar to banks, these companies are a mixture of publicly and privately owned firms which cover life, property, and casualty, but the extent of coverage in these three areas remains limited. Health insurance remains largely untapped, while areas like fire insurance are new markets, only recently entered, with life insurance business posting below industry earnings. There is increasing customer awareness and consequently true customer focus with sustainable product solutions. Therefore, good corporate governance needs to define a company seeking to differentiate itself from the competitors.

Furthermore, the evolution of microfinance institutions in Uganda was a direct response to the failure of past attempts by government and donor-funded rural credit programs to reach poor families and landless households within the rural areas. Some microfinance institutions have experienced strong growth and are now reaching a considerable number of clients. Microfinance came to be viewed as the most obvious vehicle for delivering financial services to the urban and peri-urban low-income earners as well as to the rural population. Although the microfinance industry is committed to deliver financial services and its practices to the under-privileged, there has been some concern over its recovery uncertainty (Quayes & Tanweer, 2013). Financial institutions should therefore have guidelines that can arouse management to enhance competitive advantage and increase investment and assets that are valuable, rare, and hard-to-imitate leading to superior firms' performance.

This review of literature is beneficial to financial institutions in developing economies, given the fact that much of the studies have been done in developed economies. The review is projected to shed more light on the nature of effect of corporate governance, firm characteristics, and external environment on firm performance clarifying current framework. The paper is thus based on the following themes:

(1) Theoretical foundation and
(2) Empirical foundation
    (a) Corporate governance and performance of financial institutions.
    (b) Corporate governance, firm characteristics, and performance of financial institutions.
    (c) Corporate governance, external environment, and performance of financial institutions.
    (d) Corporate governance, firm characteristics, and external environment on performance of financial institutions.

5.1. Theoretical foundation

The discussion of the theoretical review on corporate governance, firm characteristics, and external environment on firm performance considers a review of the agency theory, TCT, stakeholder theory, and RDT.

5.1.1. Agency theory

Agency theory was established by Jensen and Meckling (1976). Strategic management and business applicability has been largely influenced by the agency theory (Donaldson & Davis, 1991). The agency theory states that in modern corporations in which share ownership is widely held, managerial actions depart from those required to maximize shareholders' returns (Noriza & Norzalina, 2007). Jensen and Meckling (1976) assert that the owners (principals) and managers (agents) exercise an agency loss which is the extent to which returns to the residual claimants (owners) fall below what they would be if the principals exert direct control over the corporation. This is because managers of firms typically act as agents of the owners. The owners hire the managers and give them the authority to manage the firm for the owners' benefit. However, managers are mainly interested in accomplishing their own targets which may differ from the maximization of the firm value which is the maximization of the owners' benefit. Therefore, they will act in their own interests seeking higher salaries, perquisites, job security, and in some cases even direct exploitation of the firm's cash flows. Thus, the interests of the manager not only differ but in many cases, even oppose to those of the owners, inevitably implying a conflict of interests between the shareholders and the managers. In addition, Eriotis et al. (2007) contend that managers have attained the authority to manage the firm but the owners may only try to discourage these value transfers through monitoring and control, such as supervision by independent directors. Nonetheless, monitoring and control actions presuppose agency costs. Perfect control is however extremely costly and therefore shareholders should strive for solutions that would not extract large amounts of value from the firm and would also monitor and control managers' operations.

In regard to this study and the agency theory, agency costs can create value loss to shareholders arising from divergences of interests between the shareholders and corporate managers. Additionally, there is the impossibility of perfectly contracting an agent whose decisions affect his own welfare and the welfare of the principal since persuading the agent to act in the best interest of the principal poses a problem. Broadly, the influence of agency theory is that managers should attain the authority to manage the firm through supervision, control, and monitoring using the independent directors, at the same time emphasizing information disclosure, financial transparency, and board profile.

5.1.2. Transaction cost theory

TCT was originally introduced by Coase (1937) who tried to explain the existence of firms. Williamson (1985) then developed the idea further and elaborated the dependency of firms on outside partners, leading to disadvantages due to transaction costs, opportunism, and uncertainty. The TCT is considered as the basic theoretical framework that analyses the relation between the service provider and the customer process, implying that the theory embeds and governs both sides of the process. Transaction costs as the costs of negotiating, monitoring, and enforcing the exchanges between parties to a transaction measure the efficiency of a transaction (Bowen et al., 1995). In the process of identifying the costs of coordinating economic activities, TCT is based on two behavioral assumptions, that is bounded rationality and opportunism. Therefore, in line with those two conditions, transaction costs actually evolve because assets, investment, and other process features are transaction specific. Thus, service provider and customer, as the transaction partners, become dependent on each other.

Nalukenge (2003) posits that the actors face bounded rationality because information is scarce and costly and the capacity for information processing is always limited. Bounded rationality is based on the fact that it is impossible to foresee all potential contingencies of a situation, especially those arising from opportunism, implying that there cannot be a complete contract prior to commitment that covers all contingencies. Opportunism is the reason that contracts exist and cannot be left incomplete. Therefore, the idea that unforeseen contingencies could be met out of cooperation and mutual consideration does not match reality and takes no account of the occurrence of opportunism. As a matter of fact, TCT tries to bring service providers and customers together since it is a cost of negotiating, monitoring, and enforcing exchanges between parties to the transaction which will ultimately affect firm performance. This has been exhibited in the relationship among corporate governance, firm characteristics, and performance of financial institutions.

5.1.3. Stakeholder theory

Stakeholder theory was founded by Freeman (1984). The theory states that in a modern-day firm, managers are deemed to have an implied relationship with not only shareholders but also other stakeholders (Kock et al., 2012). de Villiers and van Staden (2011a) explained that managers' reporting of information is thus targeted not only at shareholders but also at other stakeholders. What makes managers duty-bound to explain themselves to these stakeholders through disclosure is the need to have continued access to critical resources that might be controlled by the latter (Hill & Jones, 1992). It is this mutual resource dependency that gives stakeholders other than shareholders a legitimate claim on a firm's allocation of resources (Kock et al., 2012). Therefore, within the stakeholder framework, the principal–agent relationship is extended to mean a relationship that exists between a manager and stakeholders (Kock et al., 2012).

The principal–agent relationship envisaged in the stakeholder relationship is riddled with a conflict of interests regarding how the firm's resources are allocated. Kock et al. (2012) argued that management and stakeholder interests may differ. Arguably, external environment could help align the interests of managers with those of other stakeholders. Kock et al. (2012) reasoned that government regulation or guidance provides a legitimate basis for other stakeholders to impose their wishes on management. More importantly, for managerial decision-making, government guidance potentially creates a decision-making dilemma. First, de Villiers and van Staden (2011a) explained that the availability of such guidance, or of various voluntary reporting regimes, provides a compliance platform that symbolizes a firm's efforts. Second, Kock et al. (2012) articulated that the existence of such reporting frameworks considerably increases the chances of managers being held personally responsible and answerable for any misbehavior if compliance is enforced. Support for regulation also rests on the premise that regulation of reporting reduces accounting choice; leads to more consistent and comparable reporting; and thereby reduces information asymmetry (de Villiers & van Staden, 2011b). In this respect, there is growing evidence that faced with such situations, managers strive to stay ahead of the game by disclosing information in advance when a regulation or a move toward compulsory regimes is signaled by the authorities. de Villiers and van Staden (2011a) argued that government intervention through various types of legislation adds momentum to a firm's adoption of voluntary initiatives relating to good corporate governance practices. In the same way, management of financial institutions should always focus on government regulations or guidance because they offer a legitimate basis for other stakeholders to inflict their requirements. More importantly, for managerial decision-making, external environmental factors potentially create a supporting atmosphere for decision-making. Hence, stakeholder theory has been demonstrated through the relationship among corporate governance, external environment, and firm performance.

5.1.4. Resource dependence theory

RDT was initiated by Pfeffer (1972) who stated that boards enable firms to minimize dependence or gain resources. Pfeffer broadly explained how organizations reduce environmental interdependence and uncertainty. Kor and Misangyi (2008) contend that RDT is a more successful lens for understanding boards. Pfeffer (1972) used RDT to examine boards focusing on board size and composition (ownership structure) as indicators of the board's ability to provide critical resources to the firm. Pfeffer (1972) added that ownership structure relates to the firm's environmental needs and those with greater interdependence require a higher ratio of outside directors. He concludes that ownership structure and board size are not random or independent factors, but are, rather, rational organizational responses to the conditions of the external environment. Sanders and Carpenter (1998) also supported that ownership structure is related to a firm's environmental dependence.

The resource dependence approach emphasizes that external directors enhance the ability of a firm to protect itself against the external environment, reduce uncertainty, or co-opt resources that increase the firm's ability to raise funds or increase its status and recognition (Kor & Misangyi, 2008). High proportion of outside directors is believed to be associated with high leverage position. Other researchers find a significantly negative relationship between number of outside directors on the board and leverage. Kor and Misangyi argue that outside directors tend to monitor managers more actively, causing these managers to adopt lower leverage for getting improved performance results. Also, firms with higher proportion of outside directors tend to pursue low financial leverage with a high market value of equity. On the contrary, firms with higher leverage rather have relatively more outside directors, while firms with low percentage of outside directors experience lower leverage (Abor, 2008). Implication of RDT is that directors will bring benefits to organizations such as information in the form of advice and counsel, access to channels of information between the firm and environmental contingencies, preferential access to resources, and legitimacy. Provan (1980), for example, found that firms which are able to attract and co-opt powerful members of the community onto their boards are able to acquire critical resources from the environment. In regard to the RDT, corporate governance, firm characteristics, and external environment on firm performance examined boards focusing on ownership structure and access to channels of information between the firm and environmental prospects as indicators of the board's ability to provide critical resources to the firm.

6. Corporate governance and firm performance

Noriza (2010) studied corporate governance compliance and the effects of capital structure in Malaysia. He investigated the compliance level among public-listed companies with the implementation of corporate governance code of best practices and the association to the firm's capital structure. Noriza measured corporate governance using ownership structure relationship with shareholders, financial transparency, information disclosure, and BoD composition. Capital structure was considered using debt ratio, debt to equity, and interest coverage. Methodologically, data were collected from annual reports and data streams for a sample of 126 companies over an eight-year period, that is 1998–2006. Multiple regression analysis was also performed. The findings revealed that most of the companies complied well with the code and that there was a significant association to the firm's capital structure. Tsifora and Eleftheriadou (2007) studied corporate governance mechanisms and financial performance of a manufacturing sector. The findings revealed that firms which belong to an expanded group of shareholders perform better than those firms which belong to a small group of shareholders or are family owned. Broadly, firms that present corporate governance systems are characterized by high profitability.

Mwesigwa, Nansiima, and Suubi (2014) examined whether in Uganda corporate governance, accountability, and managerial competences are related to financial performance of commercial banks. The motivation for their study was the poor performance of commercial banks in Uganda, despite the number of interventions put in place. The study adopted a cross-sectional and quantitative design basing on 25 commercial banks operating in Uganda. The study provides evidence that corporate governance, accountability, and managerial competences significantly relate to financial performance of commercial banks in Uganda. However, corporate governance was observed to be the most significant predictor of financial performance. The study recommends that corporate governance mechanisms should be put in place to enable the efficient and effective management of banks in Uganda in order to improve performance. Besides, Mwesigwa et al. (2014) considered corporate governance but did not relate firm characteristics and external environment to firm performance.

6.1. Corporate governance, firm characteristics, and firm performance

Nandi and Ghosh (2012) investigated the association between firm characteristics, corporate governance attributes, and the level of corporate disclosure of listed firms in India. In their methodology, the standard and poor (2008) model for measuring the level of corporate disclosure and multiple regressions was used. The findings revealed a positive relationship between board size, ratio of audit committee members to total board members, family control, CEO duality, firm size, profitability, liquidity, and the extent of corporate disclosure. On the other hand, the degree of corporate disclosure was negatively related to board composition, leverage, and age of the firm.

In another study, Eriotis et al. (2007) studied how firm characteristics affect capital structure in Greece. The design/methodology/approach was an investigation using panel data procedure for a sample of 129 companies listed on the Athens Stock Exchange during 1997–2001. The number of the companies in the sample corresponds to the 63% of the listed firms in 1996. The firm characteristics were analyzed as determinants of capital structure according to different explanatory theories. The hypothesis that was tested in their paper was that the debt ratio at time t depends on the size of the firm at time t, the growth of the firm at time t, its quick ratio at time t, and its interest coverage ratio at time t. The firms that maintain a debt ratio above 50% using a dummy variable were also distinguished. The findings disclosed that there is a negative relation between the debt ratio of the firms and their growth, their quick ratio, and their interest coverage ratio.

Arshad and Safdar (2009) examined the effect of ownership structure and corporate governance on capital structure of Pakistan-listed companies. Research objectives included the effects of corporate governance and ownership structure on capital structure decisions, the impact of shareholding on financing decisions, and the result of controlled variables like firm size and profitability on firms' financing mechanism. Findings revealed that corporate governance and ownership structure have important implications on the firm performance.

Bodaghi and Ahmadpour (2010) focused on the relationship between corporate governance and capital structure of listed companies from Tehran Stock Exchange. Measures of corporate governance employed were board size, board composition, and CEO/Chair duality. Bearing of shareholding on financing decisions was examined using institutional shareholding. Similarly, influence of controlled variables like firm size and profitability on firms' financing mechanism was also investigated. Results revealed that board size is significantly and negatively correlated with debt to equity ratio. However, corporate financing behavior is not found to significantly influence CEO/Chair duality and the presence of non-executive directors on the board. However, control variables: firm size and return on assets, are found to have a significant effect on capital structure. Therefore, results suggest that corporate governance variables like size and ownership structure play an important role in determination of financial mix of the firms.

6.2. Corporate governance, external environment, and firm performance

Booth, Aivazian, Demirgue-Kent and Maksimovic (2002) examined whether regulation can be used to substitute for internal monitoring mechanisms (percentage of outside directors, officer and director common stock ownership, and CEO/Chair duality) to control for agency conflicts in a firm. They found that, in general, the percentage of outside directors is negatively related to insider stock ownership, but is not affected by CEO/Chair duality. CEO/Chair duality is, however, less likely when insider stock ownership increases. Their study revealed that internal monitoring mechanisms are significantly less associated with regulated firms (banks and utilities). Conclusion is that regulations reduce the power of managerial decisions on shareholder wealth. Thus, effective internal monitoring of managers becomes less important in controlling agency conflicts.

Liang, You, and Liu (2010) aggregated previous research that adopted the resource-based view (RBV) to evaluate whether information technology (IT) and organizational resources have significant effects on firm performance. The methodology and approach was a framework that included direct and indirect effect models. A meta-analysis was directed on 42 published empirical studies that inspected how different factors in the RBV affected firm performance. The results discovered that the mediated model that included organizational capabilities as mediators between organizational resources and firm performance explained the value of IT than the direct effect model without organizational capabilities. Second, technology resources can increase efficiency performance but may not enhance financial performance directly. Additionally, the study established that technology resources increased internal and external capabilities, which in turn influenced firm performance. Organization resources positively affected organizational efficiency through its effect on internal capabilities. Their results provided direction for investing and managing organizational IT resources that enhanced their performance. In effect, managers can contribute to enhancing firm performance through transferring IT resources to firm's competencies, in regard to firm characteristics and external environment.

6.3. Corporate governance, firm characteristics, external environment, and firm performance

The joint effect of corporate governance practices, firm characteristics, and external environment on firm performance was viewed basing on Adeyemi and Fagbemi (2010) who deliberated on audit quality, corporate governance, and firm characteristics in Nigeria. The drive of the study resulted because of major corporate collapses and related frauds (mis-managed financial performance) which occurred around the world that raised doubts about the credibility of the operating and financial reporting practices of quoted companies in Nigeria. Therefore, their study provides evidence on corporate governance, audit quality, and firm-related attributes from a developing country. Logistic regression was used and findings showed that ownership by non-executive directors has the possibility of increasing the quality of auditing. Additionally, size of the company and business leverage are important factors in audit quality for companies. This implies that firms with corporate governance practices augment the quality of auditing and leverage levels, therefore improving firm performance.

Ajanthan (2013) said that corporate governance issues have been a growing area of management research, especially among large and listed firms. Good corporate governance practices are regarded as important in reducing risk for investors, attracting investment capital, and improving the performance of companies. Companies need financial resources and better earnings to promote their objectives. Therefore, factors may affect the capital structure and profitability of companies should be considered carefully. Ajanthan (2013) investigated whether there is any relationship among some specific characters of corporate governance, capital structure, and profitability. Eighteen companies were selected from those which were listed on the stock exchange during the 2007–2012. The Board Composition (BC), Board Size (BS), and CEO duality (CEOD) were considered as independent variables, whereas Debt Ratio (DR), Debt-to-Equity Ratio (DER), Returns on Equity (ROE), and Return on Assets (ROA) as dependent variables. The results indicated a positive relationship between BS, BC, CEOD, ROE, ROA, and DER, whereas negative relationship between BS and DR. In addition, CEOD has a positive relationship with DR. In addition, none of the variables have a significant relationship with capital structure and profitability. The study needs to fully capture and incorporate the moderating effect of external environment, given the fact that it accounts for variation in corporate performance (Machuki & Aosa, 2011).

7. Conclusion

Good corporate governance practices are regarded as important in reducing risk for investors, attracting investment capital, and improving the performance of companies and financial institutions inclusive. Companies need financial resources and better earnings to promote their objectives. Equally, firm characteristics play a pivotal role in determining the performance of the firm. In this regard, firms that are able to align certain firm features with the characteristics of the environment outperform other firms. Therefore, firm characteristics are essential determinants of firm performance and success. Furthermore, financial institutions today are facing extraordinary challenges in maintaining commercial survival and success. Arising from rapid changes happening in today's marketplace and emerging business practices, it is more likely for financial institutions to fall behind by not keeping up with tendencies of their external environments.

Financial institutions in developing countries like Uganda should therefore believe that the financial crisis was a powerful reminder that financial institutions are unique, and as such they demand different paradigms for evaluation and different measurements for corporate governance, firm characteristics, external environment, and subsequently performance over time. The inherent principal–agent problem is elegantly solved by making management explicitly responsible for the value maximization of the firm. Executive directors are also responsible to a board of directors, whose constituents are the shareholders of the firm. However, as long as there are profitable opportunities for financial institutions that do not directly improve their performance as a whole, the interests of shareholders and the public may be at odds. Hence, the board of directors should be attentive as far as financial decisions regarding firm characteristics and external environment of the financial institution are concerned since they face added dimension of specific regulations and supervisory actions. Broadly, financial institutions could increase firm performance and achieve value maximization through the pursuit of best practices of corporate governance, firm characteristics, and external environment that would ultimately improve the overall firm performance.

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Author details
Juliet Wakaisuka-Isingoma[1]
E-mail: julietwakaisuka@gmail.com
Josiah Aduda[2]
E-mail: jaduda@uonbi.ac.ke
Gituro Wainaina[3]
E-mail: wainainagituro@yahoo.com
Cyrus Iraya Mwangi[2]
E-mail: ciraya@gmail.com
[1] Faculty of Commerce, Department of Accounting, Makerere University Business School, Kampala, Uganda.
[2] Department of Finance and Accounting, University of Nairobi, Kenya.
[3] Department of Management Science, University of Nairobi, Kenya.

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