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Stephen K. Nkundabanyanga Augustine Ahiauzu Samuel K. Sejjaaka Joseph M. Ntayi

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A model for effective board governance in Uganda's services sector firms

Stephen K. Nkundabanyanga
Makerere University Business School, Kampala, Uganda
Augustine Ahiauzu
Rivers State University of Science and Technology, Port Harcourt, Nigeria, and
Samuel K. Sejjaaka and Joseph M. Ntayi
Makerere University Business School, Kampala, Uganda

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Abstract

Purpose – The present study was carried out with the purpose of establishing a model of effective board governance in Uganda's service sector firms.

Design/methodology/approach – This study is cross-sectional. The analysis was conducted using Analysis of Moment Structures (AMOS) software on a sample of 128 service firms in Uganda. The perceived effective board governance in Uganda was measured by the perceptions of 128 respondents who are managers or directors in each of those service firms. Three confirmatory factor analysis models were tested and fitted.

Findings – The three-dimensional model of effective board governance in Uganda – consisting of control and meetings' organization, board activity and effective communication – was determined to be the best fitting model. Evidence in support of relevant theories of board governance was adduced.

Research limitations/implications – Although plenty of literature on corporate governance exists, there is scarce literature on effective board governance conceptualization and this together with imprecise terminology regarding this area may have affected the authors' conceptualization of the study. The authors' study was limited to the service sector firms registered and operating in Kampala, Uganda and it is possible that their results are only applicable to this sector in Uganda. Nevertheless, policy makers of Uganda dealing with financial markets, academicians, company directors, company owners and even general readers interested in the area of effective board governance might find this paper handy.

Practical implications – The authors believe that application of their model should improve the quality of board governance in Uganda and can also apply to other sectors of Uganda's firms to help avert the problem of ineffective boards as evidenced by consistent firm failures in Uganda. By improving the quality of board governance, Ugandan boards will demonstrate their relevance in company direction and improvement of company value to the benefit of all stakeholders.

Originality/value – The present study provides one of the few studies that have analysed with confirmatory factor analysis (CFA) using AMOS to test effective board governance measurement model and provides a benchmark for Uganda's service firms yearning to leverage the use of their boards.

Keywords Board governance, Service firms, AMOS, Uganda, Boards

Paper type Research paper

1. Introduction and motivation

The Ugandan services sector has since early 2000s gained a significant share of Uganda's GDP growth and in 2009/2010 contributed 49 percent to GDP and to its growth by 13 percent. According to Cali *et al.* (2008) services constitute over 50 percent in low-income countries and accounted for 47 percent of economic growth in sub-Saharan Africa over the period 2000-2005 while industry contributed 37 percent and agriculture 16 percent in the same period. This implies that growth in Africa and

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indeed Uganda relies as much on services as on natural resources or agriculture, in spite of those countries benefiting from trade preferences in primary and secondary goods. The services sector could therefore provide important benefits to the Ugandan economy. For example, employment might adjust to the changes and people find more work in the services sector. This job creation is particularly useful as it often provides employment for low-skilled labor in, for example, retail sectors. This benefits the poor in particular and represents a net increase in employment. As the services sector remains the sector with the highest demonstrated potential; the importance of this sector creates much of the interest by the government and other stakeholders especially with regard to its board governance in order to gain reasonable assurance that the sector's firms continue to register impressive results. But this assurance can be jeopardized because services firms have been vulnerable to ineffective board governance.

The issue of ineffective board governance in Uganda came to the fore between September 1998 and May 1999 when four Ugandan banks were closed for imprudent banking practices (Habyarimana, 2003) and poor internal governance (Bank of Uganda, 1999; Brownbridge, 1998) and recently, there have been consistent reports of poor performance of service firms. This has often lead to some of these firms closing business (see Kasita and Emojong, 2010; Among, 2009; Tentena, 2010) and the consequent accusations that boards are not doing their jobs. Indeed even the recent "meltdowns" of significant companies in the USA, UK and the late 1990s banking crisis in Asia raised the finger to the governing boards of companies as in most cases, the governing boards were found ineffective as far as discharging their duties was concerned. Thus, effective board governance has been noted to be significant for firms in developing countries because it can lead to managerial excellence (Okpara, 2011). This is consistent with the realization of Aram and Cowen (1986) that the primary role of a board is to be a supporter of management in increasing the economic value of the firm. But, although a considerable amount of efforts have been spent on studying governing boards (Hung, 1998), there is no single, competent and integrative model of effective board governance that would act as a benchmark for effective board governance in Uganda's service firms.

Therefore, the purpose of this study was to develop a model of qualitative factors that are relevant to effective board governance in Ugandan service firms. This was necessary because a paucity of empirical qualitative board governance models has often led to the perceived attrition of credibility of board governance among firms. Moreover, understanding the nature of effective board governance is important in management research that focuses directly on what boards need to do in order to perform their roles more effectively (Ong and Wan, 2008). More so, previous attempts to solve the problem of ineffective boards often resulted in normative guidelines (for a review, see Van den and Baelden, 2005) that did not reflect empirical evidence because they were a response to a wave of well-publicized corporate scandals (Hauswald and Marquez, 2006). The effect of normative guidelines was to lead managers to embrace governance policy documents and codes of practice more as "a survival strategy than a first preference" (Mamdani, 2007, p. 3) in a process of trial and error and less of a linear development (Mamdani, 2007). This means that whereas there was much emphasis created by the need for assessment of effectiveness of boards of directors (e.g. Walker, 1999), there is little reliable information readily available to boards on how to be effective, with many of the evaluations having been performed with simplistic checklists and poorly constructed, and/or inappropriately analyzed surveys that focus on processes and directors' duties (e.g. Holland and Jackson, 1998; Herman and Renz, 2000; Scissons, 2002), rather than on "how and what to do" to achieve the outcomes of

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effective board governance. Indeed, as Garber (2002) pointed out, using normative evaluations and externally imposed criteria may do more to confuse and waste valuable time than help the board of directors achieve effective board governance. Accordingly, this study provides a model for what and how effective board governance might be for the Ugandan service sector firms and therefore contributes to academic research by producing empirical evidence to support theories relevant to board governance. This paper's focus on relevant factors for effective board governance in an African third-world setting adds new insights into roles of the predominantly unitary boards and this contributes to the scarcity of board governance literature on the African experience. Besides, most of the sample firms selected for this study are either small or medium sized hence this paper throws more light on board governance of a neglected sector which has been for years unduly ignored by most of the researchers. We believe that our model of effective board governance which ascertained important scores for conduct and meetings' organization, board activity and effective board communication can also apply to other sectors of Uganda's firms, and by so doing it could help to avert the problem of ineffective boards.

The rest of the paper proceeds as follows: Section 2 is a brief description of the features of board governance in Uganda and Section 3 is theoretical framework and literature review. This is followed by Section 4, research methodology. Section 5 is the results and discussion. Finally, Section 6 is the summary and conclusions.

2. Features of board governance in Uganda

There are two major sources of features of board governance in Uganda: The Companies Act Cap.110 and the Institute of Corporate Governance of Uganda (ICGU, 2001) Manual on corporate governance. Board governance in Uganda can be traced from the commencement of the Companies Act Cap.110, Laws of Uganda (The Companies Act, 1961). Board governance is explicitly stated under part V of the said Act. Among the provisions is included the number of directors, appointment and removal of directors and age limit, directors' duties and assignment of duties by directors. According to the Uganda Country Assessment Report and Programme of Action (Uganda APRM National Commission, 2007) unitary boards are the dominant structure for public corporations, public and private limited liability companies in Uganda. In order for both public and private companies to be registered, the Act stipulates a minimum of two directors. Critics might interpret this requirement just for companies to register. Similarly, this law is silent on how to ensure performance of the duties for which such board members are required on a company. Moreover, there is no statutory requirement for executive and non-executive or other categories of members on the board of directors. There is no law prescribing the appointment of executive and non-executive directors of companies. The number of directorships tenable is also unlimited except for under the Capital Markets Authority Regulations limit of not more than five directorships and two chairmanships for listed companies. Under the Articles of Association, the board is usually permitted to delegate power to committees which exercise powers as may be required by the board. Similarly, the Act requires that every company shall have a secretary and it is optional for single-member companies to have a company secretary but mandatory for public companies. Additionally the Act contains prohibitions, restrictions and qualifications relating to the appointment of directors, their powers and duties, and their conduct. Some of these include the eligibility criteria, the criteria for composition of boards and the criteria for remuneration of directors. However, the Act does not provide term limits for directors

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but prescribes the director's age limit at 70 years, only applicable to public companies. Other companies may if they wish provide upper age limits in their memorandum and Articles of Association.

However, as noted in "Introduction" to this paper, the issue of board governance came to prominence in Uganda between September 1998 and May 1999 when four Ugandan banks, were closed ostensibly for imprudent banking practices (Habyarimana, 2003) and poor internal governance (Bank of Uganda, 1999). In responding to this banking crisis in Uganda, the ICGU printed its first issue of corporate governance manual in 2001. This was aimed at providing a basic framework for the establishment and development of corporate governance in Uganda. The introduction to the manual points out that corporate governance is needed in Uganda because it is bridled with inefficient board of directors. This manual, however, reflects a "copy-cat" syndrome because it includes three sets of principles accepted elsewhere in the world and simply upholds international best practices in corporate governance as its mission. Hence the ICGU might be faulted for lack of originality and might indeed be faulted for lack of innovativeness. Critics might therefore question the relevance of this manual to effective board governance in Uganda. Nevertheless the ICGU Manual contains guidelines for internal systems and controls, the boards' roles and responsibilities and the committee system of the board among others. For example, the manual indicates that the board should meet regularly and frequently as is necessary for the directors to execute their duties and responsibilities; recommending that: first, there must be adequate notice to all directors of the dates and time of the meetings and of issues to be discussed at the meeting; and second, directors (or alternates where permissible) should be physically present at meetings and should effectively participate through preparation before the meeting and in the proceedings of the meeting.

Although the manual recommends that candidates for election to the board should have the background, experience or specialized knowledge that corresponds closely with the business of the company, it is not binding. The Companies Act, which is a binding document, seems to be silent on the matter. Persons below the age of 21 years, declared bankrupt by a court of law, disqualified by the Act or Articles of Association of the company are barred from being a directors and are disqualified for election as directors. Given the current law, it seems highly unlikely for Ugandan company boards to fulfill their obligations as espoused under the ICGU Manual. Besides, the lack of home-grown understanding of factors for effective board governance might be a recipe for inefficient boards in Uganda. The idea of adopting principles from elsewhere can stifle home-grown solutions and lead to unpleasant firm performance arising from problems of board governance. Therefore, the present study was necessary to establish a model for effective board governance in services firms of Uganda.

3. Theoretical framework and literature review

Theoretical framework

The framework relevant to board governance is dominated by six perspectives, namely: agency, stewardship, managerial hegemony, resource dependency, stakeholder and institutional theories. Ensuing is a brief review of these perspectives.

Agency theory recognizes the imperfection of governance structures in protecting shareholders' interests and is concerned with the consequences from the conflict of interests between managers and shareholders (Jensen and Meckling, 1976; Farma, 1980; Farma and Jensen, 1983). Agency theory supposes that the interests of managers are not necessarily aligned with the interests of shareholders and hence the board of directors is considered to be an efficient mechanism for monitoring a firm's managers

on behalf of its investors. Accordingly, effective board governance should ensure maximization of shareholders' wealth, reduce agency costs, select or dismiss the chief executive officer (CEO), evaluate the CEO and company performance, and also participate in the strategic decision process and control (Kamardin and Haron, 2011) – effectively ensuring control of the organization. Nevertheless agency-led studies privilege the end result, not a process and hence effective board governance under this perspective is (uncritically) viewed a monitoring device.

While agency theorists see managers as self-seeking, proponents of the competing stewardship theory argue that it is possible for managers' interests to be similar to those of shareholders (Davis *et al.*, 1997). The argument here is that managers need authority and desire recognition from peers and bosses. Thus, their motivation transcends mere monetary considerations. Stewardship theorists accordingly suggest a collaborative approach between directors and managers (Ong and Wan, 2008). Such an approach stresses service, calling for boards to advise the managers (Sundaramurthy and Lewis, 2003) and vice versa. Stewardship theory postulates that managers are motivated by a desire to achieve and gain intrinsic satisfaction by performing challenging tasks. Thus, the role of the board of directors in matters of strategy is seen as contributing to this managerial perspective of effective communication.

Managerial hegemony advocates that boards of directors are just statutory additions that are dominated by the management; boards play only a passive role in strategy or directing the corporation (Mace, 1971; Vence, 1983; Lorsch and MacIver, 1989). This theory indicates that owners and managers have different interests, but managers control the main levers of power.

Resource dependence theory is premised on the cogent adaptation to exogenous changes in the environment (Zinn *et al.*, 1998). Resource dependence theory views board of directors as "boundary spanners" who extract resources from the environment (Pfeffer, 1973). Thus, according to this theory the interaction of the board with the environment can be a source of strategic information, and this theory derives its insight from the fact that board members are also members of the boards of other firms, and this creates a web of linkages to competitors and other stakeholders. Linkages which are created with the firm's external environment help access important resources and create buffers against adverse external changes (Riana, 2008). In this vein, effective board governance is about the boundary spanning as one of the activities of the board. However, this is the view that is normally taken by studies looking at the human capital of the board (e.g. Nicholson and Kiel, 2004).

Stakeholder theory is underpinned by the notion that stakeholders are important to organizational performance and require explicit consideration in corporate strategy formulation (Cuganesan, 2006). Contemporary understandings of stakeholder theory derive from the definition of a stakeholder as "any group or individual who can affect or is affected by the achievement of the firm's objectives" (Freeman, 1984, p. 25). Therefore the achievement of a service company's objectives might be dependent on its board. And the firm might be considered as a coalition in which the different stakeholders participate to gain their own benefit (Freeman, 1984) which should, ideally, include managers and the company CEO. That is probably why Herman (1981) argues that managers make the vast majority of important decisions on behalf of the firm, even though shareholders may be able to wrest control from them under extreme circumstances by gaining control of the board of directors. In this breath, effective board governance should be about the board's performance evaluation in a bid to continually satisfy key stakeholders.

Institutional theory can be traced back from Olsen and Peters (1996), and from sociologists like DiMaggio and Powell (1983), Scott (1995) and Zucker (1987).

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According to Mizruchi and Fein (1999) firms constantly aim to maintain and increase legitimacy through complying with pressures that arise from their institutional environment. Three types of pressures exist which are mimetic, normative and coercive pressure (DiMaggio and Powell, 1983). In the context of institutional theory, norms of society must be followed for companies to obtain legitimacy and resources (DiMaggio and Powell, 1983). Two ways corporations comply with norms is through the decision-making process and the structure of firm (Nwabueze and Mileski, 2008).

Given the foregoing review, this study is underpinned primarily by agency, stewardship, resource dependency, stakeholder, managerial hegemony and institutional theories to provide a relevant framework for understanding effective board governance in Uganda. The support for a multi-theory approach is provided by Neville (2011) in the study of SMEs. And the majority of service firms in Uganda are small and medium. However, board governance scholars often falter when they adopt as well as modify these theories to suit their own purpose; as in doing so they are likely to be forced into ignoring some important roles of governing boards which are not compatible with the induction or deduction of any one of the theories they have chosen as their theoretical base (Hung, 1998).

Literature review

The epistemology of effective board governance shows it is derived from governance. There are, however, various qualifying adjectives of governance: corporate governance (Barrett, 1997), organizational governance (Sharp, 1999), polity governance (Sharp, 1999), policy governance (Carver, 1999), etc. Barrett (1997) defined corporate governance as the management representation of the legal entity and control of the management of an organization especially under the corporation laws of the country; Sharp (1999) argued that "[…] organizational governance is not an end in itself but a means of exercising stewardship professionalism" in the control of an organization as a part of a system on behalf of the stakeholders in that system. According to Sharp (1999) polity governance is government's legal and political representation and leadership of the polity (the people or the citizens). Carver (1999) explains that policy governance is a guide on the role of boards of directors for not-for-profit organizations emphasizing their responsibility to the ownership of the assets. The adjectives attendant to governance that different authors use in order to operationalize governance indicates that there is not a global consensus on the definition of governance. Accordingly this paper conceptualizes effective board governance in line with the definition provided by Barrett (1997), Sharp (1999) and Carver (1999). This study also defines a board in light of Conger *et al.* (1998, p. 140) observation: "A board is a team of knowledge workers, and to do its job, the board needs the same resources and capabilities that any other successful team of knowledge workers needs. Research […] indicates that to do their jobs effectively, such groups need *knowledge*, *information*, *power*, *motivation*, and *time*."

The study by Cornforth (2001) suggested that board inputs and three process variables are important in explaining effective board governance, namely: board members have the time, skills and experience to do the job, clear board roles and responsibilities, the board and management share a common vision of how to achieve their goals; and the board and management periodically review how they work. The other processes involved in his study were communication; in particular that communication between the board and management is good and there are rare misunderstandings between them, meeting practices: in particular that board has adequate notice of important issues to be discussed at board meetings; meetings have a clearly structured agenda; important items are

prioritized on board agendas and it is clear who has responsibility for follow-up actions agreed by the board. Cornforth (2001) delineated the board outputs in form of strategy and policy making, stewardship, supervising and supporting management, board maintenance and external relations and accountability. Of particular significance, Cornforth (2001) found that process variables significantly accounted for variations in board effectiveness and that overall effectiveness of the board is best judged by how effectively the board carries out the following functions: setting the organization's mission and values; helping raise funds or other resources for the organization; overseeing financial management; reviewing and deciding strategic direction; and reviewing board performance.

Clearly, and arising from studies like that of Cornforth (2001), the central issue to effective board governance is how to ensure accountability of senior managers to their stakeholders while simultaneously providing executives with the autonomy and incentives they need to produce wealth-producing strategies (Epps and Ismail, 2009; Cremers and Nair, 2005). Literature concerning board structures indicates that the number or size of the board is crucial for effective board governance. Lipton and Lorsch (1992) and Jensen (1993) observed that when firm boards expand beyond seven or eight people, they are less likely to function effectively as a curb on management overtime. As regards to the composition of the board Bhagat and Black (1999) argued that there is no empirical support for proposals that firms should have "supermajority-independent boards" with only one or two inside directors, but Tusiime *et al.* (2011), found that a high proportion of executive directors negatively relates to performance of firms. This is at odds with Farma (1980) and Farma and Jensen's (1983), who understood that boards' effectiveness in monitoring management is a function of the mix of insiders and outsiders who serve on the board. Moreover, Dalton and Dalton (2011), noted four meta-analytic studies that had addressed the relationship between board composition and corporate performance (i.e. Dalton *et al.*, 1998; DeRue *et al.*, 2009; Rhoades *et al.*, 2000; Wagner *et al.*, 1998) and concluded that there was no evidence of systematic relationships between board composition and firm financial performance. Nevertheless, it can be argued that directors should be qualified persons reflecting a diversity of training, experience and backgrounds to reflect their boundary spanning roles (Pfeffer, 1973) and so it might be desirable for the board to include a balance of executive and non-executive directors to mitigate against dominance of individuals or interest blocs in the decision making and as Murphy and Mclntyre (2007) noted, provide advice on new ways of identifying and developing talent and have the ability to act as an external source of knowledge that is bolstered by the network of contacts that the board can access. Consistent with this argument, governance literature (e.g. Huse, 2005; Roberts *et al.*, 2005) sees board roles as created by individual board of directors. This means, within this literature, individual director contribution is essentially about creating roles that a board needs to perform (Petrovic, 2008). But the effectiveness of a director involved on several boards simultaneously and the potential created for conflicting situations and competing interests can negate benefits of effective board governance. Indeed agency theorists contend that the obligations attendant on outside directorships distract CEOs from obligations to their own firms and create the potential for managerial optimism (Geletkanycz and Boyd, 2011). Additionally, the development of resource dependence theory indicates that the understanding of board roles and responsibilities has changed. The resource dependence theory comprehends the board as a mechanism for co-opting important external organizations with which the company is interdependent. One strategy here is

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to appoint representatives of competitors, key suppliers or customers to the board (Babic *et al.*, 2011). According to Pfeffer and Salancik (1978) board members provide advice and expertise, access to resources, and legitimacy, and also contribute to strategic decision making by providing access to key resources (Pugliese *et al.*, 2009). This means that the board has a service role related to management decision-making activities: co-opting external influences, realizing contacts between board members and relevant individuals to ensure pivotal company resources, ceremonial activities, and enhancement of the company's reputation, and advising the management during the strategic decision-making process. While the management bears the responsibility for the development of new strategy, the boards' advisory role enables their indirect influence over the strategic decision-making process (Nicholson and Newton, 2010).

The separation of the roles of CEO from chairperson is a key monitoring mechanisms (Abidin *et al.*, 2009). However, Dalton and Dalton (2011) stated that there is no evidence of substantive, systematic relationships between corporate financial performance and board leadership structure. Others hold the view that the two roles be separated, arguing that if the two roles are not separated, it means that the CEO also chairs the group of people in charge of monitoring and evaluating the CEO's performance, and hence duality exists giving rise to a possible conflict of interest and impairing the independence of the monitoring group (Abidin *et al.*, 2009). This is because in such a situation, the ability of the CEO to exercise independent self-evaluation is questionable (Rechner and Dalton, 1989). Fosberg and Nelson (1999) discovered that firms that switch to the dual leadership structure to control agency problems experienced a significant improvement in performance as measured by the operating income before depreciation, interest and taxes to total assets ratio. Conversely, board processes have been posited to be important for firm performance. Vafeas (1999) examined the association between board activity (measured by the frequency of meetings) and firm performance. He found that one way in which boards react to poor performance is by increasing the frequency of board meetings. He also found that frequency of board meetings are followed, in turn, by enhanced operating performance.

A key feature of the foregoing discourse is that the majority of studies on board governance have employed quantitative predictors at the expense qualitative factors predicted to improve board governance and hence firm performance. Yet, as the study by Cornforth (2001) indicated, process factors, which are essentially qualitative in nature, might provide a better explanation of the variance in effective board governance. Directors do not manage a company, they provide direction to those who do so (Beaver *et al.*, 2007) and we would like to believe that how they (boards) provide direction is itself board governance. Moreover, complying with most prescriptions of good governance does not assure companies in different settings of consistent performance results. For example, Aluchna's (2009) study indicated that complying with corporate governance practice is associated with lower return on investment. These results do not assure that companies having best supervisory board structure and its processes deliver higher returns as compared to the companies that do not. The results failed to support the qualitative observation, which indicates high predictive potential of corporate governance best practices. Conversely, Abor and Biekpe (2007), show that board size, board composition, management skill level, CEO duality, inside ownership, family business and foreign ownership have significantly positive impacts on profitability of SMEs in Ghana. Thus, although there is a growing literature confirming the validity of effective board governance there is, equally, a growing diversity of results. Furthermore, Uganda's regulatory regime is weak and contains less

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of the provisions of effective board governance; besides, the recommendations of the ICGU are not binding. This, together with equivocal validity of prescribed best corporate governance practices and the need to apply subjective measures of effective board governance warranted further research into the investigation of factors relevant to effective board governance in a third-world setting – Uganda.

4. Methodology

The questionnaire, sample and measures of board governance

This study utilized 128 responses from a sample of 377 service firms generated using Yamane's (1973) sample selection approach from a population of 6,534 formal service firms in Kampala region according to Uganda Bureau of Statistics – Uganda Business Register 2006/2007. A five-point Likert-scale-type (1961) questionnaire, designed to measure the opinion or attitude of respondents (Burns and Grove, 2009), was utilized to obtain self-reported information on selection criteria, performance evaluation of the board, meetings structure and decision making, board roles and nature of Ugandan boards. The questionnaire consisted of two sections. The first section (background information) contained six questions about the respondents' background relating to education, age, gender, service sector of their organization, position and board characteristics (number of directors in the company, non-executive directors in the company, male directors in the company, foreign directors on the board and number of times their company's board met in a year) (results are not reported for reasons of parsimony). The second section was board governance and consisted of 88 items. The item scales for effective board governance were developed consistent with the ICGU's manual on corporate governance (2001), the Companies Act Cap.110, Laws of Uganda (1961), the works of Cornforth (2001), Murphy and Mclntyre (2007), Petrovic (2008), Huse (2005), Heuvel *et al.* (2006) and practitioners like Jacobs *et al.* (2007). For example we utilized some of Jacobs *et al.* (2007) depictions of nature of boards. Principal component analysis was then performed to identify patterns in data and to reduce data to a manageable level and achieve parsimony and hence explained the maximum amount of common variance using the smallest number of explanatory constructs (Field, 2009). The resulting components were interpreted as conduct and meetings' organization, board performance evaluation, board activity/roles, effective communication and leadership board with control and meetings organization emerging the most important element of effective board governance. In total 19 questions from the original 88 explained 66.77 percent of the variance in board governance. Confirmatory factor analysis finally retained control and meetings' organization, effective communication and board activity in an effective board governance model and the nine scales described in Figure 1.

Statistical modeling

To estimate the model of effective board governance in line with our objective, we employed SEM. SEM addresses the issue of measurement error, and simultaneously estimates a system of structural equations. SEM is a comprehensive statistical approach to testing hypotheses about relations among observed and latent variables (Hoyle, 1995). According to Rigdon (1998) it is also a methodology for representing, estimating and testing a theoretical network of (mostly) linear relations between variables and according to MacCallum and Austin (2000) tests hypothesized patterns of directional and non-directional relationships among a set of observed (measured) and unobserved (latent) variables. SEM therefore helps in understanding the patterns

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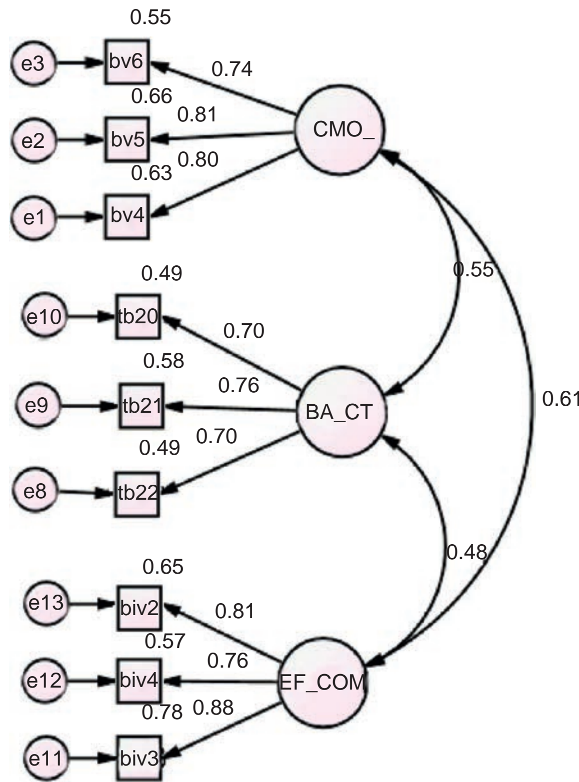

Notes: Board governance model for Uganda's Service Sector Firms: COM_: control and meetings' organization; BA_CT: board activity; EF_COM: effective communication; bv4: there is good time-management for meetings; bv5: there is clear dialogue and communication; bv6: voting results in full commitment of all decisions; bv3: board papers are delivered to members in advance; biv4: notices of board meetings are sent in advance; biv2: our board makes clear minutes; tb21: our board is rigorous in delegating operational management to the executive group; tb22: our board builds stronger controls and processes that ensure that power supports the needs of the company and not the ambitions of individuals; tb20: our board makes greater use of a management committee, chaired by the chief executive directors and key managers and the deliberations are reported to board in full. χ^2 =24.197, df =24, p=0.450, GFI =0.958, AGFI =0.922, RMR =0.010, TLI =0.999, CFI =1.000, NFl =0.952, RMSEA =0.008

Figure 1.
A model of board governance

of correlational/covariance among a set of variables and according to Kline (2011) explains as much variance as possible with the model specified. We used the estimation procedure in AMOS 18 (Arbuckle, 2009) to construct the model. The measurement and structural models were estimated sequentially to reduce interpretational confounding and to limit complexity (Anderson and Gerbing, 1988). Missing values were not an issue as only complete questionnaires for 128 respondents were used. The overall fit of our models were tested using the following fit criteria: The χ^2-test which is an absolute test of model fit requires that the model is rejected if the

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p-value is < 0.05; root mean square error of approximation (RMSEA) should be < 0.06 and Tucker-Lewis index (TLI) values of 0.95 or higher (Hu and Bentler, 1999).

Because we used self-reported data and a questionnaire a *post hoc* procedure enabled us to detect whether common methods variance (CMV) was present. We performed a Harman' one-factor test (Sejjaaka, 2010). Results indicated that CMV is not an issue in this study. We also tested for discriminant validity by, first of all using a method proposed by Anderson and Gerbing (1988), that "discriminant validity can be assessed for two estimated constructs by constraining the estimated correlation parameter […] between them to 1.0 and then performing a chi-square difference test" (p. 416). Using this procedure we in pairs compared all constructs, in all of those cases the fit of the models (dramatically) worsened. Thus, we concluded that our measures are sufficiently different from each other and could be used separately. Second, we used average variance extracted (AVE) (Fornell and Larcker, 1981) and in this case AVE for effective board governance model was 0.60 which is above 0.50 as recommended. Further, convergent validity was performed using Bentler-Bonett normed fit index (NFI); a measurement model which shows strong convergent validity with a NFI value above 0.90 (Mark and Sockel, 2001). We performed a normality test on our data. The scatter plot in Figure 2 indicates a balanced spread of scores and according to Tabachnick and Fidell (2007), when assessing bivariate scatter plots if they are oval shaped, they are normally distributed and linearly related. The plot shows that this was the case. Indeed although the plot is far from excellent, there is no evidence of true curvilinearity.

5. Results and discussion

The present study was carried out with the purpose of establishing a model of effective board governance in Uganda's service sector firms. This section presents the results and discussion. The model in Figure 1 describes board governance in Uganda's service firms and a summary of the fit statistics for the measurement models is to be found in Table I and also on the model. Observed variables/factors corresponding to each construct can also be found in Figure 1.

Our model shows an NFI of 0.952, which indicates strong convergent validity. The χ^2 value of 24.197 is non-significant at the 0.05 level: its p-value is 0.450 suggesting that the model fits the data acceptably in our population. This is substantiated by other fit indices: RMSEA = 0.008, TLI = 0.999, GFI = 0.958 and AGFI = 0.922. The Hoelter (1983) index indicated that 192 and 226 are the largest sample sizes for which one could accept at the 0.05 and 0.01 levels, respectively, the hypothesis that our model is correct.

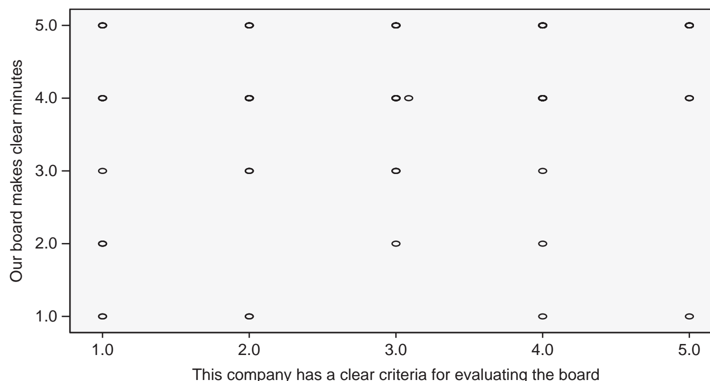

Figure 2. Bivariate scatter plots testing for multivariate normality

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And so if our sample size were any bigger than 192 and 226 we would reject our model at the 0.05 and 0.01 level, respectively. Accordingly the model of effective board governance is substantiated for the case of service firms in Uganda.

In this study all the critical ratios were >1.96 and p-values were <0.001 connoting significance. The observed factor loadings compared with their standard errors revealed evidence of an association between effective board governance and its respective constructs (Koufteros, 1999). As for item reliability an R^2 value above 0.5 is considered an acceptable reliability for each item (Bollen, 1989; Koufteros, 1999). Except for tb20 and tb22, the other items turned out to be well over the criterion of 0.05 and thus each item was a reliable factor for effective board governance. The construct reliability of effective board governance items was 0.827, 0.834 and 0.845 for CMO_, BA_CT and EF_COM, respectively. Our results confirm that board governance is a multi-dimensional concept consisting of control and meetings organization, effective communication and board activity. Thus effective board governance in Ugandan service sector firms can be defined as the way the meetings are conducted and controlled, clear and effective communication to and among board members including proper recording of board minutes; and the way the board conducts its activities and roles.

From the agency theory perspective, the proper conduct of meetings and effective communication as measures of effective board governance confirms the board as a mechanism of transparency. In this case where, for example, the minutes of the board meeting are clear, transparency in form of minutes' disclosures to the shareholders is an important mechanism for aligning shareholder and management interests. This study supports that application of agency theory as relevant framework in the study of board governance even in SMEs and developing economies, for that matter. Indeed, agency theory (Jensen and Meckling, 1976) argues that boards are relevant in agency problems and therefore board power should be used to the benefit of the company as a whole; and because of this Cadbury (1992) proposed a committee system which should ensure informed formulation of decision making (Zahra and Pearce, 1989). To ensure accountability of senior managers to their stakeholders while simultaneously providing executives with autonomy and incentives, this study confirms rigorousness in delegation as a wealth-producing strategy (Epps and Ismail, 2009) in service firms. The study confirms the need for proper flow of information between board structures (Maassen, 1999) as evidenced by the need to have board papers and notices delivered in advance of meetings together with proper recording of minutes and the need for the committees' decisions to be communicated fully to the full board. In this way the board is able to implement decision making (Kakabadse and Kakabadse, 2001) thereby ensuring separation of decision control from decision management (Maassen, 1999).

From a stakeholder perspective, well written and clear minutes of the board might guide properly the management and other stakeholders as to the direction the company is taking and act accordingly. This is consistent with the observation of Brennan and

Model	df	χ^2	p	TLI	GFI	AGFI	RMSEA
Five-factor CFA model (CMO_)	5	10.046	0.74	0.959	0.971	0.912	0.089
Four-factor CFA model (EF_COM)	2	2.662	0.264	0.990	0.990	0.951	0.051
Four-factor CFA model (BA_CT)	1	0.282	0.595	1.032	0.999	0.989	0.0001
Overall three-factor model (board governance)	24	24.197	0.450	0.999	0.958	0.922	0.008

Table I.
Summary of fit statistics for the models

Solomon (2008) that one of the effective governance variables predicted to influence disclosure and transparency is the board of directors.

True with the stewardship perspective, this study confirms that effective board governance is about making greater use of the management committee and executive directors who should report their deliberations in full to the board. This allows management to add value to top decisions/strategy and hence management should be considered as having similar interests with owners of service firms. Indeed, Abor and Adjasi (2007) have argued, that the application of the broader view of effective board governance should not be limited to the board room so as to allow boards to encourage firm entrepreneurship. Thus, stewardship theory is particularly relevant to service firms especially with regard to the intangibility of services provided. Similarly, the board should be rigorous in delegating operational management to the executive group so that it is left with the core activity/role of controlling the firm. This is ensured by building stronger controls and processes that stifle individual ambitions relative to the needs of the firm. This is because managers tend to chose projects which have immediate results as their performance is tied to the projects they choose (Abor and Adjasi, 2007). This implies that effective board governance is about supervising and holding to account those who direct and control management. This study coins this as board activity/roles. In the context of SMEs (and service firms for that matter), this is about setting rules and procedures as to how the firm is run – putting checks and balances in place to prevent abuses of authority (Abor and Adjasi, 2007). Attention must, however, be paid to the possible tensions that normally exist between owners and the board in case of sole proprietors particularly in an economy like Uganda where traditional cultural practices about ownership tend to scoff into businesses. Our model of effective board governance therefore can result in reaping the benefits of effective board governance and thus attract other SMEs into adopting the model because it is home grown.

Although traditional research finds the structural factors, e.g. composition, leadership structure and board size, to be the most relevant influences on board effectiveness (Babic *et al.*, 2011) the results of this study support behavioral approaches that emphasize as the key factors of board effectiveness those influencing the processes within boards (e.g. effort norms and other behavioral characteristics). This study provides an integrative framework for board effectiveness evaluation and responds to the argument made by Babic *et al.* (2011) that a proper model (of effective board governance) is contingent upon given socio-economic circumstances. Similarly, our study does not confirm board's culture on evaluation of director's and board's performance as a good practice proposed by Vence (1983) and Pettigrew (1992) – likely to be a valid perception as most of the board members are family members, close friends and their services appear voluntary; typical of small and medium firms or developing country firms. The study also does not confirm that boards are appointed to ensure clear definition of roles and functions of chairman and board of directors and also to assess top personnel and appointments based on their training, qualification, skills and integrity. Again this is likely to be the case for family boards, close friends and where the service of board members is viewed as voluntary thereby not attracting better brains that would require commensurate remuneration. More so, the ICGU's manual which recommends this is not binding but the Companies Act which is binding is silent on the matter. Thus this study lends support for resource dependency theory as a relevant framework for studies on boards in service firms in Uganda in so far as the board is competent in delegating and building stronger controls, consistent with what is done elsewhere and experience, and performance of a service role related to

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management decision-making activities such as advising the management during the strategic decision-making process (Babic *et al.*, 2011).

6. Summary and conclusions

The present study was carried out with the purpose of establishing a model of effective board governance in Uganda's service sector firms. The results show a good model fit and Figure 1 defines the model of effective board governance in Uganda and is comprised of three dimensions of effective board governance, namely, control and meetings' organization, board activity and effective communication; and the nine scales by which to gauge the three conceptual dimensions. The results are consistent with the notion that improvements in the way board meetings are organized and controlled, improvements in communications of the board and effective performance of board activities will improve board governance in Uganda's service sector firms. Thus, the relevancy of effective board governance cannot be over emphasized since it constitutes the organizational climate for internal activities of the company.

This study has resulted in important academic and managerial contributions. On the academic front it contributes to academic research by producing empirical evidence to support theories relevant to board governance. Its focus on factors for effective board governance in an African third-world setting adds new insights into roles of the predominantly unitary boards and we hope this contributes to the scarcity of effective board governance literature on the African experience. On the managerial front, service firms in Uganda, policy makers, company boards and management could use these findings as a guideline, which is, what to focus on in the context of improvements in board communication, performance of board roles or activities and improvements on the ways of conducting and organizing meetings. Effective board governance can easily assist the service sector firms by infusing better board communication processes, meetings' processes and better performance of board roles or activities. For example, companies should use effective communication strategies like the ones confirmed in this study to improve transparency at board level. If service firms adhere to meetings' organization that result in commitment to decisions and the performance of proper board roles relevant to the service sector, this will bring a new strategic outlook of Ugandan boards. Boards should establish policies, use time for the company wisely, make decisions about issues that are strategic and significant, delegate non-governance types of decisions to operations management and periodically review the structure and functions of the committees. For example, policies can define focus and differentiate responsibilities among the board, the management and other employees. More so, the evidence in study imply that the Ugandan service sector boards will be effective, if in return for their service, they expect proper flow of communications, advance preparation for board discussions, judicious use of time and hence opportunity to contribute. Furthermore, the results of this study should provide an input into the review and amendments to company law and the manual on corporate governance in Uganda. The current study presents the board of directors with the ability to embrace full commitment of all decisions and to leverage the use of management committees in furtherance of their duties. We believe that our model of effective board governance can also apply to other sectors of Uganda's firms, because by so doing it could help to avert the problem of ineffective boards as evidenced by consistent firm failures in Uganda. It can be predicted that firms in Uganda should be able to perform better and remain competitive as studies have indicated that effective board governance has a positive impact of firm performance. By improving the quality

of board governance, Ugandan boards will demonstrate their relevance in company direction and improvement of company value to the benefit of all stakeholders.

As with any study, there are a number of limitations with the present paper. Although there is plenty of literature on corporate governance, there is scarce literature on effective board governance conceptualization especially with regard to the behavioral perspective and this together with imprecise terminology regarding this area may have affected our conceptualization of the paper. Second, although we self-administered the questionnaire, we did not undertake follow-up interviews which would have informed us the reasons why the respondents held certain views. Third, our study was limited to the service sector firms registered and operating in Kampala, Uganda and it is possible that our results are only applicable to this sector in Uganda. Finally, the present study is cross-sectional; it is possible that the views held by individuals may change over the years. In spite of the limitations, policy makers of Uganda dealing with financial markets, academicians, company directors, company owners and even general readers interested in the field of corporate governance might find this study handy. Future research may wish to test our model in predicting firm financial performance.

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Corresponding author

Stephen K. Nkundabanyanga can be contacted at: hodaccounting@mubs.ac.ug

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