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Analysis of Board Composition and Performance of Five-Star Hotels in Kenya

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Abstract

The hospitality industry plays a critical role in a country's economic development. In Kenya, even though the sector is the second largest foreign exchange earner the industry faces a myriad of challenges. The purpose of the study was to assess the relationship between board composition and the performance of five-star hotels in Kenya. The study was anchored on the situational leadership theory. The study adopted a descriptive research design. The findings revealed that board composition had a positive and significant effect on the performance of five-star hotels. The study concluded that there exists a positive significant relationship between board composition and performance of five-star hotels in Kenya. The study recommends that board composition needs to be facilitated to improve the performance of five-star hotels in Kenya. This could go a long way in ensuring there is improved performance of five-star hotels in Kenya.

Keywords: *Board Composition, Performance, Five Star Hotels*

1.0 Introduction

The hospitality industry plays a critical role in a country's economic development. A survey study by Wanjala (2016) concluded that the hospitality industry contributes to over 10 percent of gross domestic product and employs close to 240 million people globally. In Kenya, the sector is the second largest foreign exchange earner after tea and contributes substantially to the overall economic development (GOK, 2013). Nevertheless, the industry faces a myriad of challenges, which are caused by many factors though not limited to competition, globalization, and insecurity. According to research by Cytonn (2016), the hospitality sector is oversupplied and witnessing a poor performance in some regions even though pockets of value exist in some regions especially in Nairobi and Maasai Mara and in serviced apartments. This calls for the need for good internal governance by the sector's institutions and players to provide policy and enhance competitiveness.

Problem Statement

The hospitality industry is experiencing enormous growth resulting in a cut-throat rivalry among the players. Sophisticated technology and the need for the survival of organizations attract stakeholders in an industry, which increases the need for control and accountability (Wainaina, 2012). Good governance has the advantage of building a firm's reputation, and confidence by the investors, and ensures standard accounting and reporting that attracts the capital inflow (Knell, 2016; Levitts, 2011). Despite the challenges facing the hotel industry, Yap, Chan, and Zainudin (2017) argue that good corporate governance has been considered crucial as the driving force in sustaining a firm's performance.

Interestingly, the relationship is not always as indicated. A study by Ongori, Iravo, and Munene (2013) in Kenya, shows that the hospitality industry despite having healthy corporate governance was drastically declining in its output and registered a dismal performance, with institutions closing down at an alarming rate. Despite the hospitality industry remaining pivotal in supporting other sectors, several factors have posed challenges to its survival (Waudo, 2012). The challenges have revealed the need to devise mechanisms by which corporations are controlled and directed to ensure the sustenance of the institutions (Manyuru, 2015).

The collapse of corporates has attracted interest in corporate governance as a crucial mix for the greater decision-making process (Yap et al., 2017). Even though studies have shown the contribution of corporate governance to performance (Abet, 2011; Macuvi, 2013; Mwangi, 2015), it is, however, interesting to point out that this relationship seems to openly contradict most of the known empirical establishments (Wangombe, 2014), more so in the hospitality industry in Kenya. Therefore, this poses an empirical gap motivating the need to examine the effect of corporate governance, particularly board composition on the performance of five-star rated hotels in Kenya

Research Hypothesis

Ha: There is a significant relationship between board composition and performance of five-star hotels in Kenya.

2.0 Literature Review

Situational leadership theory is based on the ways people respond to working and being led in groups (Zigarmi & Roberts, 2017). Central to understanding situational leadership are the key concepts of task behaviour, the amount of guidance and direction you provide; relationship behaviour, the amount of social and emotional support you provide; follower readiness, exhibited in followers performing a specific task or function or accomplishing a specific objective; and follower development, followers' maturity and ability to manage themselves in an organizational environment (Thompson & Aarset, 2012).

A key point is that the follower determines the leadership style; that is, the follower's behavior should determine the leadership behavior most appropriate for you to employ. Specifically, if a follower was an engaged self-starter and able to accomplish a task, you would choose to get out of the way and allow the follower to work independently. On the other hand, if a follower seems timid and uncertain about how to proceed or accomplish the task, you would step in and use task behaviour instructions, training, and guidance (Thompson & Glaso, 2018).

According to Zigami and Roberts (2017), the Situational Leadership theory suggests that there is no "one size fits all" approach to leadership in an organization. Depending on the situation, varying levels of leadership and management in an organization are necessary. However, leaders must first identify their most important tasks or priorities in terms of allowing independence, the right number of sizes in the management, and roles well defined. One of the most important situational theories accommodates is a leader who can accommodate internal governance mechanisms in an organization in terms of the board of directors having the status of the firm's backbone of oversight (Aymen, Sarra, Ahmed & Abderrazak, 2016; Chatterje, 2011). Board composition refers to the number of independent non-executive directors on the board relative to the total number of directors (Uadiale, 2010).

Similarly, Jarboui et al. (2016) noted that situational leadership theory requires the leaders of an organization to view an organization as a separate entity that needs to be managed by external and internal management to enhance its performance. He states that the presence of outside directors on the board strengthens its supervision power and affects the performance of the firm. In addition, Pereira and Filipe (2014), as well as Gavin (2013), argue that the board is an essential link between the firm and the external resources that a firm needs to maximize its performance, it is logical that the managerial abilities of the board of directors would have a significant impact on the entity's financial performance. Further, Müller (2014) noted that it is clear that the board's composition would significantly influence the entity's performance. The theoretical governance literature argues that boards fulfill their duties of advising and monitoring management by choosing board composition and size appropriately. It is on this premise the current study seeks to examine the association between board composition and the performance of five-star rated hotels in Kenya.

Song, Van Hoof, and Park (2017) investigated the impact of board composition on financial performance in the restaurant industry from a stewardship theory perspective. The composition of the board was measured as the ratio of inside and outside directors. Firm performance was operationalized as return on assets (operational performance) and Tobin's q (market-based performance). Panel regression analysis tested the research hypotheses. Using data from 25 restaurant firms from 2007 to 2013, the study found an insignificant impact of board composition on operational performance. However, a higher proportion of inside board members increases market-based performance. A higher proportion of outside board members decreases market-based performance.

Veklenko (2016) investigated the relationship between the composition of the board of directors and firms' performance. Specifically, board size and board independence were studied, expecting small and large boards as well as highly independent boards to have the greatest performance. Three performance indicators were used -return on assets (ROA), return of equity (ROE), and Tobin's Q. The analysis found a slight indication for a U-shaped relationship between board size and ROA and an inverted U-shaped relationship with ROE and Tobin's Q. However, they both were statistically not significant to conclude. The research confirmed the hypothesis that boards with a higher ratio of independent directors have a higher level of ROE, but the results investigating the effect on ROA and Tobin's Q were not statistically significant.

In equal measure, Panasian, Prevost, and Bhabra (2017) investigated board composition and its effect on firm performance among publicly listed Canadian firms. The primary dataset began with 300 companies comprising the 1995 TSE 300 Index, defined as the 300 largest Canadian companies by market capitalization listed on the Toronto Stock Exchange that year. Tobin's *q*-ratio was used to measure firm performance. Even though several explanatory variables were employed as a control for corporate governance and other firm characteristics, the regression results showed that firms that increased the proportion of outside directors are associated with higher levels of Q and that this increase in Q is predominantly exhibited by firms that are more likely to have agency problems (where $Q<1$) at the 10 percent level ($z = 1.718$). The results equally revealed that a higher percentage of outsiders on the board is associated with greater board independence and hence better monitoring, which suggests that mandating or encouraging firms to increase outside board participation has the intended impact of benefiting those firms from better oversight.

Kitui (2013) main objective of the study was to establish the effect of board composition on the financial performance of companies listed on the Nairobi Securities Exchange. Therefore, a descriptive research design was used to study whether there is an effect of board composition on the financial performance of firms listed on the Nairobi Securities Exchange. The population of interest in this study constituted all listed companies quoted at the NSE for the period of five years from 2008 to 2012. Secondary financial data sources were used for the study, where annual financial reports of individual listed firms were used over the five-year period where profitability was extracted and used as a measure of financial performance. The findings showed that board composition variables that as age, gender, independence, and ethnicity considered in the model are significantly associated with financial performance.

3.0 Methodology

The study adopted a descriptive research design and used both qualitative and quantitative approaches. The unit of analysis was five-star rated hotels and hence the study targeted all the fifteen five-star hotels operating in Kenya, while the unit of observation was 198 (head of departments, managers, and board members). The respondents were sought through a census. Structured questionnaires were the main tool to collect primary data from the targeted respondents. The data was analyzed using both descriptive and inferential statistics. Cronbach's alpha was used to test for the internal reliability of each variable used in the study. Data analysis was done using descriptive statistics, correlation, and regression analysis. The study used bivariate regression analysis to analyze the association between board composition and performance of five-star hotel variables.

4.0 Results and Discussion

Reliability Test

In evaluating the survey constructs, a reliability test was done. Reliability tests examine the degree to which individual items used in a construct are consistent with their measures (Al-Osail, et al., 2015). In this study, the reliability of the instrument (questionnaire) was tested using Cronbach alpha (α). Cronbach's alpha reliability coefficient value of 0.7 or higher is considered sufficient (Tavakol & Dennick, 2011). Reliability of all constructs representing the dependent variable (performance of five-star hotels) and the independent variable (board composition) attracted a Cronbach alpha statistic of more than 0.7. Therefore, based on the coefficient values in Table 1, the items tested were deemed reliable for this study.

Table 1: Reliability Test Results

Variable	No. of Items	Cronbach's Alpha	Conclusion
Board Composition	8	.876	Reliable
Performance of five-star hotels	8	.905	Reliable

Descriptive Statistics for the Board Composition

The study objective was to establish the relationship between board composition and performance of five-star rated hotels in Kenya. Table 2 presented the percentages, means, and standard deviation statistics relating to the information measuring the respondents' level of agreement as to how the given indicators of board composition influenced the performance of five-star hotels in Kenya. The value that had the highest frequency scores among the respondents was the occurrence, agree (value of 4.00 on the monadic scale), as all the indicators for board composition under this column had high numbers of respondents. This implied that most respondents agreed that the indicators listed for board composition influenced the performance of five-star hotels in Kenya.

From the findings in Table 2, majority of the respondents agreed that the board exercised duties effectively without interference (M=4.987, SD=0.125); The non-executive directors were independent of management thus providing unbiased business judgment (M=4.032, SD=0.762), Board had non-executive and executive directors (M=4.624, SD=0.432), The non-executive directors presented well the shareholders' interests (M=4.006, SD=0.854), The number of board members was adequate (M=4.625, SD=0.094); The number board members run the organization effectively (M=4.218, SD=0.436), The board members roles were well defined and no overlapping of roles (M=4.112, SD=0.428); The board interlocks provided greater resources and experience (M=3.998, SD=0.876). This implies that board composition was practiced and influenced performance of five-star rated hotels in Kenya.

Table 2: Descriptive Statistics for the Board Composition

Description	Mean	Std.
The board exercise duties effectively without interference	4.987	.125
The non-executive directors are independent of management thus providing unbiased business judgment	4.032	.762
Board has non-executive and executive directors	4.624	.432
The non-executive directors present well the shareholders' interests	4.006	.854
The number of board members is adequate	4.625	.094
The number of board members runs the organization effectively	4.218	.436
The board members' roles are well defined and no overlapping of roles	4.112	.428
The board interlocks provide greater resources and experience	3.998	.876

The study findings are in agreement with findings by Song, Van Hoof, and Park (2017) established that board composition improves the performance in the restaurant industry from a stewardship theory perspective. However, a higher proportion of inside board members increase market-based performance. A higher proportion of outside board members decreases market-based performance. Veklenko (2016) investigated the relationship between the composition of the board of directors and firms' performance. Specifically, board size and board independence were studied, expecting small and large boards as well as highly independent boards to have the greatest performance. Muller (2014) focused on identifying and analyzing those factors that influence financial performance, while it was logical (but not undisputed) to suppose that the managerial abilities of the board of directors would have a significant impact on the entity's financial performance. García and Herrero (2018) analyzed the structure of boards of directors and its impact on business performance, which was approximated by economic profitability. For the study of diversity, the study used an index that integrated not only the gender of board members but also their age and nationality, since these are factors that could influence the knowledge, experience, and skills of the directors. With respect to the performance of the company, it was noted that there was a negative and significant relationship with the independence of boards.

Descriptive Statistics for the Performance of Five-Star Hotels

The respondents were asked to indicate to what extent they agreed with various statements that would indicate the performance of their businesses. The statements asked about customer satisfaction, bed occupancy as well business profitability. The findings are summarised in Table 3. Hotel employees met timelines of service (M=4.998, SD=0.008); Guests' requests are attended to promptly (M=3.765, SD=0.717), employees offer personal attention to guests

(M=4.119, SD=0.113); Guests usually refer others to our facility (M=3.769, SD=0.115); The management kept clients' database records (M=3.328, SD=0.765); The hotel operated at full capacity always (M=3.328, SD=0.387); The occupancy followed peak phases (M=4.001, SD=.045). The study implications are that corporate governance practices have an impact on the performance of the hotel industry in Kenya.

Table 3: Descriptive Statistics for the Performance of Five-Star Hotels

Description	Mean	Std.
Hotel employees meet timelines of service	4.998	.008
Guest requests are attended to promptly	3.765	.717
Employees offer personal attention to guests	4.124	.113
Guests usually refer others to our facility	3.769	.115
The management keeps clients' database records	4.218	.732
The hotel operates at full capacity always	3.328	.765
The occupancy follows peak phases	4.001	.045

Correlation Analysis of Board Composition and Performance of Five-Star Hotels

The study sought to establish the relationship between board composition and performance of five-star hotels in Kenya. A Pearson Correlation was performed and the result of the Pearson correlation test as presented in Table 4 shows a correlation (r (167) = 0.372; $p<0.05$) between board composition and performance of five-star hotels in Kenya. This implies that the board composition is positively correlated to the performance of five-star hotels in Kenya. In addition, the correlation between these two variables was significant, that is $p<0.5$ implying a linear relationship between board composition and performance of five-star hotels in Kenya. This shows that board composition significantly influenced the performance of five-star hotels in Kenya. The study findings are in line with the findings by Song et al. (2017) investigated the impact of the board composition on firm performance. The study established that board composition especially a higher proportion of outside board members increased market-based performance. Johl and Salami (2014) study result shows that the age of board members does not affect firm performance, whilst diverse qualifications of board members and directors with accounting expertise are positively associated with firm performance.

Table 4: Correlation between Board composition and firm performance

		Firm Performance	Board Composition
Firm Performance		1	
Board Composition	Pearson Correlation	.372**	
	Sig.(2-tailed)	.000	1
	N	167	

Regression Analysis for Board Composition and Performance of Five Star Hotels

The study objective sought to determine the relationship between board composition and the performance of five-star hotels in Kenya. The results of the regression are presented in Table 5 displays R (the correlation between the observed and predicted values of the dependent variable), which is 0.372. This is a moderate relationship between the observed and predicted values of the dependent variable. It also shows that there is a positive correlation between board composition and the performance of five-star hotels in Kenya. Table 5 also displays R squared which is the proportion of variation in the dependent variable explained by the regression model, in this case, it is 0.138. This means that board composition can explain 13.80% of the performance of five-star hotels in Kenya. The remaining percentage (86.20%) can be explained by other factors excluded from the model. The adjusted R-square of 0.132 indicates that board composition in exclusion of the constant variable explained the change in performance of five-star hotels in Kenya by 13.20%. The value of the standard error of the estimate is shown in the output as 0.65784. It shows the average deviation of the dependent variable (performance of five-star hotels in Kenya) from the line of best fit.

Table 5 summarizes the results of an analysis of variance, with the sum of squares, degrees of freedom, and mean square being displayed for two sources of variation, regression and residual. For the accounted-for values, the mean square (the sum of squares divided by the degrees of freedom), is 271.125, the F statistic (the regression mean square divided by the residual mean square) is 26.415 and the degree of freedom (df) is 1 whereas the output for residual which displays information about the variation that is not accounted for by the model has the following values: sum of squares as 1693.550 df as 165 and a mean square of 10.264. The overall relationship was statistically significant ($F_{1,165} = 26.415$, $p<0.05$) It has a significant level of 0.000 which means that the chances are zero that the result of the regression model is due to random events instead of a true relationship, which implies that the linear regression model is a good fit for the data and hence can be used to predict the influence of board composition on the performance of five-star hotels in Kenya.

Table 5 represents the coefficients of the independent variable (board composition) and the dependent variable (performance of five-star hotels in Kenya). These findings show that the performance of five-star hotels in Kenya will be having an index of 13.893 when board composition is held constant. In addition, the Beta coefficient was 0.499 for the relationship between board composition and the performance of five-star hotels in Kenya. This shows that a unit improvement in board composition would lead to a 0.499 improvement in the performance of five-star hotels in Kenya. The t – value (3.240) of more than +1.96 indicates that the change in performance of five-star hotels in Kenya by board composition is not by chance. The relationship is significant as the P-value (0.000) was less than the significance level (0.05). Thus, yielding a regression model where $Y= \beta_0 + \beta_1 X_1 + \varepsilon$.

The general form of the equation was to predict performance of five-star hotels in Kenya; X_1= Board Composition; $Y= 13.893+ 0.499X_1$. This indicates that performance of five-star hotels in Kenya = 13.893 + 0.499* Board Composition. Therefore, we can conclude that board composition positively and significantly influences performance of five-star hotels in Kenya.

Table 5: Regression Statistics (Board Composition and Performance of Five Star Hotels)

Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.372	.138	.132	.65784

ANOVA Statistics

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	271.125	1	271.125	26.415	.000
	Residual	1693.550	165	10.264		
	Total	1964.675	166			

Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	13.893	1.876		7.405	.000
	Board Composition	.499	.154	.372	3.240	.000

Hypothesis Testing

The study hypothesized **H_a:** There is a significant relationship between board composition and performance of five-star hotels in Kenya.

The study results of the survey in Table 5 revealed that there was a positive and significant relationship between board composition and performance of five-star hotels in Kenya (β_1=0.499, t_{cal}= 3.240> $t_{critical}$ =1.96, p-value < 0.05). To test the relationship the Regression Model fitted was $Y= \beta_0 + \beta_1X_1 + \varepsilon$, that is $Y= 13.893+ 0.499X_1$. The alternate hypothesis (H_a): board composition has a positive and significant relationship with performance of five-star hotels in Kenya or ($H_{a1}: \beta_j \neq 0$) is therefore accepted (β_1=0.499, t_{cal}= 3.240> $t_{critical}$ =1.96, p-value < 0.05) and concluded that board composition (X_1) positively and significantly influences performance of five-star hotels in Kenya (Y).

The study findings are in contradiction with the findings by Song et al. (2017) investigated the impact of the board composition on financial performance. The study found an insignificant impact of board composition on operational performance. However, a higher proportion of inside board members increases market-based performance. A higher proportion of outside board members decreases market-based performance. The study results are in tandem with findings by Veklenko (2016) investigated the relationship between the composition of the board of directors and firms' performance. Specifically, board size and board independence were studied, expecting small and large boards as well as highly independent boards to have the greatest performance. The research confirmed the hypothesis that boards with a higher ratio of independent directors have a higher level of ROE, but the results investigating the effect on ROA and Tobin's Q were not statistically significant.

Muller (2014) hypothesized and in accordance with some previous studies found that board independence and the proportion of foreign directors in the total number of directors (as characteristics of corporate board composition) had a significant strong positive impact on firm performance (both contemporaneous and subsequent). Omwenga (2017) study investigated the effect of corporate governance on the financial performance of SACCOs in Kenya. The research concluded that financial performance is influenced by the board size while board composition and diversity and audit committee size do not have a significant effect on financial performance of Sacco in Kenya. The study findings are in agreement with the findings by Panasian, Prevost, and Bhabra (2017) investigated board composition and its effect on firm performance with greater board independence and hence better monitoring, suggests that mandating or encouraging firms to increase outside board participation has the intended impact of benefiting those firms from better oversight.

5.0 Conclusion

The study concluded that there exists a positive significant relationship between board composition and performance of five-star hotels in Kenya. The results reveal that board composition is statistically significant in explaining performance of five-star hotels in Kenya. The findings are supported by those of Adika (2018) who found out that there is a statistically significant positive effect of board composition attributes in form of non-executive directors and directors' nationality on firm performance. Owande (2016) found out that the overall board composition had a positive effect on performance of firms as the board size and independence had a positive effect on firm profitability. The study concluded that board composition is essential to the improvement of performance of the hotel industry.

6.0 Recommendations

The study found that board composition has a positive statically significant relationship with the performance of five-star hotels in Kenya. The study recommends that the management of five-star hotels should put in place a set of deliberate and proactive processes, policies, and structures that supports the improvement of board composition. The management should review existing policies on board composition to improve board functions. Additionally, the study recommends that the management should come up with strategic interventions to promote board independence to enhance performance of the hotels.

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