THE EFFECT OF CORPORATE GOVERNANCE STRUCTURES ON THE PERFORMANCE OF EAST AFRICA AIRLINE INDUSTRY

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ABSTRACT

The East African Airlines are facing a stiff competition from the already established airlines such as Emirates, Qatar Airways, and British Airways among others. One of the major challenges that are facing the East African Airline industry is the issue of Corporate Governance, which contributes greatly to the slow growth of this industry in this region. All the airlines in East Africa were entirely run by the governments. This research sought to study the effect of the corporate Governance structures on the performance of the East Africa Airline. The study was guided by owners/stakeholders, Board establishment and functions, Management and Regulatory Framework, The research design was descriptive and the study used exploratory approach. A self administered pre-tested questionnaire was used to collect primary data. A pilot study was conducted to test the reliability and validity of the questionnaires. From the entire sample of 10 respondents, a response rate of 60% was achieved. Using statistical package for social science (SPSS) the appropriate quantitative and qualitative techniques were used to analyze the data. The research findings established owners/stakeholders; Board establishment and functions, Management and Regulatory Framework, as independent variables for corporate performance influence the performance of East Africa Airlines Industry with 83.3% of the respondents indicated that they adhered to national guidelines for service delivery. Another 83.3% of them indicated that they annually filed their returns including audits to the relevant authorities. 67.5% of the respondents also indicated that their organizations notified relevant authorities of changes in addresses, board, name, constitution etc. and another 33.3% of them were of the opinion that their tax exemptions were processed from nonprofit status. Also the majority of the respondents unanimously mentioned that the various management aspects had influenced corporate governance structures in their respective organizations with the program managers job description, formal performance evaluation, program manager implementation, and handling of queries by the program manager scoring high. The research findings will be used by the East African Airlines, aviation consultant and also to add to the existing body of knowledge.

Key words: *corporate governance structures, performance of East Africa airline industry*

Introduction

Business entities pursue economic activities to fulfill the objectives of shareholder wealth maximization. Business growth requires capital which businesses source from outsiders- Banks, debt holders. Chandler (1977) claimed that increasing capital needs associated with growth of enterprise leads to separation of ownership and control and to dispersal of ownership. Family owners cede control to professional managers as businesses grow. Further growth causes complexity, reducing owners' internal control and the need for cheaper funds from a variety of sources. The concern for all stakeholders' interests then takes center stage. These issues border on the subject of corporate governance (CG).

Corporate governance received close attention after the entry of professional managers who wielded power over investors' resources (King Commission, 2002). Further, inconsistent accounting practices allowed managers to disclose only minimum financial information to shareholders, boards of directors engaged themselves as vendors to reap unfair profits and manipulated shareholders into approving unworthy investments and compromised auditors at meetings. Ineffective boards, whose incompetence and lack of commitment to values as well as obscurity given to minority shareholders required intervention of governments through corporate governance principles and rules.

The Cadbury committee (1992) defined CG as a system by which companies are directed and controlled. A broader view of CG is given by the Organization for Economic Cooperation and Development – OECD (2004) which defines it as involving a set of relationships in a company; that between its management, board, shareholders and other stakeholders. It provides the structure for setting and attaining company objectives and monitoring and measuring performance. The King Commission on corporate governance (2002) in South Africa advocated for an integrated approach to good governance, in the interest of a wide range of stakeholders having regard to the fundamental principles of good financial, social, ethical and environmental practice. The Kenya Private Sector Governance Trust (1999) defined governance as the manner in which power is exercised in the management of economic and social resources for sustainable human development.

The common feature in CG is that organizations are entrusted with investors' resources, earmarked for certain outcomes. The investors are interested not only in the outcomes achieved, but also in the processes used by those in positions of power to achieve them. The law gives organizations the mandate to carry out business transactions but also protect investors, rules come from different sources, including the constitution, enacted laws, ratified international conventions and laws, professional bodies, stock exchange regulations and accounting standards. (Shleifer, Vishny, Porta & Lopez-de-Silanes, 2000). Organizations must thus develop, implement, monitor and revise internal processes, policies and procedures that enable it to achieve the goals of maximum returns to its shareholders and also meet compliance requirements bestowed on it. Good corporate governance is applicable to all organizations; for profit, private, public, not for profit or small, medium and large to ensure that organizational goals and mission are realized through good stewardship of resources. Onyango (2009) acknowledged that organizations operate in complex and dynamic business environments that require complex, but flexible, governance regulation reflecting the uniqueness of each situation arising from specific factors such as legal and financial systems, culture, corporate ownership structures and economic conditions. No single set of governance rules fits all firms and situations, governance should be understood in different contexts.

In for profit organizations, shareholders incur agency costs (Jensen and Meckling, 1976) including monitoring, bonding and residual losses to control activities of managers. Agency contracts provide for performance related financial rewards to encourage managers to act in the interests of shareholders. Kingoro and Bujra (2009) discovered that members' assembly is "rarely functional" in nonprofits, and boards are mainly comprised of family and friends. Donors and the government also incur costs to ensure good governance and performance. Tools used to enforce accountability include performance assessment, evaluation, reporting requirements, laws and self-regulation.

Statement of Problem

According to the OECD (2004) Cooperate Governance provides the structure for setting and attaining company objectives and monitoring and measuring performance. The board sets a framework of rules and practices by which it ensures transparency in a company's relationship with its all stakeholders defined as debt holders, customers, managers, employees, the government and society. The framework comprises contracts between the organizations and its stakeholders defining distribution of rights, responsibilities and benefits, procedures for resolving conflict regarding the relationships in the organization and a system for checks and balances to exercise control and enforce accountability.

Governance issues arising from the conduct of business of airline business by various organizations have arisen, many boards have been accused of being ineffective due to conflict of interests; the founder member is treated as the owner rather than a servant of the board (Kenya Aviation Manual, 2001). Lack of distinct governance roles, ineffective supervision of staff, and board remuneration have also been raised as the key issues facing the airline industries. This is according to The Reporter newspaper of Tanzania quoting the African Airline Association Secretary General Dr. Elijah Chingosho when asked the challenges facing African Airlines during an interview published on 10th September 2011.

A number of studies have been done in the NGO sector in Kenya (Kingoro and Bujra, 2009; Kameri-Mbote, 2000) as well as on the issue of CG (Keitany, 2009; Naibo, 2006; Nyaga, 2007; Gustavson, Kimani and Ouma, 2005). These studies focused on contribution of non state actors to development and regulatory framework for NGO's and CG structures in corporate and public sectors. The researcher did not find documentary evidence of studies on CG structures and performance of airline industry in the East Africa region. The researcher therefore decided to study CG structures in the context of the aviation industry in East Africa, to fill this gap. This study sought to address the question: What is the relationship between CG structures and performance of the airline industry in East Africa?

From the research, it was established that the airlines that have proper CG in place performs better and the converse is true. For example, Kenya Airways has since become one of the well recognized international airlines in this part of Africa. The Kenya Airways history points to an airline that has a future since it has good CG in place. The story has it that before privatization, the head of state could ask for an aircraft to travel to London in the last minutes and then the booked passengers had their flight cancelled and this made many potential passengers to stop using the airline. The practice today is that when the head of state wants to use the airline for his travel, the state pays like any other passenger and any other inconvenience to passengers is also paid for.

Objectives of The Study

1. To Establish the effect of owner`s/stakeholders on the organizational performance of East African Airline industry
2. To establish whether Board establishment and functions affect the organizational performance of East African Airline industry
3. To establish whether management training and qualifications affect the organizational performance of East African Airline industry
4. To determine whether Regulatory framework affects the organizational performance of East African Airline industry

Literature Review

Stakeholder theory (Freeman, 1984) proposes that companies should serve the interests of a number of groups; not only that of shareholders. This approach is broad; it articulates management policies and attends to diverse stakeholders. Organizations should acknowledge their legal and moral obligations to all legitimate stakeholders; equity holders who need returns, employees who need safety and job security, customers who deserve quality and fairly priced products, creditors who need assurance that their obligations will be met, suppliers who need payment regularly and in a timely manner, regulatory bodies who enforce laws and the community who care not only for products but organizations which are also socially responsible.

Stewardship theory (Donaldson and Davis 1994) argued that managers diligently apply resources to achieve higher profits and maximum shareholders returns. It argues that managers are not only self interested but are also capable of positive actions; they have a need for achievement and internal satisfaction, and will improve their performance in their role as stewards of organizational resources to meet these needs. The Managers' motives are aligned with the interest and objectives of stakeholder groups in the organization; they protect shareholder interest and make decisions that maximize the value of their investment and to desist from substituting collective stakeholder interests with individual self-serving interests.

According to Mallin (2010) CG is a universal concept which though fairly recent in usage, is based on older theories underlying its development. These theories explain the nature of relationships in CG, and how these relationships can be managed within internally generated policies and externally imposed rules and regulations to achieve the intended performance goals and objectives.

Jensen and Meckling (1976) viewed an organization in regard to the relationship between the principal (owners), who delegate decision making power to an agent (managers). Conflicts arise when managers pursue activities that are detrimental to the interests of shareholders. Under this theory, managers should only be concerned with shareholders interests when making decisions. Managers are also presumed to be inclined to make decisions that increase their influence and power, ignoring the interests of the shareholders. Owners incur agency costs such as bonus payment; audits to monitor managers, these costs reduce the value of the firm since the shareholders have to write near perfect contracts to monitor the actions of managers.

Aldrich and Pfeffer (1976) advanced the view that organizations are not able to internally generate all the resources or functions required to maintain themselves, they must therefore develop relationships with elements in the outside environment to obtain the required resources and services. Internal systems that satisfy the demands of both internal and external resource providers must therefore to put in place, organizations are therefore active participants capable of change or adaptation to shifts in environment dynamics.

Resources give organizations power, which changes relationships by prioritizing shareholders interests, working towards increasing their value and revising compensation practices to improve performance and share price. New tactics are employed to manage dependence through better investor relations.

Research Design and Methodology

This study was carried out through a cross sectional descriptive survey. The population for this study was all airline operators registered in the East Africa region. There are 32 airline operators in the East African region. Given the small number of players in this industry the researcher considered all of them and no need of sampling hence the population was the sample. To achieve the objective of establishing CG structures, the mean and standard deviation were used. To meet the objective of determining the effect of the CG structures on the organizations' performance, the relationship between the independent variables, corporate governance structures and the dependent variables, performance were tested using regression analysis under the multiple regression equation; $Y= \alpha+\beta_1X_1+ \beta_2X_2+ \beta_3X_3$ Where; Y is the variable being predicted (performance); A is the y-intercept (where performance is zero); X_1, X_2, X_3 are the predictor variables in the equation (CG structures), and $\beta 1$, β_2, β_3, are the regression coefficients.

Regression Analysis

The research study wanted to establish the relationship between the performance of the East African Airline Industry and various corporate governance structures. In meeting organization objectives, the research findings indicated that there was a very weak positive relationship (R= 0.554) between the variables. The study also revealed that 30.7% of performance in the East African Industry could be explained by the various corporate governance structures in place. From this study it is evident that at 95% confidence level, the variables produce statistically significant values for this study hence can be relied on to explain performance of the East African Airline Industry. The findings are as shown in the Table 1.

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.554	.307	.163	.66879

From this study it was evident that at 95% confidence level, the variables together produce statistically significant values for this study (high t-values, $p < 0.05$. Positive effect was reported for all the independent variables (β= .156, β= 0.069, β= 0.258 and β= 0.192) for owners/stakeholders, board establishment, management and regulatory framework corporate organization structures respectively.

Table 2: Coefficients of Determination

Model	Unstandardized coefficients		Standardized coefficients		
	B	Std. Error	Beta	T	Sig.
(Constant)	1.068	.823		1.298	.203
Owners/ Stakeholders	.131	.138	.156	.947	.350
Board establishment and functions	.080	.198	.069	.403	.690
Management	.299	.232	.258	1.289	.206
Regulatory framework	.148	.131	.192	1.123	.269

The results of the regression equation below shows that for a 1- point increase in the independent variables, meeting organization objectives is predicted to increase by 1.068, given that all the other factors are held constant. The equation for the regression model is expressed as:

$Y_1 = a_1 + \beta_{10}X_1 + \beta_{20}X_2 + \beta_{30}X_3$

$Y_1 = 1.068 + 0.131X_1 + 0.080X_2 + 0.299X_3 + 0.148X_4$

Where

Y_1=Organizational Performance (Meeting Organizational Objectives)

X_1 = Owners/ Stakeholders

X_2 = Board establishment and functions

X_3 = Management

X4 = Regulatory framework

Meeting the Needs of Stakeholders

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.608	.370	.295	.59317

In meeting the need of the stakeholders, the research findings indicated that there was a strong positive relationship (R= 0.608) between the variables. The study also revealed that 37.0% of performance in the East African Industry could be explained by the corporate governance structures in place. From this study it is evident that at 95% confidence level, the variables produce statistically significant values for this study hence can be relied on to explain performance of the East African Airline Industry. The findings are as shown in the Tables 3.

Table 4: Coefficients of Determination

Model	**Unstandardized coefficients**		**Standardized coefficients**		
	B	Std. Error	Beta	T	Sig.
(Constant)	.864	.730		1.184	.245
Owners/ Stakeholders	.040	.122	.050	.329	.744
Board establishment and functions	.353	.175	.319	2.016	.052
Management	.422	.206	.376	2.052	.048
Regulatory framework	-.019	.117	-.025	-.162	.872

From this study it was evident that at 95% confidence level, the variables together produce statistically significant values for this study (high t-values, $p < 0.05$. Positive effect was reported for owners/ stakeholders, board establishment and functions, and management corporate governance structures respectively (β= .050, β= .319 and β= .376). However negative effect was reported for regulatory framework (β= -.025). The results of the regression equation below shows that for a 1- point increase in the independent variables, meeting needs of stakeholders is predicted to increase by .864, given that all the other factors are held constant. The equation for the regression model is expressed as:

$$Y_2 = a_2 + \beta_{11}X_1 + \beta_{21}X_2 + \beta_{31}X_3$$
$$Y_2 = 0.864 + 0.040X_1 + 0.353X_2 + 0.422X_3 - 0.019X_4$$

Where:

Y_2=Organizational Performance (Meeting Needs of stakeholders)
X_1 = Owners/ Stakeholders
X_2 = Board establishment and functions
X_3 = Management
X4 = Regulatory framework

Compliance with the Law and industry rules and regulations

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.554	.307	.225	.72232

In compliance with the law and industry rules and regulations, the research findings indicated that there was a relatively strong positive relationship (R= 0.554) between the variables. The study also revealed that 30.7% of performance in the airline industry could be explained by the corporate governance structures in place. From this study it is evident that at 95% confidence level, the variables produce statistically significant values for this study hence can be relied on to explain performance of the airline industry in East Africa.

Table 6: Coefficients of Determination

Model	**Unstandardized coefficients**		**Standardized coefficients**		
	B	Std. Error	Beta	T	Sig.
(Constant)	.759	.889		.854	.399
Owners/ Stakeholders	.007	.149	.008	.047	.962
Board establishment and functions	.072	.213	.056	.337	.738
Management	.591	.251	.454	2.359	.024
Regulatory framework	.102	.142	.119	.722	.475

From this study it was evident that at 95% confidence level, the variables together produce statistically significant values for this study (high t-values, $p < 0.05$. Positive effect was reported for all the independent variables (β= .008, β= .056, β= .454 and β= .119) for owners/stakeholders, board establishment, management and regulatory framework corporate organization structures respectively.

The results of the regression equation below shows that for a 1- point increase in the independent variables, compliance with regulatory framework is predicted to increase by .759, given that all the other factors are held constant. The equation for the regression model is expressed as:

$Y_3 = a_3 + \beta_{12}X_1 + \beta_{22}X_2 + \beta_{32}X_3$
$Y_3 = 0.759 + 0.007X_1 + 0.072X_2 + 0.591X_3 + 0.102X_4$

Where:
Y_3=Organizational Performance (Compliance with law and industry laws and regulations)
X_1 = Owners/ Stakeholders
X_2 = Board establishment and functions
X_3 = Management
X4 = Regulatory framework

Conclusions

From the study findings it can be concluded that corporate governance structures play a great role in enhance the performance of the East Africa airline Industry. Majority of the organizations in the East Africa Airline Industry shared progress reports with stakeholders on a regular basis and that they had put in place documented systems, policies and procedures to guide their operations to a great extent. Further, they had aligned their projects to meet the needs of the shareholders. The various management aspects had influenced corporate governance structures in their respective organizations with the program managers job description, formal performance evaluation, program manager implementation, and handling of queries by the program manager scoring high. This conclusion is supported by the various descriptive and inferential statistics as shown.

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