THE EFFECT OF EXECUTIVE COMPENSATION ON FINANCIAL PERFORMANCE OF LISTED COMMERCIAL BANKS IN KENYA

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NOVEMBER, 2018

DECLARATION

This project is my original work and has not been presented for a degree in any other university.

Signed…….……

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This project has been submitted for examination with our approval as university supervisors.

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DEDICATION

I dedicate this project to God, my parents Mr. and Mrs. Mutua, my sister Esther Kahuko and my niece Silantoi for their encouragement and support throughout the study period and in this project.

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I thank my supervisor Dr. Winnie Nyamute, for her unabridged attention, guidance and patience throughout the study.

LIST OF ABBREVIATIONS

CBK	Central bank of Kenya
CEO	Chief Executive Officer
CMA	Capital Markets Authority
NSE	Nairobi Securities Exchange
ROA	Return on Asset
ROE	Return on Equity

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ABSTRACT

Economic theory of executive pay has focused on the design of optimal compensation schemes to align the interests of managers and shareholders. Agency theory has identified several factors by which these interests may differ; including the level of effort exerted by the manager and problems resulting from the unobservabilty of the agent's relevant skills. This study examined the relationship between executive compensation and firm performance among the commercial banks listed at the Nairobi Stock Exchange. The study considered functional form relationship between the level of executive remuneration and accounting performance measures by using a regression model that relates pay and performance. The main objective of this study was to determine the effect of executive compensation on financial performance among listed commercial banks in Kenya. The study adopted descriptive research design. The target population comprised of the eleven commercial banks listed at the Nairobi securities exchange as at December 2017 as indicated in CMA bulletin 2017. The study employed secondary data extracted from audited financial statements and annual reports of individual listed commercial banks over the 6-year period, 2012 to 2017. STATA was used to tabulate and analyze the data. Percentages, means and frequency distribution tables were used to describe the data. Relationships between the independent and dependent variables were established by means of regression. The study established that executive annual bonuses, executive fixed salaries, executive allowances had a positive effect on financial performance of listed commercial banks while executive share ownership had a negative effect on the financial performance of the listed commercial banks in Kenya. Annual fixed salaries, firm size and capital structure has statistically significant effect on financial performance. Annual bonuses, executive allowances and executive share ownership did not show statistically significant influence on financial performance of listed commercial banks in Kenya. The study recommends that top management of listed commercial banks in Kenya should improve on executive compensation even though some of the variant of compensation may not improve financial performance that much.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Executive compensation has been an ever-ending highly controversial issue in most parts of the world especially Europe and USA. In Kenya it is just a matter of time before the new rules on disclosure of executive remuneration components by CMA and also the CBK rules to cap salaries of the executives to the size of their operations become a reality and opens up otherwise outrageous compensations earned by listed corporation's executives to the general investing public and to the increasingly watchful financial press (Gerakos, Ittner, & Moers, 2012).

Various theoretical foundations support executive compensation and financial performance. The current study is based on three theories including Agency Theory, Stakeholder Theory and Tournament Theory. The First theory to be considered was Agency Theory proposed by (Jensen & Meckling, 1976). Theory argues that Pay levels for executives are majorly founded on available estimation of executives' management skills. The second theory was Stakeholder Theory that argues that managers in firms have a web of groups they are serving (Clarkson, 1995). Finally, the study is based on Tournament Theory that demonstrates progresses pay gap between employees (players) in one rank and the following higher rank would be expansive and more noteworthy than their marginal product, therefore, giving the incentives to the challengers in the game to give a valiant effort in the company (Milgrom & Roberts, 1988).

This study was informed by otherwise outrageous benefits management takes home at the expense of creating shareholder wealth that is the most important and widely accepted goal of the firm in finance literature. As indicated by Crystal (2011), pay paid to the best officials

of traded on an open market enterprise is a politically touchy region with commentators asserting that sums paid to administrators are too high. The levels of pay in the sum total of what nations have been rising drastically over the previous decades. In addition to the fact that it is increasing in supreme terms, yet in addition in relative terms. Gabaix & Landier (2008) established that the compensation of other senior executives has risen more rapidly than that of rank and file workers but has not kept pace with CEO pay.

1.1.1 Executive Compensation

Executive compensation is pay gotten by an officer of a firm, frequently as a blend of pay, rewards, and offers of as well as call alternatives on the organization stock (Bebchuk & Grinstein, 2015), paid costs (advantages) or protection. It alludes to the advantages and compensation collecting to top administration of a partnership generally the Board of Directors including the CEO. The different segments of executive compensation incorporate an essential pay, reward, investment opportunities, and allow of offers, annuity, severance pay and perquisites however the last three have not been covered extensively in literature and have been camouflaged in most executive compensation contracts (Kuhnen & Zwiebel 2012).

Adeoti & Isiaka (2016) noted that the goal of executive compensation is to hold, attract and maintain highly qualified executives in the organization. Executive compensation that is utilized together with executive pay or compensation involves pay and motivator pay. Motivating force pay could comprise of money and non-money bundles, and is a viewpoint in back and bookkeeping that is yet to pick up domination in research particularly in creating nations like Kenya.

1.1.1 Financial Performance

This is a proportion of the degree the enterprise has achieved its objectives and targets subsequently addressing the necessities everything being equal and particularly investors. As per Dunegan, Uhl-Bien & Duchon (2012) financial performance is the monetary related state of a firm in a given time, which is otherwise called financial stability. The factors against which financial performance can be estimated could be accounting based or market based. These may appear as outright figures, proportions and portrayals of different conditions among the execution parameters (Ongore & Kusa, 2013).

Accounting based measures are effectively figured and gotten from the money related announcing process like the profit before assessment, income after expense, income per share, return on resources, return on equity etc., however caution should be applied to guard against manipulation of the financial statements by management in a bid to overstate their earnings (Jha & Hui, 2012). Executive compensation consultant with Towers Perin, Canada, accounting based measures is result based, considers both revenue, expenses and determine the investments needed to generate profits. Market based measures are premised on facts and information released to the market by the corporation and other market players like analysts. It tends to be less susceptible to manipulation though it depends to some extent on the accounting-based measures e.g. share prices, dividends (Dutta & Bose, 2007).

1.1.3 Financial Performance and Executive Compensation

Affiliated investigations on executive compensation and performance have yielded blended outcomes. The executives who oversee operations in the organization ought to be paid literally well so as persuade such talented directors to stay with the firm who was in turn empower the firm to accomplish its targets and objectives in the long haul. Murphy

(2011) gives a general review of the philosophy behind compensation of executives, beginning from the compelling empirical investigation by Jensen & Murphy (1990), that initially recognized that the relationship between compensation and firm performance baffles and noted that their minimal connection if any on the association between employee's performance and executive pay.

A study by Izan, Sidhu & Taylor (2011) has confirmed the low pay performance sensitivities. Most empirical studies have discovered a direct association between performance and money compensation as far as productivity measures is concerned. The motivation behind executive compensation is to draw in and hold talented work. It likewise urges workers to act as per every one of the partners' wants and along these lines lessen conceivable irreconcilable circumstances inside the association. Executive compensation ought to be composed in a way that influences workers decidedly and ought to satisfy three criteria as indicated by Dechow, Huson & Sloan (2014). The executive compensation ought to be focused as far as size to pull in and keep the best workers; Incentive projects conveyed and reinforce the principle goals of the organization by joining adaptable compensation to performance; Flexible compensation supported a performance situated corporate atmosphere by watching and remunerating great performance.

1.1.4 Listed Commercial Banks in Kenya

Annual report by Central Bank of Kenya (2017) shows that there are some forty-three licensed commercial banks in Kenya. Three of the banks are public financial institutions with majority shareholding being the Government and state corporations. The rest are private financial institutions. Of the private banks, 27 are local commercial banks while 13

are foreign commercial banks (CBK, 2012). However, our study adopted 11 banks that are listed at the Nairobi Securities Exchange.

On a wider scale using a cross industry comparison the financial sector and specifically the listed banks have the highest cash compensation to its executives among the listed companies at the NSE and also across the whole economy due to the specialized skills required and also the high risk as a result of operating in a highly regulated environment and this is according to PWC CEO Survey, 2013; Grant Thornton Financial Executive ,Compensation Survey, 2012 and Central Bank of Kenya report, 2012.

Further, as indicated on the yearly reports of listed firms, CEO pay in the Kenyan listed banks can be partitioned into pay rates, recompenses, money rewards and charges for administrations as executives. Another key benefit accorded to bank executives is the access to credits with commercial banks making advances to their executives in what is referred to as insider loans. The report also details the participation of executives in stock ownerships plans that is aimed at making the executive part and parcel of the ownership of the firm such that they take on projects that promises to improve the net worth of the shareholder and in turn improve their own incomes and wealth inform of dividends and appreciation in share prices from retained earnings (Muriuki, 2015).

1.2 Research Problem

Executive compensation is one of the central points that can affect firm performance (Ayodele, 2012). Frequently, studies have not really been done to disentangle how best executives that direct the issues of an organization ought to get compensated and different types of compensations they deserve. Henceforth Adeoti & Isiaka (2006) contended that

the goal of executive compensation is to draw in, persuade and hold great individuals for fulfillment of the hierarchical performance. Executive compensation that is conversely utilized with executive pay or compensation involves pay and motivating force pay. Motivating force pay could comprise of money and non-money bundles, and is an angle in finance and accounting that is yet to pick pace in research literature particularly in developing nations like Kenya.

From the reporting by the Central bank of Kenya after extended audit of the operations of Chase Bank that collapsed on the 7 of April 2016, the Audit pointed towards poor governance of the bank. To illustrate the severity of these governance issues, the bank made large amount of loans to its directors, an average of ksh 1.35 billion per director. Therefore in this case a question arised as to how could a SME bank, allow its directors to lend tens of millions of shilling to themselves? It can therefore be said that some of this bank failures is as a result of executive staff behaviour like giving themselves high loans which they never repay or even giving themselves very high salaries of even been involved in some fraud activities.

Several studies exist globally on the association between performance and compensation of executive directors of a company. Westman (2014) found that managerial ownership had an inverse association with banks' performance. Armstrong & Vashishtha (2012) showed that the improved bonuses to the executive managers leads to improved financial performance of the companies demonstrating managerial effectiveness. Fahlenbrach & Stulz (2011) demonstrated that banks offering higher compensation and that have a larger proportion of their remuneration in monetary form to their chief executive officers did not

perform more awful amid the global meltdown experienced in the United States and other countries globally.

Locally, a number of studies also exist on the issue of the nexus between performance and executive remuneration. Ongore & K'Obonyo, (2011) established a direct association between stock ownership and financial performance of firms. Lishenga (2011) noted that insider stock ownership reduces with deteriorating firm financial performance as CEO compensation is insensitive to firm performance. Gathua, Ngumi & Kiragu (2013) established that directors pay has statistically insignificant association with Kenyan commercial banks financial performance. Ongore (2011) carried out a study using quantitative method about share ownership in Kenya and in his study the stockholders have the power and motivation to nearly screen the performances of the management while noting that executive staff should be allowed to own some number of shares for themselves so that they can feel as part of the company and make decisions that increases the value of the company.

However, even with studies already done both globally and locally, scholars failed to produce conclusive evidence on relationship between financial performance and executive compensation. Additionally, few researches exist in Kenya devoted to association between financial performance and executive compensation of commercial banks that are listed at the NSE in Kenya. This study therefore sought answers to the question: what is the effect of executive compensation on financial performance of listed commercial banks in Kenya?

1.3 Research Objective

The objective of the study was to determine the effect of executive compensation on the financial performance of listed commercial banks in Kenya.

1.4 Value of the Study

The study will assist in determining the components of the various executive compensation packages and their impact on financial performance for the listed commercial banks in Kenya. The study will highlight other beneficial components of executive compensation packages which have worked and have been successfully implemented in other parts of the world to varying degrees of success but with special reference to the unique circumstances and characteristics of our Kenyan banking sector and capital markets.

This study will also be of great help to other researchers who may also decide to make more studies in regard to how executive compensation positively or negatively affect the financial performance of listed commercial banks in Kenya, and thus this study will provide a gap in which other researchers may take on the research and do further researchers by providing information that the study may not have provided. Moreover, in this regard the study will provide a bases on which other research's may be carried out.

The findings of this study will help the board remuneration committees and compensation consultants in Kenya to be able to formulate executive compensation packages consistent with shareholder wealth maximization for the benefit of both management and shareholders. This study through its findings will compare with other findings from other studies and help narrow the existing research gaps still existing in the area of executive compensation and financial performance.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The chapter elaborates on the theoretical review, determinants of financial performance, empirical review and theoretical framework.

2.2 Theoretical framework

A number of theories exist in the finance literature to that underpins the concept of executive compensation. The theories include; Agency Theory, Stakeholder Theory and Tournament Theory. The theories and their relevance for the current study is elaborate in following sub sections.

2.2.1 The Agency Theory

Agency Theory was proposed by Jensen & Meckling (1976). The central issue in the Agency Theory is the manner by which it explains how to pay chief executives such that agency problem (Jensen & Murphy, 1990). Pay levels for executives are majorly founded on available estimation of executives' management skills. As remuneration is viewed as an outcome of agency issues, the subject of how to pay the executive is the principle issue tended to in these speculations. Agency issues exist in any circumstance where one group endowed with duty of undertakings to another's resource. In this agency theory, a consideration is made between two groups that is the principal and the agent. The principal is the shareholders who are concerned with their welfare and wealth maximization while the agent who are the executive managers charged with the duty taking care of the shareholders wealth (Jensen & Meckling, 1976).

Issues of agency are focal in the corporate governance writing. Chandra (2008) had perceived, insightfully, the agency issue in a traditional work titled the Wealth of Nations by contextualizing that like the stewards of a rich man, the directors are well-suited to consider regard for little issues as not their lord's respect, and effectively give themselves an administration from having it. Carelessness and abundance, accordingly, should dependably win, in the administration of the general population constrained organization that is possessed by various investors secured with restricted risk (Mackling, 1976).

Moldoveanu & Martin (2001) noted that agency issues result from unique organizational structures connected to disappointment with managerial skills and managerial integrity. Disappointment with managerial skill alludes to accidental missteps made in executing administrative obligations. These can originate from antagonistic choice in a circumstance where the principle cannot discover if the agent precisely speaks to his capacity to take every necessary action they are contracted to do. The disappointment with the integrity of the managerial staff that alludes to their tenacious conduct that lowers the value of the assets of the business. Alchian & Demsetz (1972) noted that agency theory is based on established radical Lockean idea that managers concentrates on their own personal self-interest and ignoring the well-being of the shareholders and their wealth.

As refered to by Jensen (1994), Brennan discredit the utilization of executive pay in the public eye. In this contention, economists see rational behaviour as self-intrigued, however, this proportion is not right both in a normative and positive sense. Jensen (1994) agrees that Brennan (1994) is right that individuals do not generally act to their greatest advantage yet this gives no backing for the call for suppression of incentives. Denis, Denis & Sarin

(1999) recommend that the expectations of agency theory are unsupported in occasions when management interests' conflict with those of stockholders (Lee & O'Neill, 2001).

Agency theory underpins the current study on the relationship between executive compensation and financial performance of listed commercial banks in Kenya. Agency theory argues that the relationship between the principal and the agent where the principal is the shareholders and the agent is the executive directors. To help reduce agency problem where the managers pursue their own interest different from those of the shareholders, the shareholders can use executive compensation to motivate managers to act in their own interest of wealth maximization through methods of compensation like executive stock ownership.

2.2.2 The Stakeholder Theory

Stakeholder Theory proponents argue that managers in firms have a web of groups they are serving. The stakeholders are a group of people that influences the business and are in turn influenced by business activities. The groups have interest in the business that they need satisfied by the business. The groups may include the owners, the customers, suppliers, government and local society (Harrison & Freeman, 1999). Study by the Sundaram & Inkpen (2004) noted that stakeholder theory enables a manager to evaluate different stakeholders to establish the interests of the stakeholders in the business and identify the stakeholders that are critical to the performance and long-term survival of the firm (Donaldson & Preston, 1995).

Clarkson (1995) proposed that the company has different stakeholders with interest of wealth maximization. Harrison & Freeman, (1999) holds that the management should be

in a position to evaluate different stakeholders in the business together with their interests and how they affect and are affected by the business. Donaldson & Preston (1995) argued that the management of the firm is charged with leadership and while applying their management skills, they are responsible for managing the various interests of the stakeholders such that the conflicts are reduced in the web of relationships with the company.

The Stakeholder Theory underpins the current study on the relationship between executive compensation and performance of listed commercial banks in Kenya in that the executive is expected to act in the best interest of the various stakeholders whose action determines the survival of the organization in the long run. The executive must ensure it meets the goals and interest of all stakeholders.

2.2.3 Tournament Theory

Tournament Theory advance that compensation distribution has beneficial outcomes since it advances intra team rivalry and gives an economic incentive that urges the cream to ascend to the best' of the rank-arrange tournament. The tournament theory demonstrates progresses pay gap between employees (players) in one rank and the following higher rank would be expansive and more noteworthy than their marginal product, therefore, giving the incentives to the challengers in the game to give a valiant effort in the company. The compensation gap is the prize of the tournament, which is expected to increase the higher the level of the tournament (Rosen, 1986).

Unlike the position held by defenders of Tournament Theory that compensation distribution advances intrateam rivalry and gives an economic incentive that empowers the opposition, Social Comparison Theory hold that people routinely contrast themselves and

referent others and henceforth pay distribution and equity will on the contrarily negatively influence basic decision making and cooperation. Fundamentally, these theories appear to connect varying implications to the impacts of pay distribution of the executive teams. However, many scholars over time in the span of utilization of the theory have opposed the Tournament model as encouraging unproductiveness within the organization (Milgrom & Roberts, 1988)

Inadequacies of tournament theory when connected to executive compensation is referred to by Dye (1984) & McLaughlin (1988) as; it is hard to inspire the those who have lost and the impact could be unsettling, notwithstanding it could be troublesome to executives if their performance levels are multidimensional, job advancement may not be the suitable motivation tool in light of the fact that there may not be a coordination of the abilities in one position and the other after advancement. Milgrom & Roberts (1988) refer to collusion and sabotages by the competitors as an issue when using the Tournament Theory. Competition energizes non – helpful practices, for example, overinvestment in self-advancement through office politics by the executives (Lazear, 1989).

The Tournament Theory also underpins the current study on the relationship between executive compensation and financial performance of listed commercial banks in Kenya. The Tournament Theory is relevant in that it shows that executive compensation as it inspires the those who have lost and the impact could be unsettling, notwithstanding it could be troublesome to executives if their performance levels are multidimensional, job advancement may not be the suitable motivation tool in light of the fact that there may not be a coordination of the abilities in one position and the other after advancement.

2.3 Determinants of Financial Performance

The section presents and elaborates on factors that influence financial performance in organizations. These factors are discussed in following sub sections.

2.3.1 Firm Size

Firm size has become such a routine to use as a control variable in empirical corporate finance studies that it receives little to no discussion in most research papers even though not uncommonly it is among the most significant variables. Firms of different size distinguish themselves along different observable and unobservable dimensions (Doğan, 2013). In the determination of firm, a critical element in the classification of firm size categories is the ownership structure of firms. It is necessary to treat subsidiaries of large companies that fall into the micro firm or SME categories according to their turnover or number of employees differently from independent micro firms or SMEs. In this study on effect of firm size on financial performance in the Kenyan banking industry, the bank size criterion used by Central Bank of Kenya (CBK) was be applied (He, Fayman & Casey, 2014).

2.3.2 Liquidity

Liquidity is one of the key financial stability indicators given that its shortage in one bank causes systemic crisis in the banking sub-sector due to interconnectedness. Liquidity held by listed commercial banks reflects their ability to fund increases in assets and meet their obligations (CBK, 2015). Mwangi, Makau & Kosimbei (2014) noted that liquidity is a bank's capacity to fund increase in assets and meet both expected and unexpected cash and collateral obligations at reasonable cost and without incurring unacceptable losses. Meeme (2015) suggested that liquidity an important factor of financial performance. Liquidity

measures have a significant impact on improving cost efficiency; firms with larger expenditures on purchased inputs relative to capital were less likely to improve efficiency when liquidity and solvency were considered.

2.3.3 Capital Structure

Capital structure alludes to the proportion of debt and equity financing. On the basis, that if more debt financing is used by the organization, it needs to confront liquidation risks, yet there are additional tax advantages by a firm when it finances its activities through debt financing due to tax shield that they enjoy as the business is taxed after allowance for interest charged on debt finance (Su & Vo, 2010). It additionally the firm can reduce the agency problem by decreasing the free income of the firm (Abu-Rub, 2012). If there should arise an occurrence of inside created funds, it is said that these have the most astounding open-door cost (Akbar & Baig, 2010).

2.4 Empirical Review

There exists prior research on this topic, such as the paper by Omoregie & Kelikume (2017) that analyzed whether there was a connection between executive pay and banking performnace. It attempted to add more observational proof to the relationship between executive pay and performance. The findings are that a few elements, other than the banks performance factors, determines the executive remuneration. Additionally, Mehran & Rosenberg (2016) demonstrated that executive remuneration diminishes bank leverage and found that the execution of banks performance objectives was poor when executive pay was more line up with the shareholders interest.

Croonen (2012) also examined CEO compensation and performance in banking. The results showed that both prices of share and commercial banks net income are positively associated to remuneration awarded to CEOs in banking industry. The findings indicated that compensation of CEO has an effect on performance by having a positive association to stock prices. Mutuma, (2016) was interested in establishing the association between financial performance and executive compensation of listed firms in Nairobi securities exchange in Kenya. Using 66 listed firms for a period of between 2010 to 2014. The result established that the association between director's remuneration and firm's financial performance was not statistically significant.

Westman (2014) also carried out a similar study in Europe for a period 2001 to 2002 whereby he uses quantitative method and he found that managerial stock ownership has inverse relationship with financial performance during the financial crisis in the recent time. In particular, he found a positive effect of manager's stock ownership in small-differentiated banks and non-conventional banks. K'obonyo (2011) in an evaluation contemplated in Kenya examined the interrelations among shareholders structure and firm performance level estimated utilizing bookkeeping-based measures among all organizations listed at the NSE for a period between 1998-2010. The examination finds a positive connection between insider stock ownership and firm performance.

Ongore (2011) carried out a study using quantitative method about share ownership in Kenya and in his study, the stockholders have the power and incentive to screen the performance of the firm's administration. Close monitoring of the management can diminish agency cost and upgrade firm performance. Then again, concentrated stock ownership by management can lead to problems in connection to ignoring the privilege of

the minority stockholders and furthermore influence the creativity and innovativeness of the management. The study suggest that executive staff should be allowed to own some number of shares for themselves so that they can fell as part of the company the work for, and that was make them make decisions that positively increase the value of the company the work for. Armstrong & Vashishtha (2012), carried out a study in the United States for a period 2007-2008 using quantitative method and there is empirical evidence on the impact of bonus of top organizational leadership on financial performance, their study shows that the higher the bonus the higher the performance which demonstrate managerial effectiveness.

A study by Fahlenbrach & Stulz (2011), demonstrated that banks with higher executive pay and a bigger part of remuneration in money form for their CEOs did not perform terribly amid the financial crisis in the United States. Further, banks with higher remuneration for executives and with a bigger part of pay given as money rewards did not have more awful performance amid the emergency. The motivating factor for non-CEO top directors are not connected to bank performance amid the emergency. Bank CEOs did not reduce their stock ownership when they expected economic meltdown or amid the financial crisis. There is additionally no proof that they supported their value presentation. Study thus suggest that executive staffs should be offered better and good bonuses that was make them more motivated to perform better for the company that offers them those good bonuses they enjoy, and that lead to an increase in the value of the company they manage.

2.5 Summary and Gap

This chapter is made of both the theoretical and empirical views. Under the theoretical perspective, much emphasis has been given on avoidance of risk, measuring performance and the role of the executive in decision-making. One major contribution of the theory is agency conflicts that emanates from failure by the management to consider the interest of the stakeholder and how compensation schemes influences performance of the firm. Empirical findings show reactions in different directions in that while some scholars indicate that executive pay has an association with performance of the firm. Other scholars find no connection between the two variables in the study. Rita & Njuguna (2016) established there is no association between financial compensation and financial performance of the business organization. Kutum, (2015) & Croonen, (2012) stated an existence of a positive connection between firm performance and executive compensation. Going by the findings put by various researchers, executive compensation and other benefits are considered crucial in influencing firm performance.

2.6 The Conceptual Framework

Conceptual framework shows the diagrammatical relationship between the major variables of the study. The figure 2.1 shows the conceptual framework that was adopted by the study.

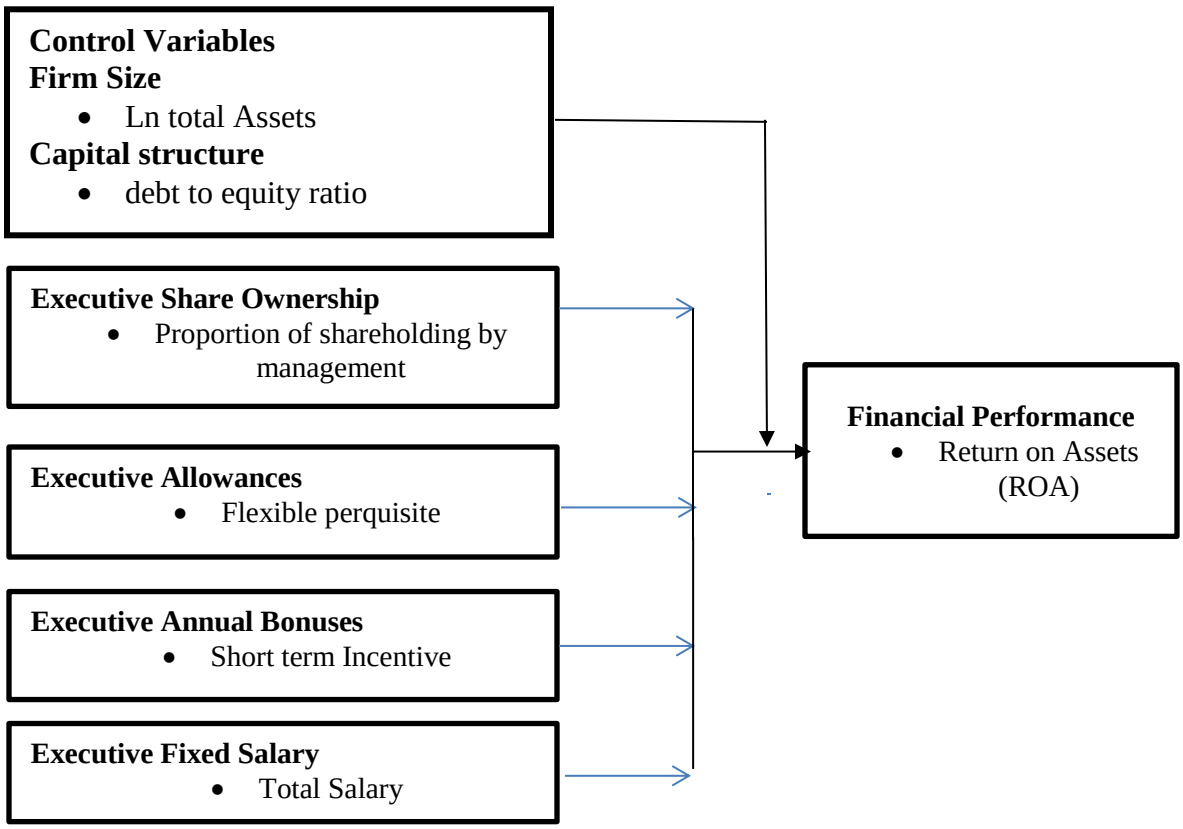

Figure 2.1: conceptual framework

The Independent Variable is executive compensation measured by executive share ownership, executive allowances, executive annual bonuses and executive fixed salary while the Dependent Variable is financial performance measured through Return on Assets. The Control Variables are Firm Size and Capital Structure.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter specifically elaborates on the research design, target population, sampling, data collection and data analysis to be adopted in the process of carrying out the study. The chapter expounds on how the researcher went about in carrying out the study and how the data was collected and analyzed. The design is a road map of how the study progressed from start to completion.

3.2 Research Design

This examination embraced a descriptive research design. As reported by Mugenda & Mugenda, (2003), descriptive research is a kind of research design that is used when the researcher mealy wants to present facts as they are without manipulation of the facts.

3.3 Population

The population of the current study contained the eleven listed commercial banks that have floated shares at the Nairobi securities exchange as at December 2018 as indicated in CMA bulletin 2018. The eleven listed commercial banks chosen as the unit of study due to nature of their operations as they tend to offer new product in the market. In addition, the same banks were chosen because of ease of getting information.

3.4 Sample

Kothari (2004) characterized sample as a subset of the population. The sample size for this empirical examination contained all the 11 listed commercial banks in Kenya as at 31st December 2017 (NSE, 2017). The study used a census that in this case the method used because it involves an exhaustive enumeration of the units constituting the target

population according to (Kothari, 2004). Since the target population comprised 11 commercial banks listed in NSE, a census of all the firm's study was conducted for the study.

3.5 Data Collection

The study employed secondary data that was extracted from audited financial statements and annual reports of individual listed commercial banks over the 6-year period, 2012 to 2017. Collection of data was accomplished by means of the secondary data collection instrument. The instrument aided in collection of data relating to executive share ownership, executive fixed salary, executive allowances, and executive annual bonuses was collected. Using the data collection instrument, the information on specific components were keyed in for each firm for every year.

3.6 Data Analysis

Data collected was sorted, classified and collated. The data was then entered into excel 2016 and exported to STATA 14 computer software. Statistical analysis generated by the aid of the software included Descriptive and inferential statistics. Descriptive statistics involved measure of central tendency and dispersion while inferential statistics took the form of regression and correlation analysis. Regression analysis was used to test the impact of executive compensation on financial performance of listed commercial banks in Kenya. The effect was examined at 95% confidence level while employing student t test.

3.6.1 Model Specification

Model specification involved coming up with a combination of study variables represented the empirical relationship between the dependent and explanatory variables.

$Yit = \alpha + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{4it} + \beta_5 X_{5it} + \beta_6 X_6 it + \mu it$..... (1)

Where: Yit =financial performance

α = the Y intercept;

X_1- X_4 Independent Variables

X_5-X_6 Control Variables

X_{1it}= executive share ownership measured by Executive Share Ownership/total number of shares of the bank.

X_{2it}= executive allowance measured by executive allowance/ total operating expenses of the bank.

X_{3it}= executive annual bonuses measured by executive annual bonuses/ total operating expenses of the bank.

X_{4it}= executive fixed salary Measured by executive fixed salaries/ total operating expenses of the bank.

X_5it = capital structure measured by ratio of debt to equity of the bank

X_6it = Firm size measured by Natural Logarithm of total Assets.

μit= error term which is assumed to be normal in distribution with mean zero and variance.

3.7 Diagnostic Test

The data was subjected to diagnostic tests to evaluate conformity with multiple regression model assumptions. This would ensure validity of the results. The study employed

normality, heteroscedasticity, multicollinearity, serial correlation and unit root diagnostic tests.

3.7.1 Normality Test

The test is conducted to test whether data exhibits a normal distribution. Non-normal distributed data may not display the correct relationship between variables studied (Garson, 2012). The study employed Shapiro-Wilk test of normality. Fifty or less sample size are not suitable for the test. The choice of this test was informed by the small number of samples to be studied. Normal data have p-value greater than the Shapiro-Wilk test significance value in the statistical test (0.05). On the other hand, data with significance value less than 0.05 are not normally distributed.

3.7.2 Heteroscedasticity Test

Gujarati (2003) described heteroscedasticity as lack constant error variance. The study used Modified wald test was used to test for heteroscedasticity. The null hypothesis in the test is that error terms have a constant variance (i.e. should be Homoscedastic). There is no heteroscedasticity if the significance values are greater than the P-value statistics test of 0.05.

3.7.3 Multicollinearity

Kothari (2004) postulates that multicollinearity exists if there is an association of independent variables. Therefore, independent variables ought to be linearly independent of each other. Cooper & Schindler (2006) asserts the existence of multicollinearity leads to invalid significance tests due to the distorted regression coefficients. The study employed Variance Inflation Factor (VIF) to test the existence of multicollinearity. If VIF is less than 5, then there is no existence of multicollinearity (Gujarati, 2003).

3.7.4 Serial Correlation

Gujarati (2003) posit that serial correlation exists if an error term of one period is correlated with that of subsequent periods. The study used Wooldridge Drukker test to test existence of autocorrelation. Data has no serial correlation if P value is greater than the 5% level of significance.

3.7.5 Unit Root Test

Unit root test is conducted to ensure that the variables are stationary. Gujarati (2003) posit that a data has no unit roots if the variance, autocorrelation and mean of the data structure do not vary with different time periods. Wooldridge (2012) asserted that stationarity ensures that the regression results are not spurious thereby guaranteeing robust regression results. The study employed Augmented Dickey Fuller (ADF) unit root test to evaluate the availability of unit roots in the data. If P-Value is greater than 5% level of significance, it implies the data is not stationary i.e. availability of unit roots.

CHAPTER FOUR: RESULTS AND DISCUSSION

4.1 Introduction

This chapter presented the results from analysis and the findings with regard to the study objectives. In addition, the following were presented in the chapter; data analysis and presentation, descriptive statistics, diagnostics tests; Multicollinearity test, panel unit root tests, normality tests, Heteroskedasticity, Autocorrelation and Hausman test. Secondary data was obtained from financial statements. To achieve this, the study employed a panel data approach and analyzed the effect of executive compensation on financial performance of listed commercial banks at the Nairobi Securities Exchange during the period 2012 to 2017

4.2 Descriptive Results

Results in table 4.1 below indicate the summary descriptive statistics of executive compensation and financial performance of listed commercial banks in Kenya. The mean for Financial performance was Mean of .04505, executive share ownership in relation to total shareholding had a mean of .0411811 while executive fixed salary in relation to total operating expense posted a mean of .01227, results also indicated that executive allowance in relation to total operating expense had a mean of .0417974, mean firm size was 18.39876, mean capital structure was .529697 and finally executive annual bonus to total operating expense mean was 0.0418.

The Std. Dev. for Financial Performance was .0171271, the standard deviation for executive share ownership to total shareholding was .0712863, executive fixed salary to total operating expense had a standard deviation of .0077563, standard deviation for

Executive Allowance to total operating expense was .0153824 and finally, standard deviation for firm size was .5820746, standard deviation for capital structure was .1775298 and finally the standard deviation for Executive annual bonuses to total operating expense was .0327412.

Executive allowance to total operating expense posted minimum of .000641, Executive share ownership to total shareholding had a minimum of 8.37e-06, Executive Fixed salary to total operating expense had a minimum of .000754, Financial Performance had a minimum of -.0134 and results for executive annual bonus to total operating expense had a minimum of .003974, minimum for firm size was 17.04326 and the minimum for capital structure was .13.

The maximum for financial performance was .077, executive share ownership to total shareholding had maximum of .2056566 while executive fixed salary to total operating expense posted a maximum of .038119, results also indicated that executive allowance to total operating expense maximum was .097318, Maximum for firm size was 19.55877, maximum for capital structure was .86 and finally executive annual bonus to total operating expense maximum was .13797

Table 4. 1: Summary Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
stockowner~p	66	.0411811	.0712863	8.37e-06	.2056566
Allowances	66	.01227	.0153824	.000641	.097318
bonuses	66	.0417974	.0327412	.003974	.13797
fixedSalary	66	.0056266	.0077563	.000754	.038119
FirmSize	66	18.39876	.5820746	17.04326	19.55877
CapitalStr~e	66	.529697	.1775298	.13	.86
ROA	66	.04505	.0171271	-.0134	.077

4.3 Panel Data Specification Tests

To determine the suitability of the panel data for statistical analysis, various tests were conducted. The tests that aimed at establishing if the panel data fulfilled the cardinal requirements of classical linear regression analysis included: normality test, panel unit root test, multicollinearity test, panel-level heteroscedasticity test, hausman test as well as serial correlation test. Where violation to these assumptions were detected, appropriate remedies were applied. This section therefore presents the results of various diagnostic tests carried out on the data together with the relevant remedial treatment undertaken to ensure suitability of the data.

4.3.1 Multicollinearity Test

According to Field (2009) VIF values in excess of 10 is an indication of the presence of Multicollinearity. The results in Table 4.2 present variance inflation factors results and were established to be 1.23 which is less than 10 and thus according to Field (2009) indicates that there is no Multicollinearity.

Table 4. 2: Variance Inflation Factor

Variable	VIF	1/VIF
stockowner~p	1.41	0.709089
CapitalStr~e	1.31	0.761426
Allowances	1.20	0.834676
bonuses	1.19	0.837850
fixedSalary	1.19	0.839473
FirmSize	1.10	0.908186
Mean VIF	1.23	

4.4.2 Panel Unit Root Tests

Most economic variables are usually non-stationary in nature and prior to running a regression analysis. Unit root tests were thus conducted using the LLC test to establish whether the variables were stationary or non-stationary. The purpose of this is to avoid spurious regression results being obtained by using non-stationary series. Results in Table 4.3 indicated that all variables are stationary (i.e. absence of unit roots) at 5% level of significance

Table 4. 3: Unit Root Test

Variable Name	Statistic(Adjusted)	P-Value	Comment
Financial Performance	-9.1936	0.000	Stationary
Executive Share Ownership	-25.2806	0.000	Stationary
Executive fixed Salary	-14.6408	0.000	Stationary
Executive Allowances	-18.2333	0.000	Stationary
Executive Bonus	-32.3135	0.000	Stationary
Firm size	-24.1200	0.000	Stationary
Capital Structure	-20.0034	0.000	Stationary

4.4.3 Heteroscedasticy Test

Modified wald test was used to test for heteroscedasticity. The null hypothesis in the test is that error terms have a constant variance (i.e. should be Homoscedastic). The results in

the Table 4.4 below indicate that the error terms are homoscedastic, given that the p-value is less than the 5% (0.000),hence the null hypothesis of constant variance was rejected.

Table 4. 4: Heteroscedasticity Test

```
================================================================================
* Ordinary Least Squares (OLS) Regression
================================================================================
  ROA = stockownership + Allowances + bonuses + fixedSalary + CapitalStructure + FirmSize
--------------------------------------------------------------------------------
  Sample Size       =          66   |   Cross Sections Number   =          11
 Wald Test          =    111.9314   |   P-Value > Chi2(6)       =      0.0000
 F-Test             =     18.6552   |   P-Value > F(6 , 59)     =      0.0000
 (Buse 1973) R2     =      0.6548   |   Raw Moments R2          =      0.9570
 (Buse 1973) R2 Adj =      0.6197   |   Raw Moments R2 Adj      =      0.9526
  Root MSE (Sigma)  =      0.0106   |   Log Likelihood Function =    210.3848
--------------------------------------------------------------------------------
- R2h= 0.6548   R2h Adj= 0.6197  F-Test =   18.66 P-Value > F(6 , 59)  0.0000
- R2v= 0.6548   R2v Adj= 0.6197  F-Test =   18.66 P-Value > F(6 , 59)  0.0000
```

ROA	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
stockownership	-.045973	.0218231	-2.11	0.039	-.089641	-.0023051
Allowances	.1268043	.0932158	1.36	0.179	-.05972	.3133287
bonuses	.0447372	.0437116	1.02	0.310	-.0427294	.1322039
fixedSalary	.7040124	.1843396	3.82	0.000	.3351496	1.072875
CapitalStructure	-.0168076	.0084565	-1.99	0.052	-.033729	.0001137
FirmSize	.0177009	.0023616	7.50	0.000	.0129753	.0224265
_cons	-.2772156	.0436475	-6.35	0.000	-.364554	-.1898772

```
================================================================================
*** Panel Data Heteroscedasticity Wald Test
================================================================================
  Ho: Panel Homoscedasticity - Ha: Panel Heteroscedasticity

- Wald Test:         LogE2 = X          =  25.1200   P-Value > Chi2(1)  0.0000
--------------------------------------------------------------------------------

.
```

4.4.4 Normality Tests

Shapiro-Walk W test test which is a more conclusive test than the graphical method was conducted. The results are as presented in table 4.5. The null hypothesis under this test is that the disturbances are not normally distributed. If the p-value is less than 0.05, the null

of normality at the 5% level was to be rejected. Given that the majority of p-value were less than 5% for the residual, the null hypothesis is rejected and thus the conclusion that the residuals are normally distributed.

Table 4. 5: Shapiro-Wilk W test for normal Data

Shapiro-Wilk W test for normal data

Variable	Obs	W	V	z	Prob>z
stockowner~p	66	0.58220	24.520	6.934	0.00000
Allowances	66	0.65459	20.272	6.522	0.00000
bonuses	66	0.89759	6.010	3.887	0.00005
fixedSalary	66	0.58415	24.405	6.924	0.00000
CapitalStr~e	66	0.96840	1.855	1.339	0.09031
ROA	66	0.96528	2.038	1.543	0.06142
FirmSize	66	0.97939	1.209	0.412	0.34015

4.4.5 Autocorrelation

To establish whether the residual is serially correlated over time, Wooldridge test for autocorrelation was conducted. The null hypothesis is that no first order serial /auto correlation exists. The results are as indicated in Table 4.6 below and therefore the null hypothesis of no autocorrelation is accepted and therefore residuals are not auto correlated (p-value=0.0018).

Table 4. 6: Autocorrelation Tests

```
. xtserial ROA stockownership Allowances bonuses fixedSalary CapitalStructure FirmSize

Wooldridge test for autocorrelation in panel data
H0: no first order autocorrelation
    F(  1,      10) =     17.705
           Prob > F =      0.0018
```

4.4.6 The Hausman Test for Model Effect Estimation

The Hausman test was employed to determine the most suitable model for this study. The null hypothesis is that the fixed effect model is appropriate and the alternative hypothesis is that Random effect estimation models is suitable tested at 5% significance level. The Chi-square test statistic is 2.93 with an insignificant probability of 0.5697 which means that the null hypothesis is rejected in favor of the. Random effects model. Therefore, we accept the random effects model as suitable for this study. The Hausman test result was presented in table 4.7

Table 4. 7: Hausman Test

```
. hausman FEM .
```

	Coefficients (b) FEM	(B) REM	(b-B) Difference	sqrt(diag(V_b-V_B)) S.E.
stockowner~p	-.205357	-.045973	-.159384	.232715
Allowances	.1107253	.1268043	-.016079	.0442296
bonuses	.1452636	.0447372	.1005264	.0792214
fixedSalary	.1345881	.7040124	-.5694242	.4512678
CapitalStr~e	-.0150836	-.0168076	.001724	.0028216
FirmSize	-.0016327	.0177009	-.0193336	.003807

```
                b = consistent under Ho and Ha; obtained from xtreg
 B = inconsistent under Ha, efficient under Ho; obtained from xtreg

    Test:  Ho:  difference in coefficients not systematic

                  chi2(6) = (b-B)'[(V_b-V_B)^(-1)](b-B)
                          =       26.41
                Prob>chi2 =      0.0002
                (V_b-V_B is not positive definite)
```

4.5 Panel Regression Analysis

The regression model helps to explain the magnitude and direction of relationship between the variables of the study through the use of coefficients like the beta coefficient and the level of significance. Based on the diagnostic tests carried out the study adopted a random

effect model and the result presented was to show the fitness of model used of the regression model in explaining the study phenomena.

Table 4. 8: Random Effect Model (Without Control Variable)

```
Random-effects GLS regression                   Number of obs     =         66
Group variable: ID                              Number of groups  =         11

R-sq:                                           Obs per group:
     within  = 0.0505                                         min =          6
     between = 0.2293                                         avg =        6.0
     overall = 0.1893                                         max =          6

                                                Wald chi2(4)      =       5.35
corr(u_i, X)   = 0 (assumed)                    Prob > chi2       =     0.2531
```

Tables 4.8 indicate that the model explains 18.93% of the total variations in financial performance of listed commercial banks as shown by the coefficient of determination (R^2) value of 0.1893. The remaining 81.07% Variations financial performance is explained by other factors not included in the model. The overall significance of the model was 0.2531 with an F value of 5.35. The level of significance was greater than 0.05 and this means that executive compensation does not show statistically significant effect on financial performance of listed commercial banks.

Table 4. 9: Random Effect Model (With Control Variable)

```
Random-effects GLS regression                   Number of obs     =         66
Group variable: ID                              Number of groups  =         11

R-sq:                                           Obs per group:
     within  = 0.0030                                         min =          6
     between = 0.9519                                         avg =        6.0
     overall = 0.6548                                         max =          6

                                                Wald chi2(6)      =     111.93
corr(u_i, X)   = 0 (assumed)                    Prob > chi2       =     0.0000
```

Y	Coef.	Std. Err.	z	P>|z|	[95% Conf.	Interval]
x1	-.045973	.0218231	-2.11	0.035	-.0887456	-.0032005
x2	.1268043	.0932158	1.36	0.174	-.0558952	.3095039
X3	.0447372	.0437116	1.02	0.306	-.0409359	.1304103
X4	.7040124	.1843396	3.82	0.000	.3427133	1.065311
X5	.0177009	.0023616	7.50	0.000	.0130722	.0223296
X6	-.0168076	.0084565	-1.99	0.047	-.033382	-.0002332
_cons	-.2772156	.0436475	-6.35	0.000	-.3627631	-.1916681
sigma_u	0					
sigma_e	.00876539					
rho	0	(fraction of variance due to u_i)				

Table 4.9 shows the effect of executive share ownership on financial performance. Using random effect model. It was established that Executive share ownership had a statistically significant effect on financial performance ($\beta 1 = -.04597$, $p = .035$ and $\alpha = 0.05$). The value of $\beta 1$ measures the elasticity of financial performance to changes in stock ownership and that for every one-unit change in stock ownership, financial performance changes by .045 units in the opposite direction. The negative effect of stock ownership could be explained by the fact that share ownership by management may lead to greater risk taking that may plunge the bank into financial performance problems since the mangers loses their objectivity in chase of risky projects that may translate to poor performance.

The significant relationship should be expected since studies done by other researchers reveal similar results. Westman (2014) also carried out a similar study in Europe for a period 2001 to 2002 whereby he uses quantitative method and he found that managerial ownership had a negative impact on the banks' performance during the recent financial crisis. however K'obonyo (2011) finds contrary results in a census study in Kenya examine the interrelations among ownership structure and firm performance measured using accounting based measures amongst all firms listed at the NSE for a period between 1998-2010. The study is informed by the proposition that insider ownership is actualized through executive share options. The findings suggest a positive relationship between insider ownership and firm performance thereby affirming the proposition that when managers own shares, they become more committed to the organization since they have a stake in the residual income of the firm and they are likely to bear the costs of mismanagement.

Results show that executive allowance had a statistically insignificant effect on financial performance of listed commercial banks ($\beta 2 = .1268043$, $p = 0.174$ and $\alpha = 0.05$). The value of $\beta 2$ measures the elasticity of financial performance to changes in executive allowance and that for every one-unit change in executive allowance, financial performance changes by .1268 units in the same direction. The insignificant effect could be attributed to that fact that financial compensation like allowances may not motivate the executive directors to improve their over sight role in prudential management of commercial banks since their motivating effect is short lived. The study is in agreement with prior studies.

Doucouliagos (2007), examine the relationship between director allowances given and performance within Australian banking using panel data covering the periods of 1992 - 2005. The outcome of their work revealed the existence of a positive relationship between CEO remuneration and bank performance he used quantitative method in his study. Haid (2006) in his study carried out an investigation by analyzing the relationship between financial perfomance and executive compensation in Germany using a sample of large listed German firms between the periods of 1987 to 2003 using both qualitative and quantitative method. The results of his findings indicate that level of executive compensation in terms of allowances allocated and financial performance is weaker in firms. Ampuero, (2009) in his research examines the relationship between allowances compensation and company performance within the banking sector, using a sample of twelve banks involving Swedish and foreign banks in Sweden covering 2006 to 2008 and adopting a combination of qualitative and quantitative method, the outcome of his findings shows variables like bonuses and allowances and also salaries are not related to financial performance.

The findings show that Executive annual bonuses had a statistically insignificant effect on financial performance of listed commercial banks in Kenya ($\beta 3 = .0447372$, $p = 0.306$ and $\alpha = 0.05$). The value of $\beta 3$ measures the elasticity of financial performance to changes in executive annual bonuses and that for every one-unit change in executive annual bonuses, financial performance changes by .0447 units in the same direction. The possible explanation for this insignificant effect is that improved annual bonuses being related to annual performance of the bank and being tied to performance of the bank may motivate

the top management of the respective banks to be prudent enough and mange efficiently to improve performance such that they can receive higher allowances at the end of financial year. However, the effect was not statistically significant meaning there are other major determinants of financial performance of commercial banks and that financial compensation may not necessary motivate executive much.

The finding is in agreement with other studies like Bruce, Skovoroda, Fattorusso and Buck (2007), carried out a study on executive bonuses and firm performance in the U.K. by investigating executive bonuses for the period 2001 to 2003 using quantitative method. Their main finding demonstrated that executive bonuses are related to higher total shareholder returns. Crumley (2008) examined the relationship between firm performance and CEO compensation in the U.S. commercial banking industry using quantitative method. The sample of his study covered 36 firms in the U.S commercial banking industry for the period between 2002-2003. His results exhibited a weak relationship between CEO remuneration and firm performance. Armstrong and Vashishtha (2012), carried out a study in the United States for a period 2007-2008 using quantitative method and there is empirical evidence on the impact of bonus of top organizational leadership on financial performance, their study show that the higher the bonus the higher the performance which demonstrate managerial effectiveness. However study by Fahlenbrach and Stulz (2011), finds contrary results that banks with larger fraction of compensation in cash bonuses for their CEOs did not perform worse during the crisis in the United States. Further, banks with higher option compensation and with a larger fraction of compensation given in the form of cash bonuses did not have worse performance during the crisis.

Using panel regression analysis, it was established that executive fixed salaries had a statistically significant effect on financial performance ($\beta 4 = .7040124$, $p = .000$ and $\alpha = 0.05$). The value of $\beta 4$ measures the elasticity of financial performance to changes in executive fixed salaries and that for every one-unit change in executive fixed salaries, financial performance changes by .7040124 units in the same direction. The effect can be attributed to the fact that when banks offer more absolute fixed salaries to executive at any particular time, they are motivated to be practice prudential management however; the effect was statistically significant due to the fact that increase in fixed salaries necessarily mean the bank will translate such heavy payment as shown by fact that when directors get higher fixed salaries, they may increase time to board meetings to attend personal investments.

Other studies also show similar results. study by Conyon, Main, Bruce and Benito (2000), carried out a study regarding executive salaries in a UK firm for a period 1996-1998 using quantitative method and they realized that there is a little relationship between these variables and thus confirmed low pay-performance sensitivities. Study by Lishenga (2011) concludes that CEO remuneration is insensitive to firm performance. In Kenya, Gathua, Ngumi and Kiragu (2013) found that executive compensation has insignificant relationship with financial performance among commercial banks in Kenya. Conyon and He (2016) examined the relationship between CEO compensation and corporate fraud in China, the study found a correlation between executive compensation and fraud, the lower the executive compensation the higher the incidences of fraud. Conyon and He (2016), studied

the effect of executive remuneration, the study found that fixed pay tend to decrease after enforcement action by China Securities and Regulatory Commission.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter deals with the summary of the findings, the conclusion and recommendations. This was done in line with the objectives of the study. Areas of further research were suggested and limitations of the study were taken into account.

5.2 Summary of Findings

The study was to assess the effect of executive share ownership financial performance among the listed commercial banks in Kenya. Executive Share Ownership and financial performance are negative and significantly related. It was established that Executive share ownership had a negative statistically insignificant effect on financial performance ($\beta 1 = -.04597$, $p = .035$ and $\alpha = 0.05$). The value $\beta 1$ was negative showing that executive share ownership has a negative effect on financial performance of listed commercial banks in Kenya hence when executive share ownership changes by one unit, financial performance changes by .04597 in the reverse direction

The study was to assess the effect of executive allowance on financial performance among the listed commercial banks in Kenya. Results show that executive allowance had a statistically insignificant effect on financial performance of listed commercial banks ($\beta 2 = .1268043$, $p = 0.174$ and $\alpha = 0.05$). The value of $\beta 2$ measures the elasticity of financial performance to changes in executive allowance and that for every one-unit change in executive allowance, financial performance changes by .1268 units in the same direction. However the insignificant effect could be attributed to that fact that financial compensation

like allowances may not motivate the executive directors to improve their over sight role in prudential management of commercial banks since their motivating effect is short lived.

The study was to assess the effect of Executive annual bonuses on financial performance among the listed commercial banks in Kenya. The findings show that Executive annual bonuses had a statistically insignificant effect on financial performance of listed commercial banks in Kenya ($\beta 3 = .0447372$, $p = 0.306$ and $\alpha = 0.05$). The value of $\beta 3$ measures the elasticity of financial performance to changes in executive annual bonuses and that for every one-unit change in executive annual bonuses, financial performance changes by .0447 units in the same direction. The possible explanation for this positive effect is that improved annual bonuses being related to annual performance of the bank and being tied to performance of the bank may motivate the top management of the respective banks to be prudent enough and mange efficiently to improve performance such that they can receive higher allowances at the end of financial year. However, the effect was not statistically significant meaning there are other major determinants of financial performance of commercial banks and that financial compensation may not necessary motivate executive much.

The study was to assess the effect of executive fixed salaries on financial performance among the listed commercial banks in Kenya. Using panel regression analysis, it was established that executive fixed salaries had a statistically significant effect on financial performance ($\beta 4 = .7040124$, $p = .000$ and $\alpha = 0.05$). The value of $\beta 4$ measures the elasticity of financial performance to changes in executive fixed salaries and that for every one-unit

change in executive fixed salaries, financial performance changes by .7040124 units in the same direction. The positive effect can be attributed to the fact that when banks offer more absolute fixed salaries to executive at any particular time, they are motivated to be practice prudential management.

5.3 Conclusion of the Study

The study concludes that Executive Share Ownership has a significant influence on financial performance of listed commercial banks in Kenya. The study finds a negative significant relationship between financial performance and executive share ownership. That means even if banks increase directors share ownership it will not have any effect on financial performance. The study therefore concludes that the effect of executive share ownership was strong. The study therefore concludes that executive share ownership may lead to improved financial performance of listed commercial banks in Kenya.

Based on the findings that the effect of Executive annual bonuses had a statistically insignificant positive effect on financial performance of listed commercial banks in Kenya. The study concludes that that executive annual bonus contributes marginally to financial performance. Any improvement of executive annual bonuses should lead to improved financial performance. However, the insignificant effect could be attributed to that fact that financial compensation like allowances may not motivate the executive directors to improve their performance level and that of the company.

Based on finding that executive allowance had a statistically insignificant positive effect on financial performance of listed commercial banks. The study concludes that any improvement in executive allowance to executive directors may translate to financial

performance of listed commercial banks. However, the effect was too marginal as evidenced by the statistically insignificant influence. The management may decide to improve the allowances of the executive directors to protect them from the economic challenges hence make them motivated in their oversight role of the operations of the banks through various committees if the banks management. However, the increase in the annual allowances may not necessarily lead to major improvement in profits of the listed commercial banks.

Based on the finding that executive fixed salaries had a statistically significant positive effect on financial performance of listed commercial banks, the study concludes that any improvement in fixed salaries offered to executive directors leads to increased financial performance through improved oversight and supervisory role. The bank management may decide to improve the fixed salaries of executive managers.

Finally, the effect of executive compensation on financial performance with the effect of control variables was statistically significant however without the effect of control variables, the effect of executive compensation is statistically insignificant hence, and the study concludes that the effect of executive compensation on financial performance may not be statistically significant.

5.4 Recommendations

Based on the conclusions, a number of recommendations are made. The management of listed commercial banks in Kenya should not increase the stock ownership of executive managers as this may lead to greater risk taking that may plunge the bank into financial performance problems since the mangers loses their objectivity in chase of risky projects

that may translate to poor performance. The increase in executive share ownership should thus be controlled. Secondly, based on the conclusion that executive annual bonuses have positive effect on financial performance. The study recommends to the top management of the listed commercial banks to consider improving the annual bonuses given to executive managers. However, the bonuses should not be given much weight, as their effect on financial performance is a weak one. Thirdly, based on the findings that executive annual allowances have a positive effect on financial performance of listed commercial banks in Kenya, The study wishes to recommend to top management of the listed commercial banks to improve the annual allowances offering to executive directors. The top management of the listed commercial banks should consider improving the annual allowances to enhance financial performance of the listed commercial banks. Finally, the study wishes to recommend to the top management of listed commercial banks to consider improving the fixed salaries of executive directors of the bank. The study this may lead to major increase in financial performance of the listed commercial banks in Kenya.

5.5 Areas of Further Research

The current study sought to establish the effect of executive compensation on financial performance of listed commercial banks. The study was successfully carried out, however a number of gaps were identified that should form gap for future studies. First, a similar study should be done with improved model. Additionally, another study should be carried that considers all the commercial banks in Kenya. Lastly, the same study could also be carried out in the deposit taking Sacco's to observe if the results are holding.

5.6 Limitations of the study

The limitations of this study included first, the study relied solely on secondary data and as such, some aspects of executive compensation could not be measured adequately. Secondary data are also general and tends to be historical. The study used the most current information on executive compensation to minimize the problem of information being out dated.

Secondly, listed commercial banks do not apply similar accounting policies hence the executive compensation figures may be exposed to variances across entities is expected based on the accounting policy including accrual policy of a firm. The study only relied on published data and made use of notes to the accountant to get additional information not presented exclusively in the financial statements.

Thirdly, Performance of a firm is affected by numerous factors that was not part of this study. Although the study examined the effect of executive compensation on financial performance of listed banks, other factors also affect financial performance. To capture the effect of other variables apart from executive compensation, the study introduced two control variables to capture the effect of the other variables that might also affect financial performance.

Finally, the research was limited to listed commercial banks at NSE, which are only 11 in number. The number was not large enough for selection of sample for the study. The researcher used a census of all listed commercial banks in Kenya since the number was small for sampling. Additionally, the study used six years of data collection to generate more observation that would enable data analysis to proceed.

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APPENDICES

Appendix i: Data Collection Sheet

	2012	2013	2014	2015	2016	2017
Executive fixed salaries						
Executive share ownership						
Executive bonuses						
Executive allowance						
Capital structure						
Total assets						
Equity						
EBIT						

Appendix II: List of Listed Commercial Banks

i KCB bank

ii Equity bank

iii Barclays bank

iv Standard chartered bank

v HF group

vi Co-Operative Bank

vii Commercial Bank of Africa

viii Stanbic bank

ix NIC bank

x DTB bank

xi National bank

Source :(NSE, 2018)

Appendix III: Raw data

ID	Time	Stock ownership	Allowances	bonuses	fixed Salary	Capital Structure	ROA	Firm Size
1	2012	0.014	0.004	0.022	0.008	0.360	0.036	18.411
1	2013	0.013	0.006	0.025	0.001	0.280	0.037	18.462
1	2014	0.014	0.007	0.023	0.001	0.250	0.070	18.589
1	2015	0.014	0.008	0.025	0.001	0.290	0.058	18.647
1	2016	0.014	0.002	0.018	0.008	0.280	0.054	18.795
1	2017	0.013	0.001	0.021	0.007	0.300	0.050	18.690
2	2012	0.002	0.010	0.035	0.001	0.650	0.020	17.978
2	2013	0.001	0.008	0.040	0.001	0.620	0.022	18.007
2	2014	0.001	0.008	0.052	0.001	0.640	0.035	18.052
2	2015	0.001	0.010	0.042	0.001	0.650	0.041	18.297
2	2016	0.001	0.010	0.046	0.001	0.560	0.043	18.469
2	2017	0.002	0.012	0.052	0.001	0.440	0.036	18.364
3	2012	0.031	0.001	0.087	0.009	0.380	0.062	18.553
3	2013	0.032	0.001	0.062	0.008	0.310	0.072	18.634
3	2014	0.032	0.001	0.045	0.005	0.460	0.048	18.769
3	2015	0.031	0.002	0.037	0.006	0.600	0.047	19.030
3	2016	0.031	0.003	0.053	0.006	0.590	0.044	19.190
3	2017	0.031	0.001	0.031	0.006	0.710	0.041	19.084
4	2012	0.001	0.014	0.098	0.002	0.700	0.049	17.746
4	2013	0.001	0.012	0.103	0.002	0.750	0.042	17.909
4	2014	0.001	0.014	0.090	0.001	0.310	0.049	18.137
4	2015	0.001	0.010	0.075	0.001	0.310	0.049	18.359
4	2016	0.001	0.010	0.075	0.001	0.280	0.045	18.650
4	2017	0.014	0.012	0.077	0.001	0.390	0.037	18.545
5	2012	0.004	0.002	0.020	0.037	0.390	0.070	18.484
5	2013	0.004	0.002	0.016	0.031	0.320	0.068	18.623
5	2014	0.004	0.001	0.025	0.038	0.700	0.074	18.840
5	2015	0.004	0.001	0.115	0.016	0.740	0.077	19.182
5	2016	0.004	0.001	0.095	0.022	0.720	0.073	19.414
5	2017	0.045	0.001	0.066	0.019	0.520	0.066	19.308
6	2012	0.004	0.010	0.037	0.004	0.480	0.025	17.043
6	2013	0.004	0.021	0.042	0.003	0.540	0.016	17.226
6	2014	0.004	0.010	0.046	0.003	0.520	0.022	17.377
6	2015	0.004	0.004	0.027	0.001	0.480	0.026	17.628
6	2016	0.004	0.005	0.042	0.002	0.540	0.021	17.786
6	2017	0.004	0.001	0.043	0.002	0.540	0.025	17.681
7	2012	0.001	0.006	0.091	0.004	0.530	0.044	18.011
7	2013	0.001	0.006	0.138	0.007	0.550	0.046	18.291

7	2014	0.001	0.005	0.107	0.013	0.580	0.052	18.336
7	2015	0.002	0.005	0.084	0.006	0.670	0.055	18.437
7	2016	0.001	0.007	0.086	0.006	0.560	0.056	18.560
7	2017	0.001	0.097	0.080	0.004	0.570	0.057	19.008
8	2012	0.176	0.003	0.011	0.002	0.570	0.052	19.008
8	2013	0.174	0.003	0.010	0.003	0.610	0.050	19.047
8	2014	0.182	0.030	0.008	0.003	0.750	0.052	19.106
8	2015	0.173	0.003	0.008	0.003	0.800	0.055	19.332
8	2016	0.172	0.005	0.007	0.004	0.760	0.059	19.559
8	2017	0.169	0.004	0.022	0.003	0.670	0.050	19.453
9	2012	0.205	0.015	0.038	0.003	0.680	0.024	17.180
9	2013	0.206	0.010	0.033	0.004	0.730	0.031	17.214
9	2014	0.200	0.014	0.033	0.004	0.740	0.017	17.494
9	2015	0.203	0.018	0.033	0.003	0.570	0.019	18.000
9	2016	0.206	0.008	0.040	0.003	0.620	0.019	18.032
9	2017	0.205	0.008	0.026	0.003	0.530	-0.013	17.927
10	2012	0.000	0.014	0.012	0.001	0.530	0.054	18.381
10	2013	0.000	0.016	0.010	0.001	0.550	0.050	18.540
10	2014	0.000	0.014	0.010	0.001	0.160	0.059	18.681
10	2015	0.000	0.014	0.009	0.001	0.180	0.060	18.626
10	2016	0.000	0.015	0.008	0.001	0.130	0.064	18.562
10	2017	0.000	0.016	0.009	0.001	0.350	0.038	18.456
11	2012	0.009	0.043	0.010	0.004	0.380	0.057	17.767
11	2013	0.009	0.040	0.009	0.003	0.460	0.046	18.011
11	2014	0.009	0.042	0.006	0.004	0.840	0.042	18.134
11	2015	0.009	0.045	0.005	0.005	0.860	0.046	18.348
11	2016	0.009	0.038	0.005	0.006	0.730	0.044	18.484
11	2017	0.008	0.038	0.004	0.006	0.700	0.040	18.378