EFFECT OF EMPLOYEE STOCK OWNERSHIP PLANS ON FINANCIAL PERFORMANCE OF COMPANIES LISTED IN THE NAIROBI SECURITIES EXCHANGE

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DECLARATION

This research project is my original work and has not been submitted for award of any degree in any other university for examination/academic purposes.

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This research project has been submitted for examination with my approval as the University of Nairobi Supervisor.

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DEDICATION

To my immediate family members for their patience and unfailing moral support throughout my period of study and for understanding and appreciating the demand of the course in terms of time and resources.

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ABSTRACT

Employee stock ownership is widely recognized as an effective means of improving corporate performance by enabling employees to participate in the creation and sharing of wealth they create in an organisation. The rationale is that Employee Stock Ownership Plans (ESOPs) align individual goals with corporate goals and help companies to retain staff, attract talent, motivate employees and enable them to share the long-term growth of the company. Previous empirical studies provide contradictory conclusion with some indicating that ESOPs enhance company performance and others arguing that just like stock options, ESOPs have a net negative effect on performance of a company in the long run.

The purpose of the study is to investigate the effect of employee stock ownership plans on financial performance of companies listed in the Nairobi Securities Exchange. This study was conducted through the use of a descriptive design. The population of study comprised of all companies listed in the NSE operating in Kenya during the study period. The study used purposeful sampling to pick 9 companies listed in the NSE having employee stock ownership. The secondary data in this analysis covered a period of 10 years from 2003 to 2012 which was exposed to sensitivity analysis using OLS regression. The results obtained from the models were presented in tables

The study found that the regression equations for the period 2003-2012 related financial performance of the companies to their ESOPS, company size and inflation. The study concludes that ESOPS have a strong positive and significant influence on the financial performance among companies listed in the NSE in Kenya. The study recommends that the companies' management should put in place and implement corporate policies in encouraging employees to take up the ESOPs among the companies listed in the NSE. This is by having a high-involvement and open culture necessary for ESOPs to thrive. The study also recommends that a public policy formulation encouraging investors and entrepreneurs to promote broad based ESOPs in their investments and enterprises. The policy also should facilitate employee buyouts scheme and business succession, a successful alternatives to selling the company to an external buyer.

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ABBREVIATIONS

CMA	Capital Market Authority
ERISA	Employee Retirement Income Security Act
ESOP	Employee Stock Ownership
ESOT	Employee Stock Ownership Trust
IPO	Initial Public Offering
MM	Modigliani and Miller theory
NCEO	National Center for Employee Ownership
NSE	Nairobi Securities Exchange
OLS	Ordinary Least Square
SPSS	Statistical Package for Social Sciences
401(K)	A retirement plan in America (a defined contribution plans)

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The separation of corporate ownership and control has long been viewed as a potential impediment to the creation of stockholder wealth. Smith (1776) as quoted by Jensen and Meckling (1976, p. 305), noted that "The directors of such joint stock companies, however, being the managers of other people's money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. However, as firm size increases, it becomes increasingly difficult for owners to possess the expertise necessary to manage the firm successfully. Managers with no stake in the corporation — no ownership and therefore no claim on firm profits may adopt strategies to maximize their own utility rather than the firm's profits. In the absence of a dominant stockholder who exercises some level of control, managers may grant themselves additional salary and benefits as long as the firm provides stockholders an adequate return (Earl, 2000). It can be argued that stockholders who lack control are no longer owners but merely providers of capital.

An Employee Stock Ownership (ESOP) is a qualified employee benefit plan that can substitute for or supplement a company's retirement plan. Money borrowed by a trust (ESOT) set up under the plan and guaranteed by the corporation is used to purchase the firm's common stock in the open market or from the corporate treasury. These shares are then distributed to employees over time on the basis of years of service or an alternative allocation method. The loan used to purchase the shares is paid off over time from employee contributions (Blasi et al., 2003).

1.1.1 Employee Stock Ownership

An ESOP is a qualified retirement plan, similar in structure to a 401(k) or profit-sharing plan. Each ESOP participant has an account that accumulates benefits to be paid at retirement or other termination of employment. However, unlike its cousins, an ESOP is designed to invest primarily in stock of the sponsoring employer. The creation of the ESOP is usually credited to Louis Kelso, a San Francisco attorney and investment banker. In 1956, Kelso implemented

for a San Francisco newspaper the first ownership transfer to employees by means of what later became known as The Kelso Plan. In 1958 he collaborated with the philosopher Mortimer Adler to write The Capitalist Manifesto outlining the economic, social and political benefits that would ensue from broad based employee ownership.

In the early 1970s, the concept attracted an important ally, Senator Russell Long of Louisiana, the long time Chairman of the Senate Finance Committee. Kelso and Long claimed that employee ownership builds commitment, which leads to productivity and profits, and argued that legislation facilitating broader-based ownership would not only increase corporate performance, but also ease workplace tensions, reduce disparities of wealth, and help build a better society.

ESOP legislation emerged amidst questions in this period over the future solvency of Social Security. When the Social Security Act was signed by President Roosevelt in 1935, one out of 70 Americans were eligible for Social Security benefits. In 1939, Social Security was expanded to cover dependents and survivors. A 1967 comprehensive study revealed that one out of 17 Americans were then eligible for Social Security benefits, but that by the year 2000 one out of every three Americans would be eligible and that by the year 2010 it would be one out of two. To address this looming shortfall, Congress adopted ERISA, and within this context passed legislation established the ESOP as a means to supplement Social Security. The legislation included attractive tax and financing advantages to induce company owners to sell company stock to employees.

The number of ESOP plans grew rapidly such that by 1993, more than 9,000 plans were in effect. Although accounting rule changes caused most public companies to replace ESOPs with 401(k) plans, new adoptions have brought the number of plans back up to that 1993 level and the number of plan participants has steadily increased throughout the period. Rosen (2006) speculates that this is due to increasing use of ESOPs in larger private companies and faster employment growth among ESOP companies.

1.1.2 Company Performance

Although, many studies have found that different companies in different countries tend to emphasize on different performance measurement, the literature suggests financial profitability and growth to be the most common measures of organizational performance.

Nambisan (2002) claimed that profitability is the best indicator to identify whether an organization is doing things right and hence profitability can be used as the primary measure of organization success. Furthermore, Earl (2000) pointed profitability as the most common measure of performance in western companies. Profit margin, return on assets, return on equity, return on sales are considered to be the common measures of financial profitability.

1.1.3 Relationship Between ESOPs And Financial Performance

ESOP advocates believe that plan adoptions would be much higher yet if more business owners knew about the advantages of ESOPs. They also note that the same conditions under which ESOPs were established in 1974 characterize current US political debates. President Bush and influential think tanks have called for policy developments furthering their goal of an ownership society. Current concerns about social security solvency suggest further inducements to employee ownership legislation. A literature review of ESOP research is especially valuable now given both this lack of knowledge and opportunity for favorable government action.

ESOPs originally were created with the idea that employees, given an ownership stake in the company, would have the incentive to increase its productivity and performance. Improvements in morale and job satisfaction were expected to promote the overall productivity and competitiveness of American industry (Pugh et al., 2000). Recently, many involved in the ESOP movement and other researchers have questioned whether ESOPs are actually being used to restructure employee work incentives as a means of fostering increased productivity. Critics contend that recently established ESOPs are being used by corporate managers to take advantage of tax benefits, boost short-term profits, or erect takeover defences.

Although most ESOP and employee ownership researchers find improved firm performance, mainstream economic theorists and many investigators still see employee ownership as suspect. Most economists predict either underinvestment and inefficient decision-making, inadequate supervision, or both (Bonin et al., 1993).

1.1.4 Nairobi Securities Exchange

The Nairobi Securities Exchange is the principal stock exchange of Kenya. It began in 1954 as an overseas stock exchange while Kenya was still a British colony with permission of the London Stock Exchange. The NSE is a member of the African Stock Exchanges Association. Nairobi Securities Exchange is Africa's fourth largest stock exchange in terms of trading volumes, and fifth in terms of market capitalization as a percentage of GDP. The Exchange works in cooperation with the Uganda Securities Exchange and the Dares Salaam Stock Exchange, including the cross listing of various equities. There are more than 50 businesses and companies listed in the Nairobi Stock Exchange, including Sasini Tea and Coffee Ltd., Kenya Airways, Jubilee Insurance, Kenya Commercial Bank Ltd., and Kengen Ltd. Most of the businesses in the exchange are in the financial or industrial sectors, though agriculture and other commercial services are also represented. Also listed are treasury bonds issued by the Government of Kenya. Occasionally, there are also privately issued corporate bonds as well.

Nairobi Securities Exchange is categorized into three market segments; Main Investment Market Segment (MIMS), Alternative Investment Market Segment (AIMS) and Fixed Income Market Segment (FIMS) (NSE Handbook, 2009). Companies listed under this segment are further categorized in ten sectors that describe the nature of their business, namely: agricultural, commercial and services, telefirm ownership and technology, automobiles and accessories, banking, insurance, investment, manufacturing and allied and construction and allied. Currently, there are Sixty one Companies listed in the Nairobi Stock Exchange. However, only nine of these have registered Employee Stock Ownership Plans (Appendix I).

1.2 Statement of the Problem

An important, but little reported development in business worldwide has been increasing numbers of employees with ownership rights in the corporation with an increasingly large economic value. Most comes through Employee Stock Ownership Plans, which were established in 1974 partly as a response to anticipated shortfalls in Social Security, but also with the hope of invigorating the economy and distributing the benefits of capitalism more widely through broad-based business ownership (Earl, 2000). Experience and research

indicate that ESOPs and employee ownership more generally do accomplish these aims, but large knowledge gaps remain.

Employee stock ownership is widely recognized as an effective means of improving corporate performance by enabling employees to participate in the creation and sharing of wealth they create in an organisation. The rationale is that Employee Stock Ownership Plans align individual goals with corporate goals and help companies to retain staff, attract talent, motivate employees and enable them to share the long-term growth of the company. However, to be economically viable, ESOPs must improve productivity and firm performance through greater employee involvement, morale and satisfaction. Previous empirical studies provide contradictory conclusion with some indicating that ESOPs enhance company performance and others arguing that just like stock options, ESOPs have a net negative effect on performance of a company in the long run. Research findings are mostly quite positive; Blasi et al. (2003) claim a confluence of favorable outcomes among nearly all empirical research studies on employee ownership. Yet few scholars outside this close knit group seem to be aware of the topic. Economists remain suspicious if not outright dismissive, and research published outside the small group of employee ownership researchers; mostly by finance scholars (Pugh et al., 2000; Weston et al., 1990; Gordon and Pound, 1990; Lisa and Zwirlein, 1995) emphasizes problems related to ESOP adoption and suggests that ESOPs have not led to significant increases in corporate performance. Although the quantity and cumulative findings of research on employee ownership may be impressive, lack of engagement with critics means that the research and the idea of employee ownership have limited impact in the larger world of knowledge and ideas, and leaves doubts about the assertions.

Locally, Maina (2002) did a study on the determinants of stock market development: the case for the Nairobi Stock Exchange, Odielo, (2004) did a study on the factors influencing long term debt decisions by companies quoted at the Nairobi Stock Exchange while Muli (2010) did a survey of the potential benefits of demutualization of Nairobi Stock Exchange. None of these local and international studies have focused on the effect of employee stock ownership plans on financial performance of companies listed in the Nairobi Securities Exchange. This study will therefore seek answer to the question: What is the effect of employee stock ownership plans on performance of companies listed in the Nairobi Securities Exchange?

1.3 Objectives of the study

i. To determine the level of ESOPS adoption among companies listed in the Nairobi Securities Exchange.
ii. To establish the effect of ESOPS on financial performance of companies listed in the Nairobi Securities Exchange.

1.4 Significance of the Study

This study is important to various stakeholders including retail and institutional investors, market regulator namely the CMA, listed companies adopting ESOPS and those seeking to have them, research institutions and the Government.

The market regulator namely the CMA would gain knowledge on how to handle employee stock ownership plans in regard to the regulations and making of policies. Due to making sound regulations and policies, this would result into improved confidence in investors in investing in the stock market.

The study would give guidelines to retail and institutional investors to enhance their understanding of the determination of the companies to invest in. This would assist the investors in making viable decisions while investing in the stock market. This study would be helpful to investors in taking rational decision like where to invest, how to invest, and what portfolio should be made to obtain maximum profits from their investment base on whether the companies have employee stock ownership plans.

The listed companies and those companies seeking to list their shares on the NSE will be able to appreciate the effect of employee stock ownership plans, and this would assist them in making sound decisions whether to have employee stock ownership plans. They would make viable decisions when making strategic decisions.

The information so obtained would be useful to research institutions and the Government who want to advance the knowledge and literature on employee stock ownership plans. It would also add to literature on the subject as reference material and stimulate further research in the area. The employee stock ownership plans implications are crucially important to economy policymakers of the developing markets, not only because employee stock ownership plans plays such key role in the performance but also it fuels the economic growth

of these markets by feeding the great capital demand. In this sense, studies focusing on the emerging markets employee stock ownership plans become essentially indispensable.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter covers literature review of the main variables of the study. In particular literature review has been done and will continue to be done on effect of employee stock ownership plans on performance of companies. The theoretical and empirical underpinning of effect of employee stock ownership plans on performance of companies is covered in this chapter. In addition a summary have also been provided at the end of the chapter.

2.2 Review of Theories

2.2.1 Agency Theory

Agency theory suggests that even though such a divergence in interests exists, owners can constrain management's ability to maximize personal utility by establishing a nexus of contracts that minimizes the divergence in interests in exchange for a level of salary and benefits to management that is greater than what owner-managers would grant themselves if they were in control of the firm (Jensen and Meckling, 1976). Agency costs arise from additional salary and benefits allowed by the contract.

Jensen and Meckling (1976) introduced the aspect of agency costs. These costs arise because in the absence of any restrictions, a firm’s management would be tempted to take actions that would benefit stockholders at the expense of bondholders (Jensen and Meckling (1976).

Due to this, bondholders impose restrictions in the operations of a firm by way of covenants which hamper the corporation’s legitimate operation. Furthermore, the bondholders are forced to monitor the firm to ensure that the covenants are upheld. The monitoring costs are passed to stockholders in terms of higher cost of debt. Covenants lead to loss in efficiency of operation of the firm. The cost efficiency and the monitoring costs are important type of agency costs which increases the cost of debt and reduces the value of equity thus reducing the advantages of debt.

Jensen and Mecking (1976) posit that a firm should consider the agency costs of debt vis a vis the benefits of debt to determine the optimum debt. Optimum debt according to them will

be the one where marginal agency costs of debt equal to marginal benefits of debt. They identified the agency costs of debt as consisting of the agency theory of capital structure.

2.2.2 Signaling Theory

Ross (1977) argues that trade off models adopted by traditional theorists do not offer a satisfactory solution to financial structure choice. He posits that it's difficult to specify exactly what the costs of bankruptcy are, particularly when it's in the interest of all parties to simply reorganize the firm.

Ross (1977) also contend that MM'S theory implied that the market know the random return stream of the firm and value this stream to set the value of the firm. He posits that what is valued in the market place is the perceived stream of the firm. Borrowing from MM's argument he stated that changes in financial structure can alter the market perception….by changing the financial structure, the firm changes its perceived risk class even though the actual risk class remains unchanged.

Ross concluded that choice of capital structure signals information to the market and that the signals will be validated in a competitive market. The implication of this theory is that managers decide on the capital structure of their company in a way that a positive signal will be sent to the market so as to increase the firms value. This is only achieved if management issue debt securities but in a way that the market will not perceive the issue as too large to invite possibilities of financial distress as this may pose a negative signal.

2.2.3 Traditional Theory of Capital Structure

Traditional theory encompasses the generally accepted wisdom of investors, analysts and company management alike. The theory has nothing to do with the pre- MMs' views on capital structure. Traditional theory holds that there are both advantages and disadvantages of corporate gearing. It holds that at low levels of gearing, the advantages of debt outweigh disadvantages and so the market value of a company gradually rises, but after a while, the situation reverses and disadvantages start to outweigh advantages. Further gearing cause the company market value to decline.

The argument advanced by this view is that the advantage of debt is tax deductibility of interest while the disadvantage of gearing is the increase in financial risk borne by equity holders. This lead to equity holders to demand a higher expected return on their capital.

Furthermore, very high gearing ratios make debt holders to suffer their own version of financial risk, making them to demand high interests from debt; raising the cost of debt Brealy and Myers (2003). Traditional view has never rested on vigorous theoretical model as does MM hypothesis.

Modigliani and Miller (1958) in their famous proposition 1 argued that a firm cannot change the total value of its securities just by splitting its cash flows into different streams. Their contention was that a firm's value is determined by its real assets not by the securities it issues (Brealy and Myers, 2003).

However, their conclusion was arrived at after making some assumptions which have been a basis for criticism of their assertions. The assumptions they made were business risk can be measured by standard deviation of earnings before interest and tax and firms with the same degree of risk are said to be in a homogenous risk class, all present and prospective investors have identical estimates of the firms future earnings, stocks and bonds are traded in perfect capital markets and debt of firms and individuals is riskless so that interest rate on debt is the risk free rate.

MM (1958) used arbitrage proof to support their argument. Arbitrage is a process where investors increase their income without increasing their exposure to risk. They argued that if two companies were only different in the way they were financed and in their total market value, investors would sell shares of the higher valued firms, buy those of the lower valued firms and continue this process until the companies had exactly the same market value (Modigliani and Miller, 1958).

Durand, (1959) reacted to MMs' irrelevance theory and questioned the applicability of arbitrage process and the assumptions of a riskless world. Following Durand's criticism MM (1963) corrected their 1958 position by recognizing the presence of taxes. They recognized that the value of the firm was dependent on the after tax net cash flows. Their propositions was that value of a levered firm is equal to value of the unlevered firm in the same risk class plus the gain from leverage which is the value of the tax savings due to debt financing and which equal to corporate tax rate times amount of debt a firm uses (Brigham and Daves, 2004).

2.3 Effect of ESOP on Financial Performance

Many studies investigate the relationship between employee ownership and organizational commitment and identification (12 studies); motivation (6 studies); participation and influence in decisions (11 studies); and behavioral measures such as turnover and absenteeism (7 studies). All these presumably have a beneficial effect on the firm (McGregor, 1960), but the link has proven surprisingly elusive and contingent (Thompson, 1967). So while it is a good bet that these relate to overall firm improvement, few studies as yet verify the links.

Nasar (1989) contended that ESOPs can eventually harm shareholders because the plans can entrench weak or ineffective management while offering little motivation for employees to become more productive. Gordon and Pound (1990) suggested that ESOPs were less effective than other types of large investors at monitoring management decisions since ESOPs are unilaterally undertaken by management, ESOP shares are held only by incumbent managerial and non-managerial employees, and ESOP trustees are frequently appointed by management.

In sharp contrast to the findings of Blasi and Kruse (2003), Pugh et al. (2000) claim that, the literature, to date, has generally provided inconsistent results. In their own study, they conclude that ESOPs provide, at best, only a short-term boost to corporate performance. In a current paper (Pugh et al., 2000), however, the authors make a more competent case that some ESOPs have been used by corporations as part of a takeover defense and that these ESOPs do not outperform the market (but others do).

2.4 Financial Performance

Financial performance is measured in terms of results (Rue and Byars, 1992). The term performance generally carries with it an understanding of a degree of achievement of an operation or a set of connected. These operations, in so far an organization's goals and objectives are concerned. These operations may have been formally put in place by the organization to evaluate and monitor the organization's capability to successfully meet its goals, and assess its employees and stakeholders responsiveness to what has been learned, though the adoption of efficient structure, system, and capital investments. Performance is key between the knowledge flow and the workflow (Sita, 2003).

Financial performance is essential to the survival of firms in the competitive and uncertain environment. Management is eager to learn how the effort of service quality improvement is related to an organization's performance (Sousa and Voss, 2002). Financial performance ultimately reflects whether or not service quality is realized in a firm. Financial performance is conceptualized as an extent to which a firm increases sales, profit, and return on equity. These are indicators of financial performance and manifest the well being of a firm collectively.

Performance outcomes result from success or market position achieved (Hooley, Greenley, Cadogan, and Fahy, 2005). Organizational performance refers to how well an organization achieves its market-oriented goals as well as its financial goals. Organizational performance means attainment of ultimate objectives of the organization as set out in the strategic plan. Performance can be determined in various ways. While there is a range of specific models, major determinants of firm-level profitability include: characteristic of the industry in which the firm competes; the firm's position relative to its competitors; and the quality or quantity of the firm's resources.

Weiner and Mahoney (1981) indicated that numerous measures of corporate performance could be used as dependent variables. However, more important than a specific measure chosen is the use of multiple measures, because different criteria of performance are likely to be differentially affected by the various independent variables (Lieberson and O'Connor, 1972). Financial Performance Ratios is used to measure the financial performance of a business. A financial ratio is an important tool for businesses and managers to measure the progress for achieving the targeted goals. Some of the important financial ratios which a firm would like to analyze include: liquidity ratio, profitability ratios, and financial leverage ratios among others.

2.5 Review of Empirical Studies

Most research on employee ownership shows robust, positive, firm-level effects. These studies show that employee owned firms are more productive and profitable, survive longer, and result in better shareholder returns. Adoption of ESOPs result in better post-adoption performance compared to pre-adoption performance and also compared to matched firms. The mechanisms by which these gains are realized are still not well understood, but researchers have begun to investigate. Some studies from prestigious journals of economics

and finance challenge these claims, and economic theory is generally suspect of employee ownership. Two opposite risks are identified –control that is either too highly centralized despite broad ownership, or insufficiently centralized.

The empirical evidence on the relationship between employee stock ownership and financial performance is mixed. ESOPs have been found to outperform non-ESOP firms in terms of sales growth, growth in employment, market value, and accounting-based returns. Conte and Tannenbaum (1978) found that a sample of 30 ESOPs exceeded 1976 industry-average pre-tax return on sales, although not significantly. However, a significant positive relationship was found between percent equity owned by employees and firm profitability. Rosen and Klein (1983) examined the employment growth characteristics during the 1972-1982 period for ESOPs with 10 or more employees. Their results indicated that for a sample of 43 ESOPs, employment growth was 2.78 percent greater per year than corresponding sector averages.

Rosen and Quarrey (1987) examined employment and sales growth in a sample of 45 ESOPs and a control group of 238 non-ESOPs chosen to correspond to each subject firm's size and industry. The time period examined was from 5 years prior to ESOP implementation to 5 years after ESOP implementation. The authors found that the ESOP firms had 1.89 percent faster growth in sales and 1.21 percent faster growth in employment than the control group prior to ESOP implementation, but the ESOP firms outperformed the control group at the rates of 5.4 percent in sales growth and 5.05 percent in employment growth after the implementation of the ESOP. Also, 73 percent of the ESOP sample significantly improved performance with regard to sales and employment growth during a five-year period immediately following the ESOP implementation. Similar results were found with a smaller sample of 20 ESOPs and a control group of non-ESOP firms (Rosen, 1991).

Gordon and Pound (2005) examined the immediate stock market reaction to the public announcement of ESOP adoptions that specifically preclude their use as a takeover defence. These authors report significantly positive share-price reactions to ESOPs adopted solely for the purpose of an employee benefit or wage concession. Although studies of large public companies provide evidence that the market reacts favourably to the announcement of nondefensive ESOPs, they do not investigate whether firm performance is actually improved in the long run. The positive share-price reaction at the time of the ESOP announcement is

consistent with the market's pricing the expectation of higher future cash flows. Whether these higher expected cash flows actually occur is an unanswered question.

Gamble (2003) did a study on ESOPS as financial performance and federal tax incentives. Previous research had suggested a relationship between the establishment of employee stock ownership plans (ESOPs) and past-adoption improvements in financial performance — presumably as a result of the alignment of employee and stockholder interests. I examine the role of tax incentives on the financial performance of ESOP firms. The results indicate that ESOPs farmed prior to the availability of tax incentives provided by the lax Reform Act of 1986 have experienced significantly greater improvement in financial performance than ESOPs established after passage of the Act, The results are consistent with my hypothesis and suggest that even though ESOPs can be utilized to reduce a firm's federal income tax liability, ESOPs may be more useful to management to reduce agency costs throughout the firm.

Even though these researchers have found a positive relationship between employee ownership and financial performance, other studies reported no relationship between employee ownership and financial performance. Kruse and Blasi (1997: 134-136) summarize eleven studies evaluating comparison of (a) performance before and after adoption of the ESOP, (b) ESOP to non-ESOP firms, and (c) post adoption performance to matched non-ESOP firms. Most of the studies find small positive, but statistically insignificant effects. Only two of the studies – on post-adoption performance (Kumbhaker & Dunbar 1993; Mitchell et al., 1990) – find significant differences. Park and Seng (1995), additionally, find significantly better post-adoption performance, but only in firms with outside block holders (possibly due to greater monitoring of management). Conducting meta-analytic statistical tests on all eleven studies, however, Kruse and Blasi (1997) are able to conclude that on average in all the performance categories, ESOP companies do better per year than non-ESOP companies and that companies do better post-adoption than pre-adoption. They estimate the average effect across tests and across studies to be approximately 4% annually.

Research findings are mostly quite positive; Blasi et al. (2003) claim a confluence of favorable outcomes among nearly all empirical research studies on employee ownership. Yet few scholars outside this close knit group seem to be aware of the topic. Economists remain suspicious if not outright dismissive, and research published outside the small group of

employee ownership researchers – mostly by finance scholars (Pugh et al., 2000; Weston et al., 1990) – emphasizes problems related to ESOP adoption and suggests that ESOPs have *not* led to significant increases in corporate performance. Although the quantity and cumulative findings of research on employee ownership may be impressive, lack of engagement with critics means that the research and the idea of employee ownership have limited impact in the larger world of knowledge and ideas, and leaves doubts about the assertions.

Research indicates not only that employee-owned firms are more profitable and productive, but that they also survive longer. Several large-scale studies show that employee-owned firms are significantly less likely than their counterparts to go bankrupt or disappear for any reason at all. Park, Kruse and Sesil (2004) tracked data on all U.S. public companies as of 1988, following them through 2001. Companies with employee ownership stakes of 5% or more were only 76% as likely as firms without employee ownership to disappear in this period. Out of 245 firms in which employees owned 5% or more of the company in 1988, 124 (50.6%) were still in business in 2001; only 97 (41.8%) out of a matched sample of 232 non-employee-owned firms were still in business in 2001.

In every category tracked (Merger or Acquisition, Bankruptcy, Liquidation, Reverse Acquisition, Leveraged Buyout, Privatization, Other, and Missing) non-employee owned firms disappeared at a greater rate than employee-owned firms .These findings were congruent with those of Blair et al. (2000). Their study tracking U.S. public companies from 1983, found that those with substantial employee ownership stakes were 20% more likely than their industry counterparts to survive through 1995.

In a current project reported on the NCEO website, Blasi and Kruse (2007) track all *privately* held companies with ESOPs in 1988, and found they had similarly higher survival rates than closely matched firms without ESOPs. Among 1176 private companies with ESOPs in 1988, 69.6% survived through 1999, compared to only 54.8% of non-ESOP companies in the same industry and of the same size.

Blasi et al. (2003) analyzed the entire universe of seventy empirical studies they could find on the effects of employee stock ownership, broad based stock options, profit sharing, and employee participation (which they describe as the four key aspects of "partnership capitalism"). They report that on average, companies and their investors made a profit on

partnership approaches, including stock options, over and above any ownership they dished out to employees. They gave workers an 8 percent ownership stake, and in return enjoyed an average of a 2 percentage point higher return on the diluted shares they still held.

Lisa and Zwirlein (1995) ESOPS in publicly held companies: evidence on productivity and firm performance. Eighty-five publicly traded firms that establish an employee stock ownership plan between 1973 and 1986 are examined to determine the effect of ESOP adoption on their productivity and performance. They analyze several measures of productivity and performance and compare the sample firms with a control group matched by industry and size. The results provide no evidence of any productivity gains or performance improvements following ESOP adoption. The proposition that employees with an equity stake will be more productive and improve firm performance is not supported.

2.6 Chapter Summary

Agency theory suggests that even though such a divergence in interests exists, owners can constrain management's ability to maximize personal utility by establishing a nexus of contracts that minimizes the divergence in interests in exchange for a level of salary and benefits to management that is greater than what owner-managers would grant themselves if they were in control of the firm. Most research on employee ownership shows robust, positive, firm-level effects. These studies show that employee owned firms are more productive and profitable, survive longer, and result in better shareholder returns. Adoption of ESOPs result in better post-adoption performance compared to pre-adoption performance and also compared to matched firms. Even though these researchers have found a positive relationship between employee ownership and financial performance, other studies reported no relationship between employee ownership and financial performance. Most of these studies are done in other countries whose strategic approach and financial footing is different from that of Kenya. This study therefore seeks to fill this gap by focusing on the effect of Employee Stock Ownership Plans on financial performance of companies listed in the Nairobi Securities Exchange.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the methodology of the study. It outlines how the study was carried out. The chapter presents the research design, the population, sample and sampling technique, data collection method and instruments and data analysis.

3.2 Research Design

This study adopted a descriptive research design. The choice of the descriptive survey research design was made based on the fact that in the study, the research is interested on the state of affairs already existing in the field and no variable was manipulated. A descriptive study attempts to describe or define a subject, often by creating a profile of a group of problems, people, or events, through the collection of data and tabulation of the frequencies on research variables or their interaction as indicated by Cooper and Schindler (2003). Descriptive research portrays an accurate profile of persons, events, or situations (Kothari, 2000). Descriptive design allowed the collection of large amount of data from a sizable population in a highly economical way.

3.3 Target Population

Cooper and Schindler (2003) define target population as the entire group that is of interest to the researcher. The target population for this study was 61 companies listed in the Nairobi Securities Exchange as at April 2013.

3.4 Sample

Ngechu (2004) underscores the importance of selecting a representative sample through making a sampling frame. From the population frame the required number of firms was selected in order to make a sample. The study used purposeful sampling to pick nine companies with approved ESOPs. According to Oso and Onen (2005), purposive sampling starts with a purpose in mind and the sample is thus selected to include people of interest and exclude those who do not suit the purpose. Saunders and Thornhill (2003) also posited that purposeful sampling is useful when one want to access a particular subset of subjects.

3.5 Data Collection

Secondary data collection method was used in this study. The secondary data was collected from the companies audited financial statements for the years 2003-2012.

3.6 Data Analysis Methods

Data was analyzed using Statistical Package for Social Sciences (SPSS Version 21.0) program. Being that the study was descriptive in nature, both quantitative analysis and inferential analysis was used as data analysis technique. The data collected was run through various regression model so as to clearly bring out the effects of change in ESOPs on firm's financial performance. The results obtained from the models was presented in tables to aid in the analysis and ease with which the inferential statistics were drawn. The under-mentioned model was used:

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$

Where: Y = Financial performance (measured by Return on Equity)

β_0 = Constant Term;

$\beta_1, \beta_2,$ and β_3 = Beta coefficients;

X_1= ESOPS (measured by Number of ESOPS/Total number of shares)

X_2=Company size (measured by natural log of Market Capitalization)

X_3= Inflation (Consumer price index)

ε = Error term

A similar Regression model was adopted by Pugh et al (2000) in a study on the effect of ESOP adoptions on corporate performance in the American Industry where they deduced that ESOPs resulted in improvements in morale and job satisfaction which promoted the overall productivity and competitiveness of American industry.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the information processed from the data collected during the study on effect of employee stock ownership plans on financial performance of companies listed in the Nairobi Securities Exchange. The sample composed of nine companies listed in the Nairobi Securities Exchange for the period (2003-2012).

4.2 Regression Results

The study conducted a cross-sectional OLS multiple regression on the selected independent variables over the period 2003-2012 and results of financial performance.

4.2.1 Year 2003 Analysis and Interpretations

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (financial performance) that is explained by all the three independent variables (ESOPS, company size and inflation).

Table 4.1: ANOVA Statistics for 2003 Data

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.987[a]	.975	.898	607415.10735

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	14157458267376.408	3	4719152755792.136	12.791	.0202[b]
	Residual	368953112632.796	1	368953112632.796		
	Total	14526411380009.203	4			

Table 4.2: Coefficients of 2003 Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	7773625	7549486.349		1.030	.491
	ESOPS	1250594184	458597247	4.527	2.727	.224
	Company size	3001	.003	4.246	2.138	.279
	Inflation	-497082	568448.518	-.529	-.874	.543

The data findings from 2003 market statistics were analyzed and the SPSS output presented in table 2 and 3 above. From the ANOVA statistics in table 4.1, the processed data, which are the population parameters, had a significance level of 0.0202 which shows that the data is ideal for making a conclusion on the population's parameter. The coefficient table in table 4.2 above was used in coming up with the model below:

FP = 7773625 + 1250594184ESOPS + 3001CS -497082 INF

According to the model, ESOPS and company size were positively correlated with financial performance while inflation was negatively correlated with financial performance. From the model, taking all factors (ESOPS, company size and inflation) constant at zero, financial performance will be 7773625. The data findings analyzed also shows that taking all other independent variables at zero, a unit increase in ESOPS will lead to a 1250594184 increase in financial performance. A unit increase in company size will lead to a 3001 increase in financial performance while a unit increase in inflation will lead to a -497082 decrease in financial performance. This infers that ESOPS had more effect on financial performance followed by company size while inflation had a negative effect.

4.2.2 Year 2004 Analysis and Interpretations

Table 4.3: ANOVA Statistics for 2004 Data

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	1.000[a]	1.000	1.000	3999.32839

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2414590280008.449	3	804863426669.483	50320.861	.003[b]
	Residual	15994627.551	1	15994627.551		
	Total	2414606274636.000	4			

Table 4.4: Coefficients of 2004 Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2083205	29066.213		71.671	.009
	ESOPS	9662765	1084855.126	.085	8.907	.071
	Company size	4.896E-005	.000	1.292	90.295	.007
	Inflation	-209460	3154.171	-.498	-66.407	.010

The data findings for 2004 statistics were processed using SPSS and the output presented in table 4.3 and 4.4 above. According to the ANOVA table 4.3 above, the parameters predicted in the table above had a significance level of 0.003 which is inadequate to be used as a population parameter in predicting the effect of ESOPS on financial performance for the companies listed in the NSE. The regression model drawn from table 4.4 above is presented below:

FP = 2083205 + 9662765 ESOPS + 4.896E-005 CS - 209460 INF

According to the table, the financial performance had an autonomous value of 2083205 that

is when the value of all the independent variables is zero. A unit increase in ESOPS increases the financial performance by 9662765 when the company size and inflation variables are held constant. A unit increase in company size, holding other variables constant, increased the financial performance by 4.896E-005. A unit increase in inflation, holding other variables constant, decreased the financial performance by - 209460. This shows that ESOPS and company size had a positive relationship with the financial performance while inflation negatively influenced the companies' financial performance.

4.2.3 Year 2005 Analysis and Interpretations

Table 4.5: ANOVA Statistics for 2005 Data

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	1.000[a]	1.000	.999	49059.36015

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	14761068084446.594	3	4920356028148.864	2044.338	.016[b]
	Residual	2406820818.602	1	2406820818.602		
	Total	14763474905265.195	4			

Table 4.6: Coefficients of 2005 Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	208328	132767		1.569	.361
	ESOPS	228645408	197812500.034	.136	1.156	.454
	Company size	5.406E-005	.000	1.132	9.854	.064
	Inflation	-23460.848	15314.481	.037	-1.532	.368

From the finding of the study on the 2005 market statistics as analyzed and presented in the above table, the following regression equation was established by the study for the year 2005:

FP = 208328 + 228645408 ESOPS + 5.406E-005 CS - 23460.848 INF

From the findings of the data it can be concluded that when the value of ESOPS, company size and inflation were zero, financial performance was 208328. The table also shows that holding company size and inflation constant, an increase by one unit of ESOPS increases financial performance by 228645408, when other factors are held constant an increase in company size by one unit increases financial performance by 5.406E-005. If one unit of inflation was increased while holding other factors constant, the financial performance would decrease by - 23460.848. This shows that the ESOPS and company size has a positive relationship with financial performance while inflation inversely affect companies' financial performance, although the ESOPS influences financial performance positively most. This notwithstanding, the model was arrived at a significance level of 0.016 which means that the model is adequate in drawing a conclusion on the population parameters.

4.2.4 Year 2006 Analysis and Interpretations

Table 4.7: ANOVA Statistics for 2006 Data

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.947[a]	.898	.795	908880.18202

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	21727220895039.332	3	7242406965013.110	8.767	.034[b]
	Residual	2478189555816.669	3	826063185272.223		
	Total	24205410450856.000	6			

Table 4.8: Coefficients of 2006 Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1687602	1605180.106		1.051	.370
	ESOPS	-1571551	15864228	-.020	-.099	.927
	Company size	4.937E-005	.000	.834	3.992	.028
	Inflation	-235336	187157.501	-.252	-1.257	.298

The market data for 2006 was regressed on SPSS and the output presented in table 4.7 and 4.8 above. From the data analyzed and presented in the table above, the model for the year 2006 is presented below:

FP = 1687602 – 1571551 ESOPS + 4.937E-005CS - 235336INF

According to the model above, holding ESOPS, company size and inflation constant at zero, financial performance will be 1687602. When the company size and inflation are held constant, a unit increase in ESOPS will decrease the financial performance by – 1571551. When other factors are held constant, a unit increase in company size will increase the financial performance by 4.937E-005. The model also shows that Inflation had a negative relationship with financial performance such that a unit increases in inflation holding other factors constant will lead to a decrease in financial performance of -235336. From the above model it can be concluded that company size positively influenced financial performance while ESOPS and inflation had a negative influence on the same. From the ANOVA statistics table 4.7 above, it shows that the parameters in the model have a .034 level of significance which shows that it is significant in predicting the effect of ESOPS on financial performance.

4.2.5 Year 2007 Analysis and Interpretations

Table 4.9: ANOVA Statistics for 2007 Data

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.967[a]	.936	.888	718769.79721

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	30110753449525.990	3	10036917816508.662	19.428	.008[b]
	Residual	2066520085504.007	4	516630021376.002		
	Total	32177273535029.996	7			

Table 4.10: Coefficients of 2007 Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	217224	1075903.309		.202	.850
	ESOPS	7538906	10575957.711	.093	.713	.515
	Company size	5.526E-005	.000	.932	6.662	.003
	Inflation	-63366	252457.865	-.034	-.251	.814

The data findings for 2007 were computed, analyzed and presented in table 9 and 10 above. According to the ANOVA statistics in table 4.9 above, the model had a significance level of 0.008 which means that the model is appropriate to be used as a population parameter. From table 10, the regression model is presented below:

FP = 217224 + 7538906ESOPS + 5.526E-005CS - 63366INF

According to the regression model, when the values of ESOPS, company size and inflation are zero, financial performance will be 217224. When ESOPS is increased by one unit, the

financial performance will increase by 7538906 while when company size is increased by one unit, the financial performance will increase by 5.526E-005. The financial performance will also decrease by – 63366 when the inflation is increased by one unit holding other factors constant. This shows that in this year, ESOPS and company size had a positive correlation with financial performance while inflation had a negative effect.

4.2.6 Year 2008 Analysis and Interpretations

Table 4.11: ANOVA Statistics for 2008 Data

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.920[a]	.847	.755	2305712.26223

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	146787704428550.900	3	48929234809516.970	9.204	.029[b]
	Residual	26581545180959.117	5	5316309036191.823		
	Total	173369249609510.030	8			

Table 4.12: Coefficients of 2008 Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1668323	6989259.413		.239	.821
	ESOPS	5658392	40175301.157	.027	.141	.893
	Company size	6.892E-005	.000	.907	4.697	.005
	Inflation	-102127	423602.576	-.043	-.241	.819

The data findings from 2008 market statistics were analyzed and the SPSS output presented in table 4.11 and 4.12 above. From the ANOVA statistics in table 4.11, the processed data, which are the population parameters, had a significance level of 0.029 which shows that the

data is ideal for making a conclusion on the population's parameter. The coefficient table in table 4.12 above was used in coming up with the model below:

FP = 1668323 + 5658392 ESOPS + 6.892E-005 CS - 102127 INF

According to the model, only ESOPS and company size were positively correlated with financial performance while inflation was negatively correlated with financial performance. From the model, taking all factors (ESOPS, company size and inflation) constant at zero, financial performance will be 1668323. The data findings analyzed also shows that taking all other independent variables at zero, a unit increase in ESOPS will lead to a 5658392 increase in financial performance. A unit increase in company size will lead to a 6.892E-005 increase in financial performance while a unit increase in inflation will lead to a -102127 decrease in financial performance. This infers that ESOPS had more effect on financial performance followed by company size while inflation had a negative effect.

4.2.7 Year 2009 Analysis and Interpretations

Table 4.13: ANOVA Statistics for 2009 Data

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.839[a]	.705	.528	2742032.91380

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	89721937275863.810	3	29907312425287.938	3.978	.036[b]
	Residual	37593722501944.410	5	7518744500388.881		
	Total	127315659777808.220	8			

Table 4.14: Coefficients of 2009 Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-4219235	4898147.817		-.861	.428
	ESOPS	87969202	49084497.521	.483	1.792	.133
	Company size	3.597E-005	.000	.332	1.123	.313
	Inflation	811684	518338.488	.446	1.566	.178

The data findings for 2009 statistics were processed using SPSS and the output presented in table 4.13 and 4.14 above. According to the ANOVA table 4.13 above, the parameters predicted in the table above had a significance level of 0.036 which is adequate to be used as a population parameter in predicting the effect of inflation on financial performance for the companies listed in the NSE. The regression model drawn from table 4.14 above is presented below:

FP = -4219235 + 87969202 ESOPS + 3.597E-005CS + 811684INF

According to the table, the financial performance had an autonomous value of -4219235 that is when the value of all the independent variables is zero. A unit increase in ESOPS increases the financial performance by 87969202 when the company size and inflation variables are held constant. A unit increase in company size, holding other variables constant, increased the financial performance by 3.597E-005. A unit increase in inflation, holding other variables constant, increased the financial performance by 811684. This shows that ESOPS, company size and inflation had a positive relationship with the financial performance.

4.2.8 Year 2010 Analysis and Interpretations

Table 4.15: ANOVA for 2010 Statistics

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.981[a]	.962	.939	1280709.20527

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	208339914184909.700	3	69446638061636.560	42.340	.001[b]
	Residual	8201080342369.181	5	1640216068473.836		
	Total	216540994527278.880	8			

Table 4.16: Coefficients of 2010 Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	885560	1247947.114		.710	.510
	ESOPS	15368456	23834192	.059	.645	.547
	Company size	6.679E-005	.000	.975	10.059	.000
	Inflation	-56473	246610.394	-.022	-.229	.828

From the finding of the study on the 2010 market statistics as analyzed and presented in the above table, the following regression equation was established by the study for the year 2010:

FP = 885560 + 15368456 ESOPS + 6.679E-005 CS - 56473 INF

From the findings of the data it can be concluded that when the value of ESOPS, company size and inflation were zero, financial performance was 885560. The table also shows that holding company size and inflation constant, an increase by one unit of ESOPS increases financial performance by 15368456, when other factors are held constant an increase in

company size by one unit increases financial performance by 6.679E-005. If one unit of inflation was increased while holding other factors constant, the financial performance would decrease by -56473. This shows that the ESOPS and company size have a positive relationship with financial performance while inflation inversely affect companies' financial performance. However, the model was arrived at a significance level of 0.001 which means that the model is adequate in drawing a conclusion on the population parameters.

4.2.9 Year 2011 Analysis and Interpretations

Table 4.17: ANOVA Statistics for 2011 Data

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.819[a]	.671	.474	3822793.98366

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	149116938973984.780	3	49705646324661.590	3.401	.011[b]
	Residual	73068769207531.470	5	14613753841506.293		
	Total	222185708181516.250	8			

Table 4.18: Coefficients of 2011 Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2576992	3285254.722		.784	.468
	ESOPS	4051242	83058431.011	.014	.049	.963
	Company size	7.116E-005	.000	.825	2.839	.036
	Inflation	-96851	274435.101	-.092	-.353	.739

The market data for 2011 was regressed on SPSS and the output presented in table 17 and 18 above. From the data analyzed and presented in the table above, the model for the year 2011 is presented below:

FP = 2576992 + 4051242 ESOPS + 7.116E-005 CS – 96851 INF

According to the model above, holding ESOPS, company size and inflation constant at zero, financial performance will be 2576992. When the company size and inflation are held constant, a unit increase in ESOPS will increase the financial performance by 4051242. When other factors are held constant, a unit increase in company size will increase the financial performance by 7.116E-005. The model also shows that inflation had a negative relationship with financial performance such that a unit increases in inflation holding other factors constant will lead to a decrease in financial performance of – 96851. From the above model it can be concluded that ESOPS and company size positively influenced financial performance while inflation had a negative influence on the same. From the ANOVA statistics table 4.18 above, it shows that the parameters in the model have a 0.011 level of significance which shows that it is significant in predicting the effect of ESOPS on financial performance.

4.2.10 Year 2012 Analysis and Interpretations

Table 4.19: ANOVA Statistics for 2011 Data

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.875[a]	.766	.626	4329731.94756

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	307536954986180.100	3	102512318328726.700	5.468	.049[b]
	Residual	93732893688538.770	5	18746578737707.754		
	Total	401269848674718.900	8			

Table 4.20: Coefficients of 2012 Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	927730	4947606		.188	.859
	ESOPS	121372521	97983950.424	.308	1.239	.270
	Company size	.0001	.000	1.045	3.753	.013
	Inflation	-269798	384871.122	-.174	-.701	.515

The data findings for 2012 were computed, analyzed and presented in table 4.19 and 4.20 above. According to the ANOVA statistics in table 4.19 above, the model had a significance level of 0.049 which means that the model is appropriate to be used as a population parameter. From table 4.20, the regression model is presented below:

FP = 927730 + 121372521 ESOPS + 0.0001 CS - 269798 INF

According to the regression model, when the values of ESOPS, company size and inflation are zero, financial performance will be 927730. When ESOPS is increased by one unit, the financial performance will increase by 121372521 while when company size is increased by one unit, the financial performance will increase by 0.0001. The financial performance will decrease by -269798 when the inflation is increased by one unit holding other factors constant. This shows that in this year, ESOPS and company size had a positive correlation with financial performance while inflation had a negative correlation with financial performance.

4.3 Summary and Interpretation of Findings

From the above regression models for the ten years, the study found out that there were several factors influencing the financial performance of companies listed in the NSE, which are ESOPS, company size and inflation. They either influenced it positively or negatively. The study found out that the intercept varied. The highest value was 7,773,625 and the lowest was -4,219,235 with an average of 1380935 for all years. The study also found out that the

coefficient of ESOPS varied from positive to negative. The highest regression value was positive with an average coefficient of 172928953. This means that ESOPS positively influenced the financial performance.

The study found out that the company size varied in value although it was positive in all cases. This means that company size positively influenced the financial performance. The study further found out that the coefficients of the inflation to be negative in all the ten regression models apart from 2009. This depicts that, according to findings, inflation negatively influences the financial performance.

The four independent variables that were studied (ESOPS, company size and inflation) explain only 79.02% of financial performance as represented by the average adjusted R^2 (0.7902). This therefore means the three independent variables contribute about 79% of financial performance decision while other factors not studied in this research contributes 21% of the financial performance of companies listed in the NSE.

There has been several studies carried out on the effect of ESOPS on firms in different sectors but findings have to a large extent corroborated the findings on the effect of ESOPS on financial performance among companies listed in the NSE in Kenya. The study concludes that ESOPS have a strong positive influence on the financial performance among companies listed in the NSE in Kenya. My results are consistent with prior research by Pugh et al. (2000) who observed that ESOPs are being used by corporate managers to take advantage of tax benefits, boost short-term profits, or erect takeover defences. Further, employee stock ownership is widely recognized as an effective means of improving corporate performance by enabling employees to participate in the creation and sharing of wealth they create in an organisation (Earl, 2000).

The study deduced that although the overall relationship between ESOPS and financial performance is positive, there are some cases showing negative relationship. Thus, the relationship between ESOPS and financial performance remains a controversial. This is in line with earlier studies that showed mixed results about the relationship between ESOPS and financial performance with few predicting a negative relationship (Pugh et al., 2000; Weston et al., 1990; Gordon and Pound, 1990; Lisa and Zwirlein, 1995) while other confirms positive relationship between inflation and financial performance (Blasi et al. 2003; Gordon and Pound, 2005). Even though these researchers have found a positive relationship between

employee ownership and financial performance, other studies reported no relationship between employee ownership and financial performance. Kruse and Blasi (1997: 134-136) summarize eleven studies evaluating comparison of (a) performance before and after adoption of the ESOP, (b) ESOP to non-ESOP firms, and (c) post adoption performance to matched non-ESOP firms. Most of the studies find small positive, but statistically insignificant effects.

From the findings, it can be observed that ESOPS affects financial performance positively. Any time a company issues ESOPS the employees and management will feel a form of ownership and will be more committed to their work leading to increased performance. However, the study deduced that the dummy variable, company size positively influence financial performance while inflation negatively influence financial performance hence the conclusion of this study is that ESOPS and company size have a strong positive correlation with financial performance while inflation has strong negative correlation with financial performance. Therefore it will be important for a firm's management to understand the relationship that exists between ESOPS, company size and inflation and financial performance and the direction that they affect the level of financial performance for effective decision making.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1Summary

The secondary data in this analysis covered a period of 10 years from 2003 to 2012. The population of study comprised of all companies listed in the NSE operating in Kenya during the study period. After the screening process, firms that were dealing with bid employee stock ownership plans were considered hence 9 companies were included in the study. The purpose of the study is to investigate the level of ESOPS adoption and the effect of employee stock ownership plans on financial performance of companies listed in the Nairobi Securities Exchange.

This study was conducted through the use of a descriptive design. The study used purposeful sampling to pick 9 companies listed in the NSE having employee stock ownership plans for the period (2003-2012) which was exposed to sensitivity analysis using OLS regression.

The study found that the regression equations for the period 2003-2012 related financial performance of the companies to their ESOPS, company size and inflation. From the above regression models for the ten years, the study found out that there were several factors influencing the financial performance of companies listed in the NSE, which are ESOPS, company size and inflation. They either influenced it positively or negatively. The three independent variables that were studied (ESOPS, company size and inflation) explain 79.02% of financial performance as represented by the average R^2.

The study concludes that ESOPS have a strong positive and significant influence on the financial performance among companies listed in the NSE in Kenya. The study recommends that the companies' management should put in place and implement corporate policies in encouraging employees to take up the ESOPs among the companies listed in the NSE. This is by having a high-involvement and open culture necessary for ESOPs to thrive. The study also recommends that a public policy formulation encouraging investors and entrepreneurs to promote broad based ESOPs in their investments and enterprises. The policy also should facilitate employee buyouts scheme and business succession, a successful alternatives to selling the company to an external buyer.

5.2 Conclusions

This paper examines the effect of ESOPs on financial performance among companies listed in the NSE in Kenya. The study concludes that ESOPs have a strong positive influence on the financial performance among companies listed in the NSE in Kenya. ESOPs are used for many reasons, including providing for a tax-favored, flexible transition of ownership in closely held companies and as a means of providing an additional benefit that ties employee and company interests together. Employee stock ownership is an effective means of improving corporate performance by enabling employees to participate in the creation and sharing of wealth they create in an organisation, greater employee morale and satisfaction.

Employees, given an ownership stake in the company, would have the incentive to increase its productivity and performance. Improvements in morale and job satisfaction were expected to promote the overall productivity and competitiveness. ESOPs are used by corporate managers to take advantage of tax benefits, boost short-term profits, or erect takeover defences.

The study deduced that although the overall relationship between ESOPs and financial performance is strong and positive, there are some cases showing negative relationship. Thus, the relationship between ESOPs and financial performance remains a controversial. These shows there are mixed results about the relationship between ESOPs and financial performance with both a negative relationship and a positive relationship between ESOPs and financial performance. This also point on the existence of a non linear relationship between these two variables. Reinforcing the findings of some previous studies such as Conte et al. (1996), our test casts further doubts on the presumed role of ESOPs in providing useful employee incentives. On the other hand, our finding supports the prediction of contract theory that highly diffused ownership does not induce meaningful work incentives. Because equity shares under an ESOP are typically allocated to a large number of employees, such plans are likely to incur a serious free-rider problem and hence are ineffective in motivating employees. The perceived benefits of an ESOP may be attainable only with an organizational form in which the incentive-productivity-performance link is more easily observable by the participating employees. ESOPs from a company's perspective can bring increased customer and employee attraction rates, talent retention and employee motivation through pride. But such recognition relies on more than quick fix perks.

5.3 Recommendations for Policy and Practice

Since the study established that ESOP have a significant influence on the financial performance, CMA should concentrate on those policies which encourage the adoption of the ESOPs among companies since they may be helpful in enhancing financial performance of the companies and therefore achievement of robust economic growth. It is essential to have someone in the company who knows ESOPs well who is charged with working with a qualified ESOP plan administrator.

Since the study deduced that ESOP generally affects the financial performance of the companies listed in the NSE positively, the researcher recommends that the companies' management should put in place and implement corporate policies that better align the interest of employees and employers so as to promote employee engagement and productivity. This can be achieved by encouraging employees to take up the ESOPs among the companies listed in the NSE and by having a high-involvement and open culture necessary for an ESOP to thrive.

Due to strong positive relationship of ESOPs and financial performance, public policy recommendation should be formulated by the Government of Kenya to promote broad based ESOP which in turn enhances national saving and facilitate as well as encouraging the development of small to medium, privately owned enterprises including startup companies.

The study also recommends that a public policy formulation encouraging investors and entrepreneurs to promote broad based ESOPs in their investments and enterprises. This is because for the enterprising business owner who has toiled for years to grow their business and now dreams of retirement, ESOPs allow for a transitional scale back of day- to- day involvement. The policy also should facilitate employee buyouts scheme and business succession, a successful alternatives to selling the company to an external buyer.

5.4 Limitations of the Study

While the results from this analysis are intriguing, there are several limitations which must be acknowledged. First, since all of the data (both independent and dependent variables) were collected from the same companies listed in the NSE, it is unclear to what extent the results suffer from common method variance. Further, the data was tedious to collect and compute as it was in very raw form.

Other limitations include the utilization of only three explanatory variables in each equation. This fairly parsimonious approach begets concerns regarding possible omitted variables. In particular, organization culture may be important factor influencing the financial performance or moderating the effect of ESOPs. Further, the financial performance computations may be incomplete. For example, the extent of firm's foreign operations and ownership structure might impact on their financial performance. We excluded these variables due to data and cost constraints.

Further, the model may not be reliable due to some shortcoming of the regression models. Due to the shortcomings of regression models, other models can be used to explain the various relationships between the variables.

In addition, the researcher was unable to collect information regarding the history of each company, which may be an important influence on ESOP attributes important in relationship to performance. For example, if an ESOP saved a company from bankruptcy, then the ESOP may be more egalitarian as opposed to if the ESOP arose out of possible tax advantages.

5.5 Suggestions for Further Research

This paper examines the effect of ESOPs on financial performance among companies listed in the NSE in Kenya. The study also recommends that a similar study to be done on other firms not listed in the NSE to allow for generalization of the effect of ESOPs on financial performance in Kenya. This is because unlisted companies have different approach to their operations not following the CMA guidelines which affect their financial performance.

The literature on ESOPs strongly suggests that without Employee Participation, employee ownership is likely to be a waste of time and effort. The success of ESOPs may also be culturally unique to that country and research is needed to assess whether Kenyans have similar attitudes towards ESOPs.

Further studies should also be done on the various aspects of ESOP valuation, including the repurchase obligation and selecting an appraiser and how they affect the financial performance of the companies listed in the NSE. A study should also be done on the effect of board compensation, trustee selection and responsibilities, and employee roles on boards on financial performance of ESOP companies.

A comparative study should also be done on the effect of ESOPs schemes in stable sectors with relatively low-educated and low-paid employees, e.g. construction, and those companies in dynamic sectors with highly educated and high-paid employees such as IT and telecommunication.

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Appendix I: Approved ESOPS at the NSE

1. East African Breweries Limited
2. Equity Bank (K) Ltd
3. Kenya Commercial Bank (K) Ltd
4. Kenol Kobil Ltd
5. Athi River Mining Ltd
6. Access (K) group
7. Safaricom Ltd
8. Housing finance Company of Kenya
9. Scangroup Ltd

Appendix II: Raw Data

NUMBER OF ESOPS (in units)

	EABL	EQUITY	KCB	KENOL	ARM	ACCESS K.	SCANGROUP	SAFARICOM	HFCK
2012	2,581,890	142,866,900	18,486,000	4,159,510	24,775,000	6,687,001	2,754,249	101,000,000	5,750,000
2011	2,581,890	154,597,000	18,486,000	4,159,510	4,955,000	6,368,490	2,754,249	101,000,000	5,750,000
2010	2,581,890	141,922,000		3,941,360	5,455,000		2,754,249	101,000,000	5,750,000
2009	2,581,890	150,184,000		3,772,000	5,955,000		8,146,470		5,750,000
2008	2,581,890	15,018,400		900,000	6,055,000		8,146,470		5,750,000
2007	2,581,890	15,018,400			6,055,000				5,750,000
2006	2,581,890	5,000,000							5,750,000
2005	1,681,890	5,000,000							
2004	1,681,890								
2003	1,681,890								

Source: NSE, (2013).

TOTAL NUMBER OF SHARES (Units)

	EABL	EQUITY	KCB	KENOL	ARM	ACCESS K.	SCANGROUP	SAFARICOM	HFCK
2012	790,774,356	3,702,777,020	2,970,249,681	1,471,761,200	495,275,000	208,084,296	284,789,128	40,000,000,000	230,600,000
2011	790,774,356	3,702,777,020	2,968,746,000	1,471,761,120	99,055,000	207,655,708	284,789,128	40,000,000,000	230,425,000
2010	790,774,356	3,702,777,020	2,950,260,000	1,471,761,120	99,055,000	207,227,120	234,570,024	40,000,000,000	230,000,000
2009	790,774,356	3,702,777,020	2,217,777,777	147,176,120	99,055,000	203,581,223	220,689,655	40,000,000,000	230,000,000
2008	790,774,356	370,277,702	2,217,777,777	130,080,120	99,055,000	203,581,223	220,689,655	40,000,000,000	230,000,000
2007	658,978,630	362,209,905	1,996,000,000	101,696,120	99,055,000	199,885,578	160,000,000		115,000,000
2006	658,978,630	90,564,550	1,996,000,000	101,696,120	93,000,000		159,000,000		115,000,000
2005	658,978,630		1,996,000,000	100,796,120	93,000,000				115,000,000
2004	109,829,772		1,996,000,000	100,796,120	93,000,000				115,000,000
2003	109,030,506		149,600,000	10,079,612	93,000,000				115,000,000
2002	109,030,506		149,600,000	10,079,612	93,000,000				115,000,000

Source: NSE, (2013).

MARKET CAPITALISATION Kshs

	EABL	EQUITY	KCB	KENOL	ARM	ACCESS K.	SCANGROUP	SAFARICOM	HFCK
2012	179,505,778,812	87,940,954,225	88,364,928,010	19,942,364,260	22,089,265,000	915,570,902	19,508,055,268	128,000,000,000	3,562,770,000
2011	154,200,999,420	60725543128	50,023,370,100	14,644,023,144	15,650,690,000	1,069,426,896	11,818,748,812	152,000,000,000	2,857,270,000
2010	143,130,158,436	99,049,285,285	64,168,155,000	14,717,611,200	18,127,065,000	2,797,566,120	12,021,713,730	220,000,000,000	6,095,000,000
2009	114,662,281,620	53,134,850,237	45,464,444,429	7,358,806,000	10,995,105,000	4,122,519,766	5,627,586,203	20,000,000,000	4,140,000,000
2008	157,364,096,844	65,168,875,552	52,117,777,760	9,713,623,920	8,964,477,500	4,224,310,377	5,737,931,030	144,000,000,000	4,462,000,000
2007	101,482,709,020	54,331,485,750	56,886,000,000	9,915,371,700	9,212,115,000	4,647,339,689	4,730,250,000		5,261,250,000
2006	91,598,029,570	12,588,472,450	56,886,000,000	10,474,700,360	7,719,000,000		3,935,250,000		5,520,000,000
2005	98,187,815,870		22,554,800,000	12,700,311,120	3,673,500,000				1,604,250,000
2004	48,874,248,540		22,554,800,000	5,090,204,060	1,395,000,000				977,500,000
2003	24,640,894,356		8,078,400,000	2,741,654,464	1,976,250,000				1,385,750,000
2002	8,995,016,745		2,543,200,000	2,741,654,464	437,100,000				598,000,000

Source: NSE, (2013).

EARNINGS AFTER TAX Kshs.000

	EABL	EQUITY	KCB	KENOL	ARM	ACCESS K.	SCANGROUP	SAFARICOM	HFCK
2012	11,186,113	12,080,255	12,203,531	-6,284,575	1,245,638	151,377	752,009	12,737,837	743,334
2011	9,023,660	10,325,157	10,981,046	3,273,831	1,150,498	109,084	911,116	13,158,973	622,278
2010	8,838,000	7,131,325	7,177,973	1,915,045	1,075,268	-7,951	640,585	15,148,038	379,531
2009	9,184,385	4,234,000	4,190,690	1,294,505	645,774	147,909	401,148	10,536,760	234,176
2008	7,528,891	3,910,000	2,974,572	593,434	503,454	203,656	315,789	13,853,286	136,427
2007	6,410,042	1,890,283	2,431,878	842,947	421,659	133,510	244,433		73,508
2006	5,776,228	753,366	1,326,027	915,878	264,557		195,526		101,049
2005	4,747,913		1,326,027	838,484	199,504				58,799
2004	1,964,146		485,520	468,745	116,718				59,976
2003	2,300,794		-3,000,639	467,129	97,106				51,847
2002	2,300,794		-3,000,639	453,894	57,390				55,851

Source: NSE, (2013).

Inflation

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Jan	1.1	8.9	12.7	9.9	3.8	2.6	16.9	12.1	9.1	4.7	18.9
Feb	1.7	7.4	13.1	14.9	7.7	3.1	16.3	11.9	5.9	4.1	18.3
March	2.1	8.1	12.9	13.9	9.5	3.3	16.7	10.5	5.3	3.6	16.7
April	1.3	10.7	8.9	14.2	9.6	3.1	17.2	7.8	4.1	4.2	15.6
May	3.2	12.7	9.7	10.4	7.5	2.1	18.2	9.9	2.7	3.9	13.1
June	3.5	11.2	9.9	10.3	6.6	2.7	17.3	6.2	3.2	4.7	12.2
July	2.8	10.9	10.9	11.9	5.5	5.3	18.1	12.8	4.3	4.5	10.1
Aug	1.5	8.9	12.6	11.8	5.1	6.2	15.9	12.1	3.3	14.49	7.7
Sep	1.4	12.3	9.9	6.9	5.8	5.1	11.7	10.5	2.6	16.6	6.1
Oct	1.3	7.8	11.6	4.3	6.9	4.4	13.9	9.9	3.1	15.5	5.4
Nov	1.6	8.4	10.8	3.7	7.9	5.2	16.4	12.4	2.9	17.3	4.14
Dec	2.2	8.2	9.4	6	7.3	9.5	15.2	9.9	2.7	19.7	3.3

Source: Kenya National Bureau Of Statistics (2013).