THE RELATIONSHIP BETWEEN DIRECTORS REMUNERATION AND FINANCIAL PERFORMANCE OF COMPANIES QUOTED AT THE NAIROBI SECURITIES EXCHANGE

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DECLARATION

This Research Project is my original work and has not been presented for a degree in any University or Institution.

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DEDICATION

I dedicate this work to my lovely wife Angela Njoki Karuga and my mother Agnes Wacera Karuga for the support and encouragement they gave me during this period when I was pursuing my Project.
ABSTRACT

Director or executive remuneration has always been a major subject for debate in the US, Europe, Asia and even in Africa’s emerging markets. The issue also got a lot of attention after the Enron scandal in 2001 as Enron’s compensation and performance management system was designed to retain and reward its most valuable employees, however it led to a dysfunctional corporate culture that led to its bankruptcy. Under the agency problem directors act as agents of the shareholders and received high pay. To resolve the agency problem many writers have recommended corporate governance principles including tying directors pay to firm performance. Companies at the Nairobi Securities exchange are required to comply with corporate governance principles issued by the Capital markets Authority. The purpose of this study was to find out if a relationship exists between director’s remuneration and firm performance and also to test the significance of this relationship.

A regression analysis of the 62 companies at the Nairobi stock exchange was conducted to establish the relationship and significance between director’s remuneration and firm performance. 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 study found a negative but non-significant relationship between director’s remuneration and firm performance. The study recommended that directors compensation and performance measures need to be disclosed publicly especially for the publicly traded companies.
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CHAPTER ONE INTRODUCTION

1.1 Background

Employees in a wide variety of employment get rewarded for their efforts based on measured performance. The rational for performance based compensation is to motivate employees to increase their efforts and output. Some evidence has suggested that payment for performance can actually increase performance. Lazear (2000) showed that a move from hourly pay to piece-rate pay increased productivity by 44%. There are many sophisticated compensation models that have been offered but have largely remained untested due to lack of sufficient data (Lazear, 2000).

Several financial and non-financial indicators are used in the design of performance evaluation tools used by most companies to determine compensation for executives (Banker and Datar, 1989). For years financial performance has been used to measure managerial performance with prior research indicating a significant relationship between financial performance of a company and executive compensation (Ittner, 1997).

It is also believed that with improved governance practices more of the firm's free cash flow will be returned to them as dividends rather than being expropriated by the managers who control the firm (Jensen, 1986; La Porta et al., 2002; Shleifer and Wolfenzon, 2002). Empirical studies have shown a relationship between improved governance practices and better firm financial performance (MacAvoy and Millstein, 2003; Millstein and MacAvoy, 1998). Data from large economies show that better-governed firms reduce control rights, which shareholders and creditors confer on managers, increasing the probability that managers invest in shareholder value creating projects (Shleifer and Vishny, 1997).

Traditionally the compensation aspect suggests that most annual cash bonus plans for key executive officers are based on accounting performance measures (Ittner, et al., 1997). Recent evidence suggests that the annual cash pay of a majority of CEOs is less than 10% of the annual benefits from their stock options and stock holdings in the employer entity (Core, et al., 2003). However most research suggests that both provide meaningful incentives for managers and also...
to then monitor their performance, accounting information is essential. The links between accounting performance measures and the current and future market value of the firm justify their use as a target that may be impacted by managerial performance. However modern managerial accounting has evolved to encompass more strategic approach that identifies and measures key financial and non-financial indicators. Use of the balance score card process is associated with higher measurement system satisfaction but have no relation with economic performance (Ittner. Et al 2003).

Teamwork has increasingly been seen as the best structure in various employment setups (Beyerlein. 2000). However suitable incentives for teams appear to be one f the most challenging tasks (Main. Et al. 1993). Individual team members will be often rewarded for the performance of the entire team so as to encourage cooperative behavior; individual members will strive for the best outcome of the whole team. However such schemes may provide free-riding incentives leading to unequal effort levels (Alchian and Demsetz. 1972). The intuitive approach is to reduce free-riding incentives in teams by promising rewards to best performers in teams (Heneman and Hippel, 1995). Another alternative would be to introduce competition among team members. Research found that designers of compensation packages face a trade-off when introducing competitive structure in to a team setting. Relative rewards are likely to have counteracting effect highlighting drawbacks of distracting team members from acting cooperatively (Ilrenbusch & Ruchala. 2006)

1.1.1 Directors Remuneration

Companies Act 1956 Section 309(1) of the Act requires that the remuneration payable both to the executive as well as non-executive directors is required to be determined by the board in accordance with and subject to the provisions of section 198 either by the articles of the company or by resolution or if the articles so require, by a special resolution, passed by the company in a general meeting. Further, Schedule VI of the Act requires disclosure of Director’s remuneration and computation of net profits for that purpose.

The compensation literature suggests that most annual cash bonus plans for key executive officers are based in large part on accounting performance measures. There is also some relationship between accounting performance and stock based compensation in many firms since
the pool of stock options or stock awards to be distributed each year is often based on annual accounting performance measures. The literature has also documented a high correlation in the total annual inceptive pay amongst the top executives in each firm, and it is commonly assumed that what is observed for the CEO is representative of the incentive pay for the entire top management team for most entities (Gore et al. 2003; Ittner, et al., 1997).

According to disclosures on the annual reports of listed companies, executive remuneration in the Kenyan banking industry can be divided into salaries, allowances, cash bonuses and fees for services as directors. Another key benefit obtained by directors is the ease of access to loans with all the listed banks having advanced loans to their directors. Firms are required to disclose information on top five executives’ compensation; Kenyan listed firms have typically publicly disclosed only aggregated total compensation of a firm’s board of directors. This compensation is limited to cash compensation as share option issues have not come into play yet as such the NSE disclosure on shares is limited to bonus and rights issues to the general investing public (NSE Handbook, 2004).

Executive compensation in Kenya has received increasing attention, and this is a longitudinal study of Kenyan executives’ pay, providing an assessment of the effect of accounting performance measurements on the pay-performance relationship over time. The banking industry provides an excellent setting for the study of incentive compatible compensation since banks have few tangible assets and large off-balance sheet positions, easily smoothed accounting returns, a weak market for corporate control, comparatively high profits and highly paid executives; banks are institutions in which owner-manager agency problems may flourish. Study therefore seeks to fill the gap by examining the sensitivity of any relationship between executive and measures of firm performance in Kenyan setting.

In the Kenyan commercial scene executive remuneration has not come under massive spotlight perhaps due to the nature of executive remuneration. The Kenyan Companies Act sets the general framework for financial accounting and reporting by all registered companies in Kenya, and stipulates the basic minimum requirements with regard to financial reporting. Due to the limited details of the Act, financial reporting and regulation are supplemented by pronouncements of the Institute of Certified Public Accountants Kenya (Barako et al, 2006). In
view of the absence of stock option advancements to the executive as a major incentive, the relationship between stock performance and executive remuneration may be weak as the stock market performance is not a determinant of the level of executive pay. This is more so given that for most listed companies the payment of executives may not be material in amount and is insignificant in its impact on price and as such it is not subjected to the materiality rule as stated in the NSE handbook (2004). Thus as per the NSE handbook, specific details of executive compensation are not required

1.1.2 Financial performance

Financial Performance is defined as a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm’s overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation.

There are many different ways to measure financial performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales. Furthermore, the analyst or investor may wish to look deeper into financial statements and seek out margin growth rates or any declining debt. (ABS, 2001)

1.1.3 Nairobi securities exchange

The Stock Exchange is a market that deals in the exchange of securities issued by publicly quoted companies and the Government.

The Nairobi Stock Exchange was formed in 1954 as a voluntary organization of stock brokers registered under the societies Act after getting clearance from the London Stock Exchange to recognize it as an overseas stock exchange. The NSE is now one of the most active capital markets in Africa in terms of trading volumes, it has grown over the years and has undergone reforms culminating to live trading in September 2006 eliminating the need of stock brokers sending dealers to the trading floor. The administration of the Nairobi Securities Exchange Limited is located on the 1st Floor, Nation Centre, Kimathi Street, Nairobi.
As a capital market institution, the Securities Exchange plays an important role in the process of economic development. It helps mobilize domestic savings thereby bringing about the reallocation of financial resources from dormant to active agents. Long-term investments are made liquid, as the transfer of securities between shareholders is facilitated. The Exchange has also enabled companies to engage local participation in their equity, thereby giving Kenyans a chance to own shares (NSE, 2007). Companies can also raise extra finance essential for expansion and development. To raise funds, a new issuer publishes a prospectus which gives all pertinent particulars about the operations and future prospects and states the price of the issue. A stock market also enhances the inflow of international capital. They can also be useful tools for privatization programmes.

Currently the NSE is made up of 55 listed companies two of which are suspended and nineteen member firms (stock broking firms). (NSE, 2010). These members of the Nairobi Stock Exchange transact business mainly on the within Nairobi stock market, with a limited proportion of business conducted in foreign securities through overseas agents. Stocks are first brought to the market and sold to investors. In the secondary market, existing shares are traded among investors.

In the Nairobi stock exchange executive compensation has not come under serious scrutiny and has largely been limited to cash salary, allowances and cash bonuses. The companies listed at the Nairobi stock exchange provide an excellent opportunity to study the relationship between executive compensation and firm performance.

1.2. Research Problem

Compensation is an important mechanism for encouraging performance, rewarding productivity and ensuring compliance with shareholders’ interests. Hence, the death of information on the directors’ pay performance association is surprising. Relatively little is known however about the determinants of the pay of directors. For example, there exist only a handful of empirical studies that explore the relationship between directors’ pay and performance (e.g. Main, Bruce and Buck 1996; Wan, Ong and Tung 2000; and Stathopoulos, Espenlaub and Walker 2004).

Globally for instance in America, The Enron scandal was revealed in October 2001, and eventually led to the bankruptcy of the Enron Corporation, an American energy company based
in Houston, Texas, and the dissolution of Arthur Andersen, which was one of the five largest audit and accountancy partnerships in the world (Bratton & William 2002). Chief Financial Officer Andrew Fastow and other executives not only misled Enron’s board of directors and audit committee on high-risk accounting practices, but also pressured Andersen to ignore the issues. Shareholders lost nearly $11 billion when Enron’s stock price, which hit a high of US$90 per share in mid-2000, plummeted to less than $1 by the end of November 2001 (Benston, George 2003). The U.S. Securities and Exchange Commission (SEC) began an investigation, and rival Houston competitor Dynegy offered to purchase the company at a fire sale price. The deal fell through, and on December 2, 2001, Enron filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code (Ayala, Astrid; Giancarlo Ibárgüen 2003).

Kenya has only 49 listed companies with a market capitalization that constitute 34% of GDP (World Bank, 2007). This is relatively small when compared to South Africa which has 668 listed companies with a market capitalization that constitutes 132% of GDP (World Bank 2007). The Kenyan Capital Market Authority (CMA) issued guidelines on corporate governance practices for publicly listed companies in 2002 (Hussein, 2003).

Local studies done include, Maina (2000) carried out a study to establish whether there exists a relationship between dividend and investment decisions since both compete for internally sourced funds and given that funds obtained by debt are very expensive and not available to all firms. Karanja (1987) studied dividend practices of publicly quoted companies and found out that there are many reasons why firms pay dividends. No study has been done on the effect of compensation on firm performance hence this study seeks to analyze the influence of Chief Executive Officer (CEO) compensation on performance of companies quoted at Nairobi Securities Exchange. Hence answering the research question: what is the effect of director’s remuneration on performance of companies quoted at Nairobi Securities Exchange?

1.3 General Objective

The general objective of this research was to analyze the relationship between director’s remuneration and financial performance of companies quoted at the Nairobi Stock Exchange.
1.3.1 Specific Objectives

The specific objectives of this study were:

i. To identify how directors remuneration director’s remuneration affects the financial performance of companies quoted at the Nairobi Securities Exchange

ii. To find out how directors remuneration affects the share price of companies quoted at the Nairobi Securities Exchange

1.4 Value of the Study

The aim of the study was to investigate the relationship between directors remuneration and financial performance of companies quoted at the Nairobi Stock Exchange. The study is expected to yield information, which will be of much value to the company for future improvement in the field of corporate governance.

1. The study will be of value shareholders as it will give insights that will assist in decision making

2. The study will also be of value to company directors and will assist them in setting their objectives for the business.

3. The value will be of value to investors, they can use findings from this research to guide their decisions in the future.
CHAPTER TWO LITERATURE REVIEW

2.1 Introduction

This chapter presents the most relevant literature by various scholars pertaining to the research questions stated in chapter 1. A review of literature is important to gain an understanding about the research topic (Hart, 2003) and to identify unexplored issues (Hart, 2003). The literature review fits two purposes; one to learn about the subjects and second to support the dissertation argument (Hart, 2003). The overall purpose of this chapter is to create a deeper understanding the effects of executive compensation in the performance of organization. Among the theories, the Accounting based Agency and Pay-Performance theories are the most significant to explain the subject of the study.

The chapter is divided into two main parts. The first covers the theoretical review on compensation which leads to development of the conceptual framework guiding this study. The second part gives the empirical studies carried out in the past and in accordance with the variables presented in the research questions.

2.2 Theoretical Framework

2.2.1 Agency theory

The separation of ownership and control gives rise to agency problems between the agents and the principals, as stated by Fama and Jensen (1983). To be exact, by the separation of ownership and control Fama and Jensen meant the separation of decision management and residual risk bearing. The problem in this setting is that the decision agents carry only a minor portion of the wealth effects of their actions (Fama and Jensen 1983). In order to control resulting agency problems, corporations separate decision management from decision control (Fama and Jensen 1983). The core of this decision control system in organizations is the board of director which has the authority to appoint, compensate, dismiss and monitor the executives and ratify their Projects (e.g. Fama and Jensen 1983; Jensen 1993).
The core of the agency theory is establishing the most effective contract to rule the relationship between the agent and the principal under certain assumptions like the conflict of interest between the agent and the principal, self-interest of both parties and managerial risk aversion (Eisenhardt 1989).

An agency relationship then, is a contract under which the principals hire the agent to work for them, equipped with necessary decision making power, as stated by Jensen and Meckling (1976). An example of such agency relationship is the corporation with dispersed ownership structure (Jensen and Meckling 1976). In the agency relationship where both the principals and the agents are utility maximizes and differ in their risk appetite, the actions of the agents are likely to differ from what would be optimal for the shareholders (Jensen and Meckling 1976). In this case, a specific contract defining the actions and decisions conducted by the director in each state of affairs, would be a viable solution (Jensen and Murphy, 1990). However, as Jensen and Murphy (1990) point out, entering into such a complete contract would be unfeasible because the investment opportunities of the company and the actions of the director are typically unnoticeable for the shareholders. Additionally, because the CEOs possess specific information about the company and its prospects it would be unreasonable to expect that the shareholders could tell the director which projects to take on and which decisions to make (Jensen and Murphy, 1990). In addition, the possibilities and incentives of the diffuse shareholders to contract with the director’s are further undermined by a free-rider problem (Hermalin & Weisbach 2003).

As an answer to this conflict of interest, the principals can offer the agents incentives to pursue shareholder wealth (Jensen & Meckling 1976; Jensen and Murphy 1990). Examples of such incentives are performance based bonuses, salary adjustments and stock options, as stated by Jensen and Murphy (1990). Other mechanisms to alleviate these agency problems, in addition to incentive compensation, are monitoring of managers’ actions and bonding by the agent (Jensen and Meckling 1976). By tying the wealth of the director St to the wealth of the shareholders, the CEOs can be persuaded to take actions in the best interest of the shareholders (Jensen and Murphy 1990). Therefore from the agency theory perspective executive compensation can be
seen as an efficient tool to reduce agency costs and thus mitigate the inherent problems with the agency relationship (Jensen & Meckling 1976; Jensen & Murphy 1990).

The use of incentive based compensation to overcome agency problems is not, however, a totally trouble-free solution because of the managerial risk aversion (Beatty and Zajac 1994). Accordingly, risk-averse CEOs who have already invested their human capital in the company would be unwilling to tie their remuneration to the company’s success (Beatty and Zajac 1994). As a consequence, the companies have to pay their CEOs more to compensate them for the higher risk (Beatty and Zajac 1994). In the same spirit Holmström (1999) points out that by tying the compensation of the agent to output like stock price, the agent is also exposed to factors that are not under his control, and as a consequence the contract is made riskier. Thus, there is a trade-off between creating efficient managerial incentives and risk sharing, which must be taken into account when establishing optimal compensation packages (e.g. Beatty and Zajac 1994; Holmström 1999; Jensen and Murphy 1990).

2.2.1 Managerial power theory

Jensen (1993) stated that the boards of directors have failed in their task of monitoring shareholder interests. This failure can be attributed, at least, to the atmosphere of politeness in boardrooms, the CEO’s dominance of the company specific information and the lack of equity ownership by both directors and managers (Jensen 1993). As a consequence, CEOs are able to gain control over the boards (Jensen 1993). Other factors that compromise the integrity of the boards of directors, according to Jensen (1993), are a large board size, insider board members, director’s duality (director’s being also the chairman of the board) and the absence of institutional owners.

Allen (1981) suggested that the managers typically use their organizational power to shield and advance their own privileges. According to Allen, the prime source of managerial power is a substantial equity stake in the company. Consequently, the director is more powerful if he owns a substantial block of the shares of the company and less powerful if the board members have block holdings (Allen 1981). Allen further stated that CEOs use their power to extract higher compensation and as a consequence, director’s compensation is directly linked to his power in a
company. Zald (1969) approached the subject of managerial power by reviewing the power of the boards in relation to the managers, and reached similar conclusions as Allen (1981).

According to Zald, the power of the boards of directors depends positively on the external resources they control. In other words, the boards of directors are more powerful the more resources (e.g. shares of the company and detailed knowledge of the company) they have under their control (Zald 1969). As a consequence, in a highly complex organization with a highly dispersed ownership structure, the director controls the information, the agendas for board meetings, the nominating processes and internal board processes altogether (Zald 1969). In a similar vein Tosi and Gomez-Mejia (1989) stated that director compensation in the management controlled companies is less tightly tied to performance than in the owner controlled companies. The reason for this is that the executives in the management-controlled companies have achieved a greater control over the internal decision mechanisms and processes and thus can influence their own compensation contracts (Tosi and Gomez-Mejia 1989).

According to Mace (1971), the boards of directors and their subcommittees are mainly symbols of the internal control mechanisms, when in reality the director makes the decisions concerning, for example, his own compensation and director selection. Loyalties that directors feel towards the director who selected them and with whom they work with, constrain their ability to critically evaluate, question or discharge the director (Mace 1971). Finally, Mace (1971) argued that the ultimate power enjoyed by the director allows him to set the agendas for board meetings. These ideas and assumptions of the managerial power are bunched together, shaped and advanced in the managerial power theory by Bebchuk, Fried and Walker in 2002. Under the managerial power theory executive compensation is not seen only as a solution to the agency problem, but also as a part of the agency problem itself (e.g. Bebchuk, Fried and Walker 2002; Bebchuk and Fried 2003). According to the managerial power theory, the managers have substantial influence over the boards of directors and as a result over their own compensation, as stated by Bebchuk et al. (2002 and 2003). As a consequence, the boards of directors do not design executive compensation packages at arm’s length but rather these compensation packages are biased towards the managers’ wishes and thus, are far from optimal (Bebchuk et al. 2002 and 2003)
The assumption under the managerial power theory is that the more power the director has the more rents he also extracts (Bebchuk et al. 2002 and 2003). The power of the director again depends on the composition of the board of directors, the presence of large shareholders, the stockholdings of the CEO, the proportion of shares held by institutional investors and the use of antitakeover arrangements (Bebchuk et al. 2002 and 2003). Accordingly, a weaker board, the absence of large shareholders, higher director stock holdings, lower institutional stockholdings and the use of antitakeover arrangements are all associated with managers having more power (Bebchuk et al. 2002 and 2003).

In a nutshell, the main difference between these two theories is that under the agency theory executive compensation is regarded as a solution to the agency problems between the agents and the shareholders, whereas under the managerial power theory executive compensation is considered as a part of that agency problem.

2.2.2 Standard Agency Theory

According to standard agency theory (Shleifer and Vishny, 1997), the choice of a privately optimal ownership structure involves a trade off between risk and incentive efficiency. Other factors kept constant, larger owners will have a stronger incentive to monitor managers and more power to enforce their interests and this should increase the inclination of managers to maximize shareholder value. Generally speaking, however, the owners’ portfolio risk will also increase the larger the ownership share. To the extent that companies differ in terms of firm specific risk, the privately optimal share of the largest shareholder (owner) will therefore, vary. Furthermore, the nature and complexity of activities carried out by individual firms may also vary, and so may the marginal effect of monitoring on the shareholder value of individual firms (Demsetz and Lehn, 1985). Small shareholders may have an insufficient incentive to maximize total shareholder value because the control and monitoring gains from large block shareholdings are shared with other investors. And if one or a very small group of shareholders attempts to acquire a large ownership stake, the gains will largely be captured by the other shareholders who sell their shares at a premium reflecting increased demand for the shares and value of the firm. This in effect leads to a positive equilibrium effect of ownership concentration on company performance since companies with large owners will do better and since minority investors have insufficient
incentives to change the ownership structure. But with increasing ownership shareholding, improved incentives will have less of an effect on performance if the marginal effect of monitoring effort is decreasing. Besides, a large ownership stake in a particular company indicates a less than fully diversified portfolio on the part of the owner so that the owner risk aversion may induce the company to trade off expected returns for lower risks. This is because a riskaverse investor, who has most of his investments in a particular line of assets, is always wary of the chances of his capital being substantially reduced or even wiped out in a hostile investment environment (Short, 1994). Finally, the separation between ownership and management becomes blurred as ownership share increases with the added risk or owner “entrenchment” due to private benefits of control (information advantages, perks, etc) (Ibid, 1994). From the above literature, and in accordance with Morck, Shleifer and Vishny (1988), the following hypothesis is suggested: There is a positive relationship between ownership concentration and firm performance.

2.3 Operationalization of the concepts

2.3.1 Board Size

Vafeas (2003) used the same indicator variable to determine remuneration committee independence in setting the director’s compensation in a larger sample of US firms for the period between 1991 and 1997. Consistent with Newman and Mozes (1999), he documented no differences in the level of director’s compensation and the pay-performance relationship between firms with an insider sitting on the remuneration committee and others with no insiders’ directors. However, he found that the compensation practices had been improved within insider influenced firms after the related regulatory changes in 1992 (i.e. the compensation disclosure and tax reforms), as he found some improvement in pay-performance sensitivity.

Anderson and Bizjak (2000) examined the association between the level of executive compensation and the proportion of outsiders serving on the remuneration committee and the presence of the director’s of the firm on its remuneration committee. They argued that firms will suffer from greater agency problems if the director’s or an insider sits on the committee. Using a randomly-selected small sample of 75 NYSE firms for the period from 1985 to 1994, they found
that neither the existence of an insider, nor the director’s of the firm on the remuneration committee, affect the level of director’s compensation. However, they documented a negative relationship between the proportion of external directors and director’s salary and bonus. On the other hand, in terms of director option sensitivity, they found it positively correlated to the percentage of outside directors on the remuneration committee but negatively and significantly related to the presence of the director on the committee.

Also, Conyon and He (2004) found the same findings that the proportion of insiders on the remuneration committee has no impact on the level of managerial compensation in a more recent sample of US firms (1998-2000).

Consistent with the literature that investigates the role of board independence on corporate governance; previous studies which examined the impact of a remuneration committee’s independence have used virtually the same measures to evaluate committee independence in setting managerial compensation. For example, the proportion of outside or inside directors sitting on the remuneration committee has been used as a proxy for committee independence in most of the earlier research (e.g. Newman and Mozes, 1999; Anderson and Bizjak, 2000; Vafeas, 2003; Conyon and He, 2004; Bonet and Conyon; 2005; Johnston, 2007), while others try to examine the differences between different sorts of outside directors according to their relationships with the firm and/or the management (e.g. Daily et al., 1998; Sun and Cahan, 2009). Generally, they argue that the presence of an independent remuneration committee helps in setting the executive compensation in a way that protects the shareholders’ interests (e.g. Vafeas, 2003). However, others suggest that insiders on the remuneration committee may have the motivation to enhance their reputation as decision-makers through setting appropriate managerial arrangements (Anderson and Bizjak, 2000).

2.3.2 Effects of Managerial Ownership

The pertinent literature on corporate governance pays much attention to the issue of shareholder identity (Shleifer and Vishny, 1997; Welch, 2004; Xu and Wang, 1997). The cited authors argue that the objective functions and the costs of exercising control over managers vary substantially for different types of owners. The implication is that, it is important, not only how much equity a
shareholder owns, but also who this shareholder is, that is, a private person, manager, financial institution, non-financial institution enterprise, multi-national corporation or government. Investors differ in terms of wealth, risk aversion and the priority they attach to shareholder value relative to other goals. Owner preferences and investment choices are influenced by shareholder interests that the owners may have in addition to their own interests (Cubbin and Leech, 1982; Nickel, 1997; Hill and Jones, 1982; Hansmann, 1988; 1996). To the extent that owners have their economic relations with the firm, conflicts of interest may arise. For example, banks may play a dual role as lenders and owners, government as regulators and owners (Thomsen and Pedersen, 1997). For each of these stakeholders, preferences regarding company strategy will involve a trade-off between the pursuit of shareholder value and other goals. A similar trade-off is implied for corporate owners such as multi-national parent companies that may want to sacrifice local profit maximization for global interest of the organization.

Among the different ownership forms, managerial ownership seems to be the most controversial as it has ambivalent effects on firm performance. On one hand, it is considered as a tool for alignment of managerial interests with those of shareholders, while on the other hand, it promotes entrenchment of managers, which is especially costly when they do not act in the interest of shareholders (Mork et al, 1988; Stulz, 1988). Thomsen and Pedersen (2000) posit that the relationship between ownership concentration (as a proxy for shareholder control over managers) and firm performance depends on the identity of the large (controlling) shareholders. One possible interpretation of this finding is that different types of shareholders have different investment priorities, and preferences for how to deal with managers’ agency problems. The overall impact of managerial ownership on corporate performance depends on the relative strengths of the incentive alignment and entrenchment effects.

Regarding government (state) ownership, there is much more unanimity in the academic circles. State ownership has been regarded as inefficient and bureaucratic. Stulz (1988) defines state-owned enterprises as “political” firms with general public as a collective owner. A specific characteristic of these firms is that individual citizens have no direct claim on their residual income and are not able to transfer their ownership rights. Ownership rights are exercised by some level in the bureaucracy, which does not have clear incentives to improve firm
performance. Yarrow (1988) considers the lack of incentives as the major argument against state ownership. Other explanations include the price policy, political intervention and human capital problems (Shleifer and Vishny, 1994). State ownership of firms is not without some benefits to the society.

Ownership could limit the level of directors’ remuneration in three ways. First, ownership could align the interest of management to the interest of owners (Jensen and Meckling, 1976). Therefore, the agency theory predicts that the alignment of interest should lead to lower directors' remuneration because excessive remuneration (and perks) leads to the value of the firm being lowered by the market. Remuneration packages (and perks) are considered as excessive if they are not linked to performance. This contention has been supported empirically by Morck et al. (1988) and McConnell and Servaes (1990). They show that at the lower level of managerial ownership (at less than five percent), the relation between managerial ownership and Rev Gr is positive. However, McConnell and Servaes's evidence indicates that management entrenchment is present when managerial ownership is 25 percent and above. Thus, it is predicted that at higher ownership levels, management tends to expropriate the firm's wealth by paying excessive compensation. Firth et al. (1999), using HK data, document evidence of a negative and strong association between executive directors' pay and family controlled firms. Their evidence also shows a negative and significant association between board's shareholdings and executive directors’ pay.

In recent years, top directors' pay has shown an upward trend. Evidence in Malaysia also shows a similar trend (e.g. Hassan et al., 2003). This upward trend is perhaps justified with the greater directors' responsibilities and accountability in managing today's modern businesses. Further, as directors, especially the executive directors, cannot diversify their risk as shareholders could, they should be entitled for higher remuneration. Further, there is no limitation on the amount of remuneration received by directors and this is stressed in the Malaysian Code which says that the remuneration packages should be able to attract and retain directors of high caliber (Malaysian Code, 2001). But, so long as the rise is commensurated with improved firm's performance, it is seen as justified. Thus, the following hypothesis is tested: H4. Managerial ownership is negatively associated with directors' remuneration. Outside directors' shareholdings could
influence directors' remuneration because the ownership leads to greater vigilance by the outside directors because their wealth is tied with the firm's performance. Jensen (1993, p. 864) contends, “many problems arise from the fact that neither managers nor non-managerial board members typically own substantial fractions of their firm's equity”. He states further that “encouraging outside board members to hold substantial equity interests would provide better incentive” (Jensen, 1993, p. 864) for them to monitor the management. Thus, the extent to which outside directors hold shares in the firms is associated with their intensity of monitoring management and in ensuring the management pursues value-increasing activities (Beatty and Zajac, 1994). Non-executive directors' incentives to be involved in monitoring management or involvement in strategy development and implementation (Kesner, 1987; Oswald and Jahera, 1991; Shivdasani and Yermack, 1999) and thus increasing the value of the firm are directly associated with the percentage of shares owned.

Hambrick and Jackson (2000) also provide evidence which shows that the extent of non-executive directors' interests not only help to create incentives but also make them feel more affiliated to the company, resulting in them being more involved in their oversight and more generous in their time and attention. In Malaysia, interests by outside directors are predicted to influence the board in making decisions relating to directors' remuneration because the issue of directors' remuneration became prominent during the 1997-1998 crisis. The Report on Corporate Governance (Finance Committee, 1999) also attempted to address this issue by recommending the formation of remuneration committee consisting of wholly or mainly non-executive directors. The hypothesis is therefore as follows:H5. Non-executive directors' interest is associated negatively with directors' remuneration. The extent to which a firm's shares are owned in large quantity by outsiders is also predicted to have significant influence in constraining management behaviors, including their remuneration. This is because these large shareholders could exercise their rights at the annual general meetings to vote against re-electing poorly performing directors and excessively remunerated directors. In addition, these large shareholders could bring down the price of firm's shares by selling their shareholdings. Thus, it is predicted the extent to which large shareholders own a firm's shares keeps management always on guard for the consequences of their decisions.
The involvement of large shareholders in monitoring or controlling activities could mitigate the agency problems could (Shleifer and Vishny, 1986; Admati et al., 1993; Huddart, 1993; Maug, 1998; Noe, 2002). The large shareholder's high incentives to monitor management are expected due to their wealth being tied into the company's financial performance. Evidence by Bethel et al. (1998) is consistent with this prediction where they find that the performance of a company improves following an acquisition of a block of shares by an active investor.

Empirical evidence in Malaysia (Abdullah, 2004) shows evidence consistent with the high monitoring incentives of outside blockholders on the increase in the value of the firm. He finds that the extent of outside blockholders' ownership is negatively associated with firm's distress status. Thus, it is therefore predicted, since excessive directors' remuneration leads to a lowering of the value of the firm, the extent of outside blockholder's ownership leads to fair directors' remuneration packages. Therefore, the hypothesis is as follows:H6. There is a negative association between the extent of outside blockholdings and directors' remuneration.

2.4 Empirical studies

Previous studies provide both theoretical and empirical support that use of both debt and dividend helps to discourage overinvestment of free cash flow by self-serving managers. Debt acts as a corporate governance mechanism that can voluntarily be used to transfer the functions of monitoring and evaluating managerial performance to the participants of the capital market (debtholders) (Agrawal and Knoeber, 1996; Begley and Feltham, 1999; Jensen, 1986). Conversely, Agrawal and Knoeber (1996) and Beiner et al. (2003) find that there is no relationship between debt and firm performance. Fama (1980) states that when managers are less diversified than their shareholders' i.e. in addition to holding stock and stock options, their human capital is also specific to the firm. Consequently, the managers may increase leverage beyond the “optimal capital structure” to increase the voting power of their equity stakes and reduce the likelihood of a takeover and the resulting possible loss of job tenure. In New Zealand companies have relied on debt as a source of capital and debtholders have a tendency to safeguard their investment, monitoring firm performance on a regular basis. It is assumed that the use of debt will have a positive effect on firm financial performance.
Linking directors' remuneration to corporate performance should be seen as fair to the shareholders, as directors, especially involving executive directors' remuneration packages, are rewarded based on their individual and corporate performance. Various studies have been carried out in UK to examine whether such a link indeed exists, with top director's remuneration being the focus (Gregg et al., 1993; Conyon and Leech, 1994; Conyon and Gregg, 1994a, b; Conyon et al., 1995). Their evidence shows that corporate growth is an important determinant of top director's remuneration. Main et al. (1996) show a positive and significant relation between the total board remuneration and the firm's performance. Conyon and Peck (1998) also document evidence of a positive and significant correlation between performance and the remuneration. Their evidence also shows a positive significant association between firm's size and the firm's highest paid director's remuneration. Jensen and Murphy (1990) find only a weak link between directors' compensation and firm's performance. Martin and Gregg (1994) also show that directors' pay growth is not related to the firm's current accounting profits but it was related positively to sales growth. Closer to Malaysia, Firth et al. (1999), found performance, as measured by contemporaneous and lagged accounting profitability, is associated positively and strongly with CEO and executive directors' compensation.

In Malaysia, Hassan et al. (2003) who examine the link between directors' remuneration and corporate performance involving firms pre- and during the Asian financial crisis period found only a weak relation, though it is positive. Interestingly, their evidence from the lag-effect analysis shows a strong relation between financial indicators and directors' remuneration. Their evidence also shows a positive and significant association between directors' remuneration and firm's size and firm's turnover, which they argue, represent firm's internal growth and the positive and significant relations of these variables are consistent with the earlier findings in the UK and in Hong Kong (Firth et al., 1999). However, one important observation from Hassan et al.'s (2003) study is that: the level of directors' remuneration showed a steady growth (1997: 5.5 percent, 1998: 2 percent) against the deteriorating ROE (1996: 16.49 percent; 1997: 11.32 percent; 1998: −3.47 percent). Thus, this evidence suggests that directors experienced an increase in their remuneration at the expense of the shareholders' returns.

similar to debt financing. The higher the payout ratio, the smaller the amount of free cash flows.
Also, Crutchley and Hansen (1989) show evidence of dividend policy acting as a corporate monitoring vehicle. Farinha (2003) provides empirical evidence of dividend policy reducing agency problems either by increasing the frequency of external capital raising and associated monitoring by investment bankers and investors (Easterbrook, 1984) or it is reasonable to assume that dividend payouts will have a positive effect on company performance.

Lewellen and Huntsman (1970) analyse 50 US firms at three-year intervals beginning from 1942 to 1963. They find strong evidence that top executives’ compensation is heavily dependent upon generation of profits. Their results also indicate that firm profits and stock market values are substantially more important in the determination of executive compensation than are firm sales.

2.5 Summary of the Literature Review
The literature reviewed the effect of directors remuneration on performance. Employee compensation increases staff morale leading the achievement of group goals. It reconciles the objectives of the group with those of its members so that each one of them is motivated to make his or her best contribution towards the accomplishment of goals and utilization of resources. Managers, therefore, should make sure that workers know their jobs well and work most efficiently. Although this is true, the authors failed to show how staff recognition affects performance of broadcasting organizations. The existing body of knowledge is not sufficient enough to explain the effects of CEOs compensation in performance. This study intends to explore on the effects of executive compensation on performance.
CHAPTER THREE RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the methodology that was used in undertaking the study. It starts by explaining the research design that was adopted; according to Sekaran (2010) a central part of research is to develop an efficient research strategy. Based on the model and variables developed in Chapter two, this chapter covers the research design and research method used to test the variables. In particular issues related research design, the population, the type of data to be collected, sampling frame, sample and sampling techniques, data collection instrument, data collection procedure, pilot test, validity and reliability of the instrument, and the data analysis and presentation are discussed.

3.2 Research Design

Research design is the general plan of how one goes about answering the research questions. Sekaran (2010) states that good research designs were have a clearly defined purpose, and had consistency between the research questions and the proposed research method. Mugenda & Mugenda (2003) define this as simply the framework or blue print for the research. Orodho (2003) define the research design as a framework for the collection and analysis of data that is suited to the research question. Orodho (2003) defines research design as the scheme, outline or plan that is used to generate answer to research problem.

Both quantitative and qualitative approaches were used. The study adopted descriptive research design. A descriptive research design determines and reports the way things are (Mugenda & Mugenda, 2003). Creswell (2003) observes that a descriptive research design is used when data are collected to describe persons, organizations, settings or phenomena. The design also has enough provision for protection of bias and maximized reliability (Kothari, 2008). Descriptive design uses a preplanned design for analysis (Mugenda and Mugenda, 2003).
3.3 Population and sample

Target population in statistics is the specific population about which information is desired. According to Kothari (2004) a population is a well defined or set of people, services, elements, events, group of things or households that are being investigated. This definition ensures that population of interest is homogeneous. Population studies are more representative because everyone has equal chance to be included in the final sample that is drawn according to Mugenda and Mugenda (2003).

The target population is also referred to as the universe into which the study population is generalized. The target population of this study was companies quoted in the Nairobi Securities Exchange. According to the Nairobi Securities Exchange, as at 2011, there are 50 Companies registered in Kenya. The study specifically focused on all the companies head office which hosts the compliance department that deals with regulators and internal controls with a population of 50, which directly affect director’s compensation activities of each of the selected companies. the study used data of performance of companies at the NSE for 5 years from 2007 to 2012

All 62 companies listed at the Nairobi Securities exchange were used in the study.

3.4 Data Collection

Creswell (2002) defines data collection as means by which information is obtained from the selected subjects of an investigation. Secondary data sources were employed through the use of financial statements and other published studies made available and previous documents or materials. The method has proven to be most effective and reliable since it does not involve the researcher taking too much to talk to the respondents. It is also inexpensive compared to other data collection methods (Mugenda and Mugenda, 2003).

Data was collected from the financial statements of companies listed at the Nairobi securities exchange. The study covered a period of 5 years from 2007 to 2012. Quoted companies are required to submit copies of their financial statements to regulators. Data was collected from all 62 companies listed at the Nairobi Securities Exchange.
3.5 Data Analysis

A multiple regression analysis was carried out to test the study problem. The multiple regression model is as follows:

\[ \text{LNREM}_i = \alpha + \beta_1 \text{DISTRS}_i + \beta_2 \text{ROA}_i + \beta_3 \text{LNASSET}_i + \beta \text{REV GR}_i + \epsilon_i \]

Where: LNREM: log natural of total directors' remuneration, DISTRS: a dummy variable, 1 for distressed company, 0 otherwise, ROA: the ratio of net income to total assets, LNASSET: log natural of total assets, REV GR is Revenue Growth \( \epsilon \): error term, and \( i \): firm 1 to \( j \). Board's total remunerations are the cash remuneration the year. Stock options are excluded. This measurement follows the approach taken by Main et al. (1996) and Hassan et al. (2003). Conyon and Gregg (1994) also argue that total remuneration is the most comprehensive measure of executive pay. Conyon (1997) further concludes that studies employing broader remuneration measures (including stock options) produce qualitatively identical results with those based on cash compensation only. As for firm's performance, two performance-related indicators are included in the model: profitability (ROA), internal growth (firm's size). These measures were used by Hassan et al. (2003) and other previous researchers (e.g. Sanders and Carpenter, 1998). Further, it has been shown that size is related to the level of executive compensation (Gomez-Mejia, 1994; Finkelstein and Hambrick, 1996; Firth et al., 1999).

From the regression equations an analysis of variance (ANOVA) was used to explain the nature of the relationship and the strength and significance. The nature of the relationship is (positive or negative) is indicated by the sign \( \beta \) in the equation. A +\( \beta \) indicates a positive relationship and a −\( \beta \) indicates a negative relationship. The Significance of the relationship was indicated by the P value where a factor of less than 0.05 indicate a significant positive of negative relationship.
CHAPTER FOUR DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

The results have been presented in 5 parts namely Agriculture, Commercial and services, Industrial and Allied, Finance and Alternative investments. Each part summarizes the sectors results. The last section shows a summary for all companies for the last 5 years.

4.2 Descriptive data

Descriptive statistics were computed for both Director's remuneration and the three measures of firm performance. From the annual averages of the companies, as shown in table 4.2.1 below, it is evident that directors’ remuneration increased with increase in return on assets and company assets.

Table 4.2.1: Summary for all companies

<table>
<thead>
<tr>
<th>Remuneration vs</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>REV GR</td>
<td>β</td>
<td>-0.063</td>
<td>-0.354</td>
<td>0.168</td>
<td>-0.421</td>
<td>-0.338</td>
</tr>
<tr>
<td></td>
<td>P</td>
<td>0.7477</td>
<td>0.053</td>
<td>0.492</td>
<td>0.259</td>
<td>0.206</td>
</tr>
<tr>
<td>ROA</td>
<td>β</td>
<td>1.162</td>
<td>0.468</td>
<td>0.348</td>
<td>2.35</td>
<td>0.975</td>
</tr>
<tr>
<td></td>
<td>P</td>
<td>0.307</td>
<td>0.695</td>
<td>0.786</td>
<td>0.111</td>
<td>0.429</td>
</tr>
<tr>
<td>ASSET</td>
<td>β</td>
<td>-0.0317</td>
<td>0.0313</td>
<td>0.273</td>
<td>0.0398</td>
<td>-0.0835</td>
</tr>
<tr>
<td></td>
<td>P</td>
<td>0.048</td>
<td>0.661</td>
<td>0.015</td>
<td>0.577</td>
<td>0.651</td>
</tr>
<tr>
<td>Average remuneration (sh.B)</td>
<td>285.5</td>
<td>338.07</td>
<td>388.8</td>
<td>418.6</td>
<td>438.5</td>
<td>448.5</td>
</tr>
</tbody>
</table>
From the research financial and investments sector recorded the highest level of Directors’ remuneration at 71.1 million, followed by industrial and allied sector at 61.1 million. The sector with the least average directors’ remuneration was alternative investments market segment with a mean Directors’ remuneration of 15.5 million. Financial and investments sector recorded the highest ROE at 17.68% followed by industrial and allied at 17.28% with the least performing, Alternative investments market segment recording a mean ROE of 5.2%.

Commercial and services sector had the highest mean of EAT at 2.1 billion followed by industrial and allied sector at 1.7 billion and the least performing was alternative investments market segment with a mean EAT of 20.1 million. Similarly, commercial and services sector had the highest mean Rev Gr at 1.91 followed by industrial and allied sector at 1.78 and the least performing was alternative investments market segment with a mean Rev Gr of 0.38. An ANOVA test was used to determine if the differences in means for the different sectors was statistically significant. The table below shows the ANOVA test results.

From the data of the companies adopted the average director’s remuneration was generally on the rise for the five year period to 2012 accompanied by a similar rise in pay volatility as reflected by the increasing standard deviation. From table 1 below it can generally be construed that director’s remuneration rose in tandem with a rising sales level and increasing profitability as measured by return on assets.

### 4.3 Regression Analysis

The study also required regression analysis so as to establish the relationship between the director’s remuneration and firm performance. According to the findings from the data, the following results were established by use of the SPSS (Statistical Package for Social Sciences).

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.364a</td>
<td>.733</td>
<td>-.020</td>
<td>13.61569</td>
</tr>
</tbody>
</table>

Source: Researcher, 2013
Predictors: (Constant), ratio of net income to total assets and log natural of total assets

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 (directors remuneration) that is explained by all the independent variables (ratio of net income to total assets).

The independent variables that were studied, explain only 73.3% of the firm performance as represented by the $R^2$(Coefficient of Determination). This therefore means the independent variables only contribute about 73.3% to the firm value while other factors not studied in this research contributes 26.7% of the firm value.

Therefore, further research should be conducted to investigate the other factors that affect firm value.

Multiple Regression Analysis

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficient</th>
<th>Std. Error</th>
<th>Beta</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (Constant)</td>
<td>0.831</td>
<td>3.803</td>
<td>0.219</td>
<td>0.828</td>
<td></td>
</tr>
<tr>
<td>Ratio of net income to total assets</td>
<td>0.139</td>
<td>0.262</td>
<td>0.132</td>
<td>0.530</td>
<td>0.599</td>
</tr>
<tr>
<td>Log natural of total assets</td>
<td>1.485</td>
<td>1.782</td>
<td>0.401</td>
<td>0.833</td>
<td>0.410</td>
</tr>
</tbody>
</table>

Source: Researcher, 2013

4.4 Discussion and interpretation of findings
The information presented above shows a mixed relationship between directors remuneration and firm performance. Table 4.2.1 presents the $\beta$ values which indicate mixed relations between
level of directors pay and firm performance. The same results exist for the relationship with the firms total assets and revenue growth.

The study further sought to examine whether the strength of the relationship between firm performance and Directors’ remuneration was influenced by the size of the firm. Stepwise regression analysis was applied and the effect of firm size was established by checking the change in R-Square and the significance of the change when firm size was introduced to the original models. The P value is above 0.05 which shows that the relationship is non-significant.

From table 13, the change in R-square is 0.733 indicates that firm size accounts for 73.3% of the variability in the directors’ remuneration. The F-change is 12.067 and is statistically insignificant (P > 0.05) indicating that firm size significantly influences the relationship between directors’ remuneration and Rev Gr. The findings suggest a positive influence of firm size on the relationship between directors’ remuneration and firm performance as measured by ROE and Rev Gr. This conforms to the findings by Ozkan (2007). However, firm size has little influence on the relationship between directors’ remuneration. This could be due to the high correlation between firm size.
CHAPTER FIVE

ANALYSIS OF RESULTS

5.1 Introduction
This chapter presents the summary of the findings from chapter four, conclusions and also recommendations of the study based on the objectives of the study. The objectives of this study were to investigate the directors remuneration and their effect to firm performance and also to identify the existence of board committees and functions and how this affects the performance of the firm.

5.2 Summary of the Major Findings
Our main findings are that there is a mixed relationship between director’s remuneration and financial performance of companies quoted at the Nairobi Stock Exchange. Surprisingly we found that although total board pay and the pay of the highest paid director was relatively high in the companies quoted at the Nairobi Stock Exchange, there was no significant difference in the pay-performance sensitivities between the financial sector and other industries. Further, although the pay-performance point estimates are slightly larger in the finance sector, the values are so small as to make it unlikely that executives in the finance sector were over-incentivized. The primary factor related to executive pay appears to be firm size.

Following the adoption of a series of corporate governance reforms throughout the ‘nineties we expected to find an increase in these pay-performance elasticities over time, since a common theme in these reforms was that executive pay should be related to company performance. However we found little evidence of any upward trend in pay-performance sensitivities, but we did identify an asymmetric relationship, in that pay-performance elasticities were high when
stock returns were high, but that pay was less sensitive to performance when stock returns were low.

This follows if executives are paid a base salary unrelated to performance, plus bonuses, which are related to above average performance and can only be positive. This one sided risk model creates an asymmetry in the pay-performance link which might potentially encourage excessive risk taking by executives in all sectors. Our results suggest that there is a stronger relationship between executive cash pay and company performance for exceptional out-performance but not unusual under-performance. A final limitation to these findings is that there may be other penalties for underperformance that we have not considered, such as turnover and loss of reputation in the managerial labour market (Renneboog and Trojanowski, 2010).

5.3 Conclusions
The study finds a negative non-significant relationship between directors compensation and company performance and further recommends that there is need to reign in the directors compensation tendencies in smaller company to favor bigger shareholders who double up as company directors to the detriment of returns and smaller owners of the company. The study finds limitations in the availability of data and relaxed disclosure requirements which do not mandate specific disclosures of director’s compensation. The suggestions for further studies include the undertaking of a similar analysis over a longer time-span and the analysis of the relationship between director’s compensation and firm value among listed company.

In the large commercial sectors, size is a key criteria in determining directors compensation as it is significantly but negatively related to compensation. The negative correlation appears to
suggest the capping of directors compensation to ensure maximization of returns to shareholders. As such, the interests of the director’s are subordinated to those of the shareholders in keeping with the agency theory.

Performance ratios and opportunity only appear to be inversely related to big company as their directors appear to subordinate their immediate financial interests to that of the overall goal of the firm which is to maximize profitability. Consequently, there is need to reign in the directors compensation tendencies in smaller company to favor bigger shareholders who double up as company directors to the detriment of returns and smaller owners of the company. Further, there is need to sensitize directors among the Kenyan commercial sector fraternity on the need to align their payment to accounting performance measures as these measures are directly linked to the maximization of shareholder wealth.

5.4 Limitations

There was not enough information on the performance management systems employed by organizations at the Nairobi securities exchange. It was difficult to establish if companies used the balance score card to measure performance or the traditional accounting performance measures.

There was not enough time to do the research as I had to do the work after working hours, this limited the scope of my work.

Information is not easily accessible. Not all company financial statements are not available online thus making it harder to access companies financial information.

There are limitations also on the tool of analysis i.e. regressions and questionnaires. For example
regression analysis has some assumptions like linearity between the dependent and independent variables. This means that the study assumes that there is a linear relationship between firm performance and executive remuneration. However regression is one of the best tools to use in studying relationships among different variables. Furthermore, there was no assumption of causality i.e. high executive pay leads to better firm performance.

5.5 Recommendations

5.5.1 Policy recommendations

This study recommends that there is need for the investors to access the performance management tools employed in publicly quoted companies. This will help in the realization of challenges or other hindrances that may hinder the functionality of the board.

There is a need for financial statements to made more easily accessible to investors and the general public. This information should be made readily available online to ease access.

Consequently, there is need to reign in the directors compensation tendencies in smaller company to favor bigger shareholders who double up as company directors to the detriment of returns and smaller owners of the company.

5.5.2 Suggestions for further research
Further research should be undertaken to establish the relation of the director’s remuneration and other economic indicators like EPS and DPS. This will help to give more information to investors when evaluating investment options.
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Core, J. and Larcker, D. (1999). Corporate Governance, chief executive officer compensation,


Cronbach, L. J. (1951). *Coefficient alpha and the internal structure of tests*.


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Table 1: Summary Agricultural sector

<table>
<thead>
<tr>
<th>Remuneration vs</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>REV GR</td>
<td>β</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>β</td>
<td>0.6520</td>
<td>-1.4700</td>
<td>0.0010</td>
<td>-0.2313</td>
<td>-1.385</td>
<td>6.870</td>
</tr>
<tr>
<td>Rsq</td>
<td>88.60%</td>
<td>86.60%</td>
<td>0.00%</td>
<td>56.40%</td>
<td>7.90%</td>
<td>53.20%</td>
</tr>
<tr>
<td>P</td>
<td>0.2190</td>
<td>0.2380</td>
<td>0.9980</td>
<td>0.459</td>
<td>0.819</td>
<td>0.479</td>
</tr>
<tr>
<td>ROA</td>
<td>β</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
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<td>-1.5000</td>
<td>0.3210</td>
<td>0.688</td>
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<td>84.40%</td>
<td>99.20%</td>
<td>27.10%</td>
<td>16.00%</td>
<td>62.90%</td>
<td>13.20%</td>
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<tr>
<td>P</td>
<td>0.2620</td>
<td>0.0580</td>
<td>0.6530</td>
<td>0.7380</td>
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<tr>
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<td>-0.0214</td>
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<td>99.50%</td>
<td>2.90%</td>
<td>81.50%</td>
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Table 2: Summary Commercial and Services

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<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
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<tr>
<td><strong>REV GR</strong></td>
<td>β</td>
<td></td>
<td></td>
<td></td>
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<td>0.965</td>
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<td>0.01%</td>
<td>2.70%</td>
<td>37.01%</td>
<td>26.40%</td>
<td>23.30%</td>
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<td>0.238</td>
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<td>β</td>
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<td>0.0723</td>
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<td>1.60%</td>
<td>1.90%</td>
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<td>0.50%</td>
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Table 3: Industrial and Allied

<table>
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<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
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<tbody>
<tr>
<td><strong>REV GR</strong></td>
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</tr>
<tr>
<td>β</td>
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<td>-0.552</td>
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<td>5.9%</td>
<td>7.2%</td>
<td>8.4%</td>
<td>7.6%</td>
<td>12.25%</td>
<td>11.85%</td>
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<tr>
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<td>0.403</td>
<td>0.612</td>
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</tr>
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<td>β</td>
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<td>-2.98</td>
<td>1.233</td>
<td>2.254</td>
<td>9.014</td>
<td>6.065</td>
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<td>2.3%</td>
<td>3.3%</td>
<td>4.5%</td>
<td>0.12%</td>
<td>10.25%</td>
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</tr>
<tr>
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<td>2009</td>
<td>2010</td>
<td>2011</td>
<td>2012</td>
</tr>
<tr>
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<td>-------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
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</tr>
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<td>0.689</td>
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<td>0.582</td>
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<td>0.361</td>
<td>0.459</td>
</tr>
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Table 4: Finance and Investment
Table 5: Alternative investments

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<th>Remuneration vs</th>
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<th>2010</th>
<th>2011</th>
<th>2012</th>
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</tr>
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<tr>
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<td>7.50%</td>
<td>4.50%</td>
<td>31.60%</td>
<td>93.10%</td>
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