THE IMPACT OF CORPORATE GOVERNANCE ON SHARE PRICES: CASE OF COMPANIES LISTED IN THE NAIROBI SECURITIES EXCHANGE

BY

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DECLARATION

I declare that, this project is my own original work and has not been presented for any academic award in any university.

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DEDICATION

This project is dedicated to:

My dear wife, Christine A. Olang`o,

My Children, Chelsea A. Omondi and Sidney O. Omondi,

Your invaluable support, understanding and encouragement accorded to me during my entire academic period has been wonderful.

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I say thank you to the almighty for giving me courage and strength to surmount all the challenges that I encountered while undertaking this project.

Finally, I and I alone, do take responsibility for all errors and omissions that might be contained in this project.

ABSTRACT

The purpose of the study was to determine the impact of corporate governance on the share prices of companies listed in the NSE.The research design used in this study was descriptive. The population chosen for this study was the companies listed in the Nairobi Securities Exchange. The use of the listed firms was due to data availability and reliability because all the quoted companies are required by law and NSE rules to file reports with the exchange and also CMA. The study covered a period of two years from Dec 2010 to 2011.The sample chosen was 30 companies chosen as a representative sample of the population out of 50 companies listed in the NSE. The selection was based on the companies listed in the Nairobi Securities Exchange for the year Dec 2010 to 2011. Companies which have been de-listed were not included in this study.

The study found that from the board structure, majority of the respondents indicated that there was limited access to large board sizes that hinder the discussion of sensitive issues in the organization. The study found out that majority of the companies listed in the Nairobi Securities Exchange had adopted good corporate governance practices which enhanced balance of power. It was established that most companies ensured that proportion of outside directors had been greatly implemented in the organization; the required board size and the number of meeting in a year were also observed as required. The regression analysis further established that there was a significant relationship between share price and corporate governance practices.

The study concluded that the companies had exhibited an increase in implementation of good corporate governance practices which can be attributed to the high level of adoption of the guidelines, board size, proportion of outside directors and the number of meetings in a year. The study also concluded that there is a significant relationship between share price and corporate governance practices; this means that, companies practicing good corporate governance practices are likely to enjoy high share prices. The study recommended thatcompanies should highly consider the implementation of good corporate governance practices since they ensure balance of power and contribute to a strong association with the firm's profitability and market value. Managerial ownership also operates without showing any evidence of a negative inflection point. Moreover, CMA guidelines should be implemented in these companies as it contributes to good corporate governance.

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ABBREVIATIONS AND ACRONYMS

ADB - African Development

CEO - Chief Executive Officer

CFO – Chief Finance Officer

CMA – Capital Markets Authority

COO - Chief Operating Officer

EPS - Earnings per Share

NSE – Nairobi Securities Exchange

ROA - Return on Assets

ROE - Return on Equity

CHAPTER ONE

1.1 Background of the Study

A series of debacles forced organizations all over the world to frame strict guidelines for corporate governance. The developments that have taken place globally in terms of political, economic and social issues have had tremendous influence in the country. This triggered the thinking process in most countries, which finally made them lay down ground rules on corporate governance. During post-liberalization, companies experienced shortage of funds to face cut-throat competition. This shortage of funds could be met through global capital and to achieve this, there is no other way other than subscribing to the highest standards of corporate governance (Jain, 2005).Therefore forcing organizations all over the world to frame strict guidelines for corporate governance. Since then corporate governance has become a catch word in the development debate.

Due to globalization, more global employment opportunities are available to employees and the only means to retain the best employees by companies is by treating them with dignity. Moreover, as a result of competition, customers have numerous choices. They prefer those organizations, which maintain the highest level of transparency in all customer interactions. Vendors and strategic partners are reluctant to work with a company, which is not transparent in its dealings with them (Sapovadia, 2006).As more and more stakeholders make an attempt to maximize their profits; the investors(especially the smaller) will have to be wary of the crafty speculators who can ruin the market confidence and decimate them. Investor training therefore is an important area of immediate action. (Shankar, 2005) Thus, each stakeholder expects trust and transparency in the organization, absence of which forces these stakeholders to react the other way and hence, the business of the organization gets affected. This paper makes an attempt to study if the share price of organizations gets affected due to corporate governance disclosures by these companies.

A firm may therefore attempt to select a trading range for its shares that enlarges the firm's investor base. It is possible that attracting new investors in this manner results in an increase in the market value of the firm that more than offsets the costs of the higher bid, ask spreads following stock splits. In addition, other dimensions of liquidity, such as the depth of the market and the volume of uninformed versus informed trading, are enhanced when the firm has a larger shareholder base. Share prices and the firm's investors have also been suggested. (Brennan and

Hughes 1991) observe that brokerage commissions are inversely related to share price and suggest that, in a world with incomplete information, brokers will produce and disseminate more information about lower priced firms. (Angel,1997) suggests that a single tick size in a market means that lower share prices increase the minimum percentage bid ask spread for a stock, consequently encouraging more market makers to both make a market in the firm's stock and to promote that stock to investors. Firms are therefore able to use low stock prices as a means to increase their investor base, which, according to (Merton 1987) will increase the firm's value. Stock exchange, a voluntary organization of stockbrokers is now one of the most active markets. Trading on the stock exchange has become fashionable tool for raising capital. This attract a number of industries because this enables them raise funds for the expansion and growth without the interest burden of funds borrowed from lends institutions, improve liquidity of their securities and to increase public awareness about the companies.

1.1.1 Corporate Governance

Corporate governance has always been an issue right from the beginning of last decade. Good Corporate Governance practice provides a means to recognize the dream of justifying risks and optimizing performance concurrently in today's aggressive and regulatory setting. Corporate Governance lays down framework for creating long-term trust between company and its stakeholders. It solves the problem of conflict of interest between the Agents and Principals. It is solved by rationalizing and monitoring risks of a company, limiting liability of top management by carefully articulating decision making process, ensuring integrity of financial reports, and finally providing a degree of confidence necessary for proper functioning of an organization.Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

For emerging market countries, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks reduce investor confidence, and can discourage outside investment. Also, as pension funds continue to invest more in equity markets, good corporate governance is crucial for preserving retirement savings. (The World Bank, 2008) On October 8, 1999, the Corporate Sector at a seminar organized by the Private Sector Initiative for Corporate Governance formally adopted a national code of best practice for Corporate Governance to guide corporate governance in Kenya,

and mandated the Private Sector Initiative to establish the Corporate Sector Foundation, and collaborate with the Global Corporate Governance Forum, the Commonwealth Association for Corporate Governance, the African Capital Markets Forum, Uganda and Tanzania in promoting good corporate governance(PSCGT, 2002).

1.1.2 Share prices and Determinants.

Stocks price changes due to market forces, i.e. buying and selling of the available stocks in the market. The following are the factors that affect or even predict the buying or selling of stock that ultimately affects stock prices of companies.

Market sentiment. The price of the stock of a company is affected most of the time by the general market direction during a session. In a bull market the stock price of most companies will rise and in a bear market the stock price of most companies will fall. One can gauge the market sentiment by looking at stock indexes or its future price movement.

The performance of the industry. The performance of the sector or industry that the company is in also plays in part in determining the stock price of the company. Most of the times, the stock price of the companies in the same industry will move in tandem with each other. This is because market conditions will generally affect the companies in the same industry the same way. Of course, there are exceptions to this. Sometimes, the stock price of a company will benefit from a piece of bad news in its competitor if the companies are competing for the same target market.

The earning results and earning guidance. The main objective of a company is to make profit. Therefore, investors and traders always assess a company based on its Earning per Share (bottom line) and Revenue (top line) and its future earning potential. In US, companies generally report the earnings results every quarter-yearly. A company that achieves good earnings results (EPS and Revenue) expects a boost in its share price and one that delivers poor earning result shall see a beating in its share price. Sometimes, besides reporting the EPS and Revenue for the past quarter, a company may also issue guidance (expected value) for the EPS and Revenue in coming quarter or coming years. This is also closely monitored by investors and is an important factor that will affect the company stock price.

Take-over or merger. In general, a company being taken-over is anticipated to get a stock price boost and the company taking over another company shall experience a drop in its share price. This is assuming that the company is being taken over at a premium, meaning it is being bought

over at a higher price than its last traded stock price. Depending on the agreed term, a company can be bought over by cash or stock (of the acquirer) or a combination of the two. In some minority cases, the stock price of the acquirer may get a boost if it is perceived that the acquisition shall contribute to its earning or revenue in the near future.

New product introduction to markets or introduction of an existing product to new markets. The introduction of new product to market is seen as a revenue enhancer for a company. This also applies to an existing product that breaks into new markets. Sometimes, the prospect of a new product introduction suffices to improve the stock price of a company, this is often observed in surges in stock prices of pharmaceuticals companies after the announcement of successful clinical trials, or FDA approvals for new drugs.

New major contracts or major Government Orders. A company that is able to obtain new major contracts or major government order is expected to see a bull run in its stock price. Those companies that fail in the contract bidding normally experience the fate of sell-off in its stocks.

Share buy-back. The act of share buy-back by a company will reduce the number of share available in the open market. Due to the law of supply and demand, a reduction in share available for trading in this case will cause a drop in supply; this will normally help increase the share price. Also, the continuing buying back of share of a company will also act as a support for the share price that helps to maintain or increase the share price. The investors may also see the share buy-back by company as a confidence booster for them in the company itself. Therefore, share buy-back is quite often used as a tool to deliver value to the investors.

Dividend announcement . The stock price may increase by an amount close to the dividend per share value. However, the stock price may drop on the ex-dividend date by the dividend per share amount. This is because anyone buying a stock on or after the ex-dividend date is not entitled to the corresponding dividend payment.

Stock splits. Stock split in theory should not have an impact to the stock price. However, it is generally observed that the stock price increases (after taking into account the increase in the number of share) after a stock split. Some attributed to the better affordability of the stock after stock split; some attributed this to the perception of cheap stock due to the lower stock price after the stock split. Some however believe that stock split has no real impact on the stock price

(effective stock price, taking into account the change in number of shares), as the stock price will increase regardless of stock split.

Insider trading. Insiders include CEO, COO, CFO, Chairman, board directors e.t.c, who have firsthand information about the operations and the financial status of a company. Therefore, the buying or selling of stocks by these insiders may herald some good or bad news about the company. This is being watched closely by savvy stock investors/traders. However, do be aware that due to compensation package that comes in the form of stock or stock options, the insiders may sell their stocks/stock options to cash-in their compensation benefits. So in this case, it may not signal anything significant about the company. A savvy investor should know how to observe and filter out this piece of information from your investment or trading decisions.

Investment Gurus / Hedge Funds trading. The investment decision of highly revered investment gurus like Warren Buffett, George Soros, Carl Icahn are closely monitored by investors and therefore will move the market. Hedge fund stock buying and selling are another source of information regarding the flow of "smart money".

Analyst upgrade / downgrades. Analyst upgrade and downgrade to a stock may have positive or negative impact to the stock prices. However, one needs to be wary of the fact that quite often analysts' upgrades or downgrades happen "after" some important news about a company. For example following an extremely disappointing earning result, many analysts will likely to downgrade the company stock. So, it is very likely that by then the stock price of that company has already priced-in the poor earning result, and analyst downgrade may not have further impact to the stock price.

Addition/Removal to/from Stock Index. Stock Index Funds are those funds that invest in those company stocks that are included in a particular stock index (e.g. S&P 500, Nasdaq-100, Dow Jones U.S. Large Cap etc.). Therefore, an inclusion of a company stock to a stock index will generate buying interest in the stock for these stock index fund managers. The stock index fund managers will dispose of the stock that has been removed from the stock index.

Others. These include news about new technology, patent approval, war, natural disaster, product recalls and lawsuits that shall have positive and negative impact to the relevant company stocks. The health or mishap of a key leader in a company may also affect the stock price of the company. David Smith (2008)

1.1.3 Nairobi Securities Exchange

The Nairobi Securities Exchange began in the early 1920s while Kenya was considered a colony under British control. It was an informal marketplace for local stocks and shares. By 1954, a true stock exchange was created when the NSE was officially recognized by the London Stock Exchange as an overseas stock exchange. After Kenyan independence from Britain, the securities exchange continued to grow and become a major financial institution. The facilities have modernized since the original "handshake over coffee" method of trading. The NSE has recently adapted an automated trading system, to keep pace with other major world stock exchanges. For continued listing in the Nairobi Securities exchange, companies are required to establish audit committees and comply with guidelines on corporate governance issued by the Capital Markets Authority. The Capital Markets Authority was created pursuant to the Capital Markets Act,chapter 485a for the purpose of promoting, regulating and facilitating the development of an orderly, fair and efficient Capital Markets in Kenya. The authority has issued guidelines on corporate Governance practices for listed companies in Kenya. (CMA, 2002).

The share prices in the Nairobi securities exchange usually vary with time and this can be attributed to factors such as changes in the economic growth of the region, threat of war or strikes, government policies or political changes. Share prices movements in the NSE market are measured by an index based on 20 representative companies and are calculated on a daily basis. The index is a general price movement indicator based on a sample or upon all the securities market companies and the sale and purchase decisions are based on its movements. The forecasts of future trends of share prices are often based on subjective factors, thus in this study appropriate forecasting models for determining the future share prices trends on the market are developed. The models are based on the securities market index as well as the share prices for Barclays Bank of Kenya Ltd, ICDC Investment Company Ltd, Kenya Commercial Bank Ltd, Standard Chartered Bank Kenya Ltd, BAT Kenya Ltd and Kenya Breweries Ltd.

1.1.4 Corporate Governance and Share Price

The price of listed shares on the NSE fluctuates every now and then. Like any other commodity, in the stock market, share prices are also dependent on so many factors. So, it is hard to point out just one or two factors that affect the price of the stocks. There are still some factors that directly influence the share prices. A number of researches have been done in this area as being one of the favorite areas of research analyst. There are many macro-economic factors affecting it and as well as various company specific factors (Lange &Sahu, 2008).

Samontaray, (2010) categorized factors affecting share price into three main classes i.e. global factors, domestic factors and local company specific factors. While Khan et al (2011) categorized these factors into two groups i.e. internal factors defined by the officers or stockholders, and the outside forces such as consumer groups and government regulations. Satisfactory corporate governance systems in a country can be formed if the following four steps are taken as proposed by Megginson (2000): (1) changes in corporate and securities laws, (2) strengthening the listing and disclosure requirements for stock exchanges, (3) independent judiciary, and (4) establishing a regulatory body capable of balancing the challenging claims of managers, outside shareholders, and creditors. Corporate governance is not only about election of directors who will make decisions on behalf of shareholders but it is the means of accountability of management (shah et al, 2009).This effort can benefit at large, but in case of failures penalties are also there such as debacles like Enron, WorldCom, and Tyco which resulted in economic failure (Javid and Iqbal 2010) while Wu, (2005) points out that poor corporate governance also breeds corruption. The corporate governance mechanisms used to ensure economic efficiency include shareholder monitoring, creditor monitoring, executive remuneration contracts, dividend policy and the regulatory framework of the corporate law regime and the stock exchanges.

The increasing international integration, deregulation and technological developments and the resulting challenges are demanding for a review of national corporate governance systems. Countries that are in terrible need of external financing require stronger and efficient corporate governance systems. Countrys' failure to attract external finance from foreign investors may be mostly due to weak investor protection (Chaudary, Goergen, and Syed, 2006). Legal reforms and voluntary codes of corporate governance are flourishing around the world but in general the effect of corporate governance on the firm's value remains unclear (Black, Jang and Kim, 2006).The dimensions of legal reforms are: (i) firms that have good governance practices, may have high market value (Black et al,2005 & Strenger,2005). (ii) firms may choose different governance practices (Black, 2001) .(iii) firms may adopt good governance rules to signal that the firm's insiders will behave well, but in this case the signal, not the firm's governance practices, affects share prices (Black et al, 2006). Share prices are the trading prices for minority shares (Black et al, 2006 & Black et al, 2005).

Black et al, (2006) claimed that there is no strong evidence that better-governed firms are more profitable or pay higher dividends. It is, however, the investors who value the same earnings or the same current dividends more highly for better-governed firms due to less risk. Corporate

Governance practice provides a means to know the dream of justify risks and optimize performance at the same time in today's strong regulatory setting. It is evident that if corporate governance is material for a firm's performance and this relationship is fully integrated by the stock market, then stock price should rapidly correct to any relevant change in the firm's governance (Gompers et al, 2003). Corporate Governance lays down an outline for creating long-term trust between company and its stakeholders (Samontaray, 2010). Shaheen and Nishat, (2005) claimed that poorly governed firms (i.e., those with low Governance Scores) have lower valuations, while better-governed firms have higher valuations. However, despite these evidences, no study has been conducted in the Kenyan context to ascertain or give a clear picture on the impact of corporate governance on share prices of firms listed in the NSE.

1.2 Research Problem

Corporate governance issues have recently received much attention from policy makers and the public due to globalization and transformations in the ownership structure of firms (due to the growth of institutional investors, privatization, and rising shareholder activism),which have increased the perceived need for more effective monitoring mechanisms and appropriate incentive schemes to improve corporate governance systems(Aguilera and Cuervo, 2004).

Share performance is determined by the positive increase in prices during a certain period of time. The classical economic view posits that the current price of a stock closely reflect the present value of its future cash flows (Charles 2006). The price of listed shares on the NSE fluctuates every now and then. The price for shares goes up and down owing to a number of factors happening from individual business units (i.e. listed company) through to a complex environment of the entire economic system.There are some factors which directly influence the share prices. There are many macro-economic factors affecting it and as well as various company specific factors (Lange, 2008).Thus, arguing that before buying or selling shares, one should first ascertain both global and domestic factors which may be influencing the market, and establish a good timing of buying or selling ones shares. Traditionally, share prices are higher when country's economy is doing stronger and lower when the country experiences poor economic performance.

Manyuru (2005) and Mutisya (2006) studied the relationship between corporate governance structures and performance in firms quoted in the Nairobi Securities Exchange. Manyuru (2005) found a positive correlation between performance and corporate governance, Mutisya (2006) found that board size, and number of meetings held in a year and the proportion of shares held by

top shareholder were significantly and positively related to firm performance. Previous research in Kenya is by Lang'at (2006) who studied the relationship between corporate governance structures and performance of firms quoted in the Nairobi Securities Exchange and found that frequency of board meetings, ratio of outside directors to total number of directors, % of insider share ownership and executive compensation were all positively related to firm performance. Kihara (2006) studied the relationship between ownership structure, governance structure and performance of firms listed in the Nairobi Securities Exchange and found no significant relationship between ownership structure and firm performance. The study however found a significant positive relationship between foreign share ownership and firm performance. Muturi (2007) surveyed the degree of compliance with the Capital Markets Authority guidelines on corporate governance. The study found that the degree of compliance was high among the listed companies in Kenya. Wanjau (2007) surveyed the relationship between corporate governance and performance in microfinance institutions in Kenya and found that Board size was positively related to turnover or loan disbursements. Ngugi (2007) studied the relationship between corporate governance structures and performance of Insurance companies in Kenya and found that Board Size and Insider Holding were positively related to performance of Insurance Companies.

A lot of material has been written on the fundamental concepts, the importance, and expression of corporate governance, share prices and companies listed in the Nairobi securities exchange and most of them are written from a broad perspective. There is a lack of major study conducted to investigate exactly the impact of corporate governance on share prices of firms listed in the NSE. This study agreed that share prices are dependent on so many factors and the research questions this study sought to answer is: Does the corporate governance of the firms listed in the NSE affect share price?

1.3Research Objective

To determine the relationship between corporate governance and the share price of companies listed in the NSE.

1.4 Research Hypothesis

Null Hypothesis: There is no relationship between corporate governance and share price of a firm.

Alternative Hypothesis: There is a relationship between corporate governance and share price of a firm.

1.5Importance of the Study

For companies listed in the NSE, this study shows the impact of internal governance practices on their performance. It would advise them on whether or not to revise their internal governance practices. The study would further point out to them whether or not to adopt corporate governance principles that exceed the ones prescribed by laws and norms in Kenya.

Companies Listed in NSE might also consider adopting more internal governance principles as opposed to the predominant external governance mechanisms. The investors in making informed investment decisions. As a result of this study, choices about which shares to buy and sell may be made on the basis of the individual company's corporate governance index.

Shareholders might also put pressure on directors to implement certain corporate governance principles. It would also advise shareholders on the optimal balance of power between the directors and the shareholders. Academicians, this study would add to the existing body of knowledge, find out whether there is causality between corporate governance and share performance, and whether causality runs from corporate governance to firm performance or otherwise.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter introduces the literature review to provide theoretical understanding of the study. It also identifies the research issues to be addressed. It also provides the conceptual framework and the detailed outline of the underlying concepts and variables.

2.2 Theoretical Review

2.2.1 Agency Theory

Adam Smith (1776) explained that the directors of companies, however, being the managers of other people's money, cannot well be expected to watch over it with the same anxious vigilance with which the partners in a partnership frequently watch over their own. Negligence and profusion therefore prevail in the management of the affairs of such a company. Fama (1980) holds that separation of security ownership and control can be explained as a result of efficient form of economic organization within the set of contracts perspectives

Fama and Jensen (1983) argue that the separation of decision and risk bearing functions observed in large corporations is common to other organizations such as professional partnerships and non-profits. They then contend that the separation of decision and risk bearing functions survives in these organizations in part because of the benefits of specialization of management and risk bearing but also because of an effective common approach to controlling the agency problems caused by separation of decision and risk bearing functions. They hypothesize that the contract structures of all these organizations separate the ratification and monitoring (control) of decisions from initiation and implementation (management) of the decisions.

Demsetz and Lehn (1985) note that large publicly traded corporations are frequently characterized as having highly diffuse ownership structures that effectively separate ownership of residual claims from control of corporate decisions. Vaninsky and Lauterbach (1999) observe that over the last century, a new form of business organization flourished as non-concentrated ownership structure emerged and that the modern diverse ownership corporation has broken the link between the ownership and active management of the firm. Berle and Means (1932) explain that agency problems occur when the principals (shareholders) lack the necessary power or

information to monitor or control the agent (managers) and when the compensation of the principal and agent is not aligned.

Jensen and Meckling (1976) define an agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. They argue that since the relationship between the stockholders and manager of a corporation fit the definition of a pure agency relationship it should be no surprise to discover that the issues associated with the "separation of ownership and control" in the modern diffuse ownership corporation are intimately associated with the general problem of agency. It is generally impossible for the principal or the agent at zero cost to ensure that the agent will make optimal decisions from the principal's viewpoint. In most agency relationships the principal and the agent will incur positive monitoring and bonding costs (non-pecuniary as well as pecuniary), and in addition there will be some divergence between the agent's decisions and those decisions which would maximize the welfare of the principal.

Jensen and Murphy (1990) explain that the conflict of interest between shareholders of a publicly owned corporation and the corporation's chief executive officer (CEO) is a classic example of a principal-agent problem. If shareholders had complete information regarding the CEO's activities and the firm's investment opportunities, they could design a contract specifying and enforcing the managerial action to be taken in each state of the world. Managerial actions and investment opportunities are not, however, perfectly observable by shareholders; indeed, shareholders do not often know what actions the CEO can take or which of these actions will increase shareholder wealth. In these situations, agency theory predicts that compensation policy will be designed to give the manager incentives to select and implement actions that increase shareholder wealth. Specifically, agency theory is directed at the ubiquitous agency relationship, in which one party (the principal) delegates work to another (the agent), who performs that work.

Jensen (1986) argues that managers take wasteful, negative net present value investment projects because they derive private benefits from controlling more assets. This is overinvestment or empire-building. Alternatively, managers may forego some positive net present value investment projects because additional investments impose private costs on them. Because managers in general prefer to work less (i.e., they are inclined to shirk), and investing requires them to spend more time overseeing the firm's activities, managers will underinvest. The optimal incentive contract for the manager ameliorates the over or underinvestment problem.

According to Agrawal and Knoeber (1996), agency problems arise within a firm whenever managers have incentives to pursue their own interests at shareholder expense. Several mechanisms can reduce these agency problems. An obvious one is managerial shareholdings. In addition, concentrated shareholdings by institutions or by block holders can increase managerial monitoring and so improve firm performance, as an outsider representation on corporate boards. The use of debt financing can improve performance by inducing monitoring by lenders. The labor market for managers can motivate managers to attend to their reputations among prospective employers so improve performance. Finally, the threat of displacement imposed by the market for corporate control can create a powerful discipline on poorly performing managers.

2.2.2 Inherent Property Rights Theory

The inherent property rights conception is based on the view that private ownership is fundamental to a desirable social order and to the development of an efficient economy. Thus, private ownership rights are inviolable in any way. This perspective was developed during the seventeenth and eighteenth centuries in corporate law theory. It was assumed that the right to incorporate is inherent in the right to own property and write contracts, and corporations should be regarded as legal extensions of their owners. (Allen, 1992)

When the modern corporation emerged, the inherence view of the corporation was further developed along with the aggregate theory which asserts that the corporation as a legal group is simply created by the state and is no more than a private association of shareholders. The new form of corporate property is the aggregation of individual property rights under a collective name, united by contract and protected by company law. Since shareholders are the owners of the corporation, the corporation has legitimate obligations and the managers have a fiduciary duty to act in the interest of the shareholders (Barker, 1958; Mayson*et al.* (1994).

Allen (1992) and Blair (1995) associate the modern Inherent property rights theory with the Chicago school of law and economics. Under this theory, assets of the corporation are the property of the shareholders, and directors and managers as agents of shareholders have no legal obligations to any other stakeholders. Hayek (1969) view individuals owning private property as pursuing their self-interests to ensure the most efficient economic activities and outcomes. Thus, the corporation that uses shareholders' capital must aim at maximizing profits to enhance shareholders' value. If a corporation uses profits for any social purpose beyond the shareholders' interest, this could be interpreted as managers' abuse of power and the allocation of corporate

resources will not be efficient. Shareholders' property rights in the corporation must therefore be fully protected and shareholder control of the corporation must be strengthened.

Friedman (1962, 1970) asserts that the social responsibility of business is harmful to the foundations of a free society with a free-enterprise, private-property system. The function of a business in a society is to make profits in a free market for shareholders and should not be confused with other social functions performed by governments, institutions, and charities. Other stakeholders' interests are served by contract or through government regulation and should not be justified in corporate governance. Directors and managers are the agents of shareholders and are responsible for maximizing the shareholders' interest. If management is allowed or required to pursue any social purpose, managerial accountability to shareholders cannot be secured and shareholders' property rights will be damaged. Thus, the only social responsibility of a business is to increase its profits.

The inherent property rights theory in general insists that, although a company is regarded as a legal person separate from its owners, the nature of shareholders as the company's owners never changes and the company is legally obliged to serve the interest of its shareholders (as the corporate members). Corporate property should be treated as a private association which demands the minimum of government regulation and interference (Gamble and Kelly, 2001).

2.2.3The Finance Model

Manne (1965) refers to the finance model as the presupposed optimum of market-based governance and advocated the market for corporate control. Keasey et al., (1995) observes that the finance model can be incorporated into the agency theory as a principal-agent, or finance, model because both are concerned with the effectiveness of market governance in ensuring that managers will act to maximize shareholders' wealth. Thus, it is also called the 'efficient market model' (Blair, 1995.).

A theorem in financial economics is that the share price today fully reflects the market value of all future profits and growth that will accrue to the company. Believing in this assumption, the advocates of the finance model hold that shareholders' interests are best served by maximizing share price in the short run. The share price is an indicator of corporate performance and the stock market is the only objective evaluation of management performance. If a firm under-performs, its share price will be lower, which provides a chance for outsiders to buy the firm's stock and run the firm more efficiently in order to obtain a larger reward. The threat of a

takeover provides management with an incentive to make efforts to perform better and maximize shareholders' return in order to make their firm bid-proof. Therefore, if the separation of ownership and control allows managers' behavior to deviate from shareholders' value of profit maximization, the pressures of capital markets and takeovers are the most effective disciplines on managerial discretion (Alchian and Kessel, 1962).

Fama, (1980) argue that corporate governance failures are best addressed by removing restrictions on factor markets and the market for corporate control. Shareholders' residual voting rights on takeover should be enhanced. Hart (1995) reject any ex post external interventions and additional obligations imposed on corporations which may distort free market mechanisms. Keasey*et al.*, 1995 conclude that any measure to improve governance and to raise the value of the firm should be adopted without compulsion.

2.2.4The Myopic Market Model

The myopic market model shares a common view with the agency theory that the corporation should serve shareholders' interests only. However, the model criticizes the Anglo-American model of corporate governance as being fundamentally flawed by an over concern with short-term return on investment, short-term corporate profits, short-term management performance, short-term stock market prices, and short-term expenditures, due to huge market pressures. This model argues that the current corporate governance systems encourage managers to focus on short-term performance by sacrificing long-term value and competitive capacity of the corporation (Moreland, 1995).

One of the features of the system is that the evaluation of both corporate performance and managerial efforts is heavily reliant on short-term financial measurements, often judged on a 1 year basis, sometimes even on a quarterly basis. Managers are forced to pay more attention to short-term earning data and forecasts and less attention to long-term investment spending such as R & D. It is also argued that the stock market is not a good indicator of corporate performance because it is unable to cope with uncertainty and thus routinely misprices assets. The prices of shares often change without any corresponding change in the underlying fundamentals. Share prices may simply result from guesses about the behavior and psychology of market participants and the changing moods and prejudices of investors, rather than from the estimations of corporate fundamental values (Keynes, 1936; Shiller, 1989).

The market for corporate control, therefore, is not an efficient disciplinary mechanism. The threat of a hostile takeover may distort and distract from true value creation as managers may be forced to act against the hostile takeover, which results in negative consequences. The myopic market model contends that corporate governance reform should encourage shareholders and managers to share long-term performance horizons. This includes increasing shareholders' loyalty and voice, reducing the ease of shareholders' exit, restricting the takeover process and voting rights for short-term shareholders, encouraging 'relationship investing' to lock financial institutions into long-term positions and empowering other groups such as employees and suppliers to form long-term relationships with the firm (Keasey*et al.*, 1997).

2.2.5The Pluralistic Model

The pluralistic model supports the idea of multiple interests of stakeholders, rather than shareholder interest alone. It argues that the corporation should serve and accommodate wider stakeholder interests in order to make the corporation more efficient and more legitimate. Unlike the social entity theory that justifies stakeholder interests on the basis of moral value and fundamental human rights, the pluralistic model legitimizes stakeholder value in a more subtle way more attuned to the traditional Anglo-American corporate governance mentality (Gamble and Kelly, 2001).

This model suggests that corporate governance should not move away from ownership rights, but that such rights should not be solely claimed by, and thus concentrated in, shareholders; ownership rights can also be claimed by other stakeholders, particularly employees. Stakeholders who make firm specific investments and contributions and bear risks in the corporation should have residual claims and should participate in the corporate decision making to enhance corporate efficiency (Blair, 1995; Kelly and Parkinson, 1998).

Stakeholding is regarded as an effective means of achieving specific ends, rather than as an end in itself. It is argued that stake holding is instrumental in increasing efficiency, competition and profitability (Stoney and Winstanley, 2001). Freeman (1984) asserts that if corporations practice stakeholder management, their performance such as profitability, stability, share prices and growth will be more successful.

2.2.6The Trusteeship Model

Kay and Silberston (1995) argue that a public corporation is not the creation of a private contract and thus not owned by any individual. Ownership is by definition where the owner has exclusive

rights of possession, use, gain and legal disposition of a material object. Shareholders merely own their shares in a company and trade their shares with others in the stock market. They do not have rights to possess and use the assets of the company, to make decision about the direction of the company, and to transfer the assets of the company to others. The residual claims of the shareholders are determined by the company and if the company's performance does not satisfy the shareholders requirements, the shareholders are left with a single option of 'exit' rather than 'voice' as shareholders in general are in no way able to monitor the management effectively and neither are they interested in running corporate business. In this sense, the assumption that the corporation is owned by the shareholders is in fact meaningless.

Deakin and Slinger (1997) and Warren (2000) hold that ownership rights are not important to business. Many public institutions such as museums, universities, and libraries perform well without clear owners. Indeed, company law does not explicitly grant shareholders ownership rights because the corporation is regarded as an independent legal person separate from its members, and shareholders are merely the 'residual claimants' of the corporation. The company has its own assets, rights and duties, and has its own will and capacity to act and is responsible for its own actions. Kay and Silberston (1995) reject the idea that management are agents of shareholders. Instead, they suggest that managers are trustees of the corporation.

2.3 Corporate Governance

Mitton (2000) defines corporate governance as the means by which minority shareholders are protected from expropriation by managers or controlling shareholders. Corporate performance is partially a function of the quality of management, which given agency problems within the firm, will be a function of the quality of governance structures within the firm. Observable variables associated with governance structure such as the ownership of top management and the board of directors, the compensation package of top management, and the composition of the board of directors will vary in ways so that firms with certain types of structures systematically outperforming firms with other governance structures (Weisbach, 1993) . Firm value is an increasing function of improved governance quality among firms with high free cash flow. In contrast, governance benefits are lower or insignificant among firms with low free cash flow. Not controlling for this conditional relation between governance and firm value could lead to erroneous conclusions that governance and firm value are unrelated. (Chi *et al.*, 2010).A system of corporate governance consists of those formal and informal institutions, laws, values, and rules that generate the menu of legal and organizational forms available in a country and which

in turn determine the distribution of power – how ownership is assigned, managerial decisions are made and monitored, information is audited and released, and profits and benefits allocated and distributed (Cornelius and Kogut, 2003).

The private sector Governance Trust (1999) defines corporate governance as the manner in which the power of a corporation is exercised in the stewardship of the corporation's portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission. World Bank (1994) defines governance in relation to government as the 'practical exercise of power and authority by governments in the management of their affairs in general and of economic development in particular'. Good governance is an important concept for African Development and is related, first of all, to the necessity to create the basic extra-economic conditions that are important for the growth of African economies, for example an effective public administration, a functional legal framework, efficient regulatory structures and transparent systems for financial and legal accountability. In this context, it is the issue of the quality of the public goods supplied at country-level that makes good governance such an important concept (ADB, 1994).

2.4 Corporate Governance and Firm Performance

It is measured using the governance index which is constructed to comprise three critical dimensions: board structure, ownership composition and disclosure policy, all of which have been established to have a significant relationship to performance.

2.4.1 Board Structure

Board size is posited to have a negative effect on performance, as it seems to hinder the discussion of sensitive issues. Yermack (1996) provides evidence that US firms with smaller boards achieve higher market values. Mak and Kusnadi (2005) single out board size as the most significant factor in explaining the valuation of Singapore and Malaysia firms. In the case of Japan, Saito (2002) documents that board size and Tobin's Q are negatively correlated. Hermalin and Weisbach (2001) argue that board independence is an important condition for the critical evaluation and monitoring of managers' performance. In effect, board independence is the focus of considerable attention in current codes of best practice.

Nonetheless, evidence of a positive effect on performance is mixed, possibly because of the difficulty of identifying truly independent directors. Whereas Bhagat and Black (2002) find no relationship between the proportion of independent directors and various indicators of firm

performance, Rosenstein and Wyatt (1990) observe a positive market reaction to the appointment of independent directors. Perry and Shivdasani (2005) explain that firms with a majority of outside directors are more likely to restructure following performance declines, and more determined in doing so.

2.4.2 Ownership Characteristics

Numerous studies have documented the role of ownership structure on firm performance. In particular. management ownership is found to have a strong association with the firm's profitability and market value. Morck et al. (1988) and McConnell and Servaes (1990)show that Tobin's Q increases with the ownership of corporate insiders. However, they caution that entrenchment can occur at intermediate levels of ownership. In contrast, Chen et al. (2003) find that the performance of Japanese firms increases monotonically with managerial ownership, without showing any evidence of a negative inflection point. Large shareholders, such as institutional investors, have the incentives to exercise control over management and the power to initiate change in case of poor performance. McConnell and Servaes (1990) confirm that their impact on firm valuation is generally positive. However, Japanese institutional investors can be constrained by their group affiliation.

(Morcket al.2000) show that bank ownership is detrimental to firm valuation. Weinstein and (Yafeh 1998) confirm that bank-controlled firms exhibit a lower profitability. For these reasons, we use foreign ownership, which is a close substitute for foreign institutional investors. (Morck and Nakamura1999) highlight the negative impact of cross-shareholdings and stable shareholdings, i.e. shares held by block holders who almost never sell out and consistently support management. (Lichtenberg and Pushner, 1994) argue that cross shareholdings insulate firms from their own problems, at the expense of performance. Likewise, we hypothesize the percentage of stable shareholdings to be detrimental to firms' performance. Equity-related compensation has been shown to have a positive influence on performance, and share prices in particular, as it contributes to align the interests of managers and shareholders and reduce the quest for private benefits (Jensen and Meckling, 1976).

2.4.3 Information and Disclosure

Transparency and the quality of information released by firms are expected to exhibit a positive correlation with their performance, one reason being that good performers are more willing to disclose information. In addition, recent studies (e.g., Durnev et al., 2004) emphasize the role of

information in relation to efficient capital allocation and growth. Several attributes are used to reflect the quality of disclosure. The number of auditors'comments in the annual report is considered negatively correlated with information quality, and hence negatively correlated with firm performance. The number of changes in accounting policy over the past 3 years can also be viewed as obscuring accounting numbers, hence facilitating account manipulations. In fact, Dharan and Lev (1993) show that the power of earnings in explaining stock returns is weaker for firms with income increasing accounting changes. They also find that changes in accounting policy with income-increasing effect have a negative impact on the firm's subsequent stock returns.

By contrast, the quality of information available to the public should reflect the firm's respect for its shareholders. In particular, the timeliness of reporting and shareholder meetings held outside the most concentrated dates can be taken as evidence of the firm's concern for its investors, which in turn is assumed to be correlated with the firm's performance. Indeed, Chambers and Penman (1984) find that the release of earnings earlier than expected is associated with greater excess returns. Givoly and Palmon (1982) show that the stock volatility of firms with early reporting is also significantly higher compared with firms with late reporting. These findings suggest that timely disclosure is valuable to investors.

2.5 Empirical Review

2.5.1 Empirical Studies

Jones, (2003) has found a direct linkage between share price and good corporate governance practice and concluded as "There have been links between levels of corporate governance and share price performance. It is always comes back to the question of the extent to which good corporate governance and shareholder activism affect a company's share price." Here he tried to proof his hypothesis through the development of corporate governance score card which later on adopted by Euro money in the year 2003.

Coombes and Watson, (2000), made a survey of 200 institutional investors across the globe and found that, investors say they would pay more for the shares of good governed companies. In a Global Investor Opinion survey conducted by McKinsey (McKinsey Investor Opinion Study, 2002), more than 50% investors are of the opinion of corporate governance is equally or more important for a business. More than 70% investors are ready to pay premium for a good governed company. 78% respondents say Corporate Governance increases long-term shareholder

value. For 56% respondents Governance factors appear to be at least if not more important than financial issues in stock selection.

In a research carried out by Gompers; Ishii, and Metrick, (2001), it is being found that an investment strategy that bought(Long) high corporate governance rating firms and sold (shorted), the lowest and worst corporate governance firms would have outperformed the index by 8.5% during the period. In another research carried out by Gompers; Ishii, and Metrick, (2003), the authors here tried to focus on the governance index and share price movement and they stated: "An investment strategy that bought firms in lowest decile of the index (strongest rights) and sold firms in the highest decile of the index (weakest rights) would have earned abnormal returns of 8.5 percent per year during the sample period."

2.5.2 Local Empirical Studies Linked to this Study

Onyango (2004) studied the relationship between ownership structure and value of firms listed at Nairobi Stock Exchange and found a cubic relationship between the value of the firm and insider ownership. The value of the firm increased when insider ownership ranged between 0% and 37%, but decreased when insider ownership ranged between 37% and 51%.Firm value again increased when insider ownership exceeded 51%.In a complementary study, Munywoki (2006) concurred that managerial entrenchment has unambiguous negative effect on firm performance as measured by ROE and that the wealth effect of insider ownership is unambiguously positive. This evidence is consistent with both the convergence of interest and entrenchment hypothesis. Overall, the insider ownership has a positive impact on firm performance.

Lang'at (2006) studied the relationship between corporate governance structures and performance of firms quoted in the Nairobi Stock Exchange and found that frequency of board meetings, ratio of outside directors to total number of directors, % of insider share ownership and executive compensation were all positively related to firm performance. Kihara (2006) studied the relationship between ownership structure, governance structure and performance of firms listed in the Nairobi Securities Exchange and found no significant relationship between ownership structure and firm performance. The study however found a significant positive relationship between foreign share ownership and firm performance.

Manyuru (2005) and Mutisya (2006) studied the relationship between corporate governance structures and performance in firms quoted in the Nairobi Stock Exchange. Manyuru (2005) found a positive correlation between performance and corporate governance, Mutisya (2006)

found that board size, number of meetings held in a year and the proportion of shares held by top shareholder were significantly and positively related to firm performance.

Mwakanongo (2007) conducted a survey of Corporate Governance practices in shipping companies operating in Kenya. His study found that the average board size was 4 with a diverse and professional and business inclination which presupposed that the companies observed and practiced good governance mechanisms. He concluded that time had come for the maritime industry to formally come up with a uniform set of corporate governance practices which every shipping company operating in Kenya should be encouraged to follow.

2.6 Conclusion

I conclude that dynamics of diverse beliefs is the primary spread mechanism of volatility in asset markets. In an efficient capital market, investors will discount the price they are willing to pay for a company's shares by the expected level of managerial agency costs. It is therefore assumed that for a company to prosper, it will choose a corporate governance structure that is efficient in minimizing agency costs (Evans *et al.*, 2002).Note that, for a firm's corporate governance practice to have a positive effect on its market value, two conditions must be satisfied. First, good governance must increase the returns to firm's shareholders; second, the stock market must be sufficiently efficient so that the share prices reflect fundamental values. These conditions are more likely to be satisfied in mature markets than in emerging markets (Bai*et al.*, 2004).Also in the work by Chen, and Zhao, (2007), using consensus cash flow forecasts, they show that there is a significant component of cash flow news in stock returns, whose importance increases with investment horizons. For horizons over three years, the importance of cash flow news far exceeds that of discount rate news. These conclusions hold at both firm and aggregate levels, and diversification only plays a secondary role in affecting the relative importance of cash flow/discount rate news. The conventional wisdom that cash flow news dominates at the firm level but discount rate news dominates at the aggregate level is largely a myth driven by the estimation methods. Henry (2010) observes that there is a growing body of international evidence supporting the existence of a correlation between corporate governance structure, firm performance and valuation outcomes. What is less clear from this evidence, however, is the channel through which governance mechanisms derive their impact. Prior studies have suggested stronger shareholder rights and legal protection mechanisms which lower investor capital costs.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section of the research paper deals with the description of the methods applied in carrying out the research study. This chapter was organized under the following sections Research Design, Target Population, Sampling procedure and Sample Size, Data Collection Methods, Data Collection Tools/Instrumentation, Procedure and Time Frame, Validity, Reliability, Operational definition of Variables, Methods of Data analysis and the Summary.

3.2 Research Design

The research design used in this study was descriptive. Descriptive design is a scientific method of investigation which involves collection and analyzing of both quantitative and qualitative data. Descriptive survey enables the researcher to summarize and organize data in an effective and meaningful way. It allows for an in-depth investigation, and places more emphasis on a full contextual analysis of fewer events or conditions and their interrelations. Descriptive research portrays an accurate profile of persons, events, or situations (Saunders, Lewis and Thornhill, 2003). Therefore, the descriptive survey was deemed the best strategy to fulfill the objectives of this study.

3.3Populationof the Study

The population chosen for this study comprised of the companies listed in the Nairobi Securities Exchange. The use of the listed firms was due to data availability and reliability because all the quoted companies are required by law and NSE rules to file reports with the exchange and also CMA. The study covered a period of two years from Dec 2010 to 2011.

3.4 Sample of the Study

The sample chosen was the 30 companies chosen as a representative sample of the population out of 50 companies listed in the NSE. The selection was based on the companies listed in the Nairobi Securities Exchange for the year Dec 2010 to 2011. Companies which have been de-listed were not included in this study.

3.5Data Collection

This study made use of primary and secondary data. Sales, Return on assets, Return on Equity and Earnings per share and share priceswere computed from data obtained from the published annual reports of the quoted companies for the year Dec 2010 to 2011.Data on Corporate Governance was obtained from both the Published financial statements and administering questionnaires targeting the listed companies.

3.6Data Analysis and Presentation

Corporate Governance indices were computed based on the governance attributes. Corporate governance was measured by majorly; Aspects of Board structure; Aspects of ownership characteristics; Aspects of information and disclosure.

As far as assigning scores is considered, annual reports and responses from the questionnaires were considered. The share price has been chosen as dependent variable, while all the rest as independent variables. A regression model with variables from all the companies listed in the Nairobi Securities Exchange was run. Tests of significance were then done to determine whether the effect of corporate governance on share performance was significant.

Sales

Sales as an indicator of a company's performance.

Return on Assets (ROA)

Return on Assets (ROA) = Net Income / Total Assets. An indicator of how profitable a company is relative to its total assets. ROA gives an idea as to how efficient management is at using its assets to generate earnings.

Return on Equity (ROE)

Return on Equity (ROE) = Net Income / Total Equity. The amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Earnings per Share (EPS)

Earnings per share (EPS) =this is the net income available to common shareholders divided by the number of shares of common stock outstanding.

3.6.1 Dependent Variable

Share price has been taken as dependent variable, so it becomes necessary that appropriate share price value is taken for the analysis. For this purpose a broad calculation of share price

Daily Average Share Price = (Intraday High + Intraday Low)/2

Annual Average Share Price = Sum of Daily Average Share Price/Number of Days Share is Traded

3.6.2 Model Specification

The methodology approach to be utilized is cross sectional multiple regression analysis.

Share Price = C + (X_1).Sales + (X_2)ROE + (X_3) ROA + (X_4) EPS + (X_5)Corporate Governance Score

Wherein, 'C' is constant and X_1, X_2, X3, X_4 and X_5 are coefficients of the independent variables. The data was analyzed using statistical package for social sciences (SPSS) version 17 and content analysis assisted in summarizing the findings. This was applied to examine and compare the impact of the independent variables on the dependent variable.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

4.1 Introduction

This chapter presents analysis and findings of the study based on data collected from the field. The analysis was focused on answering the research questions. The results are presented on the impact of the relationship between corporate governance and the share price of companies listed in the NSE.The data was gathered exclusively from questionnaire and financial statements as the research instruments. The questionnaire was designed in line with the objectives of the study.

4.2 General Information of the Respondents

This section of study formed the first part of the questionnaire. General information of the respondents gave insightful background information that helped interpret the findings on the views about business environments on corporate governance and the share price of companies listed in the NSE.

4.2.1 Gender of the Respondents

On the gender of the respondents, the study found that there were more males shown by 68% and females shown by 32% of the respondents. This is depicted in the chart below.

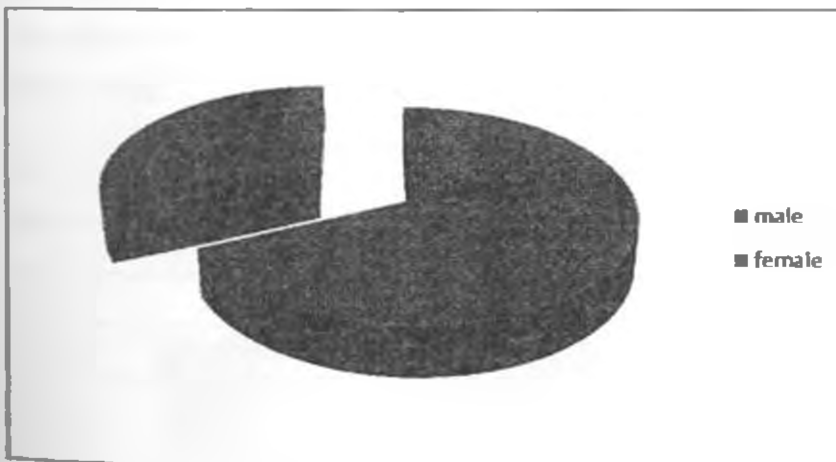

Figure 4.1 Genders of the Respondents

Source: Survey Data, 2012

4.2.2 Department in the Organization

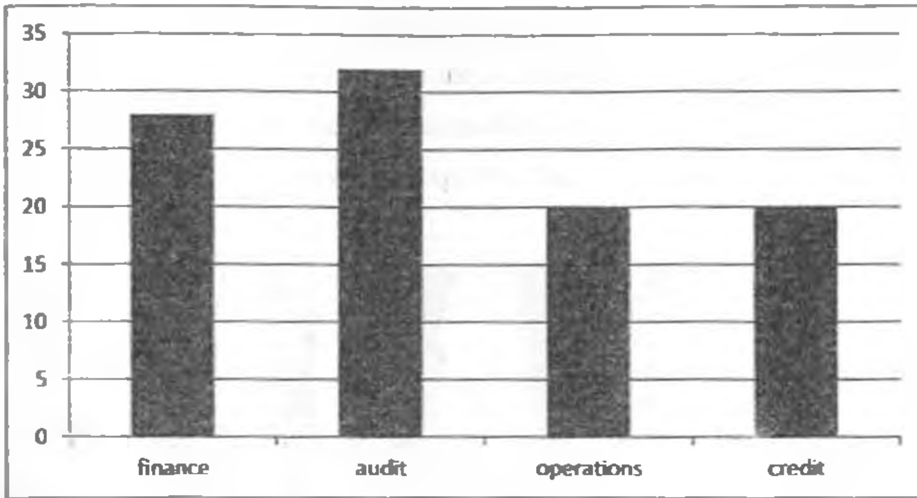

Figure 4.2 Departments in the Organization

Source: Survey Data, 2012

The study established that 32% of the respondents were in the audit department, 28% of the respondents were in the finance department. While 20% of the respondents were in the operations department and 20% of the respondents were in the credit department.

4.2.3 Designation in the organization

The study established that 52% of the respondents were middle level managers while 28% of the respondents were top level managers and 20% of the respondents were staff members in the organizations.

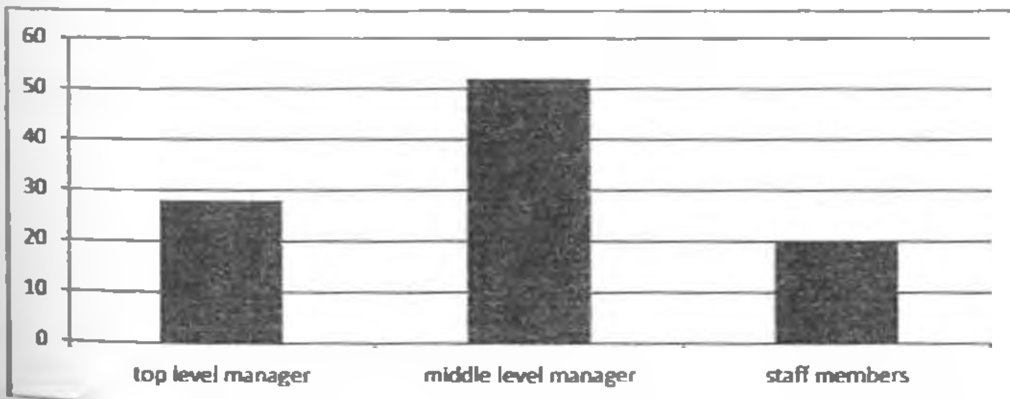

Figure 4.3 Designation in the Organization

Source: Survey Data, 2012

4.2.4 Age Distribution of the Respondents

The study also sought to establish the respondents' age bracket. From the findings, the majority of the respondents were 30-34 years old as shown by 28% of the respondents and 24% were aged 20-24 years, 35-39 years were represented by 20%, 25-29 years by 16%, over 50 years indicated by 8%, and 40-49years were represented by 4%.

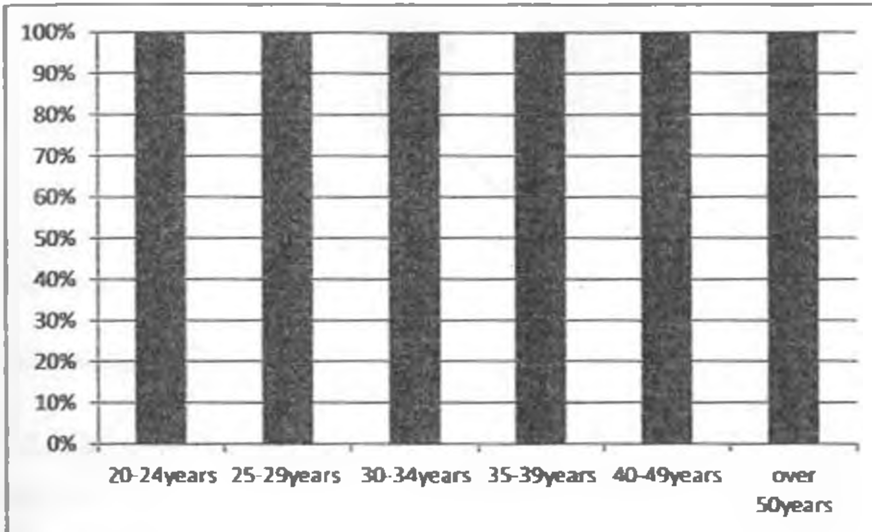

Figure 4.4 Age Distribution of the Respondents

Source: Survey Data, 2012

4.2.5 Level of Education

The study sought to establish the respondents' level of education. From the findings, the majority of the respondents were bachelor's degree graduates by 52%, followed by 28% master's degree graduates, college diploma level were represented by 20% and there were no secondary level indicated by 0%.

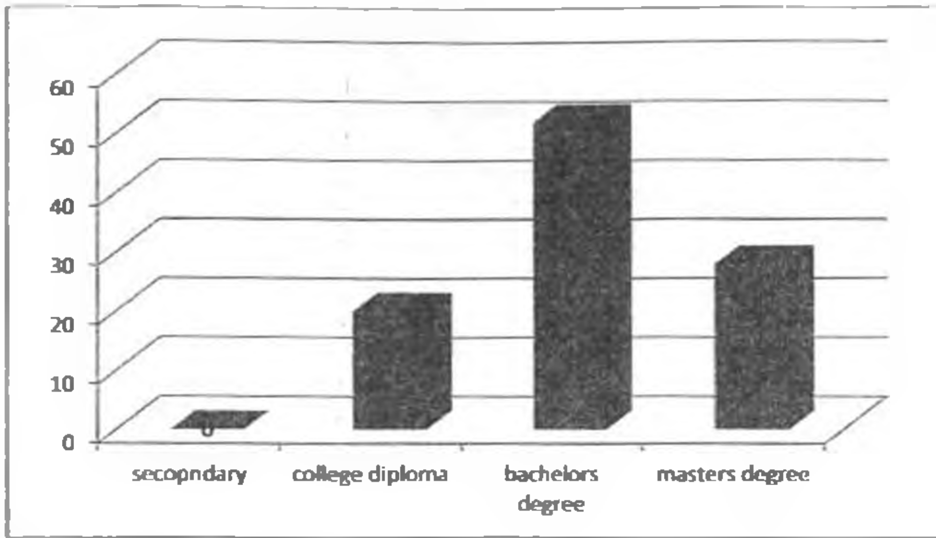

Figure 4.5 Level of Education

Source: Survey Data, 2012

4.2.6 Duration of work

The study sought to investigate the number of years the employees have worked in the organization. From the findings the respondents indicated that 28% have worked between 1-5years,20% of the respondents indicated that they have worked between 21-25years,16% of the respondents indicated that they have worked between 6-10 years,12% of the respondents indicated that they have worked over 30years,12% indicated that they have worked between 11-15years,while 8% of the respondents indicated that they have worked between 16-20years and 4% of the respondents indicated that they have worked between 26-30years.

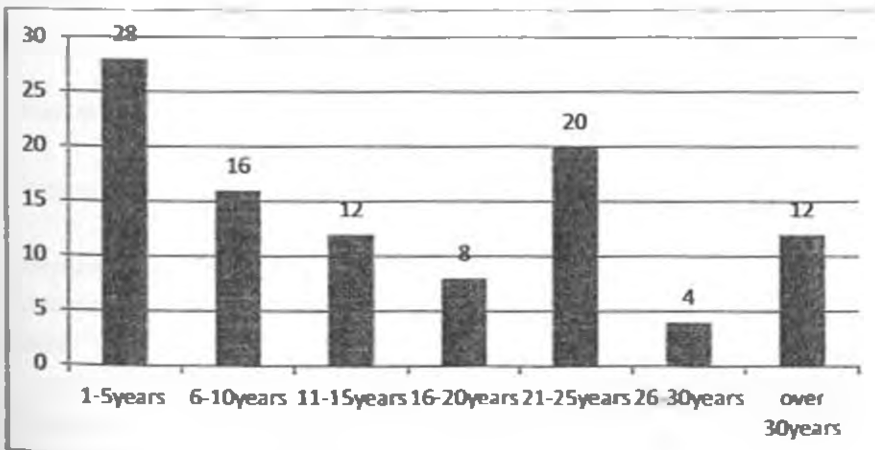

Figure 4.6Duration of work

Source: Survey Data, 2012

4.2.7 Ownership of the Organization

Table 4.1 Ownership of the Organization

Ownership	Frequency	percentage
Management ownership	13	52
Inside ownership	11	44
Foreign ownership	1	4
Total	**25**	**100**

Source: Survey Data, 2012

The study sought to investigate the type of ownership of the organization. From the results, 52% of the respondents indicated that the organization is management ownership, 44% of them indicated that the organization is an inside ownership, while 4% of the respondents indicated that it was foreign ownership.

4.3 Share Price of Companies

Table 4.2: Relationship between corporate Governance and the Share Price of Companies

Corporate governance practices	Yes		No	
	F	%	F	%
Balance of power in the board	15	60	10	40
Appointment and leadership of the board	17	68	8	32
Structure of the organization	7	28	18	72
Purpose and values	6	24	19	76
Corporate communication	5	20	20	80
Assessment of performance of the board	9	36	16	64
Responsibility to stakeholders	11	44	14	56
Social and environmental responsibility	14	56	11	44

Source: Survey Data, 2012

The study sought to investigate the relationship between corporate governance and the share price of companies. From the findings, 60% of the respondents agreed that the balance of power in the board has been adopted following the good corporate governance practices, 68% of the respondents indicated that there was good appointment and leadership of the board, 72% of the respondents indicated that the structure of the organization was not adopted to improve the financial performance, 76% of the respondents indicated that the purpose and values had not been adopted to improve the financial performance,80% of the respondents indicated that the board had not adopted corporate communication to improve the financial performance,64% of the respondents indicated that the board had not adopted assessment of performance of the board, while 56% of the respondents indicated that the responsibility to stakeholders was not adopted in the organization and 56% of the respondents indicated that the Social and environmental responsibility had been adopted in the organization.

4.4 CMA Guidelines

Table 4.3: CMA Guidelines on Corporate Governance

	Yes		No	
Guidelines	**F**	**%**	**F**	**%**
Board size	16	64	9	36
Proportion of outside directors	20	80	5	20
Number of meetings in a year	10	40	15	60

Source: Survey Data, 2012

The study sought to find out whether the organization had implemented the CMA guidelines on corporate governance. From the findings, majority of the respondents indicated that the organization had implemented the board size as shown by 64%, while 80% of the respondents indicated that the proportion of outside directors had been implemented and only 40% of the respondents indicated that number of meeting in a year had been implemented in the organization.

4.5 Board Structure

Table 4.4: Board structure and share price/performance

statement	Mean	Std Dev.
Board size as the most significant factor in explaining the valuation of firms	2.1148	1.48434
Large board sizes have a negative effect on performance	1.7869	.96807
Large board sizes hinder the discussion of sensitive issues	1.7541	1.13513
Appointment of independent directors leads to appositive market reaction	2.1148	1.52860
Board independence is an important condition for the critical evaluation and monitoring of managers' performance	2.0164	1.36005
Firms with a majority of outside directors are more likely to restructure in order to achieve high performances	1.8852	1.15612
The insider ownership has a positive impact on firm performance	1.7869	1.05063
Number of meetings has an effect on firms performance	1.9344	1.28930
Ratio of outside directors to total number of directors impacts positively on firm performance	2.4754	1.36145

Source: Survey Data, 2012

On the extent of agreement with statements related to the relationship between board structure and share price/performance, majority of the respondents indicated that there was limited access to Large board sizes that hinder the discussion of sensitive issues as shown by a mean score of 1.7541, the large board sizes had a negative effect on performance as shown by a mean score of 1.7869, the insider ownership had a positive impact on firm performance as shown by a mean score of 1.7869, number of meetings has an effect on firms performance as shown by a mean score of 1.9344, board independence is an important condition for the critical evaluation and monitoring of managers' performance as shown by a mean score of 2.0164, board size as the most significant factor in explaining the valuation of firms as shown by a mean score of 2.0164, board size as the most significant factor in explaining the valuation of firms as shown by a mean score of2.1148.and ratio of outside directors to total number of directors impacts positively on firm performance as shown by a mean score of 2.4754.

4.6 Relationship between Board Structure and Share Price/Performance

Table 4.5: Relationship Between Board Structure and Share Price/Performance

statements	Mean	StdDev
Management ownership have a strong association with the firm's profitability and market value	3.0656	1.40082
Large shareholders have the incentives to exercise control over management and the power to initiate change in case of poor performance	2.0164	1.24488
Equity related compensation contributes to align the interests of managers and shareholders and reduce the quest for private benefits	1.5410	2.77833
Equity related compensation has a positive influence on performance and share prices	2.3934	1.32008
Foreign owned/controlled firms exhibit a lower share prices and profitability	2.2951	1.53128

Source: Survey Data, 2012

The study also required the respondent to indicate the extent of the following on the relationship between board structure and share price/performance. From the study, majority of the respondents indicated that the equity related compensation contributes to align the interests of managers and shareholders and reduce the quest for private benefitsas shown by a mean score of 1.5410, large shareholders have the incentives to exercise control over management and the power to initiate change in case of poor performance as shown by a mean score of 2.0164, foreign owned/controlled firms exhibit lower share prices and profitability as shown by a mean score of 2.2951 and equity related compensation has a positive influence on performance and share prices as shown by a mean score of 2.3934 while management ownership have a strong association with the firm's profitability and market value affect to a moderate extent as shown by a mean score of 3.0656.

4.7 Share Price/Performance

Table 4.6: Relationship between board structure and share price/performance

Statements	Mean	Std Dev.
Transparency and the quality of information released by firms exhibit a positive impact on share price and performance in general	2.1148	1.48434
Timely disclosure is valuable to investors	1.7869	.96807
Changes in accounting policy with income increasing effect have a negative impact on the firms subsequent stock returns	1.7541	1.13513
Release of earnings earlier than expected leads to greater excess returns	2.1148	1.52860
Stock volatility of firms with early reporting is also significantly higher compared with firms late reporting	2.0164	1.36005
Number of auditors' comments in the annual report has a negative impact on information quality, hence negatively affect performance and share price	1.8852	1.15612

Source: Survey Data, 2012

The study sought to investigate the extent to which you agree with the following on the relationship between board structure and share price/performance.. From the study, majority of the respondents indicated that changes in accounting policy with income increasing effect have a negative impact on the firms subsequent stock returns to a great extent as shown by a mean score of 1.7541, timely disclosure is valuable to investors as shown by a mean score of 1.7869,number of auditors' comments in the annual report has a negative impact on information quality, hence negatively affect performance and share price as shown by a mean score of 1.8852, stock volatility of firms with early reporting is also significantly higher compared with firms late reporting as shown by a mean score of 2.0164, transparency and the quality of information released by firms exhibit a positive impact on share price and performance in generalas shown by a mean score of 2.1148, release of earnings earlier than expected leads to greater excess returns as shown by a mean score of 2.1148.

4.8 Regression Analysis

The following regression analysis was applied to determine whether there is a relationship between corporate governance and share price of a firm. The regression model took the following form:

Share Price = C + (X_1) Sales + (X_2) ROE + (X_3) ROA + (X_4) EPS + (X_5) Corporate Governance Score

Wherein, 'C' is constant and X_1, X_2, X3, X_4 and X_5 are coefficients of the independent variables.

Table 4.7 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					
					R Square Change	F Change	df1	df2	Sig. F Change	
1	0.864	0.746	0.532	.401	.746	1.799	18	11	.161	

A Predictors: (Constant), Sales, ROE, ROA, EPS, Corporate Governance Score

A correlation value of 0.864 was established which shows a high relationship between dependent and independent variables. This is also shown by a coefficient of determination value of 0.532. The determination coefficient value indicates that the regression line accounts for 53.2% of the total observations.

Table 4.8 ANOVA

	Sum of Squares	df	Mean Square	F	Sig.
Regression	4.236	4	1.059	1.186	.001a
Residual	37.508	116	0.893		
Total	41.745	120			

a Predictors: (Constant),Sales, ROE, ROA, EPS, Corporate Governance Score

b Dependent Variable:Share Price

The study used ANOVA to establish the significance of the regression model from which an f-significance value of $p<0.001$ was established. This shows that the regression model has a less than 0.001 likelihood (probability) of giving a wrong prediction.

Table 4.9: Regression Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.191	1.367		0.871	0.000
Sales	0.119	0.176	0.109	0.675	0.003
ROE	0. 206	0.182	0.023	0.145	0.046
ROA	0.432	0.273	0.246	1.461	0.041
EPS	0.372	0.246	0.256	1.601	0.057
Corporate Governance Score	0. 834	0.206	0.064	0.742	0.018

b Dependent Variable:Share Price

The following regression analysis was obtained:

$Y = 1.191 + 0.119X_1 + 0.206X_2 + 0.432X_3 + 0.372X_4 + 0.834X_5$

Whereby Y is Share Price, X_1 is Sales, X_2 is ROE, X_3 is ROA, X_4 is EPSand X_5isCorporate Governance Score.The model illustrates that when all variables are held at zero (constant), the share price would be 1.191. However, holding other factors constant, a unit increase in Sales, would lead to a 0.119 increase in share price, a unit increase in ROE would lead to a 0.206 increase in share price. On the other hand, a unit increase in ROA would lead to a 0.432 increase in share price while a unit increase in EPS would lead to a 0.372 increase in share price.

The study further shows that there is a significant relationship between share priceand Sales (p=0.003), ROE(p=0.046) ROA(P=0.041) andCorporate Governance Score(P= 0.018).

CHAPTER FIVE

DISCUSSION, CONCULUSION AND RECOMMENTATIONS

5.1 Introduction

This chapter provides the summary of the findings from chapter four, and also it gives the conclusions and recommendations of the study based on the objectives of the study. The general objective of this study was to determine the relationship between corporate governance and the share price of companies listed in the NSE.

5.2 Summary of the Findings

The research findings revealed that majority of the respondents were 30-34 years, it was also disclosed that majority of the respondents were bachelor's degree graduates, majority of the respondents have worked between 1-5years, and finally the study found out that majority of the respondents indicated management ownership had a strong association with the firm's profitability and market value.

The study also found from the corporate governance and the share price of companies that majority of the respondents indicated that the balance of power in the board had been mostly adopted following the good corporate governance practices. The study also found out that there was no good corporate communication to improve the financial performance in the organization.

On the issue of the CMA guidelines, the study found out that proportion of outside directors had been greatly implemented in the organization. According to the study it was found out that the board size and the number of meeting in a year were also some of the guidelines that had been implemented.

The study also found from the board structure, majority of the respondents indicated that there was limited access to large board sizes that hinder the discussion of sensitive issues in the organization. The study also found out that majority of the respondents indicated that the equity related compensation contributes to align the interests of managers and shareholders and reduce the quest for private benefits. Finally it was found out that changes in accounting policy with income increasing effect have a negative impact on the firms' subsequent stock returns to a great extent.

5.3 Discussions

The study revealed that majority of the respondents indicated management ownership had a strong association with the firm's profitability and market value. Similarly according to Morck et al. (1988) and McConnell and Servaes (1990) it was indicated that Tobin's Q increases with the ownership of corporate insiders. Chen et al. (2003) indicated that the performance of Japanese firms increases monotonically with managerial ownership, without showing any evidence of a negative inflection point.

The study revealed that on the issue of the CMA guidelines, proportion of outside directors had been greatly implemented in the organization. It was further found out that the board size and the number of meeting in a year were also some of the guidelines that had been implemented. This shows that there exists a relationship between the level of implementation of CMA guidelines on corporate governance and profitability of companies listed in the Nairobi Securities Exchange. These findings were similar to those of Nambiro (2008), which indicated that all companies listed in the Nairobi Securities exchange have implemented the CMA guidelines on corporate governance, performance of the listed companies have exhibited an increase which can be attributed to the high level of adoption of the guidelines, board size, proportion of outside directors and the number of meetings in a year increase.

The studies revealed that majority of the respondents were familiar with the company's board structure. From the findings of the study, majority of the respondents indicated that there was limited access to large board sizes that hinder the discussion of sensitive issues in the organization. The study also found out that majority of the respondents indicated that the equity related compensation contributes to align the interests of managers and shareholders and reduce the quest for private benefits. Further the study found that board size is posited to have a negative effect on performance, as it seems to hinder the discussion of sensitive issues. This shows that there exists a relationship between the board structure and share price/performance. These findings were similar to those of Yermack (1996) which provides evidence that US firms with smaller boards achieve higher market values. According to Hermalin and Weisbach (2001) it is indicated that board independence is an important condition for the critical evaluation and monitoring of managers' performance. In effect, board independence is the focus of considerable attention in current codes of best practice.

5.4 Conclusions

From the study the researcher concludes that firms increases monotonically with managerial ownership, without showing any evidence of a negative inflection point. The study also concludes that managerial ownership monotonically increases the firm, without showing any evidence of a negative inflection point.

The study also concludes that there should be implementation of the CMA guidelines; proportion of outside directors had been greatly implemented in the organization. The study concludes that the companies have exhibited an increase which can be attributed to the high level of adoption of the guidelines, board size, proportion of outside directors and the number of meetings in a year increase.

The study also concludes that the equity related compensation in the board structure contributes to align the interests of managers and shareholders and reduce the quest for private benefits.

5.5 Recommendations

The study recommends thatmanagement ownership should be considered in this case since it contributes to a strong association with the firm's profitability and market value. Managerial ownership also operates without showing any evidence of a negative inflection point.

The study further recommends CMA guidelines should be implemented in these companies as; it contributes to good corporate governance. The study recommends that there should be equity related compensation in the board structure which contributes to align the interests of managers and shareholders and reduce the quest for private benefits.

5.6 Limitation of the Study

The research was limited to companies listed in the Nairobi Securities Exchange. Other companies were not surveyed.

There was reluctance of some respondents to complete the questionnaires promptly and others even failed to complete them at all. This thus limited the number of respondents involved in the study although the researcher geared up efforts and approaches to them explaining the potential benefits of the study.

There was limited literature and data on corporate governance on share prices base in Kenya. Hence the study relies much on literature and data relating to the corporate governance on share

prices in other parts of the world especially the Western Countries. This factor thus limited the depth of discussions in the area of contributions of the impact of corporate governance on share prices: case of companies listed in the Nairobi Securities Exchange.

5.7 Suggestions for Further Research

The study has explored the impact of corporate governance on share prices with a specific reference to companies listed in the Nairobi Securities Exchange. Besides the listed companies, Kenya comprise of various other companies located in other areas in Kenya which differ in their way of management and have different settings all together. This warrants the need for another study which would ensure generalization of the study findings for all the companies in Kenya and hence pave way for new policies. The study therefore recommends another study be done with an aim to investigate the factors influencing corporate governance in Kenya.

Further a study should also be carried out to investigate the factors influencing the growth of Nairobi Securities Exchange.

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APPENDICES

Appendix 1: Introduction Letter

Elijah Omondi Mallit
University of Nairobi
School of Business
P.O.BOX 30197
Nairobi.

Dear Respondent,

Am Elijah Omondi Mallit, a student at the University of Nairobi, School of Business ,undertaking a degree of master of business administration (MBA).Currently am doing a research titled. "the impact of corporate governance on share prices", a case of companies listed in the Nairobi Securities Exchange.

Attached is a questionnaire that poses some questions about corporate governance and share prices. I would highly value and greatly appreciate your participation in answering the questions.

The information gathered from you shall be treated with outmost confidentiality and shall be used for academic purposes only.

Yours Sincerely
Elijah Omondi Mallit
(Researcher)

Appendix 2: Questionnaire

PART A: GENERAL INFORMATION

1. Gender.

   ( ) Male ( ) Female

2. Your department ....

3. Your designation...

4. What is your age bracket?

   20 – 24 Years ( ) 25 – 29 Years ( ) 30 – 34 Years( )

   35 – 34 Years ( ) 40 – 49 Years ( ) Over 50 years ( )

5. What is your highest level of education?

   Secondary ( ) Master's Degree ( )

   College diploma ( ) Others (please state) ....

   Bachelor's degree ( )

6. How many years have you worked in this institution?

   1-5 years ( ) 16-20 years ( ) 26-30 years ( )

   6-10 years ( ) 21-25 years ( ) Over 30years ( )

   11-15years ( )

7. How many board members does your organization have? ....

8. Which one of the following best describes the ownership of your organization? Management Ownership ( )Insider ownership( )Foreign ownership( )

Section B: Relationship between Corporate Governance and the Share Price of Companies

9. Has the Board in your organization adopted the following good corporate governance practices of to yield improved financial performance?

Corporate Governance Practices	Yes	No
Balance of power in the board		
Appointment and leadership of the board		
structure of the organization		
Purpose and values		
Corporate communication		
Assessment of performance of the board		

Responsibility to stakeholders		
Social and environmental responsibility		

10. Has your organization implemented the following CMA guidelines on corporate governance

Guidelines Yes No

i). Board size ( )( )

ii). Proportion of outside directors ( )( )

iii). Number of meetings in a year ( )( )

11. To what extent do you agree with the following statements on the relationship between board structure and Share Price/performance? Use a scale of 1-5 where 1- Strongly Disagree, 2- Disagree, 3- Neutral, 4- Agree, 5- Strongly Agree.

Statements	1	2	3	4	5
Board size as the most significant factor in explaining the valuation of firms					
Large board sizes have a negative effect on performance					
Large board sizes hinder the discussion of sensitive issues					
Appointment of independent directors leads to a positive market reaction					
Board independence is an important condition for the critical evaluation and monitoring of managers' performance					
Firms with smaller boards achieve higher market values					
Firms with a majority of outside directors are more likely to restructure in order to achieve high performances					
The insider ownership has a positive impact on firm performance					
Number of meetings has an effect on firms performance					
Ratio of outside directors to total number of directors impacts positively on firm performance					

12. To what extent do you agree with the following statements on the relationship between Ownership Characteristics andShare Price/Performance? Use a scale of 1-5 where 1- Strongly Disagree, 2- Disagree, 3- Neutral, 4- Agree, 5- Strongly Agree.

Statements	1	2	3	4	5
Management ownership have a strong association with the firm's profitability and market value					
Large shareholders have the incentives to exercise control over management and the power to initiate change in case of poor performance.					
Equity-related compensation has a positive influence on performance, and share prices.					
Equity-related compensation contributes to align the interests of managers and shareholders and reduce the quest for private benefits					
Foreign owned/ controlled firms exhibit a lower share prices and profitability					

13. To what extent do you agree with the following statements on the relationship between Information and Disclosure and Share Price/performance? Use a scale of 1-5 where 1- Strongly Disagree, 2- Disagree, 3- Neutral, 4- Agree, 5- Strongly Agree.

Statements	1	2	3	4	5
Transparency and the quality of information released by firms exhibit a positive impact on Share Price and performance in general					
Timely disclosure is valuable to investors					
Changes in accounting policy with income-increasing effect have a negative impact on the firm's subsequent stock returns					
Release of earnings earlier than expected leads to greater excess returns					
Stock volatility of firms with early reporting is also significantly higher compared with firms with late reporting					
Number of auditors' comments in the annual report has a negative impact on information quality, hence negatively affect firm performance and share price.					

Thank You

Appendix3: Companies Listed in the Nairobi Securities Exchange

AGRICULTURE
Eaagads Ltd
Kapchorua Tea Co. Ltd
KakuziLtd
Limuru Tea Co. Ltd
Rea Vipingo Plantations Ltd
Sasini Ltd
Williamson Tea Kenya Ltd
COMMERCIAL AND SERVICES
Express Ltd
Kenya Airways Ltd
Nation Media Group
Standard Group Ltd
TPS Eastern Africa (Serena) Ltd
Scan group Ltd
Uchumi Supermarket Ltd
Hutchings Biemer Ltd
TELECOMMUNICATION AND TECHNOLOGY
Access Kenya Group Ltd
Safaricom Ltd
AUTOMOBILES AND ACCESSORIES
Car and General (K) Ltd

CMC Holdings Ltd
Sameer Africa Ltd
Marshalls (E.A.) Ltd
BANKING
Barclays Bank Ltd
CFC Stanbic Holdings Ltd
Diamond Trust Bank Kenya Ltd
Housing Finance Co Ltd
Kenya Commercial Bank Ltd
National Bank of Kenya Ltd
NIC Bank Ltd
Standard Chartered Bank Ltd
Equity Bank Ltd
The Co-operative Bank of Kenya Ltd
INSURANCE
Jubilee Holdings Ltd
Pan Africa Insurance Holdings Ltd
Kenya Re-Insurance Corporation Ltd
CFC Insurance Holdings
British-American Investments Company Ltd
INVESTMENT
City Trust Ltd
Olympia Capital Holdings ltd
Centum Investment Co Ltd

Trans-Century Ltd
MANUFACTURING AND ALLIED
B.O.C Kenya Ltd
British American Tobacco Kenya Ltd
Carbacid Investments Ltd
East African Breweries Ltd
Mumias Sugar Co. Ltd
Unga Group Ltd
Eveready East Africa Ltd
Kenya Orchards Ltd
A.Baumann CO Ltd
CONSTRUCTION AND ALLIED
Athi River Mining