THE RELATIONSHIP BETWEEN EXECUTIVE COMPENSATION AND STOCK PRICES FOR COMPANIES QUOTED AT THE NAIROBI STOCK EXCHANGE

BY

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DECLARATION

This research proposal is my original work and has not been submitted for a degree in any other university.

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To God Almighty I give thanks, through whom all things are possible.
DEDICATION

This research report is especially dedicated to my wife Lucy and sons Lenny and Don for their support, inspiration and encouragement throughout my MBA studies.

I cannot forget my Mother Nelly for her wisdom, counsel and prayers that has been the cornerstone in my quest for Knowledge.
ABSTRACT

This paper has sought to establish whether there is a relationship between executive compensation and share prices. It measures executive compensation using directors' fees and combines other variables namely: performance; size; dividends per share and inflation. The model is applied to companies listed at the Nairobi Stock Exchange.

The model used provides empirical evidence that a direct relationship exists between share prices and executive compensation. It also confirms that indicate that, executive pay, size, performance, Dividends per share are significant determinants of stock prices since each one of them has a significance level of less than 0.05 or a t-value of greater than 2 while Inflation was not identified as a significant determinant. Overall results indicate that executive pay has a direct negative impact on the firm share prices.
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CHAPTER ONE

INTRODUCTION

1.1 Background

When dealing with executive compensation, the focus will be on financial compensation. Admittedly, it is only one of a variety of incentives available to chief executive officers (CEOs). Prestige, challenge, and power might rival or even greatly surpass pay in their importance to executives. However, an understanding of executive compensation will be useful in several theoretical contexts: executive mobility, executive caliber, strategy implementation, power patterns, attributions and managerial impacts, and organizational symbols. Moreover, CEO pay is a topic of intense interest in the business press; it lends itself to empirical inquiry; it has spawned an abundant but disjointed literature; and, finally, knowing more about CEO pay will inform inquiries into non-financial incentives for CEOs, Sidney and Donald (1988).

Current stock performance measured by stock price has received more attention in dealing with executive pay over future stock performance, due to the implicit assumption that in efficient markets, investors will immediately capitalize the present value of future firm performance increases into the stock price when the incentive pay becomes public information (Fich and Shivdasani, 2005). However, there are reasons to expect that information in executive compensation incentive pay may not be immediately impounded into returns. First, CEO compensation contracts may incorporate both observable and unobservable (to outsiders) measures of performance. If the unobservable measures in contracts are correlated with future observable measures of firm performance, then variation in current compensation that is not explained by variation in current observable performance measures should predict future variation in observable performance measure (Hayes and Schaefer, 2000). So to the extent that
firms and managers contract on net-positive unobservable managerial characteristics, this suz'ests a positive relationship between pay and future returns.

The differing interests and contractual nature between shareholders and top executives is not a new thought in economics. Adam Smith (1776) pointed this out: "What are the common wages of labour depends everywhere upon the contract usually made between those two parties, whose interests are not the same. The workmen desire to get as much, the masters to give as little as possible". He also stated: "The directors of companies, however, being the managers of other people's money than of their own, it cannot be expected that they should watch over it with the same anxious vigilance [as owners]... Negligence and profusion, therefore, must prevail, more or less, in the management of the affairs of such a company." Berle and Means (1932) suggested that the separation of ownership and control in a modern corporation may introduce the principal-agent problem due to asymmetric information between shareholders and executives. Although it can be unjustified to categorize executives' behaviour as a group, asymmetric information may enable executives' to behave opportunistically and ineffectively. This in turn can increase the probability of serious corporate accounting and compensation scandals leading a substantial decrease in shareholder value.

A key principal-agent relationship within firms is that between owners and managers. Within the corporate governance literature research has focused on how to attenuate the opportunistic behaviour of managers that is not in owners' interests. Executive remuneration is a potent device by which to attenuate managerial opportunistic behaviour. It is important that Board members are remunerated in such a way as to serve owners' interests by monitoring senior executives for opportunistic behaviour. Clearly, non-executive directors have an important role to play in this respect Hart, (1995). An important issue relates to the remuneration and incentive structures
offered to non-executive directors such as the chair of the Board of a mutual building society as opposed to executive directors.

The principal-agent problem and moral hazard is at the heart of the corporate governance debate and the separation of ownership and control in firms (Jensen and Meckling, 1976). Managers are employed by owners in order to manage and control firms' resources on owners' behalf. An agency relationship allows managers to indulge in opportunistic behaviour that serves their own interests and not necessarily those of owners. Marris (1963) suggests that managers might empire build and increase the size of the firm because power and prestige are attached to managing a large firm. Corporate governance is concerned with how best to reduce managers' opportunistic behaviour.

Pay is a device by which owners can potentially seek to create financial incentives for managers to attenuate their opportunistic behaviour. Ideally, an employment contract setting pay equal to the marginal product of labour would be written. Company profitability, however, is a consequence of both managerial effort and stochastic factors outside of managers' control. Thus, effort is not perfectly determinable from simply observing company profits. Writing employment contracts, therefore, is problematic due to the difficulties associated with unforeseen contingencies and the principal-agent problem (Jensen and Murphy, 1990).

They in addition suggest that stock options, equity ownership, performance-related-pay and performance-related dismissals can be included as part of remuneration packages in order to provide financial incentives for value-maximizing behaviour. Within the context of a highly competitive financial services marketplace, and an equally competitive executive labor market, however, companies might be expected to resort to alternative means of aligning the incentives or management with those of owners within the remuneration package.
It may well be, therefore, that any links between performance and remuneration in companies emanate from market pressures, both product and executive labor market, rather than from the usual corporate governance agency channels. The Board of Directors is the main internal control mechanism through which shareholders can control managers (Shleifer and Vishny, 1988), and, ojven the problems associated with the dispersed ownership structure, this internal control mechanism is particularly important in mutual building societies. It is the Board's role to scrutinize the highest decision makers in the organisation (Fama, 1980). It is, therefore, an important device in ensuring that Executive Directors fulfill their fiduciary duty to owners. It is often that, although the Board has a fiduciary duty to protect owners' interests, if they do not have a financial interest in the firm and have little to gain from performance gains they may not fulfill their fiduciary duty.

The pressures from competitive product and executive labor markets would imply a link between performance and remuneration for the former, while the interests of the members would probably be better served if this link was less strong for the latter. The non-executive Directors would then be better placed to curb any tendency for Executive directors to be overly concerned with profitability to the detriment of the owners. John and Senbet, (1998). A detailed analysis of the relationship between Board remuneration and company performance, and an examination of any differences in this relationship between executive directors such as the CEO and non-executive Directors such as the Chair is therefore very important.

The general purpose of the board of directors is to advise and monitor top management, to establish executive compensation, and to otherwise protect the interests of shareholders. The existing literature examines corporate governance problems that inhibit the effectiveness of the board of directors. Jensen (1993) argues that boards of directors often fail to effectively monitor the firm's management. The board may not effectively monitor executive performance because
board culture inhibits constructive criticism, and because of informational asymmetry problems that exist between management and the board.

12 Statement of the Problem

Executive compensation has long attracted a great deal of attention from financial economists. Indeed, the increase in academic papers on the subject of CEO compensation during the 1990s seems to have outpaced even the remarkable increase in CEO pay itself during this period (Murphy, 1999). Much research has focused on how executive compensation schemes can help alleviate the agency problem in publicly traded companies. To understand adequately the landscape of executive compensation, however, one must recognize that the design of compensation arrangements is also partly a product of this same agency problem.

Local studies have also focused on the area of executive compensation and its relation to firm performance. Zena, (2004) undertook a survey of performance measures for executive compensation schemes in public listed companies in Kenya, the study established that several measures of performance are variables such as sales levels, stock prices for listed firms and profit levels for the firms. In addition, the study established that different firms adopt various styles in compensating their executives.

Mululu, (2005) studied the relationship between board activity and firm performance, taking study of firms quoted on the Nairobi stock exchange. The study findings indicated that the actions of the board had a great deal of influence on firm performance, these activities such as public relations and social responsibility activities affect the firm value for listed firms. In addition, the monitoring role of the board on the executive officers in charge of management had remarkable ramifications on firm value.
Molonko, (2004) undertook a study on board structure, board compensation and firm profitability evidenced from the banking industry. The study found out that board compensation and firm size were the main determinant of firm profitability while board size and proportion of non executive directors played insignificant role in determining the firm's profitability.

Odhiambo (2006) on conducting a survey for companies listed at the Nairobi Stock Exchange on executive compensation and corporate performance in Kenya established that in incentive contracting the method of tying the executive wealth to that of shareholders closely through share based remuneration is hardly used while tying the executive pay to an appropriate performance measure is used to a limited extent.

Managers may use their discretion to benefit themselves personally in a variety of ways (Shleifer and Vishny, 1997). For example, managers may engage in empire building (Jensen, 1974; Williamson, 1964). They may fail to distribute excess cash when the firm does not have profitable investment opportunities (Jensen, 1986). Managers also may entrench themselves in their positions, making it difficult to oust them when they perform poorly (Shleifer and Vishny, 1989). Any discussion of executive compensation must proceed against the background of the fundamental agency problem afflicting management decision-making.

The focus of this paper is on publicly traded companies without a controlling shareholder. When ownership and management are separated in this way, managers might have substantial power. Berle and Means (1932) observed that top corporate executives, while in office, have almost complete discretion in management. The problem of managerial power and discretion has been analyzed in modern finance as an "agency problem, (Jensen and Meckling 1976)

It is widely believed that information can become reflected in stock prices as long as it is known and fully understood by a limited number of market professionals. In the executive compensation
context, however, the ability of plan designers to choose arrangements that favor of both the firm and the executive is puzzle. There is therefore a knowledge gap on the relationship between stock prices and executive remuneration and this paper will seeks to bridge this gap.

1.3 Objectives of the study

The objective of the study is to establish the relationship between the executive compensation and the stock prices for firms listed in the Nairobi Stock exchange.

1.4 Hypothesis

It is hypothesized in this study that there is a positive correlation between board compensation and stock prices.

1.5 Significance of the study

The management of various companies listed on the NSE can use these findings to understand how executive compensation influences the firm value measured in terms of stock returns at the Nairobi stock exchange.

The investors can also use this information to make better decisions in what firms to invest in if their interest is in the stock prices of the companies.

The scholars and academics can use this study as a basis for further research.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This literature review does an overview of executive compensation and firm's performance, reviews three main theories guiding the study on executive compensation, approaches to executive pay, power-pay relationships, stealth compensation, agency cost, board of directors and the explores the empirical studies on this subject.

2.2 Overview of Executive Compensation and firms' Performance

Compensation of chief executive officers both in terms of amount and composition has received an increasing amount of attention over the last few years. The arguments typically center on either the "exorbitant" pay levels or the compensation arrangements themselves. Jensen and Murphy (1990) suggest that the pay levels are not exorbitant and, if compared to the CEO pay levels of the 1930s, CEOs today may be underpaid. They argue that how much CEOs are paid is not that important; however, how they are paid is very important.

Jensen and Murphy (1990) provide evidence that the link between pay and performance is relatively weak, thus the composition of the compensation package needs further attention. The recent literature on agency conflicts between managers and shareholders is characterized by studies that test whether the implementation of incentive compensation schemes mitigate the manager-shareholder conflict. While these studies present evidence that incentives do influence managerial decision-making, no dominant class of incentives has been found. This finding is consistent with evidence that suggests firms must compensate according to their particular
characteristics. In this context the relationship between compensation, risk taking, and managerial behavior can be evaluated.

Previous studies have evaluated how compensation influences management behavior Agrawal and Mandelker (1987). However, it is difficult to determine the true influence of incentive compensation due to the often high degree of information asymmetry between managers and shareholders. Because managers have private and often superior information about the expected value of future projects (Bizjak, Brickley, and Coles (1993)) and their associated risks, it is difficult to observe management's true effort. Lewellen, Loderer, and Martin (1987) predict that managers of growth firms will receive a larger proportion of their pay from long-term forms of incentive compensation than those of non-growth firms.

This relationship between compensation and growth is inseparable from the relationship between compensation and risk. Lewellen, et al (1987) argues that managerial risk aversion may be reduced by the increased use of stock-based remuneration. This increase would raise the cost to the manager of variance reducing projects and raise the rewards for variance increasing projects. Mehran (1995) presents evidence that suggests managers are motivated by the form rather than the level of compensation. Consequently, the ability of compensation schemes to alter the risk taking behavior of the manager In terms of compensation levels. Smith and Watts (1982) argue that growth firms will pay relatively higher wages to managers than non-growth firms to compensate them for the difficult task of selecting investment projects as opposed to the relatively easier task of managing assets that are currently in place. In addition, since growth firms are likely to be riskier than their non-growth counterparts, managers of growth firms will demand a compensation premium for bearing this additional risk (Smith and Watts (1992).
There are many different forms of executive compensation that offer a variety of tax benefits and performance incentives (Kuepper 2009)). Such include Cash Compensation; Option Grants; Deferred Compensation; Long-Term Incentive Plans (LTIPs); Retirement Packages and other Executive Perks such as the use of a private jet, travel reimbursements and other rewards.

2.3 Determinants of Stock Prices

The price of a commodity, the economist makes us to believe is determined by the forces of demand and supply in a free economy. Even if we accept the economists” view, what factors influence demand and supply behavior? Price? Yes, but not all the time, at least there are some other factors. In the securities market, whether the primary or the secondary market, the price of equity is significantly influenced by a number of factors which include book value of the firm, dividend per share, earnings per share, price earnings ratio and dividend cover (Gompers, Ishii and Metrick, 2003). The most basic factors that influence price of equity share are demand and supply factors. If most people start buying then prices move up and if people start selling prices go down. Government policies, firm’s and industry’s performance and potentials have effects on demand behavior of investors, both in the primary and secondary markets. The factors affecting the price of an equity share can be viewed from the macro and micro economic perspectives. Macro economic factors include politics, general economic conditions that is, how the economy is performing, government regulations among others. Then there may be other factors like demand and supply conditions which can be influenced by the performance of the company and, of course, the performance of the company vis-a-vis the industry and the other players in the industry.

In a study of the impact of dividend and earnings on stock prices, Hartone (2004) argues that a significantly positive impact is made on equity prices if positive earnings information occurs after negative dividend information. Also, a significantly negative impact occurs in equity
pricing if positive dividend information is followed by negative earning information. Docking and Koch (2005) discovers that there is a direct relationship between dividend announcement and equity price behavior. Al-Qenae, Li and Wearing (2002) in their study of the effects of earning (micro-economic factor), inflation and interest rate (macro-economic factors) on the stock prices on the Kuwait Stock Exchange, discovered that the macro-economic factors significantly impact stock prices negatively. A previous study by Udegbunam and Eriki (2001) of the Nigerian capital market also shows that inflation is inversely correlated to stock market price behaviour.

2.4 Theoretical Literature Review

2.4.1 Approaches to Executive Compensation and Executive Pay Theories

Extending previous overviews by Gomez-Mejia (1994) and Balsam (2002), there are sixteen theories on executive compensation categorized into three approaches. The classification is based on the main role that pay plays in a specific theory and on the underlying legitimizing arguments or mechanisms of pay within a given theory. These approaches include: The value approach, which focuses mainly on the question how much to pay executives. Executive pay is legitimized hereby arguing that pay is set by market forces and pay is mainly regarded as the market value of executive services. Secondly The agency approach which considers pay mainly as a consequence of agency problems, and focuses on the question as to how to pay executives. Legitimizations of pay levels and structures are based on arguments of market forces and conceptions of executive pay at risk. Lastly the symbolic approach considers pay as a reflection of expectations, status, dignity or achievements, and plays a more secondary role in executive motivation. The arguments used to legitimize executive pay are based on social constructed beliefs about the implications of being in an executive position. The approach deals mainly with the question of how socially constructed beliefs influence what pay ought to reflect, Otten (2008).
Among financial economists, the dominant approach to the study of executive compensation views managers' pay arrangements as a partial remedy to the agency problem (Agency approach). Under this approach, boards are assumed to design compensation schemes to provide managers with efficient incentives to maximize shareholder value. Murphy (1999). To some researchers working within the optimal contracting model, the main flaw with existing practices seems to be that, due to political limitations on how generously executives can be treated, compensation schemes are not sufficiently high-powered (Jensen and Murphy, 1990).

Another approach to studying executive compensation focuses on a different link between the agency problem and executive compensation. Under this approach, the managerial power approach, executive compensation is viewed not only as a potential instrument for addressing the agency problem but also as part of the agency problem itself. As a number of researchers have recognized, some features of pay arrangements seem to reflect managerial rent-seeking rather than the provision of efficient incentives (Bebchuk and Fried, 2003). Managerial power and rent extraction are likely to have an important influence on the design of compensation arrangements. The managerial power approach can shed light on many significant features of the executive compensation landscape that have long been seen as puzzling by researchers working within the optimal contracting model.

Managers' influence over their own pay might impose substantial costs on shareholders beyond the excess pay executives receive by diluting and distorting managers' incentives and thereby hurting corporate performance. Compensation arrangements are likely to be shaped both by market forces that push toward value-maximizing outcomes, and by managerial influence, which leads to departures from these outcomes in directions favorable to managers. The managerial power approach simply claims that these departures are substantial and that optimal contracting alone cannot adequately explain compensation practices, Bar-Gill and Bebchuk (2002).
2.4.2 The Optimal Contracting Theory

This is an agency approach theory. The optimal contracting view recognizes that managers suffer from an agency problem and do not automatically seek to maximize shareholder value. Thus, providing managers with adequate incentives is important. Under the optimal contracting view, the board, working in shareholders' interest, attempts to provide cost-effectively such incentives to managers through their compensation packages. Optimal compensation contracts could result either from effective arm's length bargaining between the board and the executives or from market constraints that induce these parties to adopt such contracts even in the absence of arm's length bargaining. However, neither of these forces can be expected to prevent significant departures from arm's length outcomes.

Just as there is no reason to presume that managers automatically seek to maximize shareholder value, there is no reason to expect a priori that directors will either. Indeed, directors' behavior is also subject to an agency problem, which in turn undermines their ability to address effectively the agency problems in the relationship between managers and shareholders. Directors generally wish to be re-appointed to the board. (Pearl Meyers, 2002). Besides an attractive salary, a directorship is also likely to provide prestige and valuable business and social connections. CEOs play an important role in renominating directors to the board. Thus, directors usually have an incentive to favor the CEO.

To be sure, in a world in which shareholders selected individual directors, directors might have an incentive to develop reputations as shareholder-serving. However, board elections are by slate, dissidents putting forward their own director slate confront substantial impediments, and such challenges are therefore exceedingly rare (Bebchuk and Kahan, 1990). Typically, the
director slate proposed by management is the only one offered. The key to a board position is thus being placed on the company's slate.

Because the CEO's influence over the board gives her significant influence over the nomination process, directors have an incentive to "go along" with the CEO's pay arrangement, a matter dear to the CEO's heart at least as long as the compensation package remains within the range of what can plausibly be defended and justified. In addition, because being on the company's slate is the key to being appointed, developing a reputation for haggling with the CEO over compensation would hurt rather than help a director's chances of being invited to join other companies' boards. Another reason to favor the CEO is that the CEO can affect directors' compensation and perks.

Directors typically have only nominal equity interests in the firm (Baker, Jensen and Murphy, 1988). Thus, even a director who did not place much value on a board seat would still have little personal motivation to fight the CEO and her friends on the board on compensation matters. Moreover, directors usually lack easy access to independent information and advice on compensation practices necessary to effectively challenge the CEO's pay.

Market forces are not sufficiently strong and fine-tuned to assure optimal contracting outcomes. Markets, including the market for corporate control, the market for capital and the labor market for executives impose some constraints on what directors will agree to and what managers will ask them to approve. An analysis of these markets, however, indicates that the constraints they impose are far from tight and permit substantial deviations from optimal contracting (Bebchuk, Fried and Walker, 2002). In the market for corporate control firms frequently have substantial defenses against takeovers. A majority of companies have a staggered board, which prevents a
hostile acquirer from gaining control before two annual elections passes, and often enables incumbent managers to block hostile bids that are attractive to shareholders.

To overcome incumbent opposition, a hostile bidder must be prepared to pay a substantial premium; during the second half of the 1990s, the average premium in hostile acquisitions was 40 percent (Bebchuk, and Subramanian, 2002). The disciplinary force of the market for corporate control is further weakened by the prevalence of "golden parachute" provisions, as well as acquisition-related benefits that target managers often receive when an acquisition takes place. The market for corporate control thus leaves managers with considerable slack and ability to extract private benefits. To be sure, the market for control might impose some costs on managers who are especially aggressive in extracting rents; the important point is that the market for corporate control fails to impose tight constraints on executive compensation.

2.4.3 The Managerial Power theory

Managerial power theory and class hegemony theory convincingly argue that because of principal agent relationships, agents are in the natural position to have discretion in setting their own pay (Bratton, 2005; Jensen and Murphy, 2004). The very reasons for questioning the ability of optimal contracting to explain compensation practices adequately also suggest that executives have substantial influence over their own pay. In addition, these reasons suggest that the greater is managers' power, the greater is their ability to extract rents. There are limits to what directors will accept and what markets will permit, but these constraints do not prevent managers from obtaining arrangements that are substantially more favorable than those they could obtain by bargaining at arm's length.
One important building block of the managerial power approach is "outrage" costs and constraints. The tightness of the constraints managers and directors confront depends, in part, on how much "outrage" a proposed arrangement is expected to generate among relevant outsiders. Outrage might cause embarrassment or reputational harm to directors and managers, and it might reduce shareholders’ willingness to support incumbents in proxy contests or takeover bids. The more outrage a compensation arrangement is expected to generate, the more reluctant directors will be to approve the arrangement and the more hesitant managers will be to propose it in the first instance. Thus, whether a compensation arrangement that is favorable to executives but suboptimal for shareholders is adopted will depend on how it is perceived by outsiders.

According to Porter and Shackell (1997) the design of compensation arrangements is indeed influenced by how outsiders perceive them. They established that CEOs of firms receiving negative media coverage of their compensation arrangements during 1992-1994 subsequently received relatively small pay increases and had the pay-performance sensitivity of their compensation arrangements increased. Thomas and Martin (1999) find that, during the 1990s, CEOs of firms that were the target of shareholder resolutions criticizing executive pay had their annual compensation reduced over the following two years by an average of $2.7 million.

The importance of how compensation arrangements are perceived means that, in the executive compensation area, the transparency of disclosure matters. Financial economists often focus on the role of disclosure in getting information incorporated into market pricing. It is widely believed that information can become reflected in stock prices as long as it is known and fully understood by a limited number of market professionals. In the executive compensation context, however, the ability of plan designers to choose arrangements that favor managers depends on how these arrangements are perceived by a much wider group of outsiders. As a result, the transparency and salience of disclosure can have a significant effect on CEO compensation.
2.4.4 Class Hegemony Theory

This theory argues that executives within a firm and executives from other firms share a commonality of interests. Where managerial power theory stops at the boundaries of firms, class hegemony theory extends managerial views beyond these boundaries (Gomez-Mejia, 1994). Shared interests and objectives create bonds between executives that extend beyond a single organization. These bonds form relationships which in turn form a class across different organizations. By using (shared) power the executives can protect their privileges and the wealth of their class. Although primarily executives' input is used to legitimize high executive pay, setting high pay is also a token of executives' power to protect shared interests and objectives (Gomez-Mejia, 1994). Setting executive pay is thus a result of the social managerial class's power to protect their interests and objectives that are at potential risk.

2.4.5 Powers-Pay Relationships

The managerial power approach predicts that pay will be higher and or less sensitive to performance in firms in which managers have relatively more power. Other things being equal, managers would tend to have more power when the board is relatively weak or ineffectual; there is no large outside shareholder; there are fewer institutional shareholders; or managers are protected by antitakeover arrangements. There is evidence indicating that each of these factors affects pay arrangements in the way predicted by the managerial power approach. Executive compensation is higher when the board is relatively weak or ineffectual including the CEO. Core, Holthausen and Larcker (1999) find that CEO compensation is higher when the board is large, which makes it more difficult for directors to organize in opposition to the CEO; when more of the outside directors have been appointed by the CEO, which could cause them to feel a sense of gratitude or obligation to the CEO; and when outside directors serve on three or more boards, and thus are more likely to be distracted.
Also, CEO pay is 20-40 percent higher if the CEO is the chairman of the board (Cyert and Kumar, 2002). According to Core, and Larcker, (1999), CEO pay is negatively related to the share ownership of the board’s compensation committee; doubling compensation committee ownership reduces non salary compensation by 4–5 percent (Cyert, and Kumar, 2002). The presence of a large outside shareholder is likely to result in closer monitoring, and it can be expected to reduce top managers’ influence over their compensation. (Shleifer and Vishny, 1986). Cyert, and Kumar (2002) find a negative correlation between the equity ownership of the largest shareholder and the amount of CEO compensation: doubling the percentage ownership of the outside shareholder reduces nonsalary compensation by 12-14 percent.

Bertrand and Mullainathan (2000) find that CEOs in firms that lack a 5 percent external shareholder tend to receive more pay associated with profit increases that are entirely generated by external factors such as changes in oil prices and exchange rates rather than by managers’ efforts. They also find that in firms lacking large external shareholders, the cash compensation of CEOs is reduced less when their option-based compensation is increased. A larger concentration of institutional shareholders might result in greater monitoring and scrutiny of the CEO and the board. Examining CEO pay in almost 2000 firms during the period 1991-1997, Hartzell and Starks (2002) find that the more concentrated is institutional ownership, the lower is executive compensation. They also find that a larger institutional presence results in more performance-sensitive compensation.

Examining CEO compensation in the 200 largest companies during 1990-1994, Kochar and Levitas (1998) find that the effect of institutional shareholders on CEO pay depends on the types of relationships they have with the firm. They divide institutional shareholders into those that have no other business relationship with the firm and are thus concerned only with the firm’s share value and those that have other business relationships with the firm like managing a
pension fund and are thus vulnerable to management pressure pressure-sensitive institutions. As the managerial power approach predicts, CEO pay is negatively correlated with the presence of pressure-resistant institutional investors and positively correlated with the presence of pressure-sensitive ones.

The adoption of antitakeover provisions makes CEOs less vulnerable to a hostile takeover. Borokhovich, Brunarski and Parrino (1997), examining 129 firms that adopted antitakeover provisions such as a supermajority rule during the period 1979-1987, find that CEOs of firms adopting such provisions enjoy above-market compensation before adoption of the antitakeover provisions and that adoption of these provisions increases their excess compensation significantly. This pattern is not readily explainable by optimal contracting; indeed, if managers' jobs are more secure, shareholders should be able to pay managers a lower risk premium (Agrawal and Knoeber, 1998). Cheng, et al (2001) find that CEOs of Forbes 500 firms that became protected by state antitakeover legislation enacted during the period 1984—1991 reduced their holdings of shares by an average of 15 percent, apparently because the shares were not as necessary for maintaining control. Optimal contracting might predict that a CEO protected by antitakeover legislation would be required to buy more shares to restore the CEO's incentive to increase shareholder value.

2.4.6 Stealth Compensation

According to Bebchuk and Fried (2003), firms use pay practices that make less transparent the total amount of executive compensation and the extent to which compensation is decoupled from managers' own performance. Among the arrangements used by firms that camouflage the amount and the performance insensitivity of compensation are pension plans, deferred compensation, postretirement perks, and consulting contracts. Most of the pension and deferred compensation benefits given to executives do not enjoy the large tax subsidy that applies to the
standard retirement arrangements provided to other employees. In the case of executives, such arrangements largely shift tax liability from the executive to the firm in ways that sometimes even increase the joint tax liability of the two parties. The efficiency grounds for providing compensation through in-kind retirement perks and guaranteed post-reirement consulting fees are also far from clear. All of these arrangements, however, make pay less salient.

2.4.7 The Board of directors

The board of directors of a company performs the critical functions of monitoring and advising top management. Conventional wisdom suggests that a greater level of board independence allows for more effective monitoring and improves firm performance. Several studies have documented how outside non-management directors on the board affect discrete tasks, including hiring and firing of the CEO (Weisbach, 1988) (Borokhovich, et al 1996), adoption of anti-takeover provisions (Brickley, et al 1994), and negotiating takeover premiums (Byrd et al 1992), Cotter, et al 1997). A second factor perceived to affect the board's ability to function effectively is the size of the board. Lipton and Lorsch (1992) and Jensen (1993) suggest that larger boards may be less effective than smaller boards due to co-ordination problems in larger boards and problems such as director free-riding. Yermack (1996) and Eisenberg, et al (1998) provide evidence that smaller boards are associated with higher firm value, as measured by Tobin's Q. Collectively, these and similar studies have been taken to mean that smaller, outsider dominated boards are optimal from a corporate governance standpoint.

The monitoring role of the board has been studied extensively and the general consensus is that smaller boards are more effective at monitoring. The argument is that smaller groups are more cohesive, more productive, and can monitor the firm more effectively. Larger groups are fraught with problems, such as social loafing and higher co-ordination costs, and hence are not good monitors. Lipton and Lorsch (1992) argue that boards of 8 or 9 members are most effective.
They claim that, when the board is bigger, it becomes hard for all the board members to express their ideas and opinions in the limited time available at board meetings. Jensen (1993) concurs with this view, and states that board of more than 7 or 8 members function less effectively and are easier for the CEO to control. Yermack (1996), findims a negative relation between Q and board size for 452 large U.S. industrial corporations between 1984 and 1991, are interpreted by many to provide empirical support for the notion that smaller boards are better.

The advisory role of the board, however, has received far less attention. Exceptions include Klein (1998), Agrawal and Knoeber (2001), Adams and Ferreira (2003), Klein (1998) argues that the CEO's need for advice will increase with the complexity of the organization. Diversified firms are more complex (Rose and Shephard, 1997). Similarly, both Hermelin and Weisbach (1988) and Yermack (1996) suggest that CEOs of diversified firms have greater need for advice. Such firms operate in multiple segments and therefore require larger boards. Pfeffer (1972), suggests that boards are chosen to maximize the provision of important resources to the firm. Pfeffer and Salancik, (1978) Klein, 1998 suggests that advisory needs of the CEO increase with the extent to which the firm depends on the environment for resources. There has been a general push, led by institutions, regulators, and legislators, towards independent boards with higher representation of outsiders. Some important classes of firms benefit by having a substantial fraction of insiders on the board. Several factors support placing insiders on the board of directors. Inside directors can be better at selecting an appropriate strategy Baysinger and Hoskisson, (1990). Turk (1991) find that higher insider representation on a board increases research and development spending. Insiders also can add value by providing information to the board. Raheja (2004) proposes a model where firms with high project verification costs benefit from having more insiders on the board.
In addition, Klein (1998) suggests that her findings support the notion that insiders contribute valuable specific information about the organization's activities. Since inside directors possess more firm-specific knowledge (Klein, 1998), their usefulness may prove highest in firms operating in more uncertain environments, which have greater needs for specialized knowledge (Williamson, 1975). Burkart, et al, (1997) suggest that in firms where the manager's initiative leads to higher value it may be optimal to reduce monitoring and cede discretion to the management team. Managerial initiative is likely to be a critical determinant of firm value in research and development intensive firms. Then, if the fraction of outsiders is correlated with monitoring intensity, it may be expected that high-research and development firms would have less monitoring and hence, all else equal, will have a higher fraction of insiders on the board.

2.4.8 Agency Cost

The recognition of potential agency costs associated with the separation of management and ownership is not new; differences in managerial and shareholder priorities have been recognized for more than three centuries. Adam Smith (1937) adjudged the management of early joint stock companies to be negligent in many of their activities. These problems were especially prevalent in the British East Indies Company and attempts to monitor managers were largely unsuccessful because of inefficiencies and costs associated with shareholder monitoring (Kindleberger, 1984). Scott (1912) and Carlos (1992) question these assertions—while control and organization were less than ideal, the continued success and long life of the corporation imply generally sound managerial practices. Although some fraud no doubt existed, the majority of managerial activities coincided with shareholder desires.

Modern agency theory seeks to explain corporate capital structure as the result of attempts to minimize the costs associated with the separation of corporate ownership and control. Agency costs are lower in firms with high managerial ownership stakes because of the better alignment
of shareholder and manager goals (Jensen and Meckling, 1976) and in firms with large block shareholders that are better able to monitor managerial activities (Shleifer and Vishney, 1986). Agency problems result from information asymmetries, potential wealth transfers from bondholders to stockholders through the acceptance of high-risk and high-return projects by managers, and failure to accept positive net present value projects and perquisite consumption in excess of the level consumed by prudent corporate managers (Barnea, Haugen, and Senbet. 1981).

2.4.9 Empirical Studies

Lewellen and Huntsman (1970) analyze 50 US firms at three-year intervals beginning from 1942 to 1963. They find strong evidence that top executives' compensation is heavily dependent upon generation of profits. Their results also indicate that firm profits and stock market values are substantially more important in the determination of executive compensation than are firm sales. Jensen and Murphy (1990) use CEO compensation data on a sample of 1,295 firms from 1974 to 1986. They estimate pay for performance models in first differences to account how change in CEO compensation is related to change in shareholders' wealth. As a CEO compensation measure they use a broad measure of eight different components. They find that CEO pay-for-performance sensitivity has been modest and it has fallen in real terms from the 1930s:

Rosen (1990) surveys several independent empirical studies on CEO pay-for-performance. He concludes that the evidence from these studies suggests that the effect of stock returns on log compensation is in the 0.10-0.15 range. Rosen (1990) also summarizes a variety of academic pay-for-firm size elasticity works for different time periods in the U.S. and the UK. He find some variation in CEO pay-for-firm size elasticity.
Gregg, et al (1993) focus on the relationship between a highest paid director and firm performance with the UK data on a sample of 288 large listed firms over the period 1983-1991. They find evidence that the relationship between top director pay and firm performance is very weak in terms of share returns over the whole period. However, after splitting the data into two sub-periods they find a positive but small pay-for-performance relationship for the first sub-period, but not for the second. They also argue that growth in a top director’s pay is strongly correlated with the growth of firm size: a 50% increase in a firm’s sales leads to a 10% increase in a top director’s compensation.

Conyon and Leech (1994) examine the determinants of a top director salary and bonus with a sample of 294 large UK listed firms between 1983 and 1986. They find a positive but very small pay elasticity estimate with respect to firm performance. For the median top director, a 10% increase in shareholder wealth corresponds to an increase in compensation of 375 pounds. Perhaps more importantly, they find evidence that firm sales are important factors in explaining the top directors pay: an estimated elasticity is approximately 7%. Another key finding is that ownership control and concentration decrease the level of a top director’s pay, but these variables do not affect the growth of his pay.

2.5 Summary of Literature Review

Executive compensation is an extremely complex field, an industry to itself. Articles in the popular press are limited in length. Many of the incentives that apply to executives apply to all employees. For example, a bonus can motivate someone on the assembly line as well as a chief executive officer. As a result, the vast majority of executives continue to focus on the annual cash bonus as the more meaningful and, therefore, more motivating component of variable pay. This trend has led to a narrow focus on maximizing short-term results and a willingness to take risks that boost near-term returns even if those returns prove unsustainable over the long term.
Focus on Value Creation, not Just Earnings or the Profit and loss statement. Internal performance metrics should take into account how executives use the capital entrusted to them by holding them accountable for the size and sustainability of the cash flows they generate after reinvestment. These actions affect the returns of the firm evidenced by changes in prices of the issued stocks.

Among other things, a lot of research has on the other hand discussed option plan design, stealth compensation, executive loans, payments to departing executives, retirement benefits, the use of compensation consultants, and the observed relationship between CEO power and pay. Some has also focused on how managerial influence might lead to substantially inefficient arrangements that produce weak or even perverse incentives.

It is also necessary to understand that external (political) influences have shaped the executive compensation package, but not always to the benefit of shareholders clearly indicating an agency problem which affect the firm's fundamental and in return the firm's value.
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter deals with the research methodology. These are the steps taken in the data collection, and analysis. In addition to that, the data collection procedures are important components of a research and are also contained in this chapter. This section of the study describes the research design, the population and the procedure of data collection and data analysis in general.

3.2 Research design

This study is a causal research. This method assists to establish the impact or effect of executive compensation to stock prices. It is most appropriate method to study relationships.

3.3 Population of the Study

The population of interest in this study was on all the firms quoted at the Nairobi Stock Exchange (N.S.E). All the firms listed shall be studied. There are 55 companies listed on the NSE as at December 31, 2009.

3.4 Data Collection

This study was facilitated by the use of secondary data. Stock prices at the beginning and the end of each year; directors remuneration and number of directors who served each year; dividend per share declared each year and total sales reported in each year by each company shall be obtained from a Nairobi Stock Exchange bona fide data vendor while annual inflation indexes will be obtained from the Central Bank of Kenya. The period of study shall cover 5 years from 2005-2009. Five year period has been selected because similar studies in other markets take a
five year range for analysis purpose. This period is current and the events during this period will shed light on the actual activities occurring in the market at present.

3.5 Validity Test

Ten percent of this data was verified using published reports at the Nairobi Stock Exchange library.

3.6 Data Analysis

The data obtained from the secondary sources was analyzed using regression analysis. Statistical Package for Social Sciences (SPSS) version 18.0, a data analysis software shall be used to analysis the data. Tables and charts will be used for ease of understanding.

Firm stock price is the dependent variable and the independent variable will be the directors pay. To control for firm size and performance, the two variables for firm size and performance will be introduced in the model. Directors pay will be derived by dividing the directors' remuneration with the total number of directors who served during the year. This is due to the fact that all companies registered per the Companies Act Cap 486 Laws of Kenya are required to disclose in their financial statements total directors' emoluments. Firm size variable will be derived by obtaining the natural logarithm of total sales reported in a given year while performance variable will be derived by computing the return on investment (ROI). ROI will be computed by subtracting beginning-of-the-year share price from end-of-the-Year share price and then adding the results to dividends for the year followed by dividing these results with the share price at the end of the year.

3.7 Research Model

The model is presented as follows:

\[ \text{STOCK} = p_1 \times \text{PAY} + p_2 \times \text{SIZE} + p_3 \times \text{PERF} + p_4 \times \text{DPS} + p_5 \times \text{INFL} + t_i \]
Where

**STOCK** refers to the stock price at the end of the financial year

**Pi** is the directors' pay predictor constant when directors' pay changes by one unit.

**PAY** represents directors' pay which will be measured by the annual directors' remuneration. To determine the pay for each year, the total pay for the year will be divided by the number of board members so as to determine the pay per board member. Natural logarithm of this amount will then be obtained and used in the models as the pay. The reason for this is to take into account the board size.

**p_2** is the firm size predictor constant when firm size measurement parameter changes by one unit.

**SIZE** refers to the size of the firm. The pay for board members may be determined by the size of the organization. Thus, this variable is introduced in the model to control for the size of the firm. It will be measured as the natural logarithm of sales for the year.

**p_3** firm's performance predictor constant when firm's performance measurement parameter changes by one unit

**PERF** refers to performance. This variable is introduced in the model to control for firm performance which may influence what the board is paid. It will be measured as the return on investment (ROI).

**p_4** firm's dividend per share predictor constant when firm's dividend per share measurement parameter changes by one unit.
DPS refers to dividend per share. This variable is introduced in the model to control for the effect of dividends which may influence the price of share at the Nairobi stock exchange. It will be measured by the amount of the dividend that shareholders have (or will) receive for each share they own (outstanding shares) per year.

\( p \)

Inflation predictor constant when economy's inflation measurement parameter changes by one unit.

INFL refers to inflation. This variable is introduced in the model to control for inflation which may influence the price of share at the Nairobi stock exchange. It will be measured by the inflation measurement index provided by the central bank of Kenya.

\( r \)

The error term constants which predict the stock price when the independent variables are zero.

The drawbacks of method used to compute return on investment is that it doesn't take into consideration the change in the value of money over the time. On the other hand total sales by a firm in the Nairobi stock exchange may comprise revenue from investment activities that depend on performance of other firms. Although total sales is used to measure size of a firm in this research, this is a weak measure due to the fact that the nature of business a firm is involved in determines the value of the total sales. For instance, firms dealing with sale of goods will seem to have higher sales than those dealing with sale of services. However the causative effect of the variables used in the model is high since there is sufficient literature in support of this fact.
4.1 Data Preparation

Out of the fifty five companies listed at the Nairobi stock exchange five companies which had faced suspension from the market at different times, eight companies that were listed during the period of analysis and one company that had exclusion of previous financial reports due to its significance restructuring were excluded due to the fact that full set of the data was unavailable.

A multiple regression was performed between share prices at year end; pay measured by the natural logarithm of annual amount paid per director, size of the firm measured by the natural logarithm of sales, performance measured by return on investment, Dividend per share and annual Inflation index.

The overall regression model was first checked for multi-collinearity problems by first performing a correlation analysis between the independent variables. There was a slight higher correlation between pay and size however, at the exploratory phase, the regression model was run and collinearity diagnostics were done. The Variance Inflation Factor and the Conditional Index were reasonable since the conditional index was at 25.6 which is below the 30 figure threshold.

4.2 Correlation Analysis

Table 1 shows correlation coefficients between share prices and the other variables in the model. Examining the correlation matrix, there is a low and negative correlation between share prices and executive pay while a higher negative colleration exist between share prices and inflation. However there is a low positive correlation between share prices and the size of the firm but
higher correlation of 0.657 between share prices and dividends per share was observed. These results are shown on table 1

### Table 1: Correlations Matrix

<table>
<thead>
<tr>
<th></th>
<th>stock</th>
<th>Pay</th>
<th>size</th>
<th>Perf</th>
<th>DPS</th>
<th>Infl</th>
</tr>
</thead>
<tbody>
<tr>
<td>stock</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pay</td>
<td>-.09500</td>
<td>1.00000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>size</td>
<td>.088</td>
<td>.655</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>perf</td>
<td>.275</td>
<td>.038</td>
<td>-.045</td>
<td>1.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>DPS</td>
<td>0.657</td>
<td>0</td>
<td>0.125</td>
<td>0.038</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Infl</td>
<td>-.1190</td>
<td>.0070</td>
<td>.0820</td>
<td>-.16000</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>

#### 4.3 The Model

This study used the following model to test the relationship between executive remuneration and various independent variables.

\[
\text{STOCK} = \beta_0 \text{ PAY} + \beta_2 \text{ SIZE} + \beta_3 \text{ PERF} + \beta_4 \text{ DPS} + \beta_5 \text{ INFL} + \epsilon
\]

With results on table 2 the coefficients table, the model can be mathematically written as:

\[
\text{STOCK} = -7.593 \text{ PAY} + 6.48 \text{ SIZE} + 27.049 \text{ PERF} + 18.126 \text{ DPS} - 80.057 \text{ INFL} + 15.114
\]

### Table 2: Coefficients Table

<table>
<thead>
<tr>
<th></th>
<th>Coefficients</th>
<th>Std. Error</th>
<th>t</th>
<th>P-Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>15.114</td>
<td>29.853</td>
<td>.506</td>
<td>.613</td>
</tr>
<tr>
<td>Pay</td>
<td>-7.593</td>
<td>2.320</td>
<td>-3.273</td>
<td>.001</td>
</tr>
<tr>
<td>Size</td>
<td>6.480</td>
<td>2.564</td>
<td>2.528</td>
<td>.012</td>
</tr>
<tr>
<td>Perf</td>
<td>27.049</td>
<td>5.252</td>
<td>5.150</td>
<td>.000</td>
</tr>
<tr>
<td>DPS</td>
<td>18.126</td>
<td>1.446</td>
<td>12.539</td>
<td>.000</td>
</tr>
<tr>
<td>Infl</td>
<td>-80.057</td>
<td>59.594</td>
<td>-1.343</td>
<td>.181</td>
</tr>
</tbody>
</table>
Table 2 shows the coefficients table. The coefficient of pay is negative. This coefficient is statistically significance which suggests an inverse relationship between share prices and executive compensation thereby contradicting the hypothesis. This confirms that mere increase of directors’ fees will not solve the agency problems in the company and in turn it will erode the firm value measured by performance of the ordinary share in the stock market.

Coefficient for size is positive. The reason for positive relationship between size and share prices is that small companies may find it difficult to raise sufficient funds to finance all of their wealth creating investments due to asymmetric information problems. There are of cause other reasons why firm size and share price might be related. To the extent that firm size is related to market shares a positive relationship between size and share price might be expected due to market power or efficiency effects. To the extent that size is related to diversification, a positive relationship is expected, if one believes that diversification improves performance.

Coefficient for performance is positive. Although firm performance measurements are numerous, investors tend to purchase the stocks of firms perceived to have high performance and as a result increasing the demand of these stock thereby causing the prices to increase.

Coefficient for dividend per share is positive. This is due to the fact that price reactions to dividend increases are significantly more positive and to dividend decreases significantly more negative due the information content. Also, the price reactions to dividend are larger and the yield effect is stronger for low-priced and small-firm stocks.

Coefficient for inflation is negative and it was not identified as a significant determinant. However it is a known fact that when inflation increases it erode the purchasing power of the investor and as a consequence reduces the demand of the stocks forcing the prices to decline.
4.4 **Significance of the Model**

Table 3 shows the regression results. The regression statistics table shows an adjusted R Square ($R^2$) of 0.512 which suggests that the model that uses directors pay, firm size, firm performance, dividends per share and the inflations index can be used to explain 51.2% of the variation in share prices. This is a major contribution to the objective of this study.

The Coefficient of determination ($R^2$) was at 0.524. This means that the choice of independent variables to predict variation in the dependent variable only explains 52% of the total variation. The rest of the variation is explained by other variables not in the model.

A look at the regression coefficients, indicate that, pay, size, performance. Dividends per share are significant determinants of stock prices since each one of them has a significance level of less than 0.05 or a t-value of greater than 2 as shown on table 2.

**Table 3: Regression statistics**

**Summary Output**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiple R</td>
<td>0.724*</td>
</tr>
<tr>
<td>R Square</td>
<td>0.524</td>
</tr>
<tr>
<td>Adjusted R Square</td>
<td>0.512</td>
</tr>
<tr>
<td>Std. Error of the Estimate</td>
<td>55.21862</td>
</tr>
<tr>
<td>Observations</td>
<td>41</td>
</tr>
</tbody>
</table>

**Table 4: ANOVA**

<table>
<thead>
<tr>
<th></th>
<th>Sum of Squares</th>
<th>Df</th>
<th>Mean Square</th>
<th>F</th>
<th>Significance F.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>667188.139</td>
<td>5</td>
<td>133437.628</td>
<td>43.763</td>
<td>.000*</td>
</tr>
<tr>
<td>Residual</td>
<td>606770.125</td>
<td>199</td>
<td>3049.096</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1273958.263</td>
<td>204</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
4.5 A Comparison of Executive Remuneration and Share Prices

Table 5 shows the coefficients when pay was considered as the only factor affecting share prices. The coefficient of pay is negative. The coefficient is statistically significant which suggests a linear negative relationship.

Table 5: Share Prices and Executive Pay Statistics

<table>
<thead>
<tr>
<th></th>
<th>Coefficients</th>
<th>Std. Error</th>
<th>T</th>
<th>P-Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>15.114</td>
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<td>Pay</td>
<td>-7.593</td>
<td>2.320</td>
<td>-3.273</td>
<td>.001</td>
</tr>
</tbody>
</table>

STOCK = 15.14 - 7.593 PAY

This suggests that there is a linear inverse relationship between share price and the directors’ pay due to the fact that the gradient is negative, that ie -7.593. This is a low gradient suggestion low elasticity.

Since the study by Gregg, et al (1993) found evidence that the relationship between top director pay and firm performance is positive and very weak in terms of share returns over the whole period and this study has found out the there is a positive relationship between share prices and firm performance measured in terms of returns, we expect a positive relationship between directors pay and share prices as consequence.

Overall the results can be interpreted as that pay has a negative relation to stock prices. This means that an increase in pay by 1 unit, will lead to a corresponding decrease in stock price by 7.6% holding other variables constant.
CHAPTER FIVE

DATA ANALYSIS AND FINDINGS

5.1 Conclusion

Executive compensation has long attracted a great deal of attention from financial economists due to the brief that a proper understanding would be useful in several theoretical contexts such as: executive mobility, executive caliber, strategy implementation, power patterns, attributions and managerial impacts, and organizational symbols.

This paper addressed the question whether there is any empirical relationship between firm share prices and executive remuneration measured in terms of directors' pay for companies listed at the Nairobi Stock Exchange. Although agency theory provides some good reasons why such a relationship should exist, empirical evidence is rather fuzzy in this regard. Executive pay is expected to play a crucial role in controlling the agency problem.

This paper has examined the relationship between stock prices and the executive pay of the companies listed at the Nairobi stock exchange. The paper provides empirical evidence on the relationship between share prices and executive pay. Other things being constant the relationship between share prices and executive pay is linear with negative gradient of -7.593 suggesting inverse nature.

The results in this paper confirm that executive pay has an impact on the share prices.

5.2 Limitations

This study focused on listed companies, which may not be representative of all the companies in Kenya. Results were based on quantitative statistics and overlooked other essential parameters which are non-quantitative.
5.3 Recommendations

These results have confirmed that there is a relationship between share prices and executive compensation measured in terms of directors’ fees for companies listed at the Narobi Stock Exchange. Other researchers should carry research for companies that are not listed.
REFERENCES


Company's Act Cap 486 Section 197 Laws of Kenya.


