EFFECTS OF CORPORATE GOVERNANCE ON INFORMATION ASYMMETRY BETWEEN MANAGERS AND INVESTORS IN FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

BY

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OCTOBER 2014
DECLARATION

This is my original work and has not been presented for award of any degree in any university.

Signed........................................... Date....................................................
Mary Ndungo

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

Signed........................................... Date....................................................
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DEDICATION

This research project report is dedicated to my Dad and Mum Mr. and Mrs. Absalom Ndungo who have stood by me, believed in me and gave me motivation during my academic pursuits and the research work.
ACKNOWLEDGEMENTS

First, all glory and honor goes to Almighty God. He has given me good health and the finances needed to successfully complete this project. Through the process I have continuously drawn strength from the knowledge that God has a good plan for me and that my destiny was and remains in His hands. Without Him I can do nothing.

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LIST OF ACRONYMS

NSE- Nairobi Stock Exchange
CMA- Capital Markets Authority
CBK- Central Bank of Kenya
CEO- Chief Executive Officer
CAPM- Capital Asset Pricing Model
CDS account- Central Depository and Settlement account
SIIA- Software and Information Industry Association
FTSE- Financial Times Securities Exchange
ATS- Automated Trading System
FISD- Financial Information Services Division
ROE- Return on Investment
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This study aimed at investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The specific objectives of the study were to find out the effect of Board Ownership on the information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange, to investigate how board independence influences information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange and to determine how CEO duality affects information asymmetry between managers and investors in firms listed at NSE. This study was conducted using explanatory research design. The target population was 62 listed companies at the Nairobi Securities Exchange from which the data was drawn. The sample comprised of 32 firms listed in the NSE by the year 2003. Secondary data was collected using a questionnaire which contained both open and closed ended questions. A pilot test was first conducted to test the reliability and the validity of the questionnaire as an instrument. A simple random technique was used to select one staff from the corporate affairs department from each company who were the respondents. Secondary data was collected from companies’ websites, publications and data bought from the NSE. Secondary data collected was analyzed using multiple linear regression equation and the method of estimation was Ordinary Least Squares (OLS) so as to establish the relationship between corporate governance variables and information asymmetry. In order to test the significance of the model, the study conducted an analysis of variance. The results of the ANOVAs test indicate a significant value of .003 and a confidence 99 percent which was obtained indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry. Results from the coefficient of determination test indicated that $R^2$ equals 0.7, that is, changes in aggregate information asymmetry could be explained up to 70 percent by the linear relationship between Board Ownership, Board Independence and CEO/Chair Duality. Findings from the data analyzed and tabulated from the questionnaires collected revealed 65% of the respondents indicated that the CEO/Chairman given share options in the organization while 100% of the respondents indicated that their board consisted of both executive and non executive member and as such exercised some level of independence. Most (61%) of the respondents agreed the board review CEO compensation annually and 65% indicated that this compensation included share options. 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their directors selling or buying shares in the firms statement or in the firm’s web page, 65% of the firms disclosed their directors reports in the firm’s web page and all (100%) of the firms disclose their audited annual reports in the firm’s web page. From the results of the ordinary least square (OLS), Board Ownership and Board Independence were significantly negatively related to information asymmetry i.e. coefficients of -5.53 and -6.94 respectively while CEO/Chair duality was positively related to information asymmetry at +2.98. The levels of significance for all the variables were, 0.002, 0, and 0.001 respectively indicating a more than 97% confidence level. The results agree with Raheja (2005) and Myerson (1987) who found the existence of significant relationship between corporate governance variables aforementioned above in firms. The study recommends future researchers to study the association between corporate governance characteristics and information asymmetry for non-listed companies in Kenya and large family ran private companies in Kenya.
CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Corporate governance is the system that defines how organizations are to be directed and controlled by the agents. It’s a set of relationships between company directors, shareholders and other stakeholder’s as it addresses the powers of directors and of controlling shareholders over minority interest, the rights of employees, rights of creditors and other stakeholders (Muriithi, 2009). Dechow et al. (1996) defines corporate governance as an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity (Dechow, 1996). It is viewed as ethics and a moral duty of firms and is the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity, corporate accountability and transparency with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders (Gul & Leung, 2004).

The information asymmetry is rooted in the Agency Theory which explains problems arisen from the separation of ownership and management (Jensen and Meckling, 1979). This problem also inevitably transcends in corporate governance systems, where managers of the company (board of directors) are in possession of rather complete information on functioning of the company, which outside shareholders do not have. Since information asymmetry leads to ineffective decisions in corporate governance system, an effective information policy should be implemented to provide easy and equal access to information not only to shareholders, but also for all stakeholders (Ferma and Jensen, 1983). The optimal corporate governance system aims to give shareholders confidence that their company is managed efficiently, to create the highest possible profit and to preserve a firm’s reputation (Glosten and Milgrom, 1985).

The Nairobi Securities Exchange (N.S.E) is home to the largest companies in Kenya as well as several multinational firms cross listed in other global markets. The clamor for efficient governance structures and disclosure has continued to be of interest for both local and foreign investors. This paper intends to evaluate the effect of the firm’s corporate governance structures on one important firm characteristic- asymmetric information, that is the extent to which
managers know more about a firm’s value than does the rest of the world. The study will focus on firms listed in the Nairobi securities exchange.

1.1.1 Corporate Governance

The concept of governance is not new. It is as old as human civilization. Simply defined it is the process of decision-making and the process by which those decisions are implemented. Governance can be used in several contexts such as corporate governance, international governance, national governance and local governance (Liao, 2001). Having defined governance as the process of decision making and implementation, a further analysis of governance focuses on the formal and informal actors involved in decision-making and implementing the decisions made as well as the formal and informal structures that have been set in place to arrive at and implement the decision.

Corporate governance refers to the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs (Klein, 2002). Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment. Governance is a mechanism for monitoring the actions, policies and decisions of corporations. Governance involves the alignment of interests among the stakeholders.

1.1.2 Information Asymmetry

Information asymmetry can be defined as Information differences across investors (or groups of investors), and between investors and managers. This information differential has been a long standing concern among security exchange regulators and as such led them to enact regulations regarding fair disclosures which are intended to equalize information across investors by preventing companies from making disclosures to select groups of investors and analysts. Barako et al. (1998) assert that selective disclosure allows those have the advantage of certain market information beforehand to make a profit or avoid a loss at the expense of those kept in the dark. This practice leads to loss of investor confidence particularly small investors become
unwilling to invest in the fear that insiders gain at their expense; this, in turn, increases firms’ cost of capital to the extent that the risk in the economy has to be borne by fewer investors.

The issues of whether and how information differences across investors affects prices and the cost of capital cannot be addressed in conventional models of asset pricing, such as the Capital Asset Pricing Model (CAPM), this is because these models generally assume investors have homogeneous beliefs. Various studies that have developed models of capital market equilibrium where investors have heterogeneous information, reach different conclusions regarding the effects of information on the cost of capital and price of shares. Leland (1992) finds that allowing insider trading will, on average, increase stock prices despite the fact that the presence of insiders increases information asymmetry in the economy. Although he does not express his analysis in terms of cost of capital, higher stock prices on average are equal to a decrease in firms’ cost of capital. In contrast, O’Hara (2003) and Easley and O’Hara (2004) conclude that information asymmetry will increase firms’ cost of capital. These papers argue that less informed traders recognize they are at an information disadvantage and will try to hold assets where their disadvantage is less. This drives down the price of securities with high degrees of asymmetry.

1.1.3 Corporate Governance and Information Asymmetry

Corporate governance has become an issue of importance worldwide. Corporations have a vital role to play in promoting economic development and social progress. It is the engine of growth internationally, and increasingly responsible for providing employment, public and private services, goods and infrastructure. The efficiency and accountability of the corporation is now a matter of both private and public interest. Good corporate governance structures are essential in order to attract investors, by assuring them that their investments will be secure and managed in a transparent and accountable manner, as well as creates competitive and efficient companies and markets (Qian et al, 2009).

A key ingredient of an efficient market is information. Information is a stream of data coming to an entity, which may be converted into a resource of knowledge to help in a decision making process. The optimal decision depends on the access to relevant information. In the context of capital markets, corporate insiders generally have superior information about the current
condition and future prospects of the firm, compared to outside investors. The existence of information asymmetries across investors can lead to adverse private and social consequences including low investor participation, high transaction costs, thin markets and decreased gains from trade (Lev, 1988). Recognizing the adverse consequences of information asymmetry and agency problems, researchers have suggested several solutions, among which corporate governance is an important mechanism (Jensen and Meckling, 1976; Shleifer and Vishny, 1986).

The role of corporate governance is to align the interests of managers with those of shareholders through appropriate bonding and monitoring. In particular, the board of directors, elected by the shareholders, is charged with evaluating and disciplining the management team. Within their fiduciary duty to shareholders, directors have a governance responsibility to ensure greater transparency when it is in the shareholders’ interests. Since shareholders, in general, are outsiders who are at an information disadvantage about the company, corporate governance principle demand an effective and representative board of directors may be able to move the managers toward disclosing more information to the market participants and in effect eliminating and or smoothing market anomalies.

1.1.4 Nairobi Securities Exchange

The equity market in Kenya is not young but exhibits the characteristics of an underdeveloped but developing securities market. Market players have less information compared to those in developed economy. These characteristics essentially make this market relatively volatile. Nairobi Securities Exchange’s (NSE) equity market differs from those developed markets in such characteristics on firm levels as the ownership structure and corporate governance standards. The World Bank classifies NSE as both an emerging and a frontier market. A frontier market refers to a relatively small and liquid market even by the emerging market standards (Nganga, 2003).

The Nairobi Stock Exchange was set up in 1953 in Kenya, as a regional exchange for Kenya, Tanganyika, Uganda and Zanzibar. After independence in these countries, the exchange became Kenya’s national stock exchange. The stock market has developed over the years with 54 listed companies by the close of 2009. Nairobi Stock Exchange has also moved from the open-outcry trading system to Automated Trading System (ATS) in order to improve the Market’s both
informational and functional efficiency. The exchange has three market tiers: main investments market segments, alternative market segment and fixed income securities segment (NSE, 2009).

In 2011, the Nairobi Stock Exchange Limited changed its name to the Nairobi Securities Exchange Limited. The change of name reflected the strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments. In the same year, the equity settlement cycle moved from the previous T+4 settlement cycle to the T+3 settlement cycle. This allowed investors who sell their shares, to get their money three (3) days after the sale of their shares. The buyers of these shares will have their CDS accounts credited with the shares. At the same time, it became a member of the Financial Information Services Division (FISD) of the Software and Information Industry Association (SIIA). Later, the delayed index values of the FTSE NSE Kenya 15 Index and the FTSE NSE Kenya 25 Index were made available on the NSE website www.nse.co.ke. The new initiative gives investors the opportunity to access current information and provides a reliable indication of the Kenyan equity market’s performance during trading hours (NSE, 2012).

1.2 Research Problem

Corporate governance has been an important part of Company Law for many decades even before its various codes were drawn. This owes to separation of ownership and management of companies whereby fiduciary relationship exist between the shareholders as the principals or owners and directors as the agents or management (Muriithi, 2009). One important influence of governance is information disclosure. Existing literature suggests that a firm’s asymmetric information environment has an important relation with governance mechanisms. A number of papers make the case that the intensity of board monitoring should decrease with the extent of asymmetric information. For example, Raheja (2005) models the size and composition of the board and demonstrates that firms optimally employ less independent boards when it is difficult for outsiders to verify projects. Harris and Raviv (2008) also argue that an insider - controlled board may be optimal when insiders have important information relative to that of outsiders.

Recognizing the adverse consequences of information asymmetry and agency problems, researchers have suggested several solutions, among which corporate governance is an
important mechanism (Jensen & Meckling, 1976; Shleifer & Vishny, 1986). The role of corporate governance is to align the interests of managers with those of shareholders through appropriate bonding and monitoring. In particular, the board of directors, elected by the shareholders, is charged with evaluating and disciplining the management team.

In Kenya, a number of problems relating to corporate governance have been identified. The problems range from errors, mistakes to outright fraud. The origins of the problem range from concentrated ownership, weak incentives, poor protection of minority shareholders, to weak information standards (Mwangi, 2012). With such an environment in the background, the interest of both the minority shareholders and creditors could be compromised and managed to be skewed towards the interest of such block shareholders. Consequently, the issue of information asymmetry arises. Companies have crumbled right in the eyes of shareholders who all along had little or no information regarding the downfall, yet they are the owners Bagehot (1971) thus the need to monitor corporate governance structures in organizations. As earlier intimated the Kenya Capital Market Authority is doing a lot to enforce corporate governance structure and disclosure requirement so as to create investor confidence and as such there has been an upsurge of information disclosed by corporate to meet the needs of local and foreign investors (Mwangi, 2012).

In Kenya prior researches have studied the link between corporate governance and its effect on company performance, return on investment, and information disclosure among other factors as well as analyzing different governance structures in different industries. Alice (2008) while studying the relationship between corporate governance and return on investment (ROE), found out that there was a positive relationship between ROE, board size and board composition. These research findings concurred with Kihara (2006) who observed that unlike inside directors, outside directors are better and able to challenge the CEO hence a minimum of three outside directors were required on the board. Izan, Hancock and Barako (2006) studied the relationship between corporate governance and voluntary disclosure in Kenyan companies and concluded that the presence of an audit committee was a significant factor associated with the level of voluntary disclosure, and board independence was found to be significantly negatively associated with the extent of voluntary disclosure. In contrast, board leadership structure appeared not to have a significant influence on the level of voluntary disclosure by companies.
The above studies among others though have studied effects of corporate governance, this paper seeks to contribute to the body of research and directly examine the relationship between corporate governance and its effect on information asymmetry in the emerging Kenyan securities market. A research gap exists as limited researches have been done on the effect of corporate governance on the information asymmetry of listed companies in Kenya’s Nairobi Securities Exchange (NSE).

The need to carry out this study arose from the fact that listing of companies in the NSE has continued to increase and corporate governance is a key requirement that has to be adhered. Shareholders are increasingly becoming educated and informed about how the securities exchange market works. They are now more than ever aware that disclosure information has an influence the value of their investments (Diamond and Verrecchia, 1991). It was therefore important to assess if the corporate governance structures put in place by the listed firms have an impact on information asymmetry between managers and investors. This paper sought to answer the questions: Do firms’ governance structures through Board Ownership affect information asymmetry between managers and investors? Does board dependence influence information asymmetry between stockholders and managers? Does CEO duality have an effect on the level of information asymmetry between managers and investors?

1.3 Objectives of the Study

This study aimed at investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The study was guided by the following specific objectives:

i. To find out the effect of Board Ownership on the information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

ii. To investigate how board independence influences information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

iii. To determine how CEO duality affects information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

1.4 Value of the Study

The findings of this study would help managers to evaluate and appreciate what benefits they
could accrue as a result of disclosure of board processes as well as implementing solid corporate governance structures. They will understand how strategic use of corporate governance can increase and create value for the same investors, which is the main goal for the listed companies. Shareholders will realize the importance of demanding as well ensuring corporate governance structures are functional within the organization. They will understand how variables such as board Independence, CEO/Chair duality, and Board Ownership information asymmetry between them and their managers, as well as how information available to them can affect their decision making as investors. They also in annual general meetings will be in a position to demand transparency and be privy to board processes.

The stock market regulator (Capital Market Authority) will also use the findings in the implementation and development of regulations aimed at executing its mandate of promoting market confidence, investor protection and access to financial services within capital markets in Kenya and the region through effective regulation and innovation. Researchers and scholars also get valuable reference material for future studies who would wish to venture into this area of study. Findings from this study have laid a basis for empirical evidence on the effects of corporate governance on information asymmetry.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents the theoretical literature and examines the various theories that contribute to and inform corporate governance, its determinants i.e. Board Ownership, independence and CEO/chair duality. It will also review extant empirical literature relating to corporate governance and information asymmetry.

2.2 Theoretical Review

The theories upon which the concept of corporate governance draws its foundation and the areas it encompasses, date form much earlier. These theories are also drawn from a variety of disciplines such as finance, law, organizational behavior among others.

2.2.1 Agency Theory

The agency theory identifies the agency relationship between an agent and a principle (Jensen & Meckling, 1979; Ferma & Jensen, 1983). Jensen and Meckling (1979) assume that as agents do not own the corporation’s resources, they may commit ‘moral hazards’ (such as shirking duties to enjoy leisure and hiding inefficiency to avoid loss of rewards) merely to enhance their own personal wealth at the cost of their principals. There also develops a problem of information asymmetry whereby the principle and the agent have access to different levels of information, in reality this means that the principle will be at a disadvantage because the agent has more information.

In the context of corporate governance, agency theory views corporate governance mechanisms especially board of directors as being an essential monitoring device to ensure that any problem that may be brought about by the agency conflict may be minimized (Gul and Leung 2004). In theory, the board of directors is directly elected by shareholders at the company’s annual general meeting (AGM). If these directors wish to stay in their jobs they take decisions which maximize the wealth of their shareholders. In his literature review, Harris (1994) contends that company boards have evolved as part of the market solution to the problem of contracting within organizations. Fama and Jensen (1983) argued that effective corporate boards would be
composed largely of outside independent directors holding managerial positions in other companies. They argued that effective boards had to separate the problems of decision management and decision control. However, if the CEO was able to dominate the board, separation of these functions would be more difficult, and shareholders would suffer as a result. Outside directors, he contended, are able to separate these functions and exercise decision control, since reputational concerns, and perhaps any equity stakes, provides them with sufficient incentive to do so. Corporate boards should act as monitors in disagreements amongst internal managers and carry out tasks involving serious agency problems.

2.2.2 Transaction Cost Economies

This theory views the firm itself as a governance structure. It further emphasizes that the choice of an appropriate governance structure can help align the interests of directors and shareholders. This theory looks at the various investments projects available to a firm and the various ways in which these projects can be cost effectively financed either through debt of equity. According Williamson’s (1988) argument, the solution to the problem of costly financing of highly specific assets with debt is to be found in the invention of equity.

In his literature review Lev (1988) contends that the equity governance structure has three important properties. First, similarly to Agency Theory shareholders bear a residual claiming status. Second, the equity contract lasts for the duration of the life of the corporation. And third, a safeguard in the form of a board of directors is created and awarded to equity-holders. According to this view, the board bears a decision-review and monitoring relation to the firm’s management, including the review and monitoring of management’s investment policy.

2.2.3 Stakeholders Theory

The shareholder model of corporate governance relies on the assumption that shareholders are morally and legally entitled to direct the corporation since their ownership investment is an extension of their natural right to own private property (Beasely, 1996). Byard(2006) in his literature review however notes that the idea that the shareholders govern the corporation is largely a fiction’, because in reality executives exercise the highest power. Dechow et al. (1996) argue that executives can and should be made more accountable and responsive to some groups other than themselves. Stakeholders’ theory takes into account a wider group of constituents
rather than focusing on shareholders, then the governance structure may provide for some direct representation of the stakeholder groups (Shleifer and Vishny, 1997).

One premise of the stakeholder’s theory is that the stakeholders have vested interests in the firm. Shareholders on the other hand have a residual interest on the firm, that is, a right to the free cash flow once all the stakeholders (debt holders, employees, suppliers) have been paid. Freeman (1984) posits that successful managers must systematically attend to the interests of various stakeholder groups. This “enlightened self-interest” position has been expanded upon by Chen (2000) who believes that the interests of stakeholders have inherent worth irrespective of whether these advance the interests of shareholders. Under this viewpoint, the success of a corporation is not merely an end in itself but should also be seen as providing a vehicle for advancing the interests of stakeholders other than shareholders. It is therefore in the shareholders’ best interest to ensure that all the firm’s resources are utilized to their maximum effect and thus benefiting even the stakeholders. Stakeholder and shareholders may require the firm to have different corporate governance structures and monitoring mechanisms as they deem favorable to secure their interests (Claessens, 2003).

2.2.4 Stewardship Theory

In this theory, the directors of the firm are viewed as stewards of the company’s assets. They are such inclined to act in the best interest of the shareholders (Donaldson, 1990). They argue that unlike the agency theory whose thrust was an accent on managerial “opportunism” by having a board chair different from the CEO and using incentives to bind the CEO to the shareholders interests, theirs stresses on the benefit of having facilitative authority structures that unified the role of the CEO and Chair held by one person. The emphasis was not on placing management under ownership control but empowering managers to autonomously execute decisions.

It is to be noted that corporate governance continues to develop and draw its framework from a multiple of disciplines. The main theory however from which it has mainly drawn it development is the agency theory. All other theories come into play as companies increasingly become aware that they cannot operate in isolation thus the emergence and inclusion of other theories highlighted above (Donaldson 1990).
2.3 Determinants of Corporate Governance

Corporate governance being the process of decision making and implementation, it also focuses on the formal and informal parties involved in both decision-making and implementation of the decisions made. These formal and informal structures that have to be set in place to arrive at successful implementation are based on three indicators of the governance structures, these being Board Ownership, board independence and CEO duality.

2.3.1 Board Ownership

Baghat et al. (2002) propose that Board Ownership is a measure of corporate governance and found that it had a direct relation to corporate performance. They argue that Incentive-based economic models of managerial behavior motivate governance features and structures. In agency models, a conflict of interests between managers and shareholders cause managers to take actions that are costly to shareholders. Contracts are not sufficient enough to stop managers from engaging in pricey activities if shareholders are unable to observe managerial behavior directly. Board Ownership structures thus come into play. Ownership by the manager is used to induce managers to act in a manner that is consistent with the interest of shareholders.

Proponents of the adverse selection models on the other hand are motivated by the hypothesis of differential innate ability that cannot be observed by shareholders. What this means is, ownership may be used to bring on revelation of the manager's private information about cash flow or her ability to generate cash flow, which cannot be observed directly by shareholders (Myerson, 1987). From the above two models, some features of corporate governance may be interpreted as a characteristic of the contract that governs relations between shareholders and managers. Governance is affected by the same unobservable features of managerial behavior or ability that are linked to ownership and eventually performance.

2.3.2 Board Independence

The board of directors and executive management are two significant components of a firm’s governance progression. Several intimately related governance issues of the board and management include the responsibility, structure and independence of the board, and the management contract. The board seems to be an imperative internal device for resolving the agency tribulations, since it is primarily responsible for recruiting and monitoring the executive
management to defend the interests of the shareholders and other stakeholders. Prowse (1994) notes that the board makes a connection between managers and investors by taking a leadership role. He also suggests that an assessment of the board (or board sub-committees) can help establish performance criteria that can be used to achieve the corporate objective and to align the performance of the directors with the interest of the shareholders. A related literature also refers to board structure and independence as important governance components. Denis and McConnell (2003) regard a smaller board as an important determinant of corporate governance and firm performance. Solomon et al. (2003) and Tsui and Gul (2000) opine that the outside or non-executive directors play an important governance role in relation to the welfare of the investors, especially non-controlling shareholders.

The presence of outside directors improves the degree of corporate answerability and creates a balance of power between the CEO and the board (Denis and McConnell, 2003; Ricart et al., 1999). Likewise, the OECD (2003) observes that independent non-executive directors can exercise unbiased judgment in relation to the conflicts of interest among different stakeholders. This presence of independent non-executive directors seems to have an important implication in family-based governance, as Solomon et al. (2003) consider founding family dominance as a negative aspect of corporate governance. The issue of CEO duality (the CEO and board chairperson being the same individual) appears to constrain board independence, because there is a possibility of conflict of interests. Daily and Dalton (1997) and Kesner and Dalton (1986) mention that separate board structure can enhance board independence and shareholder value.

However, a separate board does not necessarily ensure better governance, as Daily and Dalton (1997) argue, the chairperson in a separate board structure might possess his/her own interest in the firm’s governance. Corporate interlocking is another inter-organisational strategy for managing the resource interdependencies such as, strategic alliances, mergers and acquisitions (Ong et al., 2003). Whilst the presence of the same individual on the boards of several firms can create firm value, it can yield a negative influence on the firm’s governance because of the potential for conflicts of interests between firms. Aside from monitoring the executive management, the board is also responsible for designing the management contract that minimises the degree of agency conflicts. Several studies (Prowse, 1994; Becht et al., 2002; McColgan, 2001) mention that a management contract aligns personal interest of the managers
with that of the shareholders and provides managers with the incentives to maximize firm value. It is suggested that a value enhancing management contract should include: basic salary components, performance-based cash bonuses and profit-based salary revisions, stock participation plan (e.g. stock options), outright ownership of the firm’s equity, pension rights, performance-based dismissal provisions, and long-term incentive plans.

2.3.4 CEO/Chair Duality

CEO duality is a contentious issue that has attracted significant public and academic scrutiny. In his study Sampson (1992) found that 75% to 80% of U.S. firms combined the CEO and chair roles into one position. However, Grinstein & Valles (2008) showed a significant jump in the number of S&P 500 companies splitting CEO/chair roles. They report that 31% of S&P 1000 firms in 2004 separated the CEO/chair roles, a marked increase from the 24% reported in 2000. They argued that corporate scandals, such as Enron and WorldCom, and the 2001 recession raised the alarm for more board vigilance and decentralization of power.

Critics of CEO duality argue that duality compromises board effectiveness in monitoring the CEO. They assert that dual CEOs are more likely to pursue selfish interests that are inconsistent with shareholders’ values. Proponents of CEO duality assert that a combined CEO/chair structure provides directional clarity and judgment that is lacking within an independent leadership structure. Separation of CEO and chair may limit CEO entrepreneurism in ventures that can increase firm value because the CEO’s decisions are consistently monitored and thus affect performance.

2.4 Transparency and Accountability

Transparency and accountability are two closely related issues that are crucial, not only in enhancing the disclosure and auditing standards of a firm, but also in developing the regulatory organ’s capacity to monitor and discipline the firm’s governance practices. Therefore, it is imperative for a firm to make its financial and non-financial information available and easily accessible to outsiders in order that everyone can make informed decisions. Effective disclosures enable existing as well as prospective investors, to evaluate the management’s past performance, forecast the firm’s future cash flow and to decide whether the risk profile of a firm is within an acceptable level (Foo et al., 2000; Gul et al., 2000). Thomas et al., (2002) note
that information to shareholders is one of the most important aspects of corporate governance, as it reflects the degree of transparency and accountability of the corporations towards its shareholders. The quality of a firm’s disclosures tends to be determined by the development of the capital market and the standards of accounting and auditing practices of a country. Whilst Claessens and Fan (2002) emphasise the quality auditing and professional integrity of the external auditors, it is commented that weak enforcement of accounting and auditing standards restraints quality auditing.

2.5 Determinants of Information Asymmetry

The main factors affecting the asymmetry of information between the managers and the investors resulting from risky securities are namely: the trading volume, the volatility of stock returns, and the stock price. Trading volume influences information asymmetry as the interplay of supply and demand determines the transaction price of each stock security. Securities are traded for cash and thus buyers must have available money and sellers must have stocks and the outcome, that is the payment and delivery of securities, takes place immediately after negotiation. Liao (2009) points out that the trading volume is closely linked with various measures of asymmetric information and this volume decreases when the earnings are announced. Additionally Byard et al. (2006) found that the inverse of the average daily trading volume positively influenced the asymmetry of information.

Stock return measures are also highlighted as determining information asymmetry. Blackwell et al., (1990) use residual volatility in daily stock returns as another proxy for information asymmetry. As Kyle (1985) pertaining the transactions of the informed and the insiders’ expected trading benefits, they are positively related to non-specific assessments of the company’s value. Insofar as the residual volatility of stock returns reflects some uncertainty about the company’s value, the problem of information asymmetry increases. Fee and Thomas (1999) have mentioned some uncertainty factors for companies such as the rates fixed by the Federal Reserve that are simultaneously relative to both insiders and outsiders. If the insiders’ transactions exceed the abnormal outputs, the superfluous information disclosure entirely does not remove the informational advantage of the leaders (Harris, 1994). There is thus a close connection between stock return and information asymmetry.
Several studies have shown that the share price explains a significant part of the information asymmetry. Comerton-Forde and Rydge (2006) in their study found that the share price is positively associated with this information asymmetry and Attig et al. (2006) noted that the share price is a vector of information, so it negatively affects the information asymmetry. Stoll (1978) posits that the trading volume and the incurred risk affect the cost of detention of market makers. He also notes that the stock price is a proxy for the unobservable minimum cost. In his empirical test stoll (1978) found that the bid-ask spread negatively affected the trading volume while the stock price positively influenced the variability of returns.

The proxy to be used to measure information asymmetry, as the dependent variable, is the bid-ask prices, spread (SPREAD). The relation between the extents of informed trading and bid-ask spreads was first discussed in (Bagehot, 1971). Bagehot (1971) argues that market makers trade with two kinds of traders informed and uninformed. While the market maker loses to informed traders, he recoups these losses from uninformed traders by increasing the bid-ask spread. Thus, a high level of informed trading leads to higher bid-ask spreads. Bagehot’s (1971) intuition was subsequently modeled by Kyle (1985), and Glosten and Milgrom (1985).

2.6 Empirical Review

It has long been recognized that greater managerial ownership generates greater alignment of the interests of shareholders and managers, and mitigates the agency problems between the two parties (Jensen and Meckling, 1976; Demsetz, 1983). Agency theory predicts that there is a positive association between management interests and the level of voluntary disclosure. Warfield et al (1995) provided that evidence supporting this contention in their findings that the extent of shareholding by management is positively associated with the amount of information disclosed about earnings. The above reasoning suggests that firms with higher Board Ownership will be associated with greater levels of disclosures and hence lower degree of information asymmetry.

Drawing from Fama and Jensen (1983) a large body of empirical evidence finds that outside directors who are independent of management’s influence help enhance shareholder value by protecting shareholder interests against managerial opportunism (Hermalin and Weisbach, 2001). Focusing on financial reporting issues in particular, (Beasley, 1996; Dechow et al.,
1996; Klein, 2002) found that outside directors are effective monitors of managerial actions. Beasley (1996) argued and provided evidence that the proportion of outside directors is positively related to the board’s ability to influence disclosure decisions.

Chen and Jaggi (2000) found empirical evidence of a positive relationship between Board independence and disclosure (including mandatory disclosure). Foo and Zain (2010) examined the association between bids-ask spread, a market-based measure of information asymmetry, and board characteristics among 227 firms listed on the Main Board of Bursa Malaysia. The results revealed that board independence is negatively related to the level of information asymmetry. Based on the foregoing discussion, it can be inferred that the proportion of outside directors in the board might have a positive impact on disclosure practices, thus leading to lower degree of information asymmetry.

Fama and Jensen (1983) pointed out that CEO duality signals the absence of separation of decision control and decision management. The result of CEO duality is the concentration of decision-making power, which could constrain board independence and reduce its ability to execute its oversight and governance roles Gul and Leung, (2004), and proved detrimental to disclosure levels and quality, especially voluntary disclosure (Ho and Wong, 2001). Huafang and Jianguo (2007) provided evidence that in increase in independent directors increases corporate disclosure and CEO duality is associated with lower disclosure. Byard et al (2006) reported that CEO duality is negatively associated with analysts’ forecast accuracy. The authors conclude that CEO duality increases information asymmetry.

2.7 Summary of Literature Review

From the studies reviewed there different interests among researchers, some analyzing corporate governance components together and others separately. Whilst a majority of corporate governance literature centers on individual governance components, a recent literature is based all related issues of corporate governance and its effects on various aspects of the organization, ranging from strategy, profitability, performance, disclosure, cost of capital, return on investment among many other aspects of the firm. Empirical studies reviewed indicate how individual governance components e.g. ownership structures, board composition, board
independence and disclosure quality and overall governance standards such as corporate governance index are associated with the firm’s valuation as well as operating performance.

Empirical evidence reviewed of the influence of individual corporate governance mechanisms various aspects of the firms is highly indicative that indeed corporate governance mechanisms do influence the success of any organization. This chapter undertook a review literature relevant to this research with the aim of getting views and opinions on investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The chapter specifically covers the theoretical foundation and the Determinants of corporate governance. Corporate governance being a relatively new area, its development has been affected by various disciplines. The main theory that has affected its development however most naturally seems to rest in the agency theory. However the stakeholders theory is coming in more into play as companies increasingly grow and become aware that they cannot operate in isolation and that they need to have a wider regard to the stakeholder constituency.

The process of the growth of a firm takes time and this is because firms have to develop the necessary capabilities to cope with growth. Entrepreneurial growth and managerial resources are inseparable and as such corporate governance and monitoring mechanisms continue to be a key component to the success of firms in both the local and the global economy (Foo and Zain, 2010). Organizations must therefore continually review their governance structures, their effect on performance and as such align them to global trends (Izan et al., 2006).
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter has covered the research design, population, sample, data collection and data analysis, which describes the firms and variables, included in the study and applied statistical techniques in investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors.

3.2 Research design

This study was conducted using explanatory research design. According to Mugenda and Mugenda (2010) exploratory research explores the why questions which in effect involved developing a causal explanation which could either be direct or indirect relationship between variables, that is, the effect of one thing on another and more specifically, the effect of one variable on another. Mugenda and Mugenda (2010) contends that exploratory research has the advantage of being relatively cheap and it will be considered for the study so as to establish the effect of corporate governance on information asymmetry of companies listed in NSE.

3.3 Target population

The target population of this study was all the companies listed at the Nairobi Securities Exchange. There are 62 listed companies at the Nairobi Securities Exchange from which the data will be drawn.

3.4 Sampling

The sample of the study involved the target population of the companies listed in the NSE. The researcher used the purposive sampling techniques. This is where the optimum sample size was a result of purposively selecting firms that were already listed by the year 2003; this is to allow a ten year analysis of data. The sample firms were adequate to fulfill the requirements of efficiency, representativeness and reliability. Unnecessarily large sample size would bring about data duplicity besides having cost and time implications while a small sample size would not be representative. The sample size was of 32 companies listed at the Nairobi Securities Exchange.

A simple random technique was used to select one staff from public relations or corporate
affairs department from each company on whom primary data was collected. This sampling technique is suitable for use since every firm in had an equal chance of being selected and thus the sampling technique eliminated bias. Secondary data was collected from company’s and NSE’s and companies’ websites and prospectus among others.

3.5 Data Collection

The study used both primary and secondary data sources in gathering data for analysis. The primary data source was semi-structured questionnaires. The questionnaires were both open and close-ended questions (Munn and Drever, 2004). A pilot test was conducted to field test the reliability and the validity of the instruments (Kothari, 2004). The data from the pilot test was analyzed using informative presentation tables and graphs.

3.6 Data Analysis

The study used multiple linear regression equation and the method of estimation was Ordinary Least Squares (OLS) so as to establish the relationship between corporate governance and information asymmetry. Ordinary least squares (OLS) is a method for estimating the unknown parameters in a linear regression model by minimizing the sum of squared vertical distances between the observed responses in the dataset, and the responses predicted by the linear approximation, thus, providing minimum-variance mean-unbiased estimation (Hayashi, 2000).

The proxy to be used to measure information asymmetry, as the dependent variable, is the bid-ask spread (SPREAD). The relation between the extents of informed trading and bid-ask spreads was first discussed in (Bagehot, 1971). Bagehot (1971) argues that market makers trade with two kinds of traders informed and uninformed. While the market maker loses to informed traders, he recoups these losses from uninformed traders by increasing the bid-ask spread. Thus, a high level of informed trading leads to higher bid-ask spreads. Bagehot’s (1971) intuition was subsequently modeled by Kyle (1985), and Glosten and Milgrom (1985). Specifically,

\[
\text{SPREAD} = \frac{1}{D_{i,t}} \sum (\text{ASK}_i - \text{BID}_i / \text{ASK}_i + \text{BID}_i)
\]

Where: \(D_{i,t}\) is the number of days in year \(t\) for firm \(i\) for which closing daily bids (\(\text{BID}_i\)) and closing daily asks (\(\text{ASK}_i\)) are available.
ASK is the price at which an investor (seller) is willing to sell, and BID is the price at which the investor (buyer) is willing to buy. Numerous studies starting from (Demsetz, 1968; Bagehot, 1971) have used bid–ask spread to proxy for information asymmetry between informed traders and liquidity traders.

Corporate board characteristics: the Variables that represent corporate board characteristics are Board Ownership, board independence and CEO duality. Board Ownership is computed as the proportion of executive share ownership to total shares of the firm. Board independence (BIND) is measured as the proportion of non-executive (independent) directors on board. CEO duality (CEO) is measured as a dummy variable, assigned 1 if the chief executive officer (or managing director) additionally occupies the position of the chairman of the board, or 0 if otherwise.

Several factors that are relevant to bid-ask spread as control variables were selected in multiple-regression models. Among of these factors are firm size, Stock return volatility, ROE and growth opportunity. Large firms may face less information asymmetry because they tend to be more mature firms, have established and time-tested disclosure policies and practices, and receive more attention from the market and regulators (Harris, 1994). Stock return volatility was included, because market makers increase the spread to make up for the uncertainty associated with volatile stocks. ROE is included on the expectation that income-generating firms disclose more information to communicate investors of their good performance (Wallace et al, 1994). Therefore it is expected that a negative relationship between firm Profitability and information asymmetry. Another important control variable is growth opportunity (GWTH), High-growth firms have greater information asymmetry because Firms with favorable future prospects are less likely to provide sensitive operating information in order to protect their competitive advantages and avoid attracting new entrants or increased competition from existing competitors (Liao, 2009). The ratio of market-to-book value of equity to proxy for growth opportunities was used.

To investigate the association between corporate governance characteristics and information asymmetry, the researcher used the following ordinary least squares (OLS) regression
SPREAD\textsubscript{\textit{i},\textit{t}} = \beta_{1}BOWN_{\textit{i},\textit{t}} + \beta_{2}BIND_{\textit{i},\textit{t}} + \beta_{3}DUAL_{\textit{i},\textit{t}} + \beta_{4}FSIZE_{\textit{i},\textit{t}} + \beta_{5}VOL_{\textit{i},\textit{t}} + \beta_{6}ROE_{\textit{i},\textit{t}} + \beta_{7}GWTH_{\textit{i},\textit{t}} + \alpha

For firm \textit{i} at the end of year \textit{t}, where:

SPREAD = defined as annual relative bid-ask spread using daily closing bids and asks.

BOWN = Board Ownership defined as proportion of executive share ownership to total shares of the firm.

BIND = percentage of independent non-executive directors on board.

DUAL = a numerical number (1) will be assigned if CEO also serves as Chairman, and (0) if not.

FSIZE = firm size defined as natural log of firm’s total assets.

VOL = Volatility defined as the standard deviation of daily security returns.

ROE = return on equity defined as income before tax and interest to total equity.

GWTH = growth prospect defined as the market value of equity divided by book value of equity.

\alpha = the error term.

3.6.1 Operationalization of the Variables

Data from the NSE was analyzed to determine the SPREAD that is the difference between the daily price that the company shares are being sold at the NSE and the price at which the buyer buys at. From company prospectus, publications were analyzed and a percentage of shares owned by the directors of the company as a proportion of the total issue of share for each year were collected to determine BOWN. Information regarding board members was collected from company prospectus and publications which was reviewed each year. BIND was the number of independent non-executive directors calculated as a proportion of the total number of board members. Information regarding chief executive officer was drawn from the yearly company prospectus; publications were reviewed to find DUAL. If the chief executive officer also serves as a chairman, a numerical value of 1 was assigned; if not the number 0 was assigned.

Figures on total assets was taken from the companies’ published audited financial statement determine FSIZE and ROE. From the balance sheet at the end of each year of analysis, the total
assets and equity were gotten, while the income before tax and interest was collected for the income statements. Statistics from the daily securities prices was collected to find the difference between the daily security prices, this difference was analyzed to determine the VOL. Market value of equity was calculated by valuing the total number of shares issued by the company using the market price at the end of each year while the book value of equity was the balance sheet value of equity at year end to get growth (GWH).
CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

This has presented data collected using questionnaires. The purpose of the study was to investigate how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The primary data was collected using a questionnaire as the data collection instrument while secondary data was collected from NSE’s and companies’ websites and prospectus. The study targeted 32 respondents. 23 questionnaires out of 32 were completed and returned giving a response rate of 72%. This response rate was good enough and conforms to that recommended by Mugenda and Mugenda (2003).

4.2 General Information

4.2.1 Major Background

The study sought to find out the major background of the respondents in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th>Major background</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Management</td>
<td>48%</td>
</tr>
<tr>
<td>Accounting/Finance</td>
<td>30%</td>
</tr>
<tr>
<td>Other</td>
<td>22%</td>
</tr>
</tbody>
</table>

Figure 4.1: Major Background

The study findings indicated that majority (48%) of the respondents were in the business management, 30% had the accounting/finance background while 22% had other backgrounds.
4.2.2 Interaction between Managers and Investors

The study sought to establish whether there is interaction between managers and investors (shareholders?) the organization. The findings are presented in the table below.

![Interaction between Managers and Investors](image)

**Figure 4.2: Interaction between Managers and Investors**

From the study findings, majority (52%) of the respondents indicated that there is interaction between managers and investors the organization and 48% of the respondents indicated that there no is interaction between managers and investors the organization.

4.2.3 Forms of Interaction

The study sought to establish the forms of interaction between managers and investors (shareholders) the organization. The findings are presented in the table below.

![Forms of interaction](image)

**Figure 4.3: Forms of interaction**

The study findings established that majority (39%) of the companies used mainstream media
as forms of interaction between managers and investors (shareholders), 30% of the companies used Annual General meetings as forms of interaction between managers and investors, 17% of the companies used company newsletters as forms of interaction between managers and investors, 9% of the companies used company websites as forms of interaction between managers and investors and 4% of the companies used company websites as forms of interaction between managers and investors.

4.3 Board Independence

4.3.1 Number of Members’ Board of Directors

The study sought to establish the number of members’ board of directors in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th>No of Board Members</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2-5 members</td>
<td>13%</td>
</tr>
<tr>
<td>6-10 members</td>
<td>52%</td>
</tr>
<tr>
<td>11-20 members</td>
<td>35%</td>
</tr>
</tbody>
</table>

Figure 4.4: Board Independence

From the study findings, majority (52%) of the respondents indicated that there are between 6-10 board of directors members in the organization, 35% indicated that there are between 11-20 board of directors members in the organization while 13% indicated that there are between 2-5 board of directors members in the organization.

4.3.2 Composition of Board Members

The study sought to describe the composition of board members in the organization. The findings are presented in the table below.
Table 4.1: Composition of Board Members

<table>
<thead>
<tr>
<th>Composition of Board Members</th>
<th>Frequency</th>
<th>Percent %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive directors only</td>
<td>4</td>
<td>17</td>
</tr>
<tr>
<td>Non executive Directors only</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Mix of both Executive &amp; Non executive</td>
<td>18</td>
<td>78</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100</td>
</tr>
</tbody>
</table>

The study findings established that most (78%) board members in the organization are a mix of both executive & non executive, 17% of the board members are executive directors while as 4% of the board members are non executive directors.

4.3.3 Strongest Voice

The study sought to establish the strongest voice in the selection of Non executive directors in the organization. The findings are presented in the table below.

![Strongest Voice Diagram]

Figure 4.5: Strongest Voice

According to the study findings 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, 39% of the respondents indicated that the controlling shareholder have the strongest voice in the
selection of Non executive directors while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors.

4.3.4 Attendance rate for the board meetings

The study sought to establish the attendance rate for the board meetings in the organization. The findings are presented in the table below.

Table 4.2: Attendance rate for the board meetings

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>51-75%</td>
<td>5</td>
</tr>
<tr>
<td>75-89%</td>
<td>11</td>
</tr>
<tr>
<td>90-100%</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
</tr>
</tbody>
</table>

According to the study findings 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%.

4.4 CEO/Chair Duality

4.4.1 Independence of Chairman of the Board

The study sought to establish whether the Chairman of the Board was an independent, non-affiliated director in the organization. The findings are presented in the table below.
Figure 4.6: Independence of the Chairman of the Board

From the study findings, majority (52%) of the respondents agreed that the Chairman of the Board was an independent, non-affiliated director in the organization while 48% of the respondents agreed that he was not an independent, non-affiliated director in the organization.

4.4.2 C.E.O as Chairman

The study sought to establish whether the C.E.O is a chairman of the company. The findings are presented in the table below.

Table 4.3: C.E.O as chairman

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>10</td>
<td>43%</td>
</tr>
<tr>
<td>No</td>
<td>13</td>
<td>57%</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 57% of the respondents indicated the C.E.O as the chairman of the company while as 43% of the respondents indicated the C.E.O as not the chairman of the company.
4.5 Board Ownership

4.5.1 Directors’ Remuneration

The study sought to establish whether the company has a written procedure or policies on directors’ remuneration. The findings are presented in the table below.

Table 4.4: Directors’ Remuneration

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>23</td>
<td>100</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100</td>
</tr>
</tbody>
</table>

From the study findings, all (100%) of the respondents agreed the company has a written procedure or policies on directors’ remuneration.

4.5.2 Independent Director’s Remuneration

The study sought to establish whether the independent director’s remuneration included share options. The findings are presented in the table below.

Figure 4.7: Independent Director’s Remuneration

From the study findings, most (74%) of the respondents agreed that the independent director’s remuneration includes share options while as 26% of the respondents did not agree that the independent director’s remuneration included share options.
4.5.3 Non Executive Director’s Remuneration

The study sought to establish whether the non-executive director’s remuneration include share options. The findings are presented in the table below.

![Pie chart showing 52% Yes and 48% No for Non-Executive Director's Remuneration.]

**Figure 4.8: Non-Executive Director’s remuneration**

According to the study findings 52% of the respondents indicated that the non-executive director’s remuneration include share options while as 48% of the respondents indicated that the non-executive director’s remuneration does not include share options.

4.5.4 Share Options

The study sought to establish whether the CEO/Chairman given share options in the organization. The findings are presented in the table below.

**Table 4.5: Share Options**

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>8</td>
<td>35%</td>
</tr>
<tr>
<td>No</td>
<td>15</td>
<td>65%</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 65% of the respondents indicated that the CEO/Chairman not given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman was given share options in the organization.
4.5.5 CEO Compensation

The study sought to establish whether the board reviewed CEO compensation annually. The findings are presented in the table below.

![CEO Compensation](image)

**Figure 4.1: CEO Compensation**

From the study findings, most (61%) of the respondents agreed the board reviewed CEO compensation annually while as 39% of the respondents did not agree that the board review CEO compensation annually.

4.6 Disclosure/Communication

The study sought to establish whether the firms disclose the following in the firm's web page. The findings are presented in the table below.

**Table 4.6: Disclosure/Communication**

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarterly financial statement</td>
<td>9</td>
<td>39%</td>
</tr>
<tr>
<td>Directors selling or buying shares in the firm</td>
<td>4</td>
<td>17%</td>
</tr>
<tr>
<td>Directors reports</td>
<td>15</td>
<td>65%</td>
</tr>
<tr>
<td>Audited Annual reports</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 39% of the firms disclose their quarterly financial statement in the firm's web page, 17% of the firms disclose their Directors selling or buying shares in the
firm statement in the firm’s web page, 65% of the firms disclose their Directors reports in the firm’s web page and all (100%) of the firms disclose their Audited annual reports in the firm’s web page.

4.7 Multiple Regression Analysis

The study adopted simple regression guided by the following model:

\[ Y = \beta_0 + \beta_1 (X_1) + \beta_2 (X_2) + \beta_3 (X_3) + \varepsilon \]

Where:

- \( Y \) is the dependent variable representing information asymmetry between managers and investors (\( X_1 \)): Board Ownership Concentration is measured by proportion of ownership held by the main shareholder of institutional nature of the quoted company.
- (\( X_2 \)): Board Independence is measured by the proportion of non-executive directors inside the board (non-executive directors / total directors).
- (\( X_3 \)): CEO Duality is measured by a dummy value of 1 of the company CEO also pairs up as the Board Chair.
- \( \varepsilon \): Standard Error term.

The above model was tested and analyzed to determine its suitability to determine the relationship between corporate governance variables above and information asymmetry and the results tabulated below;

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.387(^a)</td>
<td>.7005</td>
<td>.687</td>
<td>.23665</td>
</tr>
</tbody>
</table>

\(^a\) Predictors: (Constant), Board Ownership, Board Independence and CEO Duality

From table 4.7, R indicates that there exist a moderate relationship between the independent variables i.e CEO duality, board independence and Board Ownership, and the dependent variable information asymmetry. The coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables) R Square equals 0.7, that is, 70 percent aggregate information asymmetry can be explained through the
combined linear effects of Board Ownership, Board Independence and CEO Duality. In order to test the significance of the model, the study conducted an Analysis of Variance. The findings were as shown below:

**Table 4.8: Analysis of Variance**

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Regression</td>
<td>3</td>
<td>5</td>
<td>.331</td>
<td>5.911</td>
<td>.003</td>
</tr>
<tr>
<td>Residual</td>
<td>49</td>
<td>40</td>
<td>.056</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>45</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: Constant, Board Ownership, Board Independence and CEO Duality
b. Dependent Variable: Information asymmetry

Author: Research data (2014)

The ANOVAs results, the probability value of .003 were obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry.

**Table 4.9: Coefficients of determination**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>-5.08</td>
<td>-5.23</td>
<td></td>
<td>-6.16</td>
</tr>
<tr>
<td>Board Ownership</td>
<td>-5.53</td>
<td>010.</td>
<td>.140</td>
<td>-5.53</td>
</tr>
<tr>
<td>Board Independence</td>
<td>-6.94</td>
<td>1.027</td>
<td>.110</td>
<td>-7.37</td>
</tr>
<tr>
<td>CEO Duality</td>
<td>2.98</td>
<td>.476</td>
<td>039</td>
<td>2.33</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Information asymmetry

Author: Research data (2014)
$Y = -5.08 - 5.53X_1 - 0.42X_2 - 6.94X_3 + 0.020X_4 + 2.98X_5$

where $Y$ = Information asymmetry

$B_0$ = intercept (defines value of Information asymmetry without inclusion of predictor variables)

$X_1$ = Board Ownership

$X_2$ = Board Independence

$X_3$ = CEO Duality

Table 4.9 presents results of the simple linear regression of Aggregate Information asymmetry on Board Ownership, Board Independence and CEO Duality. From the findings, the coefficients of aggregate Information asymmetry is negative and significant, indicating that holding Board Ownership, Board Independence and CEO Duality constant Information asymmetry will be -5.08. The study also found that a unit increase in Board Ownership will cause a 5.53 decrease in information asymmetry, further a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, and a unit increase in CEO Duality will further lead to an increase in information asymmetry by a factor of 2.98.

4.8 Interpretation of Results

The study revealed that majority (52%) of the respondents agreed that Chairman is the of the Board an independent, non-affiliated director in the organization while 48% of the respondents agreed that is not of the Board an independent, non-affiliated director in the organization. 57% of the respondents indicated that the C.E.O as the chairman of the company while as 43% of the respondents indicated that the C.E.O is not the chairman of the company. This means that majority of the firms are adopting the CMA proposal to have CEO and Chair being independent. 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%. From the findings, 52% of the respondents indicated that the non executive director’s remuneration include share options while as 48% of the respondents indicated that the non executive director’s remuneration does not include share options.

According to the study findings, 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the
CEO/Chairman given share options in the organization. From the study findings, most (61%) of the respondents agreed the board review CEO compensation annually while as 39% of the respondents did not agreed the board review CEO compensation annually. Board ownership continue being an incentive used by investors to align the interests of the managers to those of the ahreholders. 39 % of the firms disclose their quarterly financial statement in the firm’s web page, 17 % of the firms disclose their Directors selling or buying shares in the firms’ statement in the firm’s web page, 65 % of the firms disclose their Directors reports in the firm’s web page and all (100 %) of the firms disclose their Audited annual reports in the firm’s web page.

The findings on the coefficient of determination indicated that R Square equals 0.7, that is, aggregate information asymmetry explain 70 percent of Board Ownership, Board Independence and CEO Duality. In order to test the significance of the model, the study conducted an Analysis of Variance. The findings on the ANOVAs results indicate that the probability value of .003 was obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry. From the findings, the coefficients of aggregate Information asymmetry is negative and significant, indicating that holding Board Ownership, Board Independence and CEO Duality constant Information asymmetry will be -5.08. The study also found that a unit increase in Board Ownership will cause a 5.53 decrease in information asymmetry, further a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, and a unit increase in CEO Duality will further lead to an increase in information asymmetry by a factor of 2.98.

Inferential statistics such as non parametric test which include analysis of variance (ANOVA) were used to test the significance of the overall model at 95% level of significance. According to Mugenda (2008) analysis of variance is used because it makes use of the F – test in terms of sums of squares residual.
CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of key data findings, conclusions drawn from the findings highlighted and policy recommendations that were made. The conclusions and Recommendations drawn were in quest of addressing research objectives of how a firm’s corporate governance affects the level of information asymmetry between managers and investors.

5.2 Summary of Findings

A fundamental issue addressed in this research was to examine the effect of corporate governance on information asymmetry between managers and investors of companies listed in the NSE. Corporate governance attributes examined in this paper are CEO/Chair duality and board independence and Board Ownership. The study finds that there exists a relationship between corporate governance and information asymmetry between managers and investors as discussed below

5.2.1 Board Independence

From the study findings table 4.6, majority (52%) of the respondents indicated that there are between 6-10 board of directors members in the organization while figure 4.4 shows 13% indicated that there are between 2-5 board of directors members in the organization. The study further established that most (78%) board members in the organization are a mix of both executive & non executive, 17 % of the board members are executive directors while as 4 % of the board members are non executive directors. 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, 39% of the respondents indicated that the controlling shareholder have the strongest voice in the selection of Non executive directors while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors. According to the study findings 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board
meetings was between 51-75%.

Further analysis from the multiple regression indicated that the coefficients of aggregate Information asymmetry was significant and negatively related, indicating that a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, while the level of significance was \( \leq 5\% \). These results collaborated with previous research that found that non-executive directors act as a reliable mechanism to diffuse agency conflicts between managers and owners (Fama & Jensen 1983). They are viewed as providing the necessary checks and balances needed to enhance board effectiveness (Franks, Mayer, & Renneboog, 2001). The results correspond to Chen & Jaggi (2000) who provide empirical evidence of the relationship between the proportion of non-executive directors on the board and corporate disclosure. The results of the research findings verify the relevance of non-executive directors as a governance mechanism that enhances the board’s capacity to ameliorate agency conflict between owners and managers.

5.2.2 CEO Duality

From the study findings, most 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman given share options in the organization. 61% of the respondents agreed the board review CEO compensation annually while as 39% of the respondents did not agreed the board review CEO compensation annually. 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their Directors selling or buying shares in the firm statement in the firm’s web page, 65% of the firms disclose their Directors reports in the firm’s web page and all (100%) of the firms disclose their Audited annual reports in the firm’s web page. Majority (52%) of the respondents agreed that Chairman is the of the Board an independent, non-affiliated director in the organization while 48% of the respondents agreed that is not of the Board an independent, non-affiliated director in the organization. 57% of the respondents indicated that the C.E.O as the chairman of the company while as 43% of the respondents indicated that the C.E.O is not the chairman of the company.

From the findings of the regression analysis, aggregate Information asymmetry is positive and
significant in relation to CEO duality, indicating that information asymmetry increased with an increase in CEO/Chair Duality. The results indicated a 2.98 coefficient at <0.5% significance level. Within the context of corporate governance, the major issue often discussed is whether the chair of the board of directors and CEO positions should be held by different persons (dual leadership structure) or by one person (unitary leadership structure). Agency theory suggests that the combined functions (unitary leadership structure) can significantly impair the boards’ most important function of monitoring, disciplining and compensating senior managers. It also enables the CEO to engage in opportunistic behavior because of his/her dominance over the board. The results are consistent with Sampson (1992) who empirically studied the relationship between corporate governance and disclosure quality and found that the extent of disclosure was higher in firms with dual leadership structures.

5.2.3 Board Ownership

From the study findings, all (100%) of the respondents agreed the company has a written procedure or policies on directors’ remuneration. Most (74%) of the respondents agreed that the independent director’s remuneration include share options while as 26% of the respondents did not agreed that the independent director’s remuneration include share options. 52% of the respondents indicated that the non executive director’s remuneration include share options while as 48% of the respondents indicated that the non executive director’s remuneration does not include share options. According to the study findings out 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman given share options in the organization.

According to the study findings, 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors. 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%.

From the findings of the regression analysis, Board Ownership was negative and significant in
relation to aggregate information asymmetry, indicating that information asymmetry decreased with an increase in Board Ownership. The results indicated a -5.53 coefficient at <0.5% significance level. The results support the agency theory predicts that there is a positive association between management interests and the level of voluntary disclosure. Warfield et al (1995) provided that evidence supporting this contention in their findings that the extent of shareholding by management is positively associated with the amount of information disclosed about earnings. The above reasoning suggests that firms with higher Board Ownership will be associated with greater levels of disclosures and hence lower degree of information asymmetry.

The findings on the ANOVAs results indicate that the probability value of .003 was obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry.

5.3 Conclusions
The relevance of corporate governance cannot be over-emphasized since it constitutes the organizational climate for the internal activities of a company. Corporate governance brings new outlook and enhances a firm’s corporate entrepreneurship and competitiveness. The study examined the role of corporate governance characteristics i.e. board composition, board independence and CEO/Chair duality and its effect on information asymmetry between managers and investors in companies listed at the NSE in Kenya.

From table 4.9, it was evident that there is a negative relationship between Board Independence information asymmetry, since their coefficient estimates are -6.94 at 0.00 the level of significance. It can be concluded therefore that from the study the level Board Independence significantly affected information asymmetry between managers and investors. These research findings are consistent with earlier research by Kihara (2006) who observed that unlike inside directors, outside directors are better and able to challenge the CEO hence a minimum of three outside directors is required on the board. It also concurs with Jensen (1993) who voices his concern that, lack of independent leadership makes it difficult for boards to respond to failure in top management team. The study concluded that board members in the organization are a mix of both executive & non executive and that the board or its nominated committee has the strongest voice in the selection of Non executive directors.
On CEO/ chair duality the findings revealed a positive coefficient of 2.98 thus a positive relationship to information asymmetry between managers and investors. The significance level was 0.002. Data collected revealed that the CEO/chairman proposed share options in the organization while as the board review CEO compensation annually. The study concluded that CEO duality is the other corporate governance index that is significantly related to the information asymmetry. This result is consistent with Gul and Leung (2004) who found that CEO duality is positively associated with international firm acquisition. His research showed that, international acquisition had a significant impact on shareholder value. He found a positive relationship between a firm leadership structure and its announcement of foreign acquisitions. Huafang and Jianguo (2007) provided evidence that CEO duality is associated with lower disclosure.

In addition the study also concluded that a unit increase in Board Ownership will cause a -5.53 decrease in information asymmetry, meaning that there exists a negative relationship between the two at a significance level of 0.001. The company's have a written procedure or policies on directors’ remuneration and that the non executive director’s remuneration include share options also, the firms disclose their directors reports in the firm’s web page while all of the firms disclose their Audited annual reports in the firm’s web page. Foo and Zain (2010) examined the association between bids-ask spread, a market-based measure of information asymmetry, and board characteristics among 227 firms listed on the Main Board of Bursa Malaysia. The results revealed that board independence is negatively related to the level of information asymmetry.

### 5.4 Limitation of the Study

The model may misestimate outcomes, because it assumes that corporate governance characteristics affect information asymmetry. The proposed indicators of corporate governance characteristics i.e. Board Ownership, Board Independence and CEO Duality may have some limitations. Whilst their use can be theoretically justified, neither construct can be accurately measured empirically.

If other corporate governance characteristics contribute to the integrity of information asymmetry, then parameter estimates may be biased. Given that the model is tested using
archival data, the data are likely to contain the influences of several factors that are not accounted for in the model. Isolating the impact of the constructs on the market’s reaction may prove difficult. The model thus applies only to large firms where there is a clear separation between ownership and management.

5.5 Recommendations

This study aimed at investigating how a firm’s corporate governance, i.e Board Ownership, board independence and CEO/chair duality affects the level of information asymmetry between managers and investors. The need to carry out this study arose from the fact that listing of companies in the NSE has continued to increase and corporate governance is a key requirement that has to be adhered. A research gap thus existed as limited researches from those reviewed had been done on the effect of corporate governance on the information asymmetry of listed companies in Kenya’s Nairobi Securities Exchange (NSE).

From the findings and conclusions, the study recommends the need for effective corporate governance practices at senior managerial level of quoted companies in Kenya to contribute to reduced information asymmetry and hence improve on actual firm liquidity and avert possible collapse of public organizations in Kenya. It is clear from the findings that corporate governance does have an effect on information asymmetry between managers and investors. The government should therefore enforce the measures it has laid down to ensure listed companies are following them so that the recommended governance structures are followed. The concerned ministries should also be very keen in the supervisory role through the relevant committees to ensure that all regulations are enforced as required e.g. books of accounts are well kept and audited as they should be.

In the Kenyan context, over the past few years there have been concerns, especially among the regulators, that companies are performing poorly and some failing partly due to weak corporate governance structure, and one of such attributes is the combined role of board chair and CEO. The concern was that such enormous powers vested in an individual make the board ineffective in its oversight and monitoring role. For example, with regard to the board leadership the Capital Markets Authority (CMA) in the Guidelines of Corporate Governance Practices, expressed a view that companies should consider separating the role of the chair and CEO, and
where the two roles are combined, to present the rationale for such a leadership structure in the annual report to shareholders. In addition, by 1997, the Central Bank of Kenya initiated a review of banks’ board structures and as part of the review urged the companies in the financial sector to separate the roles of board chair and CEO. It appears most companies embraced this advice from the regulators and changed their board leadership structure such that 43% have separated the role of board chair and CEO. Thus, because of this substantial change in the board leadership structure, there was limited differentiation among sample firms for this variable to have statistical significance in the pooled regression analysis.

An opportunity arises for further research in the development of an experiment that would identify how average investors measure information asymmetry. This is because it is unclear whether investors use abnormal accruals, as measured by aggregate accruals approach, as a representation of information asymmetry. The complexity of such models suggests that the average investor is unlikely to use this measure. The researcher also recommends future researchers to explore association between corporate governance characteristics and information asymmetry for non-listed companies in Kenya and large family ran private companies in Kenya.
REFERENCES


Kesner, I. F. & Dalton, D. R. (1986). Boards of directors and the checks and (im)balances of the


APPENDIX I: LETTER OF INTRODUCTION.

August 09th 2014.

Mary Wanjiku Ndungo
C/o University of Nairobi
P.O. Box 30197 00100
Nairobi.

Dear Respondents,

RE: ASSESSING THE EFFECT OF CORPORATE GOVERNANCE ON INFORMATION ASYMMETRY BETWEEN MANAGERS AND INVESTORS:

I am a postgraduate student at the University Of Nairobi School of Business. I am undertaking the above research project in partial fulfillment of the requirements for the award of the MBA degree. In order to achieve this, I humbly request your assistance in filling the attached questionnaire to generate data for the study. Any information you provide is purely for the purposes of this project thus your responses will be treated in strict confidence and in no circumstances will your name be mentioned in the report. Further confidentiality will be ensured through the necessary coding of the survey findings. A copy of the research report will be submitted to you upon request.

Your assistance to this regard will be highly appreciated.

Thank you in advance,

Yours Sincerely,

Mary Ndungo
M.B.A STUDENT

Dr Ogilo
SUPERVISOR
APPENDIX II: QUESTIONNAIRE

SECTION A

This section of the questionnaire refers to background and general information regarding your company. Although we are aware of the sensitivity of the questions in this section, the information will allow us to compare different respondents. Once again, I assure you that your response will remain anonymous. Your cooperation is appreciated.

1. What is your company’s name?
   ………………………………………………………………………………………………………

2. Indicate your major background (You may choose more than one if applicable
   a. Business Management [ ] b. Accounting/Finance [ ] c. Other: Please indicate--------

3. What is the main business of the company?
   ………………………………………………………………………………………………………

4. How long has your company been in existence?
   a. 0-5 years [ ] 6-10 years [ ] Over 10 years [ ]

5. Is there interaction between managers and investors (shareholders?)
   Yes [ ] No [ ]

6. If yes, in what forms?
   Annual General Meetings [ ] Company Newsletters [ ] Mainstream Media (Radio,
   Television, Newspapers) [ ] Company Website [ ] Social Media/Platforms [ ]
   Any other (Please Specify) [ ]
   ………………………………………………………………………………………………………
   ………………………………………………………………………………………………………

SECTION B

This section of the questionnaire explores aspects of Board within your organization.

1. Board Independence

7. How many members of the board of directors do you have in your company?
   a. 2-5 [ ] b. 6-10 [ ] c. 11-20 [ ] c. More than 20 [ ] (please indicate)
   ……………

8. Which of the following describes the composition of your board members:
   a. Executive directors only [ ] b. Non executive Directors only. c. Mix of both a & c [ ]

10. If your answer above is c, please indicate the number of each
    Executive ……..
    ……..
Non Executive (Independent) ……

11. Who is the strongest voice in the selection of Non executive directors?
   a. Board or its nominated Committee [ ] b. CEO c. Controlling Shareholder

12. On average what is the attendance rate for the board meetings?
   a. 90-100% [ ]  b. 75-89%  c. 51-75%

II. CEO/Chair Duality

13. Is the Chairman of the Board an independent, non-affiliated director?
   Yes [ ]  No [ ]

9. Is the C.E.O, a chairman of the company
   Yes [ ]  No [ ]

10. Does either of the two above in (Q11) act on behalf of the other
   Yes [ ]  No [ ]

III. Board Ownership

11. Does your company have a written procedure or policies on directors remuneration
   Yes [ ]  No [ ]

12. Does the independent director’s remuneration include share options?
   Yes [ ]  No [ ]

13. Does the Non executive director’s remuneration include share options?
   Yes [ ]  No [ ]

14. Is the CEO/Chairman given share options?
   Yes [ ]  No [ ]

15. Does the board review CEO compensation annually
   Yes [ ]  No [ ]

IV. Disclosure/Communication

16 Does your firm disclose the following in the firm’s web page?
   (i) Quarterly financial statement  Yes [ ]  No [ ]
   (ii) Audited Annual reports  Yes [ ]  No [ ]
   (iii) Directors reports  Yes [ ]  No [ ]
   (iv) Directors selling or buying shares in the firm  Yes [ ]  No [ ]

Thank you for your co-operation in completing this questionnaire. Kindly return the questionnaire as specified in the cover letter.
APPENDIX III: GUIDE TO COLLECT SECONDARY DATA

Asymmetric information variables
SPREAD (+)-The annual mean value of the daily percentage spread between bid and ask prices

VOLATILITY (+)-The annual average standard deviation of the day-over-day difference in the daily price change

VOLUME (-) - The annual average of daily market value of trading volume

Corporate governance variables
BSIZE (-) - The number of directors serving on the board of directors

NONEXESIZE (-)-The number of non-executives serving on the board of directors

SPLIT (-)-A dummy variable that takes on a value of one if the CEO and Chairman are different persons, zero otherwise

NONEXECHAIR (-)-A dummy variable that takes on a value of one if the chairman is a non-executive, zero otherwise
## Secondary data collection sheet

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<tr>
<td></td>
<td>BID-LOW</td>
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EFFECTS OF CORPORATE GOVERNANCE ON INFORMATION ASYMMETRY BETWEEN MANAGERS AND INVESTORS IN FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

BY

MARY WANJIKU NDUNGO
D61/70574/2007

A RESEARCH PROJECT REPORT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER 2014
DECLARATION

This is my original work and has not been presented for award of any degree in any university.

Signed............................................. Date.........................................................
Mary Ndungo

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

Signed............................................. Date.........................................................
Lecturer,
Department of Finance & Accounting,
School of Business,
Dr. Fredrick Ogilo
DEDICATION

This research project report is dedicated to my Dad and Mum Mr. and Mrs. Absalom Ndungo who have stood by me, believed in me and gave me motivation during my academic pursuits and the research work.
ACKNOWLEDGEMENTS

First, all glory and honor goes to Almighty God. He has given me good health and the finances needed to successfully complete this project. Through the process I have continuously drawn strength from the knowledge that God has a good plan for me and that my destiny was and remains in His hands. Without Him I can do nothing.

I would like to express my deep appreciation to my supervisor, Dr. Fredrick Ogilo for the insightful guidance and assistance at every stage of writing this research project. I will be eternally indebted to him for persevering with me as my advisor throughout the time it took me to complete this research project. The faculty members of staff at the University of Nairobi Mombasa campus, who generously give their time and expertise to better my work, I thank them for their contribution and their good-natured support.

I must acknowledge as well the many friends, colleagues, students and other librarians who assisted, advised, and supported my research and writing efforts over the years. Especially, I need to express my gratitude and deep appreciation to my special friend Mr. Douglas Bariu, whose friendship, knowledge, and wisdom has supported and enlightened me over the many years of our friendship. He consistently helped me keep perspective on what is important in life and showed me how to deal with reality.
LIST OF ACRONYMS

NSE- Nairobi Stock Exchange
CMA- Capital Markets Authority
CBK- Central Bank of Kenya
CEO- Chief Executive Officer
CAPM- Capital Asset Pricing Model
CDS account- Central Depository and Settlement account
SIIA- Software and Information Industry Association
FTSE- Financial Times Securities Exchange
ATS- Automated Trading System
FISD- Financial Information Services Division
ROE- Return on Investment
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ABSTRACT

This study aimed at investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The specific objectives of the study were to find out the effect of Board Ownership on the information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange, to investigate how board independence influences information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange and to determine how CEO duality affects information asymmetry between managers and investors in firms listed at NSE. This study was conducted using explanatory research design. The target population was 62 listed companies at the Nairobi Securities Exchange from which the data was drawn. The sample comprised of 32 firms listed in the NSE by the year 2003. Secondary data was collected using a questionnaire which contained both open and closed ended questions. A pilot test was first conducted to test the reliability and the validity of the questionnaire as an instrument. A simple random technique was used to select one staff from the corporate affairs department from each company who were the respondents. Secondary data was collected from companies’ websites, publications and data bought from the NSE. Secondary data was collected using multiple linear regression equation and the method of estimation was Ordinary Least Squares (OLS) so as to establish the relationship between corporate governance variables and information asymmetry. In order to test the significance of the model, the study conducted an analysis of variance. The results of the ANOVAs test indicate a significant value of .003 and a confidence 99 percent which was obtained indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry. Results from the coefficient of determination test indicated that R Square equals 0.7, that is, changes in aggregate information asymmetry could be explained up to 70 percent by the linear relationship between Board Ownership, Board Independence and CEO/Chair Duality. Findings from the data analyzed and tabulated from the questionnaires collected revealed 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 100% of the respondents indicated that their board consisted of both executive and non executive member and as such exercised some level of independence. Most (61%) of the respondents agreed the board review CEO compensation annually and 65% indicated that this compensation included share options . 39 % of the firms disclose their quarterly financial statement in the firm’s web page, 17 % of the firms disclose their directors selling or buying shares in the firms statement or in the firm’s web page, 65 % of the firms disclosed their directors reports in the firm’s web page and all (100 %) of the firms disclose their audited annual reports in the firm’s web page. From the results of the ordinary least square (OLS), Board Ownership and Board Independence were significantly negatively related to information asymmetry i.e. coefficients of -5.53 and -6.94 respectively while CEO/Chair duality was positively related to information asymmetry at +2.98. The levels of significance for all the variables were, 0.002, 0, and 0.001 respectively indicating a more than 97% confidence level. The results agree with Raheja (2005) and Myerson (1987) who found the existence of significant relationship between corporate governance variables aforementioned above in firms. The study recommends future researchers to study the association between corporate governance characteristics and information asymmetry for non-listed companies in Kenya and large family ran private companies in Kenya.
CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Corporate governance is the system that defines how organizations are to be directed and controlled by the agents. It’s a set of relationships between company directors, shareholders and other stakeholder’s as it addresses the powers of directors and of controlling shareholders over minority interest, the rights of employees, rights of creditors and other stakeholders (Muriithi, 2009). Dechow et al. (1996) defines corporate governance as an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity (Dechow, 1996). It is viewed as ethics and a moral duty of firms and is the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity, corporate accountability and transparency with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders (Gul & Leung, 2004).

The information asymmetry is rooted in the Agency Theory which explains problems arisen from the separation of ownership and management (Jensen and Meckling, 1979). This problem also inevitably transcends in corporate governance systems, where managers of the company (board of directors) are in possession of rather complete information on functioning of the company, which outside shareholders do not have. Since information asymmetry leads to ineffective decisions in corporate governance system, an effective information policy should be implemented to provide easy and equal access to information not only to shareholders, but also for all stakeholders (Ferma and Jensen, 1983). The optimal corporate governance system aims to give shareholders confidence that their company is managed efficiently, to create the highest possible profit and to preserve a firm’s reputation (Glosten and Milgrom, 1985).

The Nairobi Securities Exchange (N.S.E) is home to the largest companies in Kenya as well as several multinational firms cross listed in other global markets. The clamor for efficient governance structures and disclosure has continued to be of interest for both local and foreign investors. This paper intends to evaluate the effect of the firm’s corporate governance structures on one important firm characteristic- asymmetric information, that is the extent to which
managers know more about a firm’s value than does the rest of the world. The study will focus on firms listed in the Nairobi securities exchange.

1.1.1 Corporate Governance

The concept of governance is not new. It is as old as human civilization. Simply defined it is the process of decision-making and the process by which those decisions are implemented. Governance can be used in several contexts such as corporate governance, international governance, national governance and local governance (Liao, 2001). Having defined governance as the process of decision making and implementation, a further analysis of governance focuses on the formal and informal actors involved in decision-making and implementing the decisions made as well as the formal and informal structures that have been set in place to arrive at and implement the decision.

Corporate governance refers to the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs (Klein, 2002). Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment. Governance is a mechanism for monitoring the actions, policies and decisions of corporations. Governance involves the alignment of interests among the stakeholders.

1.1.2 Information Asymmetry

Information asymmetry can be defined as Information differences across investors (or groups of investors), and between investors and managers. This information differential has been a long standing concern among security exchange regulators and as such led them to enact regulations regarding fair disclosures which are intended to equalize information across investors by preventing companies from making disclosures to select groups of investors and analysts. Barako et al. (1998) assert that selective disclosure allows those have the advantage of certain market information beforehand to make a profit or avoid a loss at the expense of those kept in the dark. This practice leads to loss of investor confidence particularly small investors become
unwilling to invest in the fear that insiders gain at their expense; this, in turn, increases firms’ cost of capital to the extent that the risk in the economy has to be borne by fewer investors.

The issues of whether and how information differences across investors affects prices and the cost of capital cannot be addressed in conventional models of asset pricing, such as the Capital Asset Pricing Model (CAPM), this is because these models generally assume investors have homogeneous beliefs. Various studies that have developed models of capital market equilibrium where investors have heterogeneous information, reach different conclusions regarding the effects of information on the cost of capital and price of shares. Leland (1992) finds that allowing insider trading will, on average, increase stock prices despite the fact that the presence of insiders increases information asymmetry in the economy. Although he does not express his analysis in terms of cost of capital, higher stock prices on average are equal to a decrease in firms’ cost of capital. In contrast, O’Hara (2003) and Easley and O’Hara (2004) conclude that information asymmetry will increase firms’ cost of capital. These papers argue that less informed traders recognize they are at an information disadvantage and will try to hold assets where their disadvantage is less. This drives down the price of securities with high degrees of asymmetry.

1.1.3 Corporate Governance and Information Asymmetry

Corporate governance has become an issue of importance worldwide. Corporations have a vital role to play in promoting economic development and social progress. It is the engine of growth internationally, and increasingly responsible for providing employment, public and private services, goods and infrastructure. The efficiency and accountability of the corporation is now a matter of both private and public interest. Good corporate governance structures are essential in order to attract investors, by assuring them that their investments will be secure and managed in a transparent and accountable manner, as well as creates competitive and efficient companies and markets (Qian et al, 2009).

A key ingredient of an efficient market is information. Information is a stream of data coming to an entity, which may be converted into a resource of knowledge to help in a decision making process. The optimal decision depends on the access to relevant information. In the context of capital markets, corporate insiders generally have superior information about the current
condition and future prospects of the firm, compared to outside investors. The existence of information asymmetries across investors can lead to adverse private and social consequences including low investor participation, high transaction costs, thin markets and decreased gains from trade (Lev, 1988). Recognizing the adverse consequences of information asymmetry and agency problems, researchers have suggested several solutions, among which corporate governance is an important mechanism (Jensen and Meckling, 1976; Shleifer and Vishny, 1986).

The role of corporate governance is to align the interests of managers with those of shareholders through appropriate bonding and monitoring. In particular, the board of directors, elected by the shareholders, is charged with evaluating and disciplining the management team. Within their fiduciary duty to shareholders, directors have a governance responsibility to ensure greater transparency when it is in the shareholders’ interests. Since shareholders, in general, are outsiders who are at an information disadvantage about the company, corporate governance principle demand an effective and representative board of directors may be able to move the managers toward disclosing more information to the market participants and in effect eliminating and or smoothing market anomalies.

1.1.4 Nairobi Securities Exchange

The equity market in Kenya is not young but exhibits the characteristics of an underdeveloped but developing securities market. Market players have less information compared to those in developed economy. These characteristics essentially make this market relatively volatile. Nairobi Securities Exchange’s (NSE) equity market differs from those developed markets in such characteristics on firm levels as the ownership structure and corporate governance standards. The World Bank classifies NSE as both an emerging and a frontier market. A frontier market refers to a relatively small and liquid market even by the emerging market standards (Nganga, 2003).

The Nairobi Stock Exchange was set up in 1953 in Kenya, as a regional exchange for Kenya, Tanganyika, Uganda and Zanzibar. After independence in these countries, the exchange became Kenya’s national stock exchange. The stock market has developed over the years with 54 listed companies by the close of 2009. Nairobi Stock Exchange has also moved from the open-outcry trading system to Automated Trading System (ATS) in order to improve the Market’s both
informational and functional efficiency. The exchange has three market tiers: main investments market segments, alternative market segment and fixed income securities segment (NSE, 2009).

In 2011, the Nairobi Stock Exchange Limited changed its name to the Nairobi Securities Exchange Limited. The change of name reflected the strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments. In the same year, the equity settlement cycle moved from the previous T+4 settlement cycle to the T+3 settlement cycle. This allowed investors who sell their shares, to get their money three (3) days after the sale of their shares. The buyers of these shares will have their CDS accounts credited with the shares. At the same time, it became a member of the Financial Information Services Division (FISD) of the Software and Information Industry Association (SIIA). Later, the delayed index values of the FTSE NSE Kenya 15 Index and the FTSE NSE Kenya 25 Index were made available on the NSE website www.nse.co.ke. The new initiative gives investors the opportunity to access current information and provides a reliable indication of the Kenyan equity market’s performance during trading hours (NSE, 2012).

1.2 Research Problem

Corporate governance has been an important part of Company Law for many decades even before its various codes were drawn. This owes to separation of ownership and management of companies whereby fiduciary relationship exist between the shareholders as the principals or owners and directors as the agents or management (Muriithi, 2009). One important influence of governance is information disclosure. Existing literature suggests that a firm’s asymmetric information environment has an important relation with governance mechanisms. A number of papers make the case that the intensity of board monitoring should decrease with the extent of asymmetric information. For example, Raheja (2005) models the size and composition of the board and demonstrates that firms optimally employ less independent boards when it is difficult for outsiders to verify projects. Harris and Raviv (2008) also argue that an insider - controlled board may be optimal when insiders have important information relative to that of outsiders.

Recognizing the adverse consequences of information asymmetry and agency problems, researchers have suggested several solutions, among which corporate governance is an
important mechanism (Jensen & Meckling, 1976; Shleifer & Vishny, 1986). The role of corporate governance is to align the interests of managers with those of shareholders through appropriate bonding and monitoring. In particular, the board of directors, elected by the shareholders, is charged with evaluating and disciplining the management team.

In Kenya, a number of problems relating to corporate governance have been identified. The problems range from errors, mistakes to outright fraud. The origins of the problem range from concentrated ownership, weak incentives, poor protection of minority shareholders, to weak information standards (Mwangi, 2012). With such an environment in the background, the interest of both the minority shareholders and creditors could be compromised and managed to be skewed towards the interest of such block shareholders. Consequently, the issue of information asymmetry arises. Companies have crumbled right in the eyes of shareholders who all along had little or no information regarding the downfall, yet they are the owners. Bagehot (1971) thus the need to monitor corporate governance structures in organizations. As earlier intimated the Kenya Capital Market Authority is doing a lot to enforce corporate governance structure and disclosure requirement so as to create investor confidence and as such there has been an upsurge of information disclosed by corporate to meet the needs of local and foreign investors (Mwangi, 2012).

In Kenya prior researches have studied the link between corporate governance and its effect on company performance, return on investment, and information disclosure among other factors as well as analyzing different governance structures in different industries. Alice (2008) while studying the relationship between corporate governance and return on investment (ROE), found out that there was a positive relationship between ROE, board size and board composition. These research findings concurred with Kihara (2006) who observed that unlike inside directors, outside directors are better and able to challenge the CEO hence a minimum of three outside directors were required on the board. Izan, Hancock and Barako (2006) studied the relationship between corporate governance and voluntary disclosure in Kenyan companies and concluded that the presence of an audit committee was a significant factor associated with the level of voluntary disclosure, and board independence was found to be significantly negatively associated with the extent of voluntary disclosure. In contrast, board leadership structure appeared not to have a significant influence on the level of voluntary disclosure by companies.
The above studies among others though have studied effects of corporate governance, this paper seeks to contribute to the body of research and directly examine the relationship between corporate governance and its effect on information asymmetry in the emerging Kenyan securities market. A research gap exists as limited researches have been done on the effect of corporate governance on the information asymmetry of listed companies in Kenya’s Nairobi Securities Exchange (NSE).

The need to carry out this study arose from the fact that listing of companies in the NSE has continued to increase and corporate governance is a key requirement that has to be adhered. Shareholders are increasingly becoming educated and informed about how the securities exchange market works. They are now more than ever aware that disclosure information has an influence the value of their investments (Diamond and Verrecchia, 1991). It was therefore important to assess if the corporate governance structures put in place by the listed firms have an impact on information asymmetry between managers and investors. This paper sought to answer the questions: Do firms’ governance structures through Board Ownership affect information asymmetry between managers and investors? Does board dependence influence information asymmetry between stockholders and managers? Does CEO duality have an effect on the level of information asymmetry between managers and investors?

1.3 Objectives of the Study

This study aimed at investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The study was guided by the following specific objectives:

i. To find out the effect of Board Ownership on the information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

ii. To investigate how board independence influences information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

iii. To determine how CEO duality affects information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

1.4 Value of the Study

The findings of this study would help managers to evaluate and appreciate what benefits they
could accrue as a result of disclosure of board processes as well as implementing solid corporate governance structures. They will understand how strategic use of corporate governance can increase and create value for the same investors, which is the main goal for the listed companies. Shareholders will realize the importance of demanding as well ensuring corporate governance structures are functional within the organization. They will understand how variables such as board Independence, CEO/Chair duality, and Board Ownership information asymmetry between them and their managers, as well as how information available to them can affect their decision making as investors. They also in annual general meetings will be in a position to demand transparency and be privy to board processes.

The stock market regulator (Capital Market Authority) will also use the findings in the implementation and development of regulations aimed at executing its mandate of promoting market confidence, investor protection and access to financial services within capital markets in Kenya and the region through effective regulation and innovation. Researchers and scholars also get valuable reference material for future studies who would wish to venture into this area of study. Findings from this study have laid a basis for empirical evidence on the effects of corporate governance on information asymmetry.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents the theoretical literature and examines the various theories that contribute to and inform corporate governance, its determinants i.e. Board Ownership, independence and CEO/chair duality. It will also review extant empirical literature relating to corporate governance and information asymmetry.

2.2 Theoretical Review

The theories upon which the concept of corporate governance draws its foundation and the areas it encompasses, date form much earlier. These theories are also drawn from a variety of disciplines such as finance, law, organizational behavior among others.

2.2.1 Agency Theory

The agency theory identifies the agency relationship between an agent and a principle (Jensen & Meckling, 1979; Ferma & Jensen, 1983). Jensen and Meckling (1979) assume that as agents do not own the corporation’s resources, they may commit ‘moral hazards’ (such as shirking duties to enjoy leisure and hiding inefficiency to avoid loss of rewards) merely to enhance their own personal wealth at the cost of their principals. There also develops a problem of information asymmetry whereby the principle and the agent have access to different levels of information, in reality this means that the principle will be at a disadvantage because the agent has more information.

In the context of corporate governance, agency theory views corporate governance mechanisms especially board of directors as being an essential monitoring device to ensure that any problem that may be brought about by the agency conflict may be minimized (Gul and Leung 2004). In theory, the board of directors is directly elected by shareholders at the company’s annual general meeting (AGM). If these directors wish to stay in their jobs they take decisions which maximize the wealth of their shareholders. In his literature review, Harris (1994) contends that company boards have evolved as part of the market solution to the problem of contracting within organizations. Fama and Jensen (1983) argued that effective corporate boards would be
composed largely of outside independent directors holding managerial positions in other companies. They argued that effective boards had to separate the problems of decision management and decision control. However, if the CEO was able to dominate the board, separation of these functions would be more difficult, and shareholders would suffer as a result. Outside directors, he contended, are able to separate these functions and exercise decision control, since reputational concerns, and perhaps any equity stakes, provides them with sufficient incentive to do so. Corporate boards should act as monitors in disagreements amongst internal managers and carry out tasks involving serious agency problems.

2.2.2 Transaction Cost Economies

This theory views the firm itself as a governance structure. It further emphasizes that the choice of an appropriate governance structure can help align the interests of directors and shareholders. This theory looks at the various investments projects available to a firm and the various ways in which these projects can be cost effectively financed either through debt of equity. According Williamson’s (1988) argument, the solution to the problem of costly financing of highly specific assets with debt is to be found in the invention of equity.

In his literature review Lev (1988) contends that the equity governance structure has three important properties. First, similarly to Agency Theory shareholders bear a residual claiming status. Second, the equity contract lasts for the duration of the life of the corporation. And third, a safeguard in the form of a board of directors is created and awarded to equity-holders. According to this view, the board bears a decision-review and monitoring relation to the firm’s management, including the review and monitoring of management’s investment policy.

2.2.3 Stakeholders Theory

The shareholder model of corporate governance relies on the assumption that shareholders are morally and legally entitled to direct the corporation since their ownership investment is an extension of their natural right to own private property (Beasely, 1996). Byard(2006) in his literature review however notes that the idea that the shareholders govern the corporation is largely a fiction’, because in reality executives exercise the highest power. Dechow et al. (1996) argue that executives can and should be made more accountable and responsive to some groups other than themselves. Stakeholders’ theory takes into account a wider group of constituents
rather than focusing on shareholders, then the governance structure may provide for some direct representation of the stakeholder groups (Shleifer and Vishny, 1997).

One premise of the stakeholder’s theory is that the stakeholders have vested interests in the firm. Shareholders on the other hand have a residual interest on the firm, that is, a right to the free cash flow ones all the stakeholders (debt holders, employees, suppliers) have been paid. Freeman (1984) posits that successful managers must systematically attend to the interests of various stakeholder groups. This “enlightened self-interest” position has been expanded upon by Chen (2000) who believes that the interests of stakeholders have inherent worth irrespective of whether these advance the interests of shareholders. Under this viewpoint, the success of a corporation is not merely an end in itself but should also be seen as providing a vehicle for advancing the interests of stakeholders other than shareholders. It is therefore in the shareholders best interest to ensure that all the firm’s resources are utilized to their maximum effect and thus benefiting even the stakeholders. Stakeholder and shareholders may require the firm to have different corporate governance structures and monitoring mechanisms as they deem favorable to secure their interests (Claessens, 2003)

### 2.2.4 Stewardship Theory

In this theory, the directors of the firm are viewed as stewards of the company’s assets. They are such inclined to act in the best interest of the shareholders (Donaldson, 1990). They argue that unlike the agency theory whose thrust was an accent on managerial “opportunism” by having a board chair different form the CEO and using incentives to bind the CEO to the shareholders interests, theirs stresses on the benefit of having facilitative authority structures that unified the role of the CEO and Chair held by one person. The emphasis was not on placing management under ownership control but empowering managers to autonomously execute decisions.

It is to be noted that corporate governance continues to develop and draw its framework from a multiple of disciplines. The main theory however from which it has mainly drawn it development is the agency theory. All other theories come into play as companies increasingly become aware that they cannot operate in isolation thus the emergence and inclusion of other theories highlighted above (Donaldson 1990).
2.3 Determinants of Corporate Governance

Corporate governance being the process of decision making and implementation, it also focuses on the formal and informal parties involved in both decision-making and implementation of the decisions made. These formal and informal structures that have to be set in place to arrive at successful implementation are based on three indicators of the governance structures, these being Board Ownership, board independence and CEO duality.

2.3.1 Board Ownership

Baghat et al. (2002) propose that Board Ownership is a measure of corporate governance and found that it had a direct relation to corporate performance. They argue that Incentive-based economic models of managerial behavior motivate governance features and structures. In agency models, a conflict of interests between managers and shareholders cause managers to take actions that are costly to shareholders. Contracts are not sufficient enough to stop managers from engaging in pricey activities if shareholders are unable to observe managerial behavior directly. Board Ownership structures thus come into play. Ownership by the manager is used to induce managers to act in a manner that is consistent with the interest of shareholders.

Proponents of the adverse selection models on the other hand are motivated by the hypothesis of differential innate ability that cannot be observed by shareholders. What this means is, ownership may be used to bring on revelation of the manager's private information about cash flow or her ability to generate cash flow, which cannot be observed directly by shareholders (Myerson, 1987). From the above two models, some features of corporate governance may be interpreted as a characteristic of the contract that governs relations between shareholders and managers. Governance is affected by the same unobservable features of managerial behavior or ability that are linked to ownership and eventually performance.

2.3.2 Board Independence

The board of directors and executive management are two significant components of a firm’s governance progression. Several intimately related governance issues of the board and management include the responsibility, structure and independence of the board, and the management contract. The board seems to be an imperative internal device for resolving the agency tribulations, since it is primarily responsible for recruiting and monitoring the executive
management to defend the interests of the shareholders and other stakeholders. Prowse (1994) notes that the board makes a connection between managers and investors by taking a leadership role. He also suggests that an assessment of the board (or board sub-committees) can help establish performance criteria that can be used to achieve the corporate objective and to align the performance of the directors with the interest of the shareholders. A related literature also refers to board structure and independence as important governance components. Denis and McConnell (2003) regard a smaller board as an important determinant of corporate governance and firm performance. Solomon et al. (2003) and Tsui and Gul (2000) opine that the outside or non-executive directors play an important governance role in relation to the welfare of the investors, especially non-controlling shareholders.

The presence of outside directors improves the degree of corporate answerability and creates a balance of power between the CEO and the board (Denis and McConnell, 2003; Ricart et al., 1999). Likewise, the OECD (2003) observes that independent non-executive directors can exercise unbiased judgment in relation to the conflicts of interest among different stakeholders. This presence of independent non-executive directors seems to have an important implication in family-based governance, as Solomon et al. (2003) consider founding family dominance as a negative aspect of corporate governance. The issue of CEO duality (the CEO and board chairperson being the same individual) appears to constrain board independence, because there is a possibility of conflict of interests. Daily and Dalton (1997) and Kesner and Dalton (1986) mention that separate board structure can enhance board independence and shareholder value.

However, a separate board does not necessarily ensure better governance, as Daily and Dalton (1997) argue, the chairperson in a separate board structure might possess his/her own interest in the firm’s governance. Corporate interlocking is another inter-organisational strategy for managing the resource interdependencies such as, strategic alliances, mergers and acquisitions (Ong et al., 2003). Whilst the presence of the same individual on the boards of several firms can create firm value, it can yield a negative influence on the firm’s governance because of the potential for conflicts of interests between firms. Aside from monitoring the executive management, the board is also responsible for designing the management contract that minimises the degree of agency conflicts. Several studies (Prowse, 1994; Becht et al., 2002; McColgan, 2001) mention that a management contract aligns personal interest of the managers
with that of the shareholders and provides managers with the incentives to maximize firm value. It is suggested that a value enhancing management contract should include: basic salary components, performance-based cash bonuses and profit-based salary revisions, stock participation plan (e.g. stock options), outright ownership of the firm’s equity, pension rights, performance-based dismissal provisions, and long-term incentive plans.

2.3.4 CEO/Chair Duality

CEO duality is a contentious issue that has attracted significant public and academic scrutiny. In his study Sampson (1992) found that 75% to 80% of U.S. firms combined the CEO and chair roles into one position. However, Grinstein & Valles (2008) showed a significant jump in the number of S&P 500 companies splitting CEO/chair roles. They report that 31% of S&P 1000 firms in 2004 separated the CEO/chair roles, a marked increase from the 24% reported in 2000. They argued that corporate scandals, such as Enron and WorldCom, and the 2001 recession raised the alarm for more board vigilance and decentralization of power.

Critics of CEO duality argue that duality compromises board effectiveness in monitoring the CEO. They assert that dual CEOs are more likely to pursue selfish interests that are inconsistent with shareholders’ values. Proponents of CEO duality assert that a combined CEO/chair structure provides directional clarity and judgment that is lacking within an independent leadership structure. Separation of CEO and chair may limit CEO entrepreneurism in ventures that can increase firm value because the CEO’s decisions are consistently monitored and thus affect performance.

2.4 Transparency and Accountability

Transparency and accountability are two closely related issues that are crucial, not only in enhancing the disclosure and auditing standards of a firm, but also in developing the regulatory organ’s capacity to monitor and discipline the firm’s governance practices. Therefore, it is imperative for a firm to make its financial and non-financial information available and easily accessible to outsiders in order that everyone can make informed decisions. Effective disclosures enable existing as well as prospective investors, to evaluate the management’s past performance, forecast the firm’s future cash flow and to decide whether the risk profile of a firm is within an acceptable level (Foo et al., 2000; Gul et al., 2000). Thomas et al., (2002) note
that information to shareholders is one of the most important aspects of corporate governance, as it reflects the degree of transparency and accountability of the corporations towards its shareholders. The quality of a firm’s disclosures tends to be determined by the development of the capital market and the standards of accounting and auditing practices of a country. Whilst Claessens and Fan (2002) emphasise the quality auditing and professional integrity of the external auditors, it is commented that weak enforcement of accounting and auditing standards restrains quality auditing.

2.5 Determinants of Information Asymmetry

The main factors affecting the asymmetry of information between the managers and the investors resulting from risky securities are namely: the trading volume, the volatility of stock returns, and the stock price. Trading volume influences information asymmetry as the interplay of supply and demand determines the transaction price of each stock security. Securities are traded for cash and thus buyers must have available money and sellers must have stocks and the outcome, that is the payment and delivery of securities, takes place immediately after negotiation. Liao (2009) points out that the trading volume is closely linked with various measures of asymmetric information and this volume decreases when the earnings are announced. Additionally Byard et al. (2006) found that the inverse of the average daily trading volume positively influenced the asymmetry of information.

Stock return measures are also highlighted as determining information asymmetry. Blackwell et al., (1990) use residual volatility in daily stock returns as another proxy for information asymmetry. As Kyle (1985) pertaining the transactions of the informed and the insiders’ expected trading benefits, they are positively related to non-specific assessments of the company’s value. Insofar as the residual volatility of stock returns reflects some uncertainty about the company’s value, the problem of information asymmetry increases. Fee and Thomas (1999) have mentioned some uncertainty factors for companies such as the rates fixed by the Federal Reserve that are simultaneously relative to both insiders and outsiders. If the insiders’ transactions exceed the abnormal outputs, the superfluous information disclosure entirely does not remove the informational advantage of the leaders (Harris, 1994). There is thus a close connection between stock return and information asymmetry.
Several studies have shown that the share price explains a significant part of the information asymmetry. Comerton-Forde and Rydge (2006) in their study found that the share price is positively associated with this information asymmetry and Attig et al. (2006) noted that the share price is a vector of information, so it negatively affects the information asymmetry. Stoll (1978) posits that the trading volume and the incurred risk affect the cost of detention of market makers. He also notes that the stock price is a proxy for the unobservable minimum cost. In his empirical test stoll (1978) found that the bid-ask spread negatively affected the trading volume while the stock price positively influenced the variability of returns.

The proxy to be used to measure information asymmetry, as the dependent variable, is the bid-ask prices, spread (SPREAD). The relation between the extents of informed trading and bid-ask spreads was first discussed in (Bagehot,1971). Bagehot (1971) argues that market makers trade with two kinds of traders informed and uninformed. While the market maker loses to informed traders, he recoups these losses from uninformed traders by increasing the bid-ask spread. Thus, a high level of informed trading leads to higher bid-ask spreads. Bagehot’s (1971) intuition was subsequently modeled by Kyle (1985), and Glosten and Milgrom (1985).

2.6 Empirical Review

It has long been recognized that greater managerial ownership generates greater alignment of the interests of shareholders and managers, and mitigates the agency problems between the two parties (Jensen and Meckling, 1976; Demsetz, 1983). Agency theory predicts that there is a positive association between management interests and the level of voluntary disclosure. Warfield et al (1995) provided that evidence supporting this contention in their findings that the extent of shareholding by management is positively associated with the amount of information disclosed about earnings. The above reasoning suggests that firms with higher Board Ownership will be associated with greater levels of disclosures and hence lower degree of information asymmetry.

Drawing from Fama and Jensen (1983) a large body of empirical evidence finds that outside directors who are independent of management’s influence help enhance shareholder value by protecting shareholder interests against managerial opportunism (Hermalin and Weisbach, 2001). Focusing on financial reporting issues in particular, (Beasley, 1996; Dechow et al.,
1996; Klein, 2002) found that outside directors are effective monitors of managerial actions. Beasley (1996) argued and provided evidence that the proportion of outside directors is positively related to the board’s ability to influence disclosure decisions.

Chen and Jaggi (2000) found empirical evidence of a positive relationship between Board independence and disclosure (including mandatory disclosure). Foo and Zain (2010) examined the association between bids-ask spread, a market-based measure of information asymmetry, and board characteristics among 227 firms listed on the Main Board of Bursa Malaysia. The results revealed that board independence is negatively related to the level of information asymmetry. Based on the foregoing discussion, it can be inferred that the proportion of outside directors in the board might have a positive impact on disclosure practices, thus leading to lower degree of information asymmetry.

Fama and Jensen (1983) pointed out that CEO duality signals the absence of separation of decision control and decision management. The result of CEO duality is the concentration of decision-making power, which could constrain board independence and reduce its ability to execute its oversight and governance roles Gul and Leung, (2004), and proved detrimental to disclosure levels and quality, especially voluntary disclosure (Ho and Wong, 2001). Huafang and Jianguo (2007) provided evidence that in increase in independent directors increases corporate disclosure and CEO duality is associated with lower disclosure. Byard et al (2006) reported that CEO duality is negatively associated with analysts’ forecast accuracy. The authors conclude that CEO duality increases information asymmetry.

2.7 Summary of Literature Review

From the studies reviewed there different interests among researchers, some analyzing corporate governance components together and others separately. Whilst a majority of corporate governance literature centers on individual governance components, a recent literature is based all related issues of corporate governance and its effects on various aspects of the organization, ranging from strategy, profitability, performance, disclosure, cost of capital, return on investment among many other aspects of the firm. Empirical studies reviewed indicate how individual governance components e.g. ownership structures, board composition, board
independence and disclosure quality and overall governance standards such as corporate governance index are associated with the firm’s valuation as well as operating performance.

Empirical evidence reviewed of the influence of individual corporate governance mechanisms various aspects of the firms is highly indicative that indeed corporate governance mechanisms do influence the success of any organization. This chapter undertook a review literature relevant to this research with the aim of getting views and opinions on investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The chapter specifically covers the theoretical foundation and the Determinants of corporate governance. Corporate governance being a relatively new area, its development has been affected by various disciplines. The main theory that has affected its development however most naturally seems to rest in the agency theory. However the stakeholders theory is coming in more into play as companies increasingly grow and become aware that they cannot operate in isolation and that they need to have a wider regard to the stakeholder constituency.

The process of the growth of a firm takes time and this is because firms have to develop the necessary capabilities to cope with growth. Entrepreneurial growth and managerial resources are inseparable and as such corporate governance and monitoring mechanisms continue to be a key component to the success of firms in both the local and the global economy (Foo and Zain, 2010). Organizations must therefore continually review their governance structures, their effect on performance and as such align them to global trends (Izan et al., 2006).
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter has covered the research design, population, sample, data collection and data analysis, which describes the firms and variables, included in the study and applied statistical techniques in investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors.

3.2 Research design

This study was conducted using explanatory research design. According to Mugenda and Mugenda (2010) exploratory research explores the why questions which in effect involved developing a causal explanation which could either be direct or indirect relationship between variables, that is, the effect of one thing on another and more specifically, the effect of one variable on another. Mugenda and Mugenda (2010) contends that exploratory research has the advantage of being relatively cheap and it will be considered for the study so as to establish the effect of corporate governance on information asymmetry of companies listed in NSE.

3.3 Target population

The target population of this study was all the companies listed at the Nairobi Securities Exchange. There are 62 listed companies at the Nairobi Securities Exchange from which the data will be drawn.

3.4 Sampling

The sample of the study involved the target population of the companies listed in the NSE. The researcher used the purposive sampling techniques. This is where the optimum sample size was a result of purposively selecting firms that were already listed by the year 2003; this is to allow a ten year analysis of data. The sample firms were adequate to fulfill the requirements of efficiency, representativeness and reliability. Unnecessarily large sample size would bring about data duplicity besides having cost and time implications while a small sample size would not be representative. The sample size was of 32 companies listed at the Nairobi Securities Exchange.

A simple random technique was used to select one staff from public relations or corporate
affairs department from each company on whom primary data was collected. This sampling technique is suitable for use since every firm in had an equal chance of being selected and thus the sampling technique eliminated bias. Secondary data was collected from company’s and NSE’s and companies’ websites and prospectus among others.

3.5 Data Collection

The study used both primary and secondary data sources in gathering data for analysis. The primary data source was semi-structured questionnaires. The questionnaires were both open and close-ended questions (Munn and Drever, 2004). A pilot test was conducted to field test the reliability and the validity of the instruments (Kothari, 2004). The data from the pilot test was analyzed using informative presentation tables and graphs.

3.6 Data Analysis

The study used multiple linear regression equation and the method of estimation was Ordinary Least Squares (OLS) so as to establish the relationship between corporate governance and information asymmetry. Ordinary least squares (OLS) is a method for estimating the unknown parameters in a linear regression model by minimizing the sum of squared vertical distances between the observed responses in the dataset, and the responses predicted by the linear approximation, thus, providing minimum-variance mean-unbiased estimation (Hayashi, 2000).

The proxy to be used to measure information asymmetry, as the dependent variable, is the bid-ask spread (SPREAD). The relation between the extents of informed trading and bid-ask spreads was first discussed in (Bagehot, 1971). Bagehot (1971) argues that market makers trade with two kinds of traders informed and uninformed. While the market maker loses to informed traders, he recoups these losses from uninformed traders by increasing the bid-ask spread. Thus, a high level of informed trading leads to higher bid-ask spreads. Bagehot’s (1971) intuition was subsequently modeled by Kyle (1985), and Glosten and Milgrom (1985). Specifically,

$$SPREAD = \frac{1}{D_{i,t}} \sum \left\{ \frac{ASK_i - BID_i}{ASK_i + BID_i} \right\}$$

Where: $D_{i,t}$ is the number of days in year t for firm i for which closing daily bids ($BID_i$) and closing daily asks ($ASK_i$) are available.
ASK is the price at which an investor (seller) is willing to sell, and BID is the price at which the investor (buyer) is willing to buy. Numerous studies starting from (Demsetz, 1968; Bagehot, 1971) have used bid–ask spread to proxy for information asymmetry between informed traders and liquidity traders.

Corporate board characteristics: the Variables that represent corporate board characteristics are Board Ownership, board independence and CEO duality. Board Ownership is computed as the proportion of executive share ownership to total shares of the firm. Board independence (BIND) is measured as the proportion of non-executive (independent) directors on board. CEO duality (CEO) is measured as a dummy variable, assigned 1 if the chief executive officer (or managing director) additionally occupies the position of the chairman of the board, or 0 if otherwise.

Several factors that are relevant to bid-ask spread as control variables were selected in multiple-regression models. Among of these factors are firm size, Stock return volatility, ROE and growth opportunity. Large firms may face less information asymmetry because they tend to be more mature firms, have established and time-tested disclosure policies and practices, and receive more attention from the market and regulators (Harris, 1994). Stock return volatility was included, because market makers increase the spread to make up for the uncertainty associated with volatile stocks. ROE is included on the expectation that income-generating firms disclose more information to communicate investors of their good performance (Wallace et al, 1994). Therefore it is expected that a negative relationship between firm Profitability and information asymmetry. Another important control variable is growth opportunity (GWTH), High-growth firms have greater information asymmetry because Firms with favorable future prospects are less likely to provide sensitive operating information in order to protect their competitive advantages and avoid attracting new entrants or increased competition from existing competitors (Liao, 2009). The ratio of market-to-book value of equity to proxy for growth opportunities was used.

To investigate the association between corporate governance characteristics and information asymmetry, the researcher used the following ordinary least squares (OLS) regression
SPREAD\textsubscript{i,t} = \beta_1 \text{BOWN}_{i,t} + \beta_2 \text{BIND}_{i,t} + \beta_3 \text{DUAL}_{i,t} + \beta_4 \text{FSIZE}_{i,t} + \beta_5 \text{VOL}_{i,t} + \beta_6 \text{ROE}_{i,t} + \beta_7 \text{GWTH}_{i,t} + \alpha

For firm i at the end of year t, where:

SPREAD = defined as annual relative bid-ask spread using daily closing bids and asks.

BOWN = Board Ownership defined as proportion of executive share ownership to total shares of the firm.

BIND = percentage of independent non-executive directors on board.

DUAL = a numerical number (1) will be assigned if CEO also serves as Chairman, and (0) if not.

FSIZE = firm size defined as natural log of firm’s total assets.

VOL = Volatility defined as the standard deviation of daily security returns.

ROE = return on equity defined as income before tax and interest to total equity.

GWTH = growth prospect defined as the market value of equity divided by book value of equity.

\alpha = the error term.

3.6.1 Operationalization of the Variables

Data from the NSE was analyzed to determine the SPREAD that is the difference between the daily price that the company shares are being sold at the NSE and the price at which the buyer buys at. From company prospectus, publications were analyzed and a percentage of shares owned by the directors of the company as a proportion of the total issue of share for each year were collected to determine BOWN. Information regarding board members was collected from company prospectus and publications which was reviewed each year. BIND was the number of independent non-executive directors calculated as a proportion of the total number of board members. Information regarding chief executive officer was drawn from the yearly company prospectus; publications were reviewed to find DUAL. If the chief executive officer also serves as a chairman, a numerical value of 1 was assigned; if not the number 0 was assigned.

Figures on total assets was taken from the companies’ published audited financial statement determine FSIZE and ROE. From the balance sheet at the end of each year of analysis, the total
assets and equity were gotten, while the income before tax and interest was collected for the income statements. Statistics from the daily securities prices was collected to find the difference between the daily security prices, this difference was analyzed to determine the VOL. Market value of equity was calculated by valuing the total number of shares issued by the company using the market price at the end of each year while the book value of equity was the balance sheet value of equity at year end to get growth (GWTH).
CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

This has presented data collected using questionnaires. The purpose of the study was to investigate how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The primary data was collected using a questionnaire as the data collection instrument while secondary data was collected from NSE’s and companies’ websites and prospectus. The study targeted 32 respondents. 23 questionnaires out of 32 were completed and returned giving a response rate of 72%. This response rate was good enough and conforms to that recommended by Mugenda and Mugenda (2003).

4.2 General Information

4.2.1 Major Background

The study sought to find out the major background of the respondents in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th>Major background</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Management</td>
<td>48%</td>
</tr>
<tr>
<td>Accounting/Finance</td>
<td>30%</td>
</tr>
<tr>
<td>Other</td>
<td>22%</td>
</tr>
</tbody>
</table>

Figure 4.1: Major Background

The study findings indicated that majority (48%) of the respondents were in the business management, 30% had the accounting/finance background while 22% had other backgrounds.
4.2.2 Interaction between Managers and Investors

The study sought to establish whether there is interaction between managers and investors (shareholders?) the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th>Interaction between Managers and Investors</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>52%</td>
<td>48%</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4.2: Interaction between Managers and Investors

From the study findings, majority (52%) of the respondents indicated that there is interaction between managers and investors the organization and 48% of the respondents indicated that there no is interaction between managers and investors the organization.

4.2.3 Forms of Interaction

The study sought to establish the forms of interaction between managers and investors (shareholders) the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th>Forms of interaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Media/Platforms</td>
</tr>
<tr>
<td>Company Website</td>
</tr>
<tr>
<td>Mainstream Media</td>
</tr>
<tr>
<td>Company Newsletters</td>
</tr>
<tr>
<td>Annual General Meetings</td>
</tr>
</tbody>
</table>

Figure 4.3: Forms of interaction

The study findings established that majority (39%) of the companies used main stream media
as forms of interaction between managers and investors (shareholders), 30% of the companies used Annual General meetings as forms of interaction between managers and investors, 17% of the companies used company newsletters as forms of interaction between managers and investors, 9% of the companies used company websites as forms of interaction between managers and investors and 4% of the companies used company websites as forms of interaction between managers and investors.

4.3 Board Independence

4.3.1 Number of Members’ Board of Directors

The study sought to establish the number of members’ board of directors in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th>No of Board Members</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2-5 member</td>
<td>13%</td>
</tr>
<tr>
<td>6-10 member</td>
<td>52%</td>
</tr>
<tr>
<td>11-20 member</td>
<td>35%</td>
</tr>
</tbody>
</table>

![Figure 4. 4: Board Independence](image)

From the study findings, majority (52%) of the respondents indicated that there are between 6-10 board of directors members in the organization, 35% indicated that there are between 11-20 board of directors members in the organization while 13% indicated that there are between 2-5 board of directors members in the organization.

4.3.2 Composition of Board Members

The study sought to describe the composition of board members in the organization. The findings are presented in the table below.
Table 4.1: Composition of Board Members

<table>
<thead>
<tr>
<th>Composition of Board Members</th>
<th>Frequency</th>
<th>Percent %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive directors only</td>
<td>4</td>
<td>17</td>
</tr>
<tr>
<td>Non executive Directors only</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Mix of both Executive &amp; Non executive</td>
<td>18</td>
<td>78</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100</td>
</tr>
</tbody>
</table>

The study findings established that most (78%) board members in the organization are a mix of both executive & non executive, 17% of the board members are executive directors while as 4% of the board members are non executive directors.

4.3.3 Strongest Voice

The study sought to establish the strongest voice in the selection of Non executive directors in the organization. The findings are presented in the table below.

![Strongest voice](image)

According to the study findings 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, 39% of the respondents indicated that the controlling shareholder have the strongest voice in the
selection of Non executive directors while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors.

4.3.4 Attendance rate for the board meetings

The study sought to establish the attendance rate for the board meetings in the organization. The findings are presented in the table below.

Table 4.2: Attendance rate for the board meetings

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>51-75%</td>
<td>5</td>
</tr>
<tr>
<td>75-89%</td>
<td>11</td>
</tr>
<tr>
<td>90-100%</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
</tr>
</tbody>
</table>

According to the study findings 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%.

4.4 CEO/Chair Duality

4.4.1 Independence of Chairman of the Board

The study sought to establish whether the Chairman of the Board was an independent, non-affiliated director in the organization. The findings are presented in the table below.
Figure 4. 6: Independence of the Chairman of the Board

From the study findings, majority (52%) of the respondents agreed that the Chairman of the Board was an independent, non-affiliated director in the organization while 48% of the respondents agreed that he was not an independent, non-affiliated director in the organization.

4.4.2 C.E.O as Chairman

The study sought to establish whether the C.E.O is a chairman of the company. The findings are presented in the table below.

Table 4. 3: C.E.O as chairman

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>10</td>
<td>43%</td>
</tr>
<tr>
<td>No</td>
<td>13</td>
<td>57%</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 57% of the respondents indicated the C.E.O as the chairman of the company while as 43% of the respondents indicated the C.E.O as not the chairman of the company.
4.5 Board Ownership

4.5.1 Directors’ Remuneration

The study sought to establish whether the company has a written procedure or policies on directors’ remuneration. The findings are presented in the table below.

Table 4.4: Directors’ Remuneration

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>23</td>
<td>100</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100</td>
</tr>
</tbody>
</table>

From the study findings, all (100%) of the respondents agreed the company has a written procedure or policies on directors’ remuneration.

4.5.2 Independent Director’s Remuneration

The study sought to establish whether the independent director’s remuneration included share options. The findings are presented in the table below.

Figure 4.7: Independent Director’s Remuneration

From the study findings, most (74%) of the respondents agreed that the independent director’s remuneration includes share options while as 26% of the respondents did not agree that the independent director’s remuneration included share options.

30
4.5.3 Non Executive Director’s Remuneration

The study sought to establish whether the non-executive director’s remuneration include share options. The findings are presented in the table below.

![Pie Chart](image)

Figure 4.8: Non-Executive Director’s remuneration

According to the study findings 52% of the respondents indicated that the non-executive director’s remuneration include share options while as 48% of the respondents indicated that the non-executive director’s remuneration does not include share options.

4.5.4 Share Options

The study sought to establish whether the CEO/Chairman given share options in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>8</td>
<td>35%</td>
</tr>
<tr>
<td>No</td>
<td>15</td>
<td>65%</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 65% of the respondents indicated that the CEO/Chairman not given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman was given share options in the organization.
4.5.5 CEO Compensation

The study sought to establish whether the board reviewed CEO compensation annually. The findings are presented in the table below.

![Figure 4.1: CEO Compensation](image)

From the study findings, most (61%) of the respondents agreed the board reviewed CEO compensation annually while as 39% of the respondents did not agree that the board review CEO compensation annually.

4.6 Disclosure/Communication

The study sought to establish whether the firms disclose the following in the firm’s web page. The findings are presented in the table below.

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarterly financial statement</td>
<td>9</td>
<td>39%</td>
</tr>
<tr>
<td>Directors selling or buying shares in the firm</td>
<td>4</td>
<td>17%</td>
</tr>
<tr>
<td>Directors reports</td>
<td>15</td>
<td>65%</td>
</tr>
<tr>
<td>Audited Annual reports</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their Directors selling or buying shares in the
firm statement in the firm’s web page, 65% of the firms disclose their Directors reports in the firm’s web page and all (100%) of the firms disclose their Audited annual reports in the firm’s web page.

4.7 Multiple Regression Analysis

The study adopted simple regression guided by the following model:

\[ Y = \beta_0 + \beta_1 (X_1) + \beta_2 (X_2) + \beta_3 (X_3) + \varepsilon \]

Where:

\( Y = \) is the dependent variable representing information asymmetry between managers and investors \((X_1)\): Board Ownership Concentration is measured by proportion of ownership held by the main shareholder of institutional nature of the quoted company.

\((X_2)\): Board Independence is measured by the proportion of non-executive directors inside the board \((\text{non-executive directors} / \text{total directors})\).

\((X_3)\): CEO Duality is measured by a dummy value of 1 of the company CEO also pairs up as the Board Chair.

\( \varepsilon \): Standard Error term.

The above model was tested and analyzed to determine its suitability to determine the relationship between corporate governance variables above and information asymmetry and the results tabulated below;

**Table 4.7: Model Summary**

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.387a</td>
<td>.7005</td>
<td>.687</td>
<td>.23665</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Board Ownership, Board Independence and CEO Duality

Author: Research data (2014)

From table 4.7, R indicates that there exist a moderate relationship between the independent variables i.e CEO duality, board independence and Board Ownership, and the dependent variable information asymmetry. The coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables) R Square equals 0.7, that is, 70 percent aggregate information asymmetry can be explained through the
combined linear effects of Board Ownership, Board Independence and CEO Duality. In order to test the significance of the model, the study conducted an Analysis of Variance. The findings were as shown below:

### Table 4.8: Analysis of Variance

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>3</td>
<td>5</td>
<td>5.331</td>
<td>5.911</td>
<td>.003&lt;sup&gt;a&lt;/sup&gt;</td>
</tr>
<tr>
<td>Residual</td>
<td>49</td>
<td>40</td>
<td>.056</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>45</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<sup>a</sup> Predictors: Constant, Board Ownership, Board Independence and CEO Duality

b. Dependent Variable: Information asymmetry

Author: Research data (2014)

The ANOVAs results, the probability value of .003 were obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry.

### Table 4.9: Coefficients of determination

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>I (Constant)</td>
<td>-5.08</td>
<td>-5.23</td>
<td>-6.16</td>
<td>0.048</td>
</tr>
<tr>
<td>Board Ownership</td>
<td>-5.53</td>
<td>0.10</td>
<td>.140</td>
<td>-5.53</td>
</tr>
<tr>
<td>Board Independence</td>
<td>-6.94</td>
<td>1.027</td>
<td>.110</td>
<td>-7.37</td>
</tr>
<tr>
<td>CEO Duality</td>
<td>2.98</td>
<td>.476</td>
<td>0.039</td>
<td>2.33</td>
</tr>
</tbody>
</table>

<sup>a</sup> Dependent Variable: Information asymmetry

Author: Research data (2014)
\[ Y = -5.08 - 5.53X_1 - 0.42X_2 - 6.94X_3 + 0.020X_4 + 2.98X_5 \]

where \( Y \) = Information asymmetry

\( B_0 \) = intercept (defines value of Information asymmetry without inclusion of predictor variables)

\( X_1 \) = Board Ownership

\( X_2 \) = Board Independence

\( X_3 \) = CEO Duality

Table 4.9 presents results of the simple linear regression of Aggregate Information asymmetry on Board Ownership, Board Independence and CEO Duality. From the findings, the coefficients of aggregate Information asymmetry is negative and significant, indicating that holding Board Ownership, Board Independence and CEO Duality constant Information asymmetry will be -5.08. The study also found that a unit increase in Board Ownership will cause a 5.53 decrease in information asymmetry, further a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, and a unit increase in CEO Duality will further lead to an increase in information asymmetry by a factor of 2.98.

### 4.8 Interpretation of Results

The study revealed that majority (52%) of the respondents agreed that Chairman is the of the Board an independent, non-affiliated director in the organization while 48% of the respondents agreed that is not of the Board an independent, non-affiliated director in the organization. 57% of the respondents indicated that the C.E.O as the chairman of the company while as 43% of the respondents indicated that the C.E.O is not the chairman of the company. This means that majority of the firms are adopting the CMA proposal to have CEO and Chair being independent. 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%. From the findings, 52% of the respondents indicated that the non-executive director’s remuneration include share options while as 48% of the respondents indicated that the non-executive director’s remuneration does not include share options.

According to the study findings, 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the
CEO/Chairman given share options in the organization. From the study findings, most (61%) of the respondents agreed the board review CEO compensation annually while as 39% of the respondents did not agreed the board review CEO compensation annually. Board ownership continue being an incentive used by investors to align the interests of the managers to those of the shareholders. 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their Directors selling or buying shares in the firms’ statement in the firm’s web page, 65% of the firms disclose their Directors reports in the firm’s web page and all (100%) of the firms disclose their Audited annual reports in the firm’s web page.

The findings on the coefficient of determination indicated that R Square equals 0.7, that is, aggregate information asymmetry explain 70 percent of Board Ownership, Board Independence and CEO Duality. In order to test the significance of the model, the study conducted an Analysis of Variance. The findings on the ANOVAs results indicate that the probability value of .003 was obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry. From the findings, the coefficients of aggregate Information asymmetry is negative and significant, indicating that holding Board Ownership, Board Independence and CEO Duality constant Information asymmetry will be -5.08. The study also found that a unit increase in Board Ownership will cause a 5.53 decrease in information asymmetry, further a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, and a unit increase in CEO Duality will further lead to an increase in information asymmetry by a factor of 2.98.

Inferential statistics such as non parametric test which include analysis of variance (ANOVA) were used to test the significance of the overall model at 95% level of significance. According to Mugenda (2008) analysis of variance is used because it makes use of the F – test in terms of sums of squares residual.
CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of key data findings, conclusions drawn from the findings highlighted and policy recommendations that were made. The conclusions and Recommendations drawn were in quest of addressing research objectives of how a firm’s corporate governance affects the level of information asymmetry between managers and investors.

5.2 Summary of Findings

A fundamental issue addressed in this research was to examine the effect of corporate governance on information asymmetry between managers and investors of companies listed in the NSE. Corporate governance attributes examined in this paper are CEO/Chair duality and board independence and Board Ownership. The study finds that there exists a relationship between corporate governance and information asymmetry between managers and investors as discussed below

5.2.1 Board Independence

From the study findings table 4.6, majority (52%) of the respondents indicated that there are between 6-10 board of directors members in the organization while figure 4.4 shows 13% indicated that there are between 2-5 board of directors members in the organization. The study further established that most (78%) board members in the organization are a mix of both executive & non executive, 17% of the board members are executive directors while as 4% of the board members are non executive directors. 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, 39% of the respondents indicated that the controlling shareholder have the strongest voice in the selection of Non executive directors while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors. According to the study findings 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board
meetings was between 51-75%.

Further analysis from the multiple regression indicated that the coefficients of aggregate Information asymmetry was significant and negatively related, indicating that a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, while the level of significance was ≤5%. These results collaborated with previous research that found that non-executive directors act as a reliable mechanism to diffuse agency conflicts between managers and owners (Fama & Jensen 1983). They are viewed as providing the necessary checks and balances needed to enhance board effectiveness (Franks, Mayer, & Renneboog, 2001). The results correspond to Chen & Jaggi (2000) who provide empirical evidence of the relationship between the proportion of non-executive directors on the board and corporate disclosure. The results of the research findings verify the relevance of non-executive directors as a governance mechanism that enhances the board’s capacity to ameliorate agency conflict between owners and managers.

5.2.2 CEO Duality

From the study findings, most 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman given share options in the organization. 61% of the respondents agreed the board review CEO compensation annually while as 39% of the respondents did not agreed the board review CEO compensation annually. 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their Directors selling or buying shares in the firm statement in the firm’s web page, 65% of the firms disclose their Directors reports in the firm’s web page and all (100%) of the firms disclose their Audited annual reports in the firm’s web page. Majority (52%) of the respondents agreed that Chairman is the of the Board an independent, non-affiliated director in the organization while 48% of the respondents agreed that is not of the Board an independent, non-affiliated director in the organization. 57% of the respondents indicated that the C.E.O as the chairman of the company while as 43% of the respondents indicated that the C.E.O is not the chairman of the company.

From the findings of the regression analysis, aggregate Information asymmetry is positive and
significant in relation to CEO duality, indicating that information asymmetry increased with an increase in CEO/Chair Duality. The results indicated a 2.98 coefficient at <0.5% significance level. Within the context of corporate governance, the major issue often discussed is whether the chair of the board of directors and CEO positions should be held by different persons (dual leadership structure) or by one person (unitary leadership structure). Agency theory suggests that the combined functions (unitary leadership structure) can significantly impair the boards’ most important function of monitoring, disciplining and compensating senior managers. It also enables the CEO to engage in opportunistic behavior because of his/her dominance over the board. The results are consistent with Sampson (1992) who empirically studied the relationship between corporate governance and disclosure quality and found that the extent of disclosure was higher in firms with dual leadership structures.

5.2.3 Board Ownership

From the study findings, all (100%) of the respondents agreed the company has a written procedure or policies on directors’ remuneration. Most (74%) of the respondents agreed that the independent director’s remuneration include share options while as 26% of the respondents did not agreed that the independent director’s remuneration include share options. 52 % of the respondents indicated that the non executive director’s remuneration include share options while as 48% of the respondents indicated that the non executive director’s remuneration does not include share options. According to the study findings out 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman given share options in the organization.

According to the study findings, 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors. 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%.

From the findings of the regression analysis, Board Ownership was negative and significant in
relation to aggregate information asymmetry, indicating that information asymmetry decreased with an increase in Board Ownership. The results indicated a -5.53 coefficient at <0.5% significance level. The results support the agency theory predicts that there is a positive association between management interests and the level of voluntary disclosure. Warfield et al (1995) provided that evidence supporting this contention in their findings that the extent of shareholding by management is positively associated with the amount of information disclosed about earnings. The above reasoning suggests that firms with higher Board Ownership will be associated with greater levels of disclosures and hence lower degree of information asymmetry.

The findings on the ANOVAs results indicate that the probability value of .003 was obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry.

5.3 Conclusions

The relevance of corporate governance cannot be over-emphasized since it constitutes the organizational climate for the internal activities of a company. Corporate governance brings new outlook and enhances a firm’s corporate entrepreneurship and competitiveness. The study examined the role of corporate governance characteristics i.e. board composition, board independence and CEO/Chair duality and its effect on information asymmetry between managers and investors in companies listed at the NSE in Kenya.

From table 4.9, it was evident that there is a negative relationship between Board Independence information asymmetry, since their coefficient estimates are -6.94 at 0.00 the level of significance. It can be concluded therefore that from the study the level Board Independence significantly affected information asymmetry between managers and investors. These research findings are consistent with earlier research by Kihara (2006) who observed that unlike inside directors, outside directors are better and able to challenge the CEO hence a minimum of three outside directors is required on the board. It also concurs with Jensen (1993) who voices his concern that, lack of independent leadership makes it difficult for boards to respond to failure in top management team. The study concluded that board members in the organization are a mix of both executive & non executive and that the board or its nominated committee has the strongest voice in the selection of Non executive directors.
On CEO/ chair duality the findings revealed a positive coefficient of 2.98 thus a positive relationship to information asymmetry between managers and investors. The significance level was 0.002. Data collected revealed that the CEO/chairman proposed share options in the organization while as the board review CEO compensation annually. The study concluded that CEO duality is the other corporate governance index that is significantly related to the information asymmetry. This result is consistent with Gul and Leung (2004) who found that CEO duality is positively associated with international firm acquisition. His research showed that, international acquisition had a significant impact on shareholder value. He found a positive relationship between a firm leadership structure and its announcement of foreign acquisitions. Huafang and Jianguo (2007) provided evidence that CEO duality is associated with lower disclosure.

In addition the study also concluded that a unit increase in Board Ownership will cause a -5.53 decrease in information asymmetry, meaning that there exists a negative relationship between the two at a significance level of 0.001. The company's have a written procedure or policies on directors’ remuneration and that the non executive director’s remuneration include share options also, the firms disclose their directors reports in the firm’s web page while all of the firms disclose their Audited annual reports in the firm’s web page. Foo and Zain (2010) examined the association between bids-ask spread, a market-based measure of information asymmetry, and board characteristics among 227 firms listed on the Main Board of Bursa Malaysia. The results revealed that board independence is negatively related to the level of information asymmetry.

5.4 Limitation of the Study

The model may misestimate outcomes, because it assumes that corporate governance characteristics affect information asymmetry. The proposed indicators of corporate governance characteristics i.e. Board Ownership, Board Independence and CEO Duality may have some limitations. Whilst their use can be theoretically justified, neither construct can be accurately measured empirically.

If other corporate governance characteristics contribute to the integrity of information asymmetry, then parameter estimates may be biased. Given that the model is tested using
archival data, the data are likely to contain the influences of several factors that are not accounted for in the model. Isolating the impact of the constructs on the market’s reaction may prove difficult. The model thus applies only to large firms where there is a clear separation between ownership and management.

5.5 Recommendations

This study aimed at investigating how a firm’s corporate governance, i.e Board Ownership, board independence and CEO/chair duality affects the level of information asymmetry between managers and investors. The need to carry out this study arose from the fact that listing of companies in the NSE has continued to increase and corporate governance is a key requirement that has to be adhered. A research gap thus existed as limited researches from those reviewed had been done on the effect of corporate governance on the information asymmetry of listed companies in Kenya’s Nairobi Securities Exchange (NSE).

From the findings and conclusions, the study recommends the need for effective corporate governance practices at senior managerial level of quoted companies in Kenya to contribute to reduced information asymmetry and hence improve on actual firm liquidity and avert possible collapse of public organizations in Kenya. It is clear from the findings that corporate governance does have an effect on information asymmetry between managers and investors. The government should therefore enforce the measures it has laid down to ensure listed companies are following them so that the recommended governance structures are followed. The concerned ministries should also be very keen in the supervisory role through the relevant committees to ensure that all regulations are enforced as required e.g. books of accounts are well kept and audited as they should be.

In the Kenyan context, over the past few years there have been concerns, especially among the regulators, that companies are performing poorly and some failing partly due to weak corporate governance structure, and one of such attributes is the combined role of board chair and CEO. The concern was that such enormous powers vested in an individual make the board ineffective in its oversight and monitoring role. For example, with regard to the board leadership the Capital Markets Authority (CMA) in the Guidelines of Corporate Governance Practices, expressed a view that companies should consider separating the role of the chair and CEO, and
where the two roles are combined, to present the rationale for such a leadership structure in the annual report to the shareholders. In addition, by 1997, the Central Bank of Kenya initiated a review of banks’ board structures and as part of the review urged the companies in the financial sector to separate the roles of board chair and CEO. It appears most companies embraced this advice from the regulators and changed their board leadership structure such that 43% have separated the role of board chair and CEO. Thus, because of this substantial change in the board leadership structure, there was limited differentiation among sample firms for this variable to have statistical significance in the pooled regression analysis.

An opportunity arises for further research in the development of an experiment that would identify how average investors measure information asymmetry. This is because it is unclear whether investors use abnormal accruals, as measured by aggregate accruals approach, as a representation of information asymmetry. The complexity of such models suggests that the average investor is unlikely to use this measure. The researcher also recommends future researchers to explore association between corporate governance characteristics and information asymmetry for non-listed companies in Kenya and large family ran private companies in Kenya.
REFERENCES


Kesner, I. F. & Dalton, D. R. (1986). Boards of directors and the checks and (im)balances of the


1552-1583.


APPENDIX I: LETTER OF INTRODUCTION.
August 09th 2014.
Mary Wanjiku Ndungo
C/o University of Nairobi
P.O. Box 30197 00100
Nairobi.
Dear Respondents,

RE: ASSESSING THE EFFECT OF CORPORATE GOVERNANCE ON INFORMATION ASYMMETRY BETWEEN MANAGERS AND INVESTORS:
I am a postgraduate student at the University Of Nairobi School of Business. I am undertaking the above research project in partial fulfillment of the requirements for the award of the MBA degree. In order to achieve this, I humbly request your assistance in filling the attached questionnaire to generate data for the study. Any information you provide is purely for the purposes of this project thus your responses will be treated in strict confidence and in no circumstances will your name be mentioned in the report. Further confidentiality will be ensured through the necessary coding of the survey findings. A copy of the research report will be submitted to you upon request.
Your assistance to this regard will be highly appreciated.
Thank you in advance,

Yours Sincerely,

Mary Ndungo
M.B.A STUDENT

Dr Ogilo
SUPERVISOR
APPENDIX II: QUESTIONNAIRE

SECTION A
This section of the questionnaire refers to background and general information regarding your company. Although we are aware of the sensitivity of the questions in this section, the information will allow us to compare different respondents. Once again, I assure you that your response will remain anonymous. Your cooperation is appreciated.

1. What is your company’s name?

……………………………………………………………………

2. Indicate your major background (You may choose more than one if applicable)
   a. Business Management [ ] b. Accounting/Finance [ ] c. Other: Please indicate--------

3. What is the main business of the company?

……………………………………………………………………

4. How long has your company been in existence?
   a. 0-5 years [ ] 6-10 years [ ] Over 10 years [ ]

5. Is there interaction between managers and investors (shareholders?)
   Yes [ ] No [ ]

6. If yes, in what forms?
   Annual General Meetings [ ] Company Newsletters [ ] Mainstream Media (Radio, Television, Newspapers) [ ] Company Website [ ] Social Media/Platforms [ ]
   Any other (Please Specify) [ ]

…………………………………………………………………………………………………………………………

SECTION B
This section of the questionnaire explores aspects of Board within your organization.

I. Board Independence

7. How many members of the board of directors do you have in your company?
   a. 2-5 [ ] b. 6-10 [ ] c. 11-20 [ ] c. More than 20 [ ] (please indicate)

 …………..

8. Which of the following describes the composition of your board members:
   a. Executive directors only [ ] b. Non executive Directors only. c. Mix of both a & c [ ]

10. If your answer above is c, please indicate the number of each
    Executive ……..
Non Executive (Independent) ……

11. Who is the strongest voice in the selection of Non executive directors?
   a. Board or its nominated Committee [ ] b. CEO c. Controlling Shareholder

12. On average what is the attendance rate for the board meetings?
   a. 90-100% [ ] b. 75-89% c. 51-75%

II. CEO/Chair Duality

13. Is the Chairman of the Board an independent, non-affiliated director?
   Yes [ ] No [ ]

9. Is the C.E.O, a chairman of the company
   Yes [ ] No [ ]

10. Does either of the two above in (Q11) act on behalf of the other
    Yes [ ] No [ ]

III. Board Ownership

11. Does your company have a written procedure or policies on directors remuneration
    Yes [ ] No [ ]

12. Does the independent director’s remuneration include share options?
    Yes [ ] No [ ]

13. Does the Non executive director’s remuneration include share options?
    Yes [ ] No [ ]

14. Is the CEO/Chairman given share options?
    Yes [ ] No [ ]

15. Does the board review CEO compensation annually
    Yes [ ] No [ ]

IV. Disclosure/Communication

16 Does your firm disclose the following in the firm’s web page?
   (i) Quarterly financial statement Yes [ ] No [ ]
   (ii) Audited Annual reports Yes [ ] No [ ]
   (iii) Directors reports Yes[ ] No [ ]
   (iv) Directors selling or buying shares in the firm Yes [ ] No [ ]

Thank you for your co-operation in completing this questionnaire. Kindly return the questionnaire as specified in the cover letter.
APPENDIX III: GUIDE TO COLLECT SECONDARY DATA

Asymmetric information variables

SPREAD (+)- The annual mean value of the daily percentage spread between bid and ask prices

VOLATILITY (+)- The annual average standard deviation of the day-over-day difference in the daily price change

VOLUME (-) - The annual average of daily market value of trading volume

Corporate governance variables

BSIZE (-) - The number of directors serving on the board of directors

NONEXESIZE (-)- The number of non-executives serving on the board of directors

SPLIT (-)- A dummy variable that takes on a value of one if the CEO and Chairman are different persons, zero otherwise

NONEXECHAIR (-)- A dummy variable that takes on a value of one if the chairman is a non-executive, zero otherwise
## Secondary data collection sheet

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<tr>
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<td>VOLATILITY (+)-</td>
<td>SD OF DAILY PRICE CHANGES</td>
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<td>VOLUME (-)</td>
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</tr>
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<td>BSIZE (-)</td>
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<td></td>
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<tr>
<td>SPLIT (-)-</td>
<td>1=CEO &amp; DIRECTOR ARE SAME ZERO OTHERWISE</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>NONEXECHAIR (-)-</td>
<td>1=CHAIRMAN IS NON-EXEC ZERO OTHERWISE</td>
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</table>


EFFECTS OF CORPORATE GOVERNANCE ON INFORMATION ASYMMETRY BETWEEN MANAGERS AND INVESTORS IN FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

BY

MARY WANJIKA NDUNGO
D61/70574/2007

A RESEARCH PROJECT REPORT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER 2014
DECLARATION

This is my original work and has not been presented for award of any degree in any university.

Signed........................................... Date..................................................
Mary Ndungo

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

Signed........................................... Date..................................................
Lecturer,
Department of Finance & Accounting,
School of Business,
Dr. Fredrick Ogilo
DEDICATION

This research project report is dedicated to my Dad and Mum Mr. and Mrs. Absalom Ndungo who have stood by me, believed in me and gave me motivation during my academic pursuits and the research work.
ACKNOWLEDGEMENTS

First, all glory and honor goes to Almighty God. He has given me good health and the finances needed to successfully complete this project. Through the process I have continuously drawn strength from the knowledge that God has a good plan for me and that my destiny was and remains in His hands. Without Him I can do nothing.

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LIST OF ACRONYMS

NSE- Nairobi Stock Exchange
CMA- Capital Markets Authority
CBK- Central Bank of Kenya
CEO- Chief Executive Officer
CAPM- Capital Asset Pricing Model
CDS account- Central Depository and Settlement account
SIIA- Software and Information Industry Association
FTSE- Financial Times Securities Exchange
ATS- Automated Trading System
FISD- Financial Information Services Division
ROE- Return on Investment
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ABSTRACT

This study aimed at investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The specific objectives of the study were to find out the effect of Board Ownership on the information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange, to investigate how board independence influences information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange and to determine how CEO duality affects information asymmetry between managers and investors in firms listed at NSE. This study was conducted using explanatory research design. The target population was 62 listed companies at the Nairobi Securities Exchange from which the data was drawn. The sample comprised of 32 firms listed in the NSE by the year 2003. Secondary data was collected using a questionnaire which contained both open and closed ended questions. A pilot test was first conducted to test the reliability and the validity of the questionnaire as an instrument. A simple random technique was used to select one staff from the corporate affairs department from each company who were the respondents. Secondary data was collected from companies’ websites, publications and data bought from the NSE. Secondary data collected was analyzed using multiple linear regression equation and the method of estimation was Ordinary Least Squares (OLS) so as to establish the relationship between corporate governance variables and information asymmetry. In order to test the significance of the model, the study conducted an analysis of variance. The results of the ANOVAs test indicate a significant value of .003 and a confidence 99 percent which was obtained indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry. Results from the coefficient of determination test indicated that R Square equals 0.7, that is, changes in aggregate information asymmetry could be explained up to 70 percent by the linear relationship between Board Ownership, Board Independence and CEO/Chair Duality. Findings from the data analyzed and tabulated from the questionnaires collected revealed 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 100% of the respondents indicated that their board consisted of both executive and non executive member and as such exercised some level of independence. Most (61%) of the respondents agreed the board review CEO compensation annually and 65% indicated that this compensation included share options. 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their directors selling or buying shares in the firms statement or in the firm’s web page, 65% of the firms disclosed their directors reports in the firm’s web page and all (100%) of the firms disclose their audited annual reports in the firm’s web page. From the results of the ordinary least square (OLS), Board Ownership and Board Independence were significantly negatively related to information asymmetry i.e. coefficients of -5.53 and -6.94 respectively while CEO/Chair duality was positively related to information asymmetry at +2.98. The levels of significance for all the variables were, 0.002, 0, and 0.001 respectively indicating a more than 97% confidence level. The results agree with Raheja (2005) and Myerson (1987) who found the existence of significant relationship between corporate governance variables aforementioned above in firms. The study recommends future researchers to study the association between corporate governance characteristics and information asymmetry for non-listed companies in Kenya and large family ran private companies in Kenya.
CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Corporate governance is the system that defines how organizations are to be directed and controlled by the agents. It’s a set of relationships between company directors, shareholders and other stakeholders as it addresses the powers of directors and of controlling shareholders over minority interest, the rights of employees, rights of creditors and other stakeholders (Muriithi, 2009). Dechow et al. (1996) defines corporate governance as an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity (Dechow, 1996). It is viewed as ethics and a moral duty of firms and is the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity, corporate accountability and transparency with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders (Gul & Leung, 2004).

The information asymmetry is rooted in the Agency Theory which explains problems arisen from the separation of ownership and management (Jensen and Meckling, 1979). This problem also inevitably transcends in corporate governance systems, where managers of the company (board of directors) are in possession of rather complete information on functioning of the company, which outside shareholders do not have. Since information asymmetry leads to ineffective decisions in corporate governance system, an effective information policy should be implemented to provide easy and equal access to information not only to shareholders, but also for all stakeholders (Ferma and Jensen, 1983). The optimal corporate governance system aims to give shareholders confidence that their company is managed efficiently, to create the highest possible profit and to preserve a firm’s reputation (Glosten and Milgrom, 1985).

The Nairobi Securities Exchange (N.S.E) is home to the largest companies in Kenya as well as several multinational firms cross listed in other global markets. The clamor for efficient governance structures and disclosure has continued to be of interest for both local and foreign investors. This paper intends to evaluate the effect of the firm’s corporate governance structures on one important firm characteristic- asymmetric information, that is the extent to which
managers know more about a firm’s value than does the rest of the world. The study will focus on firms listed in the Nairobi securities exchange.

1.1.1 Corporate Governance

The concept of governance is not new. It is as old as human civilization. Simply defined it is the process of decision-making and the process by which those decisions are implemented. Governance can be used in several contexts such as corporate governance, international governance, national governance and local governance (Liao, 2001). Having defined governance as the process of decision making and implementation, a further analysis of governance focuses on the formal and informal actors involved in decision-making and implementing the decisions made as well as the formal and informal structures that have been set in place to arrive at and implement the decision.

Corporate governance refers to the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs (Klein, 2002). Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment. Governance is a mechanism for monitoring the actions, policies and decisions of corporations. Governance involves the alignment of interests among the stakeholders.

1.1.2 Information Asymmetry

Information asymmetry can be defined as Information differences across investors (or groups of investors), and between investors and managers. This information differential has been a long standing concern among security exchange regulators and as such led them to enact regulations regarding fair disclosures which are intended to equalize information across investors by preventing companies from making disclosures to select groups of investors and analysts. Barako et al. (1998) assert that selective disclosure allows those have the advantage of certain market information beforehand to make a profit or avoid a loss at the expense of those kept in the dark. This practice leads to loss of investor confidence particularly small investors become
unwilling to invest in the fear that insiders gain at their expense; this, in turn, increases firms’ cost of capital to the extent that the risk in the economy has to be borne by fewer investors.

The issues of whether and how information differences across investors affects prices and the cost of capital cannot be addressed in conventional models of asset pricing, such as the Capital Asset Pricing Model (CAPM), this is because these models generally assume investors have homogeneous beliefs. Various studies that have developed models of capital market equilibrium where investors have heterogeneous information, reach different conclusions regarding the effects of information on the cost of capital and price of shares. Leland (1992) finds that allowing insider trading will, on average, increase stock prices despite the fact that the presence of insiders increases information asymmetry in the economy. Although he does not express his analysis in terms of cost of capital, higher stock prices on average are equal to a decrease in firms’ cost of capital. In contrast, O’Hara (2003) and Easley and O’Hara (2004) conclude that information asymmetry will increase firms’ cost of capital. These papers argue that less informed traders recognize they are at an information disadvantage and will try to hold assets where their disadvantage is less. This drives down the price of securities with high degrees of asymmetry.

1.1.3 Corporate Governance and Information Asymmetry

Corporate governance has become an issue of importance worldwide. Corporations have a vital role to play in promoting economic development and social progress. It is the engine of growth internationally, and increasingly responsible for providing employment, public and private services, goods and infrastructure. The efficiency and accountability of the corporation is now a matter of both private and public interest. Good corporate governance structures are essential in order to attract investors, by assuring them that their investments will be secure and managed in a transparent and accountable manner, as well as creates competitive and efficient companies and markets (Qian et al, 2009).

A key ingredient of an efficient market is information. Information is a stream of data coming to an entity, which may be converted into a resource of knowledge to help in a decision making process. The optimal decision depends on the access to relevant information. In the context of capital markets, corporate insiders generally have superior information about the current
condition and future prospects of the firm, compared to outside investors. The existence of information asymmetries across investors can lead to adverse private and social consequences including low investor participation, high transaction costs, thin markets and decreased gains from trade (Lev, 1988). Recognizing the adverse consequences of information asymmetry and agency problems, researchers have suggested several solutions, among which corporate governance is an important mechanism (Jensen and Meckling, 1976; Shleifer and Vishny, 1986).

The role of corporate governance is to align the interests of managers with those of shareholders through appropriate bonding and monitoring. In particular, the board of directors, elected by the shareholders, is charged with evaluating and disciplining the management team. Within their fiduciary duty to shareholders, directors have a governance responsibility to ensure greater transparency when it is in the shareholders’ interests. Since shareholders, in general, are outsiders who are at an information disadvantage about the company, corporate governance principle demand an effective and representative board of directors may be able to move the managers toward disclosing more information to the market participants and in effect eliminating and or smoothing market anomalies.

1.1.4 Nairobi Securities Exchange

The equity market in Kenya is not young but exhibits the characteristics of an underdeveloped but developing securities market. Market players have less information compared to those in developed economy. These characteristics essentially make this market relatively volatile. Nairobi Securities Exchange’s (NSE) equity market differs from those developed markets in such characteristics on firm levels as the ownership structure and corporate governance standards. The World Bank classifies NSE as both an emerging and a frontier market. A frontier market refers to a relatively small and liquid market even by the emerging market standards (Nganga, 2003).

The Nairobi Stock Exchange was set up in 1953 in Kenya, as a regional exchange for Kenya, Tanganyika, Uganda and Zanzibar. After independence in these countries, the exchange became Kenya’s national stock exchange. The stock market has developed over the years with 54 listed companies by the close of 2009. Nairobi Stock Exchange has also moved from the open-outcry trading system to Automated Trading System (ATS) in order to improve the Market’s both
informational and functional efficiency. The exchange has three market tiers: main investments market segments, alternative market segment and fixed income securities segment (NSE, 2009).

In 2011, the Nairobi Stock Exchange Limited changed its name to the Nairobi Securities Exchange Limited. The change of name reflected the strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments. In the same year, the equity settlement cycle moved from the previous T+4 settlement cycle to the T+3 settlement cycle. This allowed investors who sell their shares, to get their money three (3) days after the sale of their shares. The buyers of these shares will have their CDS accounts credited with the shares. At the same time, it became a member of the Financial Information Services Division (FISD) of the Software and Information Industry Association (SIIA). Later, the delayed index values of the FTSE NSE Kenya 15 Index and the FTSE NSE Kenya 25 Index were made available on the NSE website www.nse.co.ke. The new initiative gives investors the opportunity to access current information and provides a reliable indication of the Kenyan equity market’s performance during trading hours (NSE, 2012).

1.2 Research Problem

Corporate governance has been an important part of Company Law for many decades even before its various codes were drawn. This owes to separation of ownership and management of companies whereby fiduciary relationship exist between the shareholders as the principals or owners and directors as the agents or management (Muriithi, 2009). One important influence of governance is information disclosure. Existing literature suggests that a firm’s asymmetric information environment has an important relation with governance mechanisms. A number of papers make the case that the intensity of board monitoring should decrease with the extent of asymmetric information. For example, Raheja (2005) models the size and composition of the board and demonstrates that firms optimally employ less independent boards when it is difficult for outsiders to verify projects. Harris and Raviv (2008) also argue that an insider - controlled board may be optimal when insiders have important information relative to that of outsiders.

Recognizing the adverse consequences of information asymmetry and agency problems, researchers have suggested several solutions, among which corporate governance is an
important mechanism (Jensen & Meckling, 1976; Shleifer & Vishny, 1986). The role of corporate governance is to align the interests of managers with those of shareholders through appropriate bonding and monitoring. In particular, the board of directors, elected by the shareholders, is charged with evaluating and disciplining the management team.

In Kenya, a number of problems relating to corporate governance have been identified. The problems range from errors, mistakes to outright fraud. The origins of the problem range from concentrated ownership, weak incentives, poor protection of minority shareholders, to weak information standards (Mwangi, 2012). With such an environment in the background, the interest of both the minority shareholders and creditors could be compromised and managed to be skewed towards the interest of such block shareholders. Consequently, the issue of information asymmetry arises. Companies have crumbled right in the eyes of shareholders who all along had little or no information regarding the downfall, yet they are the owners. Bagehot (1971) thus the need to monitor corporate governance structures in organizations. As earlier intimated the Kenya Capital Market Authority is doing a lot to enforce corporate governance structure and disclosure requirement so as to create investor confidence and as such there has been an upsurge of information disclosed by corporate to meet the needs of local and foreign investors (Mwangi, 2012).

In Kenya prior researches have studied the link between corporate governance and its effect on company performance, return on investment, and information disclosure among other factors as well as analyzing different governance structures in different industries. Alice (2008) while studying the relationship between corporate governance and return on investment (ROE), found out that there was a positive relationship between ROE, board size and board composition. These research findings concurred with Kihara (2006) who observed that unlike inside directors, outside directors are better and able to challenge the CEO hence a minimum of three outside directors were required on the board. Izan, Hancock and Barako (2006) studied the relationship between corporate governance and voluntary disclosure in Kenyan companies and concluded that the presence of an audit committee was a significant factor associated with the level of voluntary disclosure, and board independence was found to be significantly negatively associated with the extent of voluntary disclosure. In contrast, board leadership structure appeared not to have a significant influence on the level of voluntary disclosure by companies.
The above studies among others though have studied effects of corporate governance, this paper seeks to contribute to the body of research and directly examine the relationship between corporate governance and its effect on information asymmetry in the emerging Kenyan securities market. A research gap exists as limited researches have been done on the effect of corporate governance on the information asymmetry of listed companies in Kenya’s Nairobi Securities Exchange (NSE).

The need to carry out this study arose from the fact that listing of companies in the NSE has continued to increase and corporate governance is a key requirement that has to be adhered. Shareholders are increasingly becoming educated and informed about how the securities exchange market works. They are now more than ever aware that disclosure information has an influence the value of their investments (Diamond and Verrecchia, 1991). It was therefore important to assess if the corporate governance structures put in place by the listed firms have an impact on information asymmetry between managers and investors. This paper sought to answer the questions: Do firms’ governance structures through Board Ownership affect information asymmetry between managers and investors? Does board dependence influence information asymmetry between stockholders and managers? Does CEO duality have an effect on the level of information asymmetry between managers and investors?

1.3 Objectives of the Study

This study aimed at investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The study was guided by the following specific objectives:

i. To find out the effect of Board Ownership on the information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

ii. To investigate how board independence influences information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

iii. To determine how CEO duality affects information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

1.4 Value of the Study

The findings of this study would help managers to evaluate and appreciate what benefits they
could accrue as a result of disclosure of board processes as well as implementing solid corporate governance structures. They will understand how strategic use of corporate governance can increase and create value for the same investors, which is the main goal for the listed companies. Shareholders will realize the importance of demanding as well ensuring corporate governance structures are functional within the organization. They will understand how variables such as board Independence, CEO/Chair duality, and Board Ownership information asymmetry between them and their managers, as well as how information available to them can affect their decision making as investors. They also in annual general meetings will be in a position to demand transparency and be privy to board processes.

The stock market regulator (Capital Market Authority) will also use the findings in the implementation and development of regulations aimed at executing its mandate of promoting market confidence, investor protection and access to financial services within capital markets in Kenya and the region through effective regulation and innovation. Researchers and scholars also get valuable reference material for future studies who would wish to venture into this area of study. Findings from this study have laid a basis for empirical evidence on the effects of corporate governance on information asymmetry.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents the theoretical literature and examines the various theories that contribute to and inform corporate governance, its determinants i.e. Board Ownership, independence and CEO/chair duality. It will also review extant empirical literature relating to corporate governance and information asymmetry.

2.2 Theoretical Review

The theories upon which the concept of corporate governance draws its foundation and the areas it encompasses, date form much earlier. These theories are also drawn from a variety of disciplines such as finance, law, organizational behavior among others.

2.2.1 Agency Theory

The agency theory identifies the agency relationship between an agent and a principle (Jensen & Meckling, 1979; Ferma & Jensen, 1983). Jensen and Meckling (1979) assume that as agents do not own the corporation’s resources, they may commit ‘moral hazards’ (such as shirking duties to enjoy leisure and hiding inefficiency to avoid loss of rewards) merely to enhance their own personal wealth at the cost of their principals. There also develops a problem of information asymmetry whereby the principle and the agent have access to different levels of information, in reality this means that the principle will be at a disadvantage because the agent has more information.

In the context of corporate governance, agency theory views corporate governance mechanisms especially board of directors as being an essential monitoring device to ensure that any problem that may be brought about by the agency conflict may be minimized (Gul and Leung 2004). In theory, the board of directors is directly elected by shareholders at the company’s annual general meeting (AGM). If these directors wish to stay in their jobs they take decisions which maximize the wealth of their shareholders. In his literature review, Harris (1994) contends that company boards have evolved as part of the market solution to the problem of contracting within organizations. Fama and Jensen (1983) argued that effective corporate boards would be
composed largely of outside independent directors holding managerial positions in other companies. They argued that effective boards had to separate the problems of decision management and decision control. However, if the CEO was able to dominate the board, separation of these functions would be more difficult, and shareholders would suffer as a result. Outside directors, he contended, are able to separate these functions and exercise decision control, since reputational concerns, and perhaps any equity stakes, provides them with sufficient incentive to do so. Corporate boards should act as monitors in disagreements amongst internal managers and carry out tasks involving serious agency problems.

2.2.2 Transaction Cost Economies

This theory views the firm itself as a governance structure. It further emphasizes that the choice of an appropriate governance structure can help align the interests of directors and shareholders. This theory looks at the various investments projects available to a firm and the various ways in which these projects can be cost effectively financed either through debt of equity. According Williamson’s (1988) argument, the solution to the problem of costly financing of highly specific assets with debt is to be found in the invention of equity.

In his literature review Lev (1988) contends that the equity governance structure has three important properties. First, similarly to Agency Theory shareholders bear a residual claiming status. Second, the equity contract lasts for the duration of the life of the corporation. And third, a safeguard in the form of a board of directors is created and awarded to equity-holders. According to this view, the board bears a decision-review and monitoring relation to the firm’s management, including the review and monitoring of management’s investment policy.

2.2.3 Stakeholders Theory

The shareholder model of corporate governance relies on the assumption that shareholders are morally and legally entitled to direct the corporation since their ownership investment is an extension of their natural right to own private property (Beasely, 1996). Byard(2006) in his literature review however notes that the idea that the shareholders govern the corporation is largely a fiction’, because in reality executives exercise the highest power. Dechow et al. (1996) argue that executives can and should be made more accountable and responsive to some groups other than themselves. Stakeholders’ theory takes into account a wider group of constituents
rather than focusing on shareholders, then the governance structure may provide for some direct representation of the stakeholder groups (Shleifer and Vishny, 1997).

One premise of the stakeholder’s theory is that the stakeholders have vested interests in the firm. Shareholders on the other hand have a residual interest on the firm, that is, a right to the free cash flow ones all the stakeholders (debt holders, employees, suppliers) have been paid. Freeman (1984) posits that successful managers must systematically attend to the interests of various stakeholder groups. This “enlightened self-interest” position has been expanded upon by Chen (2000) who believes that the interests of stakeholders have inherent worth irrespective of whether these advance the interests of shareholders. Under this viewpoint, the success of a corporation is not merely an end in itself but should also be seen as providing a vehicle for advancing the interests of stakeholders other than shareholders. It is therefore in the shareholders best interest to ensure that all the firm’s resources are utilized to their maximum effect and thus benefiting even the stakeholders. Stakeholder and shareholders may require the firm to have different corporate governance structures and monitoring mechanisms as they deem favorable to secure their interests (Claessens, 2003)

2.2.4 Stewardship Theory

In this theory, the directors of the firm are viewed as stewards of the company’s assets. They are such inclined to act in the best interest of the shareholders (Donaldson ,1990). They argue that unlike the agency theory whose thrust was an accent on managerial “opportunism” by having a board chair different form the CEO and using incentives to bind the CEO to the shareholders interests, theirs stresses on the benefit of having facilitative authority structures that unified the role of the CEO and Chair held by one person. The emphasis was not on placing management under ownership control but empowering managers to autonomously execute decisions.

It is to be noted that corporate governance continues to develop and draw its framework from a multiple of disciplines. The main theory however from which it has mainly drawn it development is the agency theory. All other theories come into play as companies increasingly become aware that they cannot operate in isolation thus the emergence and inclusion of other theories highlighted above (Donaldson 1990).
2.3 Determinants of Corporate Governance

Corporate governance being the process of decision making and implementation, it also focuses on the formal and informal parties involved in both decision-making and implementation of the decisions made. These formal and informal structures that have to be set in place to arrive at successful implementation are based on three indicators of the governance structures, these being Board Ownership, board independence and CEO duality.

2.3.1 Board Ownership

Baghat et al. (2002) propose that Board Ownership is a measure of corporate governance and found that it had a direct relation to corporate performance. They argue that Incentive-based economic models of managerial behavior motivate governance features and structures. In agency models, a conflict of interests between managers and shareholders cause managers to take actions that are costly to shareholders. Contracts are not sufficient enough to stop managers from engaging in pricey activities if shareholders are unable to observe managerial behavior directly. Board Ownership structures thus come into play. Ownership by the manager is used to induce managers to act in a manner that is consistent with the interest of shareholders.

Proponents of the adverse selection models on the other hand are motivated by the hypothesis of differential innate ability that cannot be observed by shareholders. What this means is, ownership may be used to bring on revelation of the manager's private information about cash flow or her ability to generate cash flow, which cannot be observed directly by shareholders (Myerson, 1987). From the above two models, some features of corporate governance may be interpreted as a characteristic of the contract that governs relations between shareholders and managers. Governance is affected by the same unobservable features of managerial behavior or ability that are linked to ownership and eventually performance.

2.3.2 Board Independence

The board of directors and executive management are two significant components of a firm’s governance progression. Several intimately related governance issues of the board and management include the responsibility, structure and independence of the board, and the management contract. The board seems to be an imperative internal device for resolving the agency tribulations, since it is primarily responsible for recruiting and monitoring the executive
management to defend the interests of the shareholders and other stakeholders. Prowse (1994) notes that the board makes a connection between managers and investors by taking a leadership role. He also suggests that an assessment of the board (or board sub-committees) can help establish performance criteria that can be used to achieve the corporate objective and to align the performance of the directors with the interest of the shareholders. A related literature also refers to board structure and independence as important governance components. Denis and McConnell (2003) regard a smaller board as an important determinant of corporate governance and firm performance. Solomon et al. (2003) and Tsui and Gul (2000) opine that the outside or non-executive directors play an important governance role in relation to the welfare of the investors, especially non-controlling shareholders.

The presence of outside directors improves the degree of corporate answerability and creates a balance of power between the CEO and the board (Denis and McConnell, 2003; Ricart et al., 1999). Likewise, the OECD (2003) observes that independent non-executive directors can exercise unbiased judgment in relation to the conflicts of interest among different stakeholders. This presence of independent non-executive directors seems to have an important implication in family-based governance, as Solomon et al. (2003) consider founding family dominance as a negative aspect of corporate governance. The issue of CEO duality (the CEO and board chairperson being the same individual) appears to constrain board independence, because there is a possibility of conflict of interests. Daily and Dalton (1997) and Kesner and Dalton (1986) mention that separate board structure can enhance board independence and shareholder value.

However, a separate board does not necessarily ensure better governance, as Daily and Dalton (1997) argue, the chairperson in a separate board structure might possess his/her own interest in the firm’s governance. Corporate interlocking is another inter-organisational strategy for managing the resource interdependencies such as, strategic alliances, mergers and acquisitions (Ong et al., 2003). Whilst the presence of the same individual on the boards of several firms can create firm value, it can yield a negative influence on the firm’s governance because of the potential for conflicts of interests between firms. Aside from monitoring the executive management, the board is also responsible for designing the management contract that minimises the degree of agency conflicts. Several studies (Prowse, 1994; Becht et al., 2002; McColgan, 2001) mention that a management contract aligns personal interest of the managers
with that of the shareholders and provides managers with the incentives to maximize firm value. It is suggested that a value enhancing management contract should include: basic salary components, performance-based cash bonuses and profit-based salary revisions, stock participation plan (e.g. stock options), outright ownership of the firm’s equity, pension rights, performance-based dismissal provisions, and long-term incentive plans.

2.3.4 CEO/Chair Duality

CEO duality is a contentious issue that has attracted significant public and academic scrutiny. In his study Sampson (1992) found that 75% to 80% of U.S. firms combined the CEO and chair roles into one position. However, Grinstein & Valles (2008) showed a significant jump in the number of S&P 500 companies splitting CEO/chair roles. They report that 31% of S&P 1000 firms in 2004 separated the CEO/chair roles, a marked increase from the 24% reported in 2000. They argued that corporate scandals, such as Enron and WorldCom, and the 2001 recession raised the alarm for more board vigilance and decentralization of power.

Critics of CEO duality argue that duality compromises board effectiveness in monitoring the CEO. They assert that dual CEOs are more likely to pursue selfish interests that are inconsistent with shareholders’ values. Proponents of CEO duality assert that a combined CEO/chair structure provides directional clarity and judgment that is lacking within an independent leadership structure. Separation of CEO and chair may limit CEO entrepreneurism in ventures that can increase firm value because the CEO’s decisions are consistently monitored and thus affect performance.

2.4 Transparency and Accountability

Transparency and accountability are two closely related issues that are crucial, not only in enhancing the disclosure and auditing standards of a firm, but also in developing the regulatory organ’s capacity to monitor and discipline the firm’s governance practices. Therefore, it is imperative for a firm to make its financial and non-financial information available and easily accessible to outsiders in order that everyone can make informed decisions. Effective disclosures enable existing as well as prospective investors, to evaluate the management’s past performance, forecast the firm’s future cash flow and to decide whether the risk profile of a firm is within an acceptable level (Foo et al., 2000; Gul et al., 2000). Thomas et al., (2002) note
that information to shareholders is one of the most important aspects of corporate governance, as it reflects the degree of transparency and accountability of the corporations towards its shareholders. The quality of a firm’s disclosures tends to be determined by the development of the capital market and the standards of accounting and auditing practices of a country. Whilst Claessens and Fan (2002) emphasise the quality auditing and professional integrity of the external auditors, it is commented that weak enforcement of accounting and auditing standards restrains quality auditing.

2.5 Determinants of Information Asymmetry

The main factors affecting the asymmetry of information between the managers and the investors resulting from risky securities are namely: the trading volume, the volatility of stock returns, and the stock price. Trading volume influences information asymmetry as the interplay of supply and demand determines the transaction price of each stock security. Securities are traded for cash and thus buyers must have available money and sellers must have stocks and the outcome, that is the payment and delivery of securities, takes place immediately after negotiation. Liao (2009) points out that the trading volume is closely linked with various measures of asymmetric information and this volume decreases when the earnings are announced. Additionally Byard et al. (2006) found that the inverse of the average daily trading volume positively influenced the asymmetry of information.

Stock return measures are also highlighted as determining information asymmetry. Blackwell et al., (1990) use residual volatility in daily stock returns as another proxy for information asymmetry. As Kyle (1985) pertaining the transactions of the informed and the insiders’ expected trading benefits, they are positively related to non-specific assessments of the company’s value. Insofar as the residual volatility of stock returns reflects some uncertainty about the company’s value, the problem of information asymmetry increases. Fee and Thomas (1999) have mentioned some uncertainty factors for companies such as the rates fixed by the Federal Reserve that are simultaneously relative to both insiders and outsiders. If the insiders’ transactions exceed the abnormal outputs, the superfluous information disclosure entirely does not remove the informational advantage of the leaders (Harris, 1994). There is thus a close connection between stock return and information asymmetry.
Several studies have shown that the share price explains a significant part of the information asymmetry. Comerton-Forde and Rydge (2006) in their study found that the share price is positively associated with this information asymmetry and Attig et al. (2006) noted that the share price is a vector of information, so it negatively affects the information asymmetry. Stoll (1978) posits that the trading volume and the incurred risk affect the cost of detention of market makers. He also notes that the stock price is a proxy for the unobservable minimum cost. In his empirical test stoll (1978) found that the bid-ask spread negatively affected the trading volume while the stock price positively influenced the variability of returns.

The proxy to be used to measure information asymmetry, as the dependent variable, is the bid-ask prices, spread (SPREAD). The relation between the extents of informed trading and bid-ask spreads was first discussed in (Bagehot, 1971). Bagehot (1971) argues that market makers trade with two kinds of traders informed and uninformed. While the market maker loses to informed traders, he recoups these losses from uninformed traders by increasing the bid-ask spread. Thus, a high level of informed trading leads to higher bid-ask spreads. Bagehot’s (1971) intuition was subsequently modeled by Kyle (1985), and Glosten and Milgrom (1985).

### 2.6 Empirical Review

It has long been recognized that greater managerial ownership generates greater alignment of the interests of shareholders and managers, and mitigates the agency problems between the two parties (Jensen and Meckling, 1976; Demsetz, 1983). Agency theory predicts that there is a positive association between management interests and the level of voluntary disclosure. Warfield et al (1995) provided that evidence supporting this contention in their findings that the extent of shareholding by management is positively associated with the amount of information disclosed about earnings. The above reasoning suggests that firms with higher Board Ownership will be associated with greater levels of disclosures and hence lower degree of information asymmetry.

Drawing from Fama and Jensen (1983) a large body of empirical evidence finds that outside directors who are independent of management’s influence help enhance shareholder value by protecting shareholder interests against managerial opportunism (Hermalin and Weisbach, 2001). Focusing on financial reporting issues in particular, (Beasley, 1996; Dechow et al.,
1996; Klein, 2002) found that outside directors are effective monitors of managerial actions. Beasley (1996) argued and provided evidence that the proportion of outside directors is positively related to the board’s ability to influence disclosure decisions.

Chen and Jaggi (2000) found empirical evidence of a positive relationship between Board independence and disclosure (including mandatory disclosure). Foo and Zain (2010) examined the association between bids-ask spread, a market-based measure of information asymmetry, and board characteristics among 227 firms listed on the Main Board of Bursa Malaysia. The results revealed that board independence is negatively related to the level of information asymmetry. Based on the foregoing discussion, it can be inferred that the proportion of outside directors in the board might have a positive impact on disclosure practices, thus leading to lower degree of information asymmetry.

Fama and Jensen (1983) pointed out that CEO duality signals the absence of separation of decision control and decision management. The result of CEO duality is the concentration of decision-making power, which could constrain board independence and reduce its ability to execute its oversight and governance roles Gul and Leung, (2004), and proved detrimental to disclosure levels and quality, especially voluntary disclosure (Ho and Wong, 2001). Huafang and Jianguo (2007) provided evidence that in increase in independent directors increases corporate disclosure and CEO duality is associated with lower disclosure. Byard et al (2006) reported that CEO duality is negatively associated with analysts’ forecast accuracy. The authors conclude that CEO duality increases information asymmetry.

2.7 Summary of Literature Review

From the studies reviewed there different interests among researchers, some analyzing corporate governance components together and others separately. Whilst a majority of corporate governance literature centers on individual governance components, a recent literature is based all related issues of corporate governance and its effects on various aspects of the organization, ranging from strategy, profitability, performance, disclosure, cost of capital, return on investment among many other aspects of the firm. Empirical studies reviewed indicate how individual governance components e.g. ownership structures, board composition, board
independence and disclosure quality and overall governance standards such as corporate governance index are associated with the firm’s valuation as well as operating performance.

Empirical evidence reviewed of the influence of individual corporate governance mechanisms various aspects of the firms is highly indicative that indeed corporate governance mechanisms do influence the success of any organization. This chapter undertook a review literature relevant to this research with the aim of getting views and opinions on investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The chapter specifically covers the theoretical foundation and the Determinants of corporate governance. Corporate governance being a relatively new area, its development has been affected by various disciplines. The main theory that has affected its development however most naturally seems to rest in the agency theory. However the stakeholders theory is coming in more into play as companies increasingly grow and become aware that they cannot operate in isolation and that they need to have a wider regard to the stakeholder constituency.

The process of the growth of a firm takes time and this is because firms have to develop the necessary capabilities to cope with growth. Entrepreneurial growth and managerial resources are inseparable and as such corporate governance and monitoring mechanisms continue to be a key component to the success of firms in both the local and the global economy (Foo and Zain, 2010). Organizations must therefore continually review their governance structures, their effect on performance and as such align them to global trends (Izan et al., 2006).
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter has covered the research design, population, sample, data collection and data analysis, which describes the firms and variables, included in the study and applied statistical techniques in investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors.

3.2 Research design

This study was conducted using explanatory research design. According to Mugenda and Mugenda (2010) exploratory research explores the why questions which in effect involved developing a causal explanation which could either be direct or indirect relationship between variables, that is, the effect of one thing on another and more specifically, the effect of one variable on another. Mugenda and Mugenda (2010) contends that exploratory research has the advantage of being relatively cheap and it will be considered for the study so as to establish the effect of corporate governance on information asymmetry of companies listed in NSE.

3.3 Target population

The target population of this study was all the companies listed at the Nairobi Securities Exchange. There are 62 listed companies at the Nairobi Securities Exchange from which the data will be drawn.

3.4 Sampling

The sample of the study involved the target population of the companies listed in the NSE. The researcher used the purposive sampling techniques. This is where the optimum sample size was a result of purposively selecting firms that were already listed by the year 2003; this is to allow a ten year analysis of data. The sample firms were adequate to fulfill the requirements of efficiency, representativeness and reliability. Unnecessarily large sample size would bring about data duplicity besides having cost and time implications while a small sample size would not be representative. The sample size was of 32 companies listed at the Nairobi Securities Exchange.

A simple random technique was used to select one staff from public relations or corporate
affairs department from each company on whom primary data was collected. This sampling technique is suitable for use since every firm in had an equal chance of being selected and thus the sampling technique eliminated bias. Secondary data was collected from company’s’ and NSE’s and companies’ websites and prospectus among others.

3.5 Data Collection

The study used both primary and secondary data sources in gathering data for analysis. The primary data source was semi-structured questionnaires. The questionnaires were both open and close-ended questions (Munn and Drever, 2004). A pilot test was conducted to field test the reliability and the validity of the instruments (Kothari, 2004). The data from the pilot test was analyzed using informative presentation tables and graphs.

3.6 Data Analysis

The study used multiple linear regression equation and the method of estimation was Ordinary Least Squares (OLS) so as to establish the relationship between corporate governance and information asymmetry. Ordinary least squares (OLS) is a method for estimating the unknown parameters in a linear regression model by minimizing the sum of squared vertical distances between the observed responses in the dataset, and the responses predicted by the linear approximation, thus, providing minimum-variance mean-unbiased estimation (Hayashi, 2000).

The proxy to be used to measure information asymmetry, as the dependent variable, is the bid-ask spread (SPREAD). The relation between the extents of informed trading and bid-ask spreads was first discussed in (Bagehot, 1971). Bagehot (1971) argues that market makers trade with two kinds of traders informed and uninformed. While the market maker loses to informed traders, he recoups these losses from uninformed traders by increasing the bid-ask spread. Thus, a high level of informed trading leads to higher bid-ask spreads. Bagehot’s (1971) intuition was subsequently modeled by Kyle (1985), and Glosten and Milgrom (1985). Specifically,

\[
\text{SPREAD} = \frac{1}{D_{it}} \sum \left\{ \frac{\text{ASK}_i - \text{BID}_i}{\text{ASK}_i + \text{BID}_i} \right\}
\]

Where: \(D_{it}\) is the number of days in year t for firm i for which closing daily bids (\(\text{BID}_i\)) and closing daily asks (\(\text{ASK}_i\)) are available.
ASK is the price at which an investor (seller) is willing to sell, and BID is the price at which the investor (buyer) is willing to buy. Numerous studies starting from (Demsetz, 1968; Bagehot, 1971) have used bid–ask spread to proxy for information asymmetry between informed traders and liquidity traders.

Corporate board characteristics: the Variables that represent corporate board characteristics are Board Ownership, board independence and CEO duality. Board Ownership is computed as the proportion of executive share ownership to total shares of the firm. Board independence (BIND) is measured as the proportion of non-executive (independent) directors on board. CEO duality (CEO) is measured as a dummy variable, assigned 1 if the chief executive officer (or managing director) additionally occupies the position of the chairman of the board, or 0 if otherwise.

Several factors that are relevant to bid-ask spread as control variables were selected in multiple-regression models. Among of these factors are firm size, Stock return volatility, ROE and growth opportunity. Large firms may face less information asymmetry because they tend to be more mature firms, have established and time-tested disclosure policies and practices, and receive more attention from the market and regulators (Harris, 1994). Stock return volatility was included, because market makers increase the spread to make up for the uncertainty associated with volatile stocks. ROE is included on the expectation that income-generating firms disclose more information to communicate investors of their good performance (Wallace et al, 1994). Therefore it is expected that a negative relationship between firm Profitability and information asymmetry. Another important control variable is growth opportunity (GWTH), High-growth firms have greater information asymmetry because Firms with favorable future prospects are less likely to provide sensitive operating information in order to protect their competitive advantages and avoid attracting new entrants or increased competition from existing competitors (Liao, 2009). The ratio of market-to-book value of equity to proxy for growth opportunities was used.

To investigate the association between corporate governance characteristics and information asymmetry, the researcher used the following ordinary least squares (OLS) regression
SPREAD\textsubscript{i,t} = \beta_1 \text{BOWN}_{i,t} + \beta_2 \text{BIND}_{i,t} + \beta_3 \text{DUAL}_{i,t} + \beta_4 \text{FSIZE}\textsubscript{i,t} + \beta_5 \text{VOL}\textsubscript{i,t} + \beta_6 \text{ROE}\textsubscript{i,t} + \beta_7 \text{GWTH}\textsubscript{i,t} + \alpha

For firm i at the end of year t, where:

**SPREAD** = defined as annual relative bid-ask spread using daily closing bids and asks.

**BOWN** = Board Ownership defined as proportion of executive share ownership to total shares of the firm.

**BIND** = percentage of independent non-executive directors on board.

**DUAL** = a numerical number (1) will be assigned if CEO also serves as Chairman, and (0) if not.

**FSIZE** = firm size defined as natural log of firm’s total assets.

**VOL** = Volatility defined as the standard deviation of daily security returns.

**ROE** = return on equity defined as income before tax and interest to total equity.

**GWTH** = growth prospect defined as the market value of equity divided by book value of equity.

\( \alpha \) = the error term.

### 3.6.1 Operationalization of the Variables

Data from the NSE was analyzed to determine the SPREAD that is the difference between the daily price that the company shares are being sold at the NSE and the price at which the buyer buys at. From company prospectus, publications were analyzed and a percentage of shares owned by the directors of the company as a proportion of the total issue of share for each year were collected to determine BOWN. Information regarding board members was collected from company prospectus and publications which was reviewed each year. BIND was the number of independent non-executive directors calculated as a proportion of the total number of board members. Information regarding chief executive officer was drawn from the yearly company prospectus; publications were reviewed to find DUAL. If the chief executive officer also serves as a chairman, a numerical value of 1 was assigned; if not the number 0 was assigned.

Figures on total assets was taken from the companies’ published audited financial statement determine FSIZE and ROE. From the balance sheet at the end of each year of analysis, the total
assets and equity were gotten, while the income before tax and interest was collected for the income statements. Statistics from the daily securities prices was collected to find the difference between the daily security prices, this difference was analyzed to determine the VOL. Market value of equity was calculated by valuing the total number of shares issued by the company using the market price at the end of each year while the book value of equity was the balance sheet value of equity at year end to get growth (GWTH).
CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

This has presented data collected using questionnaires. The purpose of the study was to investigate how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The primary data was collected using a questionnaire as the data collection instrument while secondary data was collected from NSE’s and companies’ websites and prospectus. The study targeted 32 respondents. 23 questionnaires out of 32 were completed and returned giving a response rate of 72%. This response rate was good enough and conforms to that recommended by Mugenda and Mugenda (2003).

4.2 General Information

4.2.1 Major Background

The study sought to find out the major background of the respondents in the organization. The findings are presented in the table below.

![Major Background](image)

**Figure 4.1: Major Background**

The study findings indicated that majority (48%) of the respondents were in the business management, 30% had the accounting/finance background while 22% had other backgrounds.
4.2.2 Interaction between Managers and Investors

The study sought to establish whether there is interaction between managers and investors (shareholders?) the organization. The findings are presented in the table below.

![Interaction between Managers and Investors](image)

**Figure 4.2: Interaction between Managers and Investors**

From the study findings, majority (52%) of the respondents indicated that there is interaction between managers and investors the organization and 48% of the respondents indicated that there no is interaction between managers and investors the organization.

4.2.3 Forms of Interaction

The study sought to establish the forms of interaction between managers and investors (shareholders) the organization. The findings are presented in the table below.

![Forms of interaction](image)

**Figure 4.3: Forms of interaction**

The study findings established that majority (39%) of the companies used main stream media
as forms of interaction between managers and investors (shareholders), 30% of the companies used Annual General meetings as forms of interaction between managers and investors, 17% of the companies used company newsletters as forms of interaction between managers and investors, 9% of the companies used company websites as forms of interaction between managers and investors and 4% of the companies used company websites as forms of interaction between managers and investors.

4.3 Board Independence

4.3.1 Number of Members’ Board of Directors

The study sought to establish the number of members’ board of directors in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th>No of Board Members</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2-5 members</td>
<td>13%</td>
</tr>
<tr>
<td>6-10 members</td>
<td>52%</td>
</tr>
<tr>
<td>11-20 members</td>
<td>35%</td>
</tr>
</tbody>
</table>

Figure 4.4: Board Independence

From the study findings, majority (52%) of the respondents indicated that there are between 6-10 board of directors members in the organization, 35% indicated that there are between 11-20 board of directors members in the organization while 13% indicated that there are between 2-5 board of directors members in the organization.

4.3.2 Composition of Board Members

The study sought to describe the composition of board members in the organization. The findings are presented in the table below.
Table 4.1: Composition of Board Members

<table>
<thead>
<tr>
<th>Composition of Board Members</th>
<th>Frequency</th>
<th>Percent %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive directors only</td>
<td>4</td>
<td>17</td>
</tr>
<tr>
<td>Non executive Directors only</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Mix of both Executive &amp; Non executive</td>
<td>18</td>
<td>78</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>23</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The study findings established that most (78%) board members in the organization are a mix of both executive & non executive, 17% of the board members are executive directors while as 4% of the board members are non executive directors.

4.3.3 Strongest Voice

The study sought to establish the strongest voice in the selection of Non executive directors in the organization. The findings are presented in the table below.

Figure 4.5: Strongest Voice

According to the study findings 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, 39% of the respondents indicated that the controlling shareholder have the strongest voice in the
selection of Non executive directors while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors.

**4.3.4 Attendance rate for the board meetings**

The study sought to establish the attendance rate for the board meetings in the organization. The findings are presented in the table below.

**Table 4.2: Attendance rate for the board meetings**

<table>
<thead>
<tr>
<th>Attendance Rate</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>51-75%</td>
<td>5</td>
<td>22</td>
</tr>
<tr>
<td>75-89%</td>
<td>11</td>
<td>48</td>
</tr>
<tr>
<td>90-100%</td>
<td>7</td>
<td>30</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>23</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

According to the study findings 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%.

**4.4 CEO/Chair Duality**

**4.4.1 Independence of Chairman of the Board**

The study sought to establish whether the Chairman of the Board was an independent, non-affiliated director in the organization. The findings are presented in the table below.
Figure 4.6: Independence of the Chairman of the Board

From the study findings, majority (52%) of the respondents agreed that the Chairman of the Board was an independent, non-affiliated director in the organization while 48% of the respondents agreed that he was not an independent, non-affiliated director in the organization.

4.4.2 C.E.O as Chairman

The study sought to establish whether the C.E.O is a chairman of the company. The findings are presented in the table below.

Table 4.3: C.E.O as chairman

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>10</td>
<td>43%</td>
</tr>
<tr>
<td>No</td>
<td>13</td>
<td>57%</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 57% of the respondents indicated the C.E.O as the chairman of the company while as 43% of the respondents indicated the C.E.O as not the chairman of the company.
4.5 Board Ownership

4.5.1 Directors’ Remuneration

The study sought to establish whether the company has a written procedure or policies on directors’ remuneration. The findings are presented in the table below.

Table 4. 4: Directors’ Remuneration

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>23</td>
<td>100</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100</td>
</tr>
</tbody>
</table>

From the study findings, all (100%) of the respondents agreed the company has a written procedure or policies on directors’ remuneration.

4.5.2 Independent Director’s Remuneration

The study sought to establish whether the independent director’s remuneration included share options. The findings are presented in the table below.

Figure 4. 7: Independent Director’s Remuneration

From the study findings, most (74%) of the respondents agreed that the independent director’s remuneration includes share options while as 26% of the respondents did not agree that the independent director’s remuneration included share options.
4.5.3 Non Executive Director’s Remuneration

The study sought to establish whether the non-executive director’s remuneration include share options. The findings are presented in the table below.

![Pie chart showing 52% Yes and 48% No.]

Figure 4. 8: Non-Executive Director’s remuneration

According to the study findings 52 % of the respondents indicated that the non-executive director’s remuneration include share options while as 48% of the respondents indicated that the non-executive director’s remuneration does not include share options.

4.5.4 Share Options

The study sought to establish whether the CEO/Chairman given share options in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>8</td>
<td>35%</td>
</tr>
<tr>
<td>No</td>
<td>15</td>
<td>65%</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 65% of the respondents indicated that the CEO/Chairman not given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman was given share options in the organization.
4.5.5 CEO Compensation

The study sought to establish whether the board reviewed CEO compensation annually. The findings are presented in the table below.

![CEO Compensation Chart]

**Figure 4.1: CEO Compensation**

From the study findings, most (61%) of the respondents agreed the board reviewed CEO compensation annually while as 39% of the respondents did not agree that the board review CEO compensation annually.

4.6 Disclosure/Communication

The study sought to establish whether the firms disclose the following in the firm’s web page. The findings are presented in the table below.

**Table 4.6: Disclosure/Communication**

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarterly financial statement</td>
<td>9</td>
<td>39%</td>
</tr>
<tr>
<td>Directors selling or buying shares in the firm</td>
<td>4</td>
<td>17%</td>
</tr>
<tr>
<td>Directors reports</td>
<td>15</td>
<td>65%</td>
</tr>
<tr>
<td>Audited Annual reports</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their Directors selling or buying shares in the
firm statement in the firm’s web page, 65 % of the firms disclose their Directors reports in the firm’s web page and all (100 %) of the firms disclose their Audited annual reports in the firm’s web page.

4.7 Multiple Regression Analysis

The study adopted simple regression guided by the following model:

\[ Y = \beta_0 + \beta_1 (X_1) + \beta_2 (X_2) + \beta_3 (X_3) + \varepsilon \]

Where:-

\( Y = \) is the dependent variable representing information asymmetry between managers and investors \((X_1)\): Board Ownership Concentration is measured by proportion of ownership held by the main shareholder of institutional nature of the quoted company.

\((X_2)\): Board Independence is measured by the proportion of non-executive directors inside the board \((\text{non-executive directors} / \text{total directors})\).

\((X_3)\): CEO Duality is measured by a dummy value of 1 of the company CEO also pairs up as the Board Chair.

\( \varepsilon \): Standard Error term.

The above model was tested and analyzed to determine its suitability to determine the relationship between corporate governance variables above and information asymmetry and the results tabulated below;

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.387(^a)</td>
<td>.7005</td>
<td>.687</td>
<td>.23665</td>
</tr>
</tbody>
</table>

\(^a\) Predictors: (Constant), Board Ownership, Board Independence and CEO Duality

Author: Research data (2014)

From table 4.7, R indicates that there exist a moderate relationship between the independent variables i.e CEO duality, board independence and Board Ownership, and the dependent variable information asymmetry. The coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables) R Square equals 0.7, that is, 70 percent aggregate information asymmetry can be explained through the
combined linear effects of Board Ownership, Board Independence and CEO Duality. In order to test the significance of the model, the study conducted an Analysis of Variance. The findings were as shown below:

**Table 4.8: Analysis of Variance**

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Regression</td>
<td>3</td>
<td>5</td>
<td>.331</td>
<td>5.911</td>
<td>.003a</td>
</tr>
<tr>
<td>Residual</td>
<td>49</td>
<td>40</td>
<td>.056</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>45</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: Constant, Board Ownership, Board Independence and CEO Duality

b. Dependent Variable: Information asymmetry

Author: Research data (2014)

The ANOVAs results, the probability value of .003 were obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry.

**Table 4.9: Coefficients of determination**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>-5.08</td>
<td>-5.23</td>
<td>-6.16</td>
<td>0.048</td>
</tr>
<tr>
<td>Board Ownership</td>
<td>-5.53</td>
<td>0.10</td>
<td>0.140</td>
<td>-5.53</td>
</tr>
<tr>
<td>Board Independence</td>
<td>-6.94</td>
<td>1.027</td>
<td>0.110</td>
<td>-7.37</td>
</tr>
<tr>
<td>CEO Duality</td>
<td>2.98</td>
<td>0.476</td>
<td>0.39</td>
<td>2.33</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Information asymmetry

Author: Research data (2014)
\[ Y = -5.08 - 5.53X_1 - 0.42X_2 - 6.94X_3 + 0.020X_4 + 2.98X_5 \]

where \( Y \) = Information asymmetry

\( B_0 \) = intercept (defines value of Information asymmetry without inclusion of predictor variables)

\( X_1 = \) Board Ownership

\( X_2 = \) Board Independence

\( X_3 = \) CEO Duality

Table 4.9 present results of the simple linear regression of Aggregate Information asymmetry on Board Ownership, Board Independence and CEO Duality. From the findings, the coefficients of aggregate Information asymmetry is negative and significant, indicating that holding Board Ownership, Board Independence and CEO Duality constant Information asymmetry will be -5.08. The study also found that a unit increase in Board Ownership will cause a 5.53 decrease in information asymmetry, further a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, and a unit increase in CEO Duality will further lead to an increase in information asymmetry by a factor of 2.98.

4.8 Interpretation of Results

The study revealed that majority (52%) of the respondents agreed that Chairman is the of the Board an independent, non-affiliated director in the organization while 48% of the respondents agreed that is not of the Board an independent, non-affiliated director in the organization. 57% of the respondents indicated that the C.E.O as the chairman of the company while as 43% of the respondents indicated that the C.E.O is not the chairman of the company. This means that majority of the firms are adopting the CMA proposal to have CEO and Chair being independent. 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%. From the findings, 52% of the respondents indicated that the non executive director’s remuneration include share options while as 48% of the respondents indicated that the non executive director’s remuneration does not include share options.

According to the study findings, 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the
CEO/Chairman given share options in the organization. From the study findings, most (61%) of the respondents agreed the board review CEO compensation annually while 39% of the respondents did not agree the board review CEO compensation annually. Board ownership continue being an incentive used by investors to align the interests of the managers to those of the shareholders. 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their Directors selling or buying shares in the firms’ statement in the firm’s web page, 65% of the firms disclose their Directors reports in the firm’s web page and all (100%) of the firms disclose their Audited annual reports in the firm’s web page.

The findings on the coefficient of determination indicated that R Square equals 0.7, that is, aggregate information asymmetry explain 70 percent of Board Ownership, Board Independence and CEO Duality. In order to test the significance of the model, the study conducted an Analysis of Variance. The findings on the ANOVAs results indicate that the probability value of .003 was obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry. From the findings, the coefficients of aggregate Information asymmetry is negative and significant, indicating that holding Board Ownership, Board Independence and CEO Duality constant Information asymmetry will be -5.08. The study also found that a unit increase in Board Ownership will cause a 5.53 decrease in information asymmetry, further a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, and a unit increase in CEO Duality will further lead to an increase in information asymmetry by a factor of 2.98.

Inferential statistics such as non parametric test which include analysis of variance (ANOVA) were used to test the significance of the overall model at 95% level of significance. According to Mugenda (2008) analysis of variance is used because it makes use of the F – test in terms of sums of squares residual.
CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of key data findings, conclusions drawn from the findings highlighted and policy recommendations that were made. The conclusions and Recommendations drawn were in quest of addressing research objectives of how a firm’s corporate governance affects the level of information asymmetry between managers and investors.

5.2 Summary of Findings

A fundamental issue addressed in this research was to examine the effect of corporate governance on information asymmetry between managers and investors of companies listed in the NSE. Corporate governance attributes examined in this paper are CEO/Chair duality and board independence and Board Ownership. The study finds that there exists a relationship between corporate governance and information asymmetry between managers and investors as discussed below

5.2.1 Board Independence

From the study findings table 4.6, majority (52%) of the respondents indicated that there are between 6-10 board of directors members in the organization while figure 4.4 shows 13% indicated that there are between 2-5 board of directors members in the organization. The study further established that most (78%) board members in the organization are a mix of both executive & non executive, 17% of the board members are executive directors while as 4% of the board members are non executive directors. 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, 39% of the respondents indicated that the controlling shareholder have the strongest voice in the selection of Non executive directors while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors. According to the study findings 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board
meetings was between 51-75%.

Further analysis from the multiple regression indicated that the coefficients of aggregate Information asymmetry was significant and negatively related, indicating that a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, while the level of significance was ≤5%. These results collaborated with previous research that found that non-executive directors act as a reliable mechanism to diffuse agency conflicts between managers and owners (Fama & Jensen 1983). They are viewed as providing the necessary checks and balances needed to enhance board effectiveness (Franks, Mayer, & Renneboog, 2001). The results correspond to Chen & Jaggi (2000) who provide empirical evidence of the relationship between the proportion of non-executive directors on the board and corporate disclosure. The results of the research findings verify the relevance of non-executive directors as a governance mechanism that enhances the board’s capacity to ameliorate agency conflict between owners and managers.

5.2.2 CEO Duality

From the study findings, most 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman given share options in the organization. 61% of the respondents agreed the board review CEO compensation annually while as 39% of the respondents did not agreed the board review CEO compensation annually. 39 % of the firms disclose their quarterly financial statement in the firm’s web page, 17 % of the firms disclose their Directors selling or buying shares in the firm statement in the firm’s web page, 65 % of the firms disclose their Directors reports in the firm’s web page and all (100 %) of the firms disclose their Audited annual reports in the firm’s web page. Majority (52%) of the respondents agreed that Chairman is the of the Board an independent, non-affiliated director in the organization while 48% of the respondents agreed that is not of the Board an independent, non-affiliated director in the organization. 57 % of the respondents indicated that the C.E.O as the chairman of the company while as 43 % of the respondents indicated that the C.E.O is not the chairman of the company.

From the findings of the regression analysis, aggregate Information asymmetry is positive and
significant in relation to CEO duality, indicating that information asymmetry increased with an increase in CEO/Chair Duality. The results indicated a 2.98 coefficient at <0.5% significance level. Within the context of corporate governance, the major issue often discussed is whether the chair of the board of directors and CEO positions should be held by different persons (dual leadership structure) or by one person (unitary leadership structure). Agency theory suggests that the combined functions (unitary leadership structure) can significantly impair the boards’ most important function of monitoring, disciplining and compensating senior managers. It also enables the CEO to engage in opportunistic behavior because of his/her dominance over the board. The results are consistent with Sampson (1992) who empirically studied the relationship between corporate governance and disclosure quality and found that the extent of disclosure was higher in firms with dual leadership structures.

5.2.3 Board Ownership

From the study findings, all (100%) of the respondents agreed the company has a written procedure or policies on directors’ remuneration. Most (74%) of the respondents agreed that the independent director’s remuneration include share options while as 26% of the respondents did not agreed that the independent director’s remuneration include share options. 52% of the respondents indicated that the non executive director’s remuneration include share options while as 48% of the respondents indicated that the non executive director’s remuneration does not include share options. According to the study findings out 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman given share options in the organization.

According to the study findings, 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors. 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%.

From the findings of the regression analysis, Board Ownership was negative and significant in
relation to aggregate information asymmetry, indicating that information asymmetry decreased with an increase in Board Ownership. The results indicated a -5.53 coefficient at <0.5% significance level. The results support the agency theory predicts that there is a positive association between management interests and the level of voluntary disclosure. Warfield et al (1995) provided that evidence supporting this contention in their findings that the extent of shareholding by management is positively associated with the amount of information disclosed about earnings. The above reasoning suggests that firms with higher Board Ownership will be associated with greater levels of disclosures and hence lower degree of information asymmetry.

The findings on the ANOVAs results indicate that the probability value of .003 was obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry.

5.3 Conclusions
The relevance of corporate governance cannot be over-emphasized since it constitutes the organizational climate for the internal activities of a company. Corporate governance brings new outlook and enhances a firm’s corporate entrepreneurship and competitiveness. The study examined the role of corporate governance characteristics i.e. board composition, board independence and CEO/Chair duality and its effect on information asymmetry between managers and investors in companies listed at the NSE in Kenya.

From table 4.9, it was evident that there is a negative relationship between Board Independence information asymmetry, since their coefficient estimates are -6.94 at 0.00 the level of significance. It can be concluded therefore that from the study the level Board Independence significantly affected information asymmetry between managers and investors. These research findings are consistent with earlier research by Kihara (2006) who observed that unlike inside directors, outside directors are better and able to challenge the CEO hence a minimum of three outside directors is required on the board. It also concurs with Jensen (1993) who voices his concern that, lack of independent leadership makes it difficult for boards to respond to failure in top management team. The study concluded that board members in the organization are a mix of both executive & non executive and that the board or its nominated committee has the strongest voice in the selection of Non executive directors.
On CEO/ chair duality the findings revealed a positive coefficient of 2.98 thus a positive relationship to information asymmetry between managers and investors. The significance level was 0.002. Data collected revealed that the CEO/chairman proposed share options in the organization while as the board review CEO compensation annually. The study concluded that CEO duality is the other corporate governance index that is significantly related to the information asymmetry. This result is consistent with Gul and Leung (2004) who found that CEO duality is positively associated with international firm acquisition. His research showed that, international acquisition had a significant impact on shareholder value. He found a positive relationship between a firm leadership structure and its announcement of foreign acquisitions. Huafang and Jianguo (2007) provided evidence that CEO duality is associated with lower disclosure.

In addition the study also concluded that a unit increase in Board Ownership will cause a -5.53 decrease in information asymmetry, meaning that there exists a negative relationship between the two at a significance level of 0.001. The company’s have a written procedure or policies on directors’ remuneration and that the non executive director’s remuneration include share options also, the firms disclose their directors reports in the firm’s web page while all of the firms disclose their Audited annual reports in the firm’s web page. Foo and Zain (2010) examined the association between bids-ask spread, a market-based measure of information asymmetry, and board characteristics among 227 firms listed on the Main Board of Bursa Malaysia. The results revealed that board independence is negatively related to the level of information asymmetry.

5.4 Limitation of the Study

The model may misestimate outcomes, because it assumes that corporate governance characteristics affect information asymmetry. The proposed indicators of corporate governance characteristics i.e. Board Ownership, Board Independence and CEO Duality may have some limitations. Whilst their use can be theoretically justified, neither construct can be accurately measured empirically.

If other corporate governance characteristics contribute to the integrity of information asymmetry, then parameter estimates may be biased. Given that the model is tested using
archival data, the data are likely to contain the influences of several factors that are not accounted for in the model. Isolating the impact of the constructs on the market’s reaction may prove difficult. The model thus applies only to large firms where there is a clear separation between ownership and management.

5.5 Recommendations

This study aimed at investigating how a firm’s corporate governance, i.e Board Ownership, board independence and CEO/chair duality affects the level of information asymmetry between managers and investors. The need to carry out this study arose from the fact that listing of companies in the NSE has continued to increase and corporate governance is a key requirement that has to be adhered. A research gap thus existed as limited researches from those reviewed had been done on the effect of corporate governance on the information asymmetry of listed companies in Kenya’s Nairobi Securities Exchange (NSE).

From the findings and conclusions, the study recommends the need for effective corporate governance practices at senior managerial level of quoted companies in Kenya to contribute to reduced information asymmetry and hence improve on actual firm liquidity and avert possible collapse of public organizations in Kenya. It is clear from the findings that corporate governance does have an effect on information asymmetry between managers and investors. The government should therefore enforce the measures it has laid down to ensure listed companies are following them so that the recommended governance structures are followed. The concerned ministries should also be very keen in the supervisory role through the relevant committees to ensure that all regulations are enforced as required e.g. books of accounts are well kept and audited as they should be.

In the Kenyan context, over the past few years there have been concerns, especially among the regulators, that companies are performing poorly and some failing partly due to weak corporate governance structure, and one of such attributes is the combined role of board chair and CEO. The concern was that such enormous powers vested in an individual make the board ineffective in its oversight and monitoring role. For example, with regard to the board leadership the Capital Markets Authority (CMA) in the Guidelines of Corporate Governance Practices, expressed a view that companies should consider separating the role of the chair and CEO, and
where the two roles are combined, to present the rationale for such a leadership structure in the annual report to the shareholders. In addition, by 1997, the Central Bank of Kenya initiated a review of banks’ board structures and as part of the review urged the companies in the financial sector to separate the roles of board chair and CEO. It appears most companies embraced this advice from the regulators and changed their board leadership structure such that 43% have separated the role of board chair and CEO. Thus, because of this substantial change in the board leadership structure, there was limited differentiation among sample firms for this variable to have statistical significance in the pooled regression analysis.

An opportunity arises for further research in the development of an experiment that would identify how average investors measure information asymmetry. This is because it is unclear whether investors use abnormal accruals, as measured by aggregate accruals approach, as a representation of information asymmetry. The complexity of such models suggests that the average investor is unlikely to use this measure. The researcher also recommends future researchers to explore association between corporate governance characteristics and information asymmetry for non-listed companies in Kenya and large family ran private companies in Kenya.
REFERENCES


Kesner, I. F. & Dalton, D. R. (1986). Boards of directors and the checks and (im)balances of the


APPENDIX I: LETTER OF INTRODUCTION.
August 09th 2014.
Mary Wanjiku Ndungo
C/o University of Nairobi
P.O. Box 30197 00100
Nairobi.
Dear Respondents,

RE: ASSESSING THE EFFECT OF CORPORATE GOVERNANCE ON INFORMATION ASYMMETRY BETWEEN MANAGERS AND INVESTORS:
I am a postgraduate student at the University Of Nairobi School of Business. I am undertaking the above research project in partial fulfillment of the requirements for the award of the MBA degree. In order to achieve this, I humbly request your assistance in filling the attached questionnaire to generate data for the study. Any information you provide is purely for the purposes of this project thus your responses will be treated in strict confidence and in no circumstances will your name be mentioned in the report. Further confidentiality will be ensured through the necessary coding of the survey findings. A copy of the research report will be submitted to you upon request.
Your assistance to this regard will be highly appreciated.
Thank you in advance,

Yours Sincerely,

Mary Ndungo
M.B.A STUDENT

Dr Ogilo
SUPERVISOR
APPENDIX II: QUESTIONNAIRE

SECTION A

This section of the questionnaire refers to background and general information regarding your company. Although we are aware of the sensitivity of the questions in this section, the information will allow us to compare different respondents. Once again, I assure you that your response will remain anonymous. Your cooperation is appreciated.

1. What is your company’s name?
   …………………………………………………………………………………

2. Indicate your major background (You may choose more than one if applicable
   a. Business Management [ ] b. Accounting/Finance [ ] c. Other: Please indicate--------

3. What is the main business of the company?
   …………………………………………………………………………………

4. How long has your company been in existence?
   a. 0-5 years [ ] 6-10 years [ ] Over 10 years [ ]

5. Is there interaction between managers and investors (shareholders?)
   Yes [ ] No [ ]

6. If yes, in what forms?
   Annual General Meetings [ ] Company Newsletters [ ] Mainstream Media (Radio,
   Television, Newspapers) [ ] Company Website [ ] Social Media/Platforms [ ]
   Any other (Please Specify) [ ]
   …………………………………………………………………………………
   …………………………………………………………………………………

SECTION B

This section of the questionnaire explores aspects of Board within your organization.

I. Board Independence

7. How many members of the board of directors do you have in your company?
   a. 2-5 [ ] b. 6-10 [ ] c. 11-20 [ ] c. More than 20 [ ] (please indicate)
   ……………

8. Which of the following describes the composition of your board members:
   a. Executive directors only [ ] b. Non executive Directors only. c. Mix of both a & c [ ]

10. If your answer above is c, please indicate the number of each
    Executive ………
Non Executive (Independent) ……

11. Who is the strongest voice in the selection of Non executive directors?
   a. Board or its nominated Committee [ ] b. CEO c. Controlling Shareholder

12. On average what is the attendance rate for the board meetings?
   a. 90-100% [ ] b. 75-89% c. 51-75%

II. CEO/Chair Duality

13. Is the Chairman of the Board an independent, non-affiliated director?
   Yes [ ] No [ ]

9. Is the C.E.O, a chairman of the company
   Yes [ ] No [ ]

10. Does either of the two above in (Q11) act on behalf of the other
    Yes [ ] No [ ]

III. Board Ownership

11. Does your company have a written procedure or policies on directors remuneration
    Yes [ ] No [ ]

12. Does the independent director’s remuneration include share options?
    Yes [ ] No [ ]

13. Does the Non executive director’s remuneration include share options?
    Yes [ ] No [ ]

14. Is the CEO/Chairman given share options?
    Yes [ ] No [ ]

15. Does the board review CEO compensation annually
    Yes [ ] No [ ]

IV. Disclosure/Communication

16 Does your firm disclose the following in the firm’s web page?
   (i) Quarterly financial statement Yes [ ] No [ ]
   (ii) Audited Annual reports Yes [ ] No [ ]
   (iii) Directors reports Yes[ ] No [ ]
   (iv) Directors selling or buying shares in the firm Yes [ ] No [ ]

Thank you for your co-operation in completing this questionnaire. Kindly return the questionnaire as specified in the cover letter.
APPENDIX III: GUIDE TO COLLECT SECONDARY DATA

Asymmetric information variables

SPREAD (+)- The annual mean value of the daily percentage spread between bid and ask prices

VOLATILITY (+)- The annual average standard deviation of the day-over-day difference in the daily price change

VOLUME (-) - The annual average of daily market value of trading volume

Corporate governance variables

BSIZE (-) - The number of directors serving on the board of directors

NONEXESIZE (-)- The number of non-executives serving on the board of directors

SPLIT (-)- A dummy variable that takes on a value of one if the CEO and Chairman are different persons, zero otherwise

NONEXECHAIR (-)- A dummy variable that takes on a value of one if the chairman is a non-executive, zero otherwise
## Secondary data collection sheet

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<td>VOLATILITY (+):</td>
<td>SD OF DAILY PRICE CHANGES</td>
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<tr>
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<td>BSIZE (-):</td>
<td>NO. OF DIRECTORS</td>
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<tr>
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<td>NONEXESIZE (-):</td>
<td>NON-EXEC DIRECTORS</td>
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<td>8</td>
<td>SPLIT (-):</td>
<td>1=CEO &amp; DIRECTOR ARE SAME ZERO OTHERWISE</td>
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<td>9</td>
<td>NONEXECHAIR (-):</td>
<td>1=CHAIRMAN IS NON-EXEC ZERO OTHERWISE</td>
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</table>
EFFECTS OF CORPORATE GOVERNANCE ON INFORMATION ASYMMETRY BETWEEN MANAGERS AND INVESTORS IN FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

BY

MARY WANJIKU NDUNGO
D61/70574/2007

A RESEARCH PROJECT REPORT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER 2014
DECLARATION

This is my original work and has not been presented for award of any degree in any university.

Signed........................................... Date..................................................

Mary Ndungo

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

Signed........................................... Date..................................................

Lecturer,
Department of Finance & Accounting,
School of Business,
Dr. Fredrick Ogilo
DEDICATION

This research project report is dedicated to my Dad and Mum Mr. and Mrs. Absalom Ndungo who have stood by me, believed in me and gave me motivation during my academic pursuits and the research work.
ACKNOWLEDGEMENTS

First, all glory and honor goes to Almighty God. He has given me good health and the finances needed to successfully complete this project. Through the process I have continuously drawn strength from the knowledge that God has a good plan for me and that my destiny was and remains in His hands. Without Him I can do nothing.

I would like to express my deep appreciation to my supervisor, Dr. Fredrick Ogilo for the insightful guidance and assistance at every stage of writing this research project. I will be eternally indebted to him for persevering with me as my advisor throughout the time it took me to complete this research project. The faculty members of staff at the University of Nairobi Mombasa campus, who generously give their time and expertise to better my work, I thank them for their contribution and their good-natured support.

I must acknowledge as well the many friends, colleagues, students and other librarians who assisted, advised, and supported my research and writing efforts over the years. Especially, I need to express my gratitude and deep appreciation to my special friend Mr. Douglas Bariu, whose friendship, knowledge, and wisdom has supported and enlightened me over the many years of our friendship. He consistently helped me keep perspective on what is important in life and showed me how to deal with reality.
LIST OF ACRONYMS

NSE- Nairobi Stock Exchange
CMA- Capital Markets Authority
CBK- Central Bank of Kenya
CEO- Chief Executive Officer
CAPM- Capital Asset Pricing Model
CDS account- Central Depository and Settlement account
SIIA- Software and Information Industry Association
FTSE- Financial Times Securities Exchange
ATS- Automated Trading System
FISD- Financial Information Services Division
ROE- Return on Investment
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CHAPTER ONE: INTRODUCTION ................................................................................................................... 1

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ABSTRACT

This study aimed at investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The specific objectives of the study were to find out the effect of Board Ownership on the information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange, to investigate how board independence influences information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange and to determine how CEO duality affects information asymmetry between managers and investors in firms listed at NSE. This study was conducted using explanatory research design. The target population was 62 listed companies at the Nairobi Securities Exchange from which the data was drawn. The sample comprised of 32 firms listed in the NSE by the year 2003. Secondary data was collected using a questionnaire which contained both open and closed ended questions. A pilot test was first conducted to test the reliability and the validity of the questionnaire as an instrument. A simple random technique was used to select one staff from the corporate affairs department from each company who were the respondents. Secondary data was collected from companies’ websites, publications and data bought from the NSE. Secondary data collected was analyzed using multiple linear regression equation and the method of estimation was Ordinary Least Squares (OLS) so as to establish the relationship between corporate governance variables and information asymmetry. In order to test the significance of the model, the study conducted an analysis of variance. The results of the ANOVAs test indicate a significant value of .003 and a confidence 99 percent which was obtained indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry. Results from the coefficient of determination test indicated that R Square equals 0.7, that is, changes in aggregate information asymmetry could be explained up to 70 percent by the linear relationship between Board Ownership, Board Independence and CEO/Chair Duality. Findings from the data analyzed and tabulated from the questionnaires collected revealed 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 100% of the respondents indicated that their board consisted of both executive and non executive member and as such exercised some level of independence. Most (61%) of the respondents agreed the board review CEO compensation annually and 65% indicated that this compensation included share options. 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their directors reports in the firm’s web page, 65% of the firms disclosed their directors reports in the firm’s web page and all (100%) of the firms disclose their audited annual reports in the firm’s web page. From the results of the ordinary least square (OLS), Board Ownership and Board Independence were significantly negatively related to information asymmetry i.e. coefficients of -5.53 and -6.94 respectively while CEO/Chair duality was positively related to information asymmetry at +2.98. The levels of significance for all the variables were, 0.002, 0, and 0.001 respectively indicating a more than 97% confidence level. The results agree with Raheja (2005) and Myerson (1987) who found the existence of significant relationship between corporate governance variables aforementioned above in firms. The study recommends future researchers to study the association between corporate governance characteristics and information asymmetry for non-listed companies in Kenya and large family ran private companies in Kenya.
CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Corporate governance is the system that defines how organizations are to be directed and controlled by the agents. It’s a set of relationships between company directors, shareholders and other stakeholder’s as it addresses the powers of directors and of controlling shareholders over minority interest, the rights of employees, rights of creditors and other stakeholders (Muriithi, 2009). Dechow et al. (1996) defines corporate governance as an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity (Dechow, 1996). It is viewed as ethics and a moral duty of firms and is the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity, corporate accountability and transparency with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders (Gul & Leung, 2004).

The information asymmetry is rooted in the Agency Theory which explains problems arisen from the separation of ownership and management (Jensen and Meckling, 1979). This problem also inevitably transcends in corporate governance systems, where managers of the company (board of directors) are in possession of rather complete information on functioning of the company, which outside shareholders do not have. Since information asymmetry leads to ineffective decisions in corporate governance system, an effective information policy should be implemented to provide easy and equal access to information not only to shareholders, but also for all stakeholders (Ferma and Jensen, 1983). The optimal corporate governance system aims to give shareholders confidence that their company is managed efficiently, to create the highest possible profit and to preserve a firm’s reputation (Glosten and Milgrom, 1985).

The Nairobi Securities Exchange (N.S.E) is home to the largest companies in Kenya as well as several multinational firms cross listed in other global markets. The clamor for efficient governance structures and disclosure has continued to be of interest for both local and foreign investors. This paper intends to evaluate the effect of the firm’s corporate governance structures on one important firm characteristic- asymmetric information, that is the extent to which
managers know more about a firm’s value than does the rest of the world. The study will focus on firms listed in the Nairobi securities exchange.

1.1.1 Corporate Governance

The concept of governance is not new. It is as old as human civilization. Simply defined it is the process of decision-making and the process by which those decisions are implemented. Governance can be used in several contexts such as corporate governance, international governance, national governance and local governance (Liao, 2001). Having defined governance as the process of decision making and implementation, a further analysis of governance focuses on the formal and informal actors involved in decision-making and implementing the decisions made as well as the formal and informal structures that have been set in place to arrive at and implement the decision.

Corporate governance refers to the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs (Klein, 2002). Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment. Governance is a mechanism for monitoring the actions, policies and decisions of corporations. Governance involves the alignment of interests among the stakeholders.

1.1.2 Information Asymmetry

Information asymmetry can be defined as Information differences across investors (or groups of investors), and between investors and managers. This information differential has been a long standing concern among security exchange regulators and as such led them to enact regulations regarding fair disclosures which are intended to equalize information across investors by preventing companies from making disclosures to select groups of investors and analysts. Barako et al. (1998) assert that selective disclosure allows those have the advantage of certain market information beforehand to make a profit or avoid a loss at the expense of those kept in the dark. This practice leads to loss of investor confidence particularly small investors become
unwilling to invest in the fear that insiders gain at their expense; this, in turn, increases firms’ cost of capital to the extent that the risk in the economy has to be borne by fewer investors.

The issues of whether and how information differences across investors affects prices and the cost of capital cannot be addressed in conventional models of asset pricing, such as the Capital Asset Pricing Model (CAPM), this is because these models generally assume investors have homogeneous beliefs. Various studies that have developed models of capital market equilibrium where investors have heterogeneous information, reach different conclusions regarding the effects of information on the cost of capital and price of shares. Leland (1992) finds that allowing insider trading will, on average, increase stock prices despite the fact that the presence of insiders increases information asymmetry in the economy. Although he does not express his analysis in terms of cost of capital, higher stock prices on average are equal to a decrease in firms’ cost of capital. In contrast, O’Hara (2003) and Easley and O’Hara (2004) conclude that information asymmetry will increase firms’ cost of capital. These papers argue that less informed traders recognize they are at an information disadvantage and will try to hold assets where their disadvantage is less. This drives down the price of securities with high degrees of asymmetry.

1.1.3 Corporate Governance and Information Asymmetry

Corporate governance has become an issue of importance worldwide. Corporations have a vital role to play in promoting economic development and social progress. It is the engine of growth internationally, and increasingly responsible for providing employment, public and private services, goods and infrastructure. The efficiency and accountability of the corporation is now a matter of both private and public interest. Good corporate governance structures are essential in order to attract investors, by assuring them that their investments will be secure and managed in a transparent and accountable manner, as well as creates competitive and efficient companies and markets (Qian et al, 2009).

A key ingredient of an efficient market is information. Information is a stream of data coming to an entity, which may be converted into a resource of knowledge to help in a decision making process. The optimal decision depends on the access to relevant information. In the context of capital markets, corporate insiders generally have superior information about the current
condition and future prospects of the firm, compared to outside investors. The existence of information asymmetries across investors can lead to adverse private and social consequences including low investor participation, high transaction costs, thin markets and decreased gains from trade (Lev, 1988). Recognizing the adverse consequences of information asymmetry and agency problems, researchers have suggested several solutions, among which corporate governance is an important mechanism (Jensen and Meckling, 1976; Shleifer and Vishny, 1986).

The role of corporate governance is to align the interests of managers with those of shareholders through appropriate bonding and monitoring. In particular, the board of directors, elected by the shareholders, is charged with evaluating and disciplining the management team. Within their fiduciary duty to shareholders, directors have a governance responsibility to ensure greater transparency when it is in the shareholders’ interests. Since shareholders, in general, are outsiders who are at an information disadvantage about the company, corporate governance principle demand an effective and representative board of directors may be able to move the managers toward disclosing more information to the market participants and in effect eliminating and or smoothing market anomalies.

1.1.4 Nairobi Securities Exchange

The equity market in Kenya is not young but exhibits the characteristics of an underdeveloped but developing securities market. Market players have less information compared to those in developed economy. These characteristics essentially make this market relatively volatile. Nairobi Securities Exchange’s (NSE) equity market differs from those developed markets in such characteristics on firm levels as the ownership structure and corporate governance standards. The World Bank classifies NSE as both an emerging and a frontier market. A frontier market refers to a relatively small and liquid market even by the emerging market standards (Nganga, 2003).

The Nairobi Stock Exchange was set up in 1953 in Kenya, as a regional exchange for Kenya, Tanganyika, Uganda and Zanzibar. After independence in these countries, the exchange became Kenya’s national stock exchange. The stock market has developed over the years with 54 listed companies by the close of 2009. Nairobi Stock Exchange has also moved from the open-outcry trading system to Automated Trading System (ATS) in order to improve the Market’s both
informational and functional efficiency. The exchange has three market tiers: main investments market segments, alternative market segment and fixed income securities segment (NSE, 2009).

In 2011, the Nairobi Stock Exchange Limited changed its name to the Nairobi Securities Exchange Limited. The change of name reflected the strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments. In the same year, the equity settlement cycle moved from the previous T+4 settlement cycle to the T+3 settlement cycle. This allowed investors who sell their shares, to get their money three (3) days after the sale of their shares. The buyers of these shares will have their CDS accounts credited with the shares. At the same time, it became a member of the Financial Information Services Division (FISD) of the Software and Information Industry Association (SIIA). Later, the delayed index values of the FTSE NSE Kenya 15 Index and the FTSE NSE Kenya 25 Index were made available on the NSE website www.nse.co.ke. The new initiative gives investors the opportunity to access current information and provides a reliable indication of the Kenyan equity market’s performance during trading hours (NSE, 2012).

1.2 Research Problem

Corporate governance has been an important part of Company Law for many decades even before its various codes were drawn. This owes to separation of ownership and management of companies whereby fiduciary relationship exist between the shareholders as the principals or owners and directors as the agents or management (Muriithi, 2009). One important influence of governance is information disclosure. Existing literature suggests that a firm’s asymmetric information environment has an important relation with governance mechanisms. A number of papers make the case that the intensity of board monitoring should decrease with the extent of asymmetric information. For example, Raheja (2005) models the size and composition of the board and demonstrates that firms optimally employ less independent boards when it is difficult for outsiders to verify projects. Harris and Raviv (2008) also argue that an insider - controlled board may be optimal when insiders have important information relative to that of outsiders.

Recognizing the adverse consequences of information asymmetry and agency problems, researchers have suggested several solutions, among which corporate governance is an
important mechanism (Jensen & Meckling, 1976; Shleifer & Vishny, 1986). The role of corporate governance is to align the interests of managers with those of shareholders through appropriate bonding and monitoring. In particular, the board of directors, elected by the shareholders, is charged with evaluating and disciplining the management team.

In Kenya, a number of problems relating to corporate governance have been identified. The problems range from errors, mistakes to outright fraud. The origins of the problem range from concentrated ownership, weak incentives, poor protection of minority shareholders, to weak information standards (Mwangi, 2012). With such an environment in the background, the interest of both the minority shareholders and creditors could be compromised and managed to be skewed towards the interest of such block shareholders. Consequently, the issue of information asymmetry arises. Companies have crumbled right in the eyes of shareholders who all along had little or no information regarding the downfall, yet they are the owners Bagehot (1971) thus the need to monitor corporate governance structures in organizations. As earlier intimated the Kenya Capital Market Authority is doing a lot to enforce corporate governance structure and disclosure requirement so as to create investor confidence and as such there has been an upsurge of information disclosed by corporate to meet the needs of local and foreign investors (Mwangi, 2012).

In Kenya prior researches have studied the link between corporate governance and its effect on company performance, return on investment, and information disclosure among other factors as well as analyzing different governance structures in different industries. Alice (2008) while studying the relationship between corporate governance and return on investment (ROE), found out that there was a positive relationship between ROE, board size and board composition. These research findings concurred with Kihara (2006) who observed that unlike inside directors, outside directors are better and able to challenge the CEO hence a minimum of three outside directors were required on the board. Izan, Hancock and Barako (2006) studied the relationship between corporate governance and voluntary disclosure in Kenyan companies and concluded that the presence of an audit committee was a significant factor associated with the level of voluntary disclosure, and board independence was found to be significantly negatively associated with the extent of voluntary disclosure. In contrast, board leadership structure appeared not to have a significant influence on the level of voluntary disclosure by companies.
The above studies among others though have studied effects of corporate governance, this paper seeks to contribute to the body of research and directly examine the relationship between corporate governance and its effect on information asymmetry in the emerging Kenyan securities market. A research gap exists as limited researches have been done on the effect of corporate governance on the information asymmetry of listed companies in Kenya’s Nairobi Securities Exchange (NSE).

The need to carry out this study arose from the fact that listing of companies in the NSE has continued to increase and corporate governance is a key requirement that has to be adhered. Shareholders are increasingly becoming educated and informed about how the securities exchange market works. They are now more than ever aware that disclosure information has an influence the value of their investments (Diamond and Verrecchia, 1991). It was therefore important to assess if the corporate governance structures put in place by the listed firms have an impact on information asymmetry between managers and investors. This paper sought to answer the questions: Do firms’ governance structures through Board Ownership affect information asymmetry between managers and investors? Does board dependence influence information asymmetry between stockholders and managers? Does CEO duality have an effect on the level of information asymmetry between managers and investors?

1.3 Objectives of the Study

This study aimed at investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The study was guided by the following specific objectives:

i. To find out the effect of Board Ownership on the information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

ii. To investigate how board independence influences information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

iii. To determine how CEO duality affects information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

1.4 Value of the Study

The findings of this study would help managers to evaluate and appreciate what benefits they
could accrue as a result of disclosure of board processes as well as implementing solid corporate governance structures. They will understand how strategic use of corporate governance can increase and create value for the same investors, which is the main goal for the listed companies. Shareholders will realize the importance of demanding as well ensuring corporate governance structures are functional within the organization. They will understand how variables such as board Independence, CEO/Chair duality, and Board Ownership information asymmetry between them and their managers, as well as how information available to them can affect their decision making as investors. They also in annual general meetings will be in a position to demand transparency and be privy to board processes.

The stock market regulator (Capital Market Authority) will also use the findings in the implementation and development of regulations aimed at executing its mandate of promoting market confidence, investor protection and access to financial services within capital markets in Kenya and the region through effective regulation and innovation. Researchers and scholars also get valuable reference material for future studies who would wish to venture into this area of study. Findings from this study have laid a basis for empirical evidence on the effects of corporate governance on information asymmetry.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents the theoretical literature and examines the various theories that contribute to and inform corporate governance, its determinants i.e. Board Ownership, independence and CEO/chair duality. It will also review extant empirical literature relating to corporate governance and information asymmetry.

2.2 Theoretical Review

The theories upon which the concept of corporate governance draws its foundation and the areas it encompasses, date form much earlier. These theories are also drawn from a variety of disciplines such as finance, law, organizational behavior among others.

2.2.1 Agency Theory

The agency theory identifies the agency relationship between an agent and a principle (Jensen & Meckling, 1979; Ferma & Jensen, 1983). Jensen and Meckling (1979) assume that as agents do not own the corporation’s resources, they may commit ‘moral hazards’ (such as shirking duties to enjoy leisure and hiding inefficiency to avoid loss of rewards) merely to enhance their own personal wealth at the cost of their principals. There also develops a problem of information asymmetry whereby the principle and the agent have access to different levels of information, in reality this means that the principle will be at a disadvantage because the agent has more information.

In the context of corporate governance, agency theory views corporate governance mechanisms especially board of directors as being an essential monitoring device to ensure that any problem that may be brought about by the agency conflict may be minimized (Gul and Leung 2004). In theory, the board of directors is directly elected by shareholders at the company’s annual general meeting (AGM). If these directors wish to stay in their jobs they take decisions which maximize the wealth of their shareholders. In his literature review, Harris (1994) contends that company boards have evolved as part of the market solution to the problem of contracting within organizations. Fama and Jensen (1983) argued that effective corporate boards would be
composed largely of outside independent directors holding managerial positions in other companies. They argued that effective boards had to separate the problems of decision management and decision control. However, if the CEO was able to dominate the board, separation of these functions would be more difficult, and shareholders would suffer as a result. Outside directors, he contended, are able to separate these functions and exercise decision control, since reputational concerns, and perhaps any equity stakes, provides them with sufficient incentive to do so. Corporate boards should act as monitors in disagreements amongst internal managers and carry out tasks involving serious agency problems.

2.2.2 Transaction Cost Economies

This theory views the firm itself as a governance structure. It further emphasizes that the choice of an appropriate governance structure can help align the interests of directors and shareholders. This theory looks at the various investments projects available to a firm and the various ways in which these projects can be cost effectively financed either through debt of equity. According Williamson’s (1988) argument, the solution to the problem of costly financing of highly specific assets with debt is to be found in the invention of equity.

In his literature review Lev (1988) contends that the equity governance structure has three important properties. First, similarly to Agency Theory shareholders bear a residual claiming status. Second, the equity contract lasts for the duration of the life of the corporation. And third, a safeguard in the form of a board of directors is created and awarded to equity-holders. According to this view, the board bears a decision-review and monitoring relation to the firm’s management, including the review and monitoring of management’s investment policy.

2.2.3 Stakeholders Theory

The shareholder model of corporate governance relies on the assumption that shareholders are morally and legally entitled to direct the corporation since their ownership investment is an extension of their natural right to own private property (Beasely, 1996). Byard(2006) in his literature review however notes that the idea that the shareholders govern the corporation is largely a fiction’, because in reality executives exercise the highest power. Dechow et al. (1996) argue that executives can and should be made more accountable and responsive to some groups other than themselves. Stakeholders’ theory takes into account a wider group of constituents
rather than focusing on shareholders, then the governance structure may provide for some direct representation of the stakeholder groups (Shleifer and Vishny, 1997).

One premise of the stakeholder’s theory is that the stakeholders have vested interests in the firm. Shareholders on the other hand have a residual interest on the firm, that is, a right to the free cash flow ones all the stakeholders (debt holders, employees, suppliers) have been paid. Freeman (1984) posits that successful managers must systematically attend to the interests of various stakeholder groups. This “enlightened self-interest” position has been expanded upon by Chen (2000) who believes that the interests of stakeholders have inherent worth irrespective of whether these advance the interests of shareholders. Under this viewpoint, the success of a corporation is not merely an end in itself but should also be seen as providing a vehicle for advancing the interests of stakeholders other than shareholders. It is therefore in the shareholders best interest to ensure that all the firm’s resources are utilized to their maximum effect and thus benefiting even the stakeholders. Stakeholder and shareholders may require the firm to have different corporate governance structures and monitoring mechanisms as they deem favorable to secure their interests (Claessens, 2003)

2.2.4 Stewardship Theory

In this theory, the directors of the firm are viewed as stewards of the company’s assets. They are such inclined to act in the best interest of the shareholders (Donaldson, 1990). They argue that unlike the agency theory whose thrust was an accent on managerial “opportunism” by having a board chair different from the CEO and using incentives to bind the CEO to the shareholders interests, theirs stresses on the benefit of having facilitative authority structures that unified the role of the CEO and Chair held by one person. The emphasis was not on placing management under ownership control but empowering managers to autonomously execute decisions.

It is to be noted that corporate governance continues to develop and draw its framework from a multiple of disciplines. The main theory however from which it has mainly drawn it development is the agency theory. All other theories come into play as companies increasingly become aware that they cannot operate in isolation thus the emergence and inclusion of other theories highlighted above (Donaldson 1990).
2.3 Determinants of Corporate Governance

Corporate governance being the process of decision making and implementation, it also focuses on the formal and informal parties involved in both decision-making and implementation of the decisions made. These formal and informal structures that have to be set in place to arrive at successful implementation are based on three indicators of the governance structures, these being Board Ownership, board independence and CEO duality.

2.3.1 Board Ownership

Baghat et al. (2002) propose that Board Ownership is a measure of corporate governance and found that it had a direct relation to corporate performance. They argue that Incentive-based economic models of managerial behavior motivate governance features and structures. In agency models, a conflict of interests between managers and shareholders cause managers to take actions that are costly to shareholders. Contracts are not sufficient enough to stop managers from engaging in pricey activities if shareholders are unable to observe managerial behavior directly. Board Ownership structures thus come into play. Ownership by the manager is used to induce managers to act in a manner that is consistent with the interest of shareholders.

Proponents of the adverse selection models on the other hand are motivated by the hypothesis of differential innate ability that cannot be observed by shareholders. What this means is, ownership may be used to bring on revelation of the manager's private information about cash flow or her ability to generate cash flow, which cannot be observed directly by shareholders (Myerson, 1987). From the above two models, some features of corporate governance may be interpreted as a characteristic of the contract that governs relations between shareholders and managers. Governance is affected by the same unobservable features of managerial behavior or ability that are linked to ownership and eventually performance.

2.3.2 Board Independence

The board of directors and executive management are two significant components of a firm’s governance progression. Several intimately related governance issues of the board and management include the responsibility, structure and independence of the board, and the management contract. The board seems to be an imperative internal device for resolving the agency tribulations, since it is primarily responsible for recruiting and monitoring the executive
management to defend the interests of the shareholders and other stakeholders. Prowse (1994) notes that the board makes a connection between managers and investors by taking a leadership role. He also suggests that an assessment of the board (or board sub-committees) can help establish performance criteria that can be used to achieve the corporate objective and to align the performance of the directors with the interest of the shareholders. A related literature also refers to board structure and independence as important governance components. Denis and McConnell (2003) regard a smaller board as an important determinant of corporate governance and firm performance. Solomon et al. (2003) and Tsui and Gul (2000) opine that the outside or non-executive directors play an important governance role in relation to the welfare of the investors, especially non-controlling shareholders.

The presence of outside directors improves the degree of corporate answerability and creates a balance of power between the CEO and the board (Denis and McConnell, 2003; Ricart et al., 1999). Likewise, the OECD (2003) observes that independent non-executive directors can exercise unbiased judgment in relation to the conflicts of interest among different stakeholders. This presence of independent non-executive directors seems to have an important implication in family-based governance, as Solomon et al. (2003) consider founding family dominance as a negative aspect of corporate governance. The issue of CEO duality (the CEO and board chairperson being the same individual) appears to constrain board independence, because there is a possibility of conflict of interests. Daily and Dalton (1997) and Kesner and Dalton (1986) mention that separate board structure can enhance board independence and shareholder value.

However, a separate board does not necessarily ensure better governance, as Daily and Dalton (1997) argue, the chairperson in a separate board structure might possess his/her own interest in the firm’s governance. Corporate interlocking is another inter-organisational strategy for managing the resource interdependencies such as, strategic alliances, mergers and acquisitions (Ong et al., 2003). Whilst the presence of the same individual on the boards of several firms can create firm value, it can yield a negative influence on the firm’s governance because of the potential for conflicts of interests between firms. Aside from monitoring the executive management, the board is also responsible for designing the management contract that minimises the degree of agency conflicts. Several studies (Prowse, 1994; Becht et al., 2002; McColgan, 2001) mention that a management contract aligns personal interest of the managers
with that of the shareholders and provides managers with the incentives to maximize firm value. It is suggested that a value enhancing management contract should include: basic salary components, performance-based cash bonuses and profit-based salary revisions, stock participation plan (e.g. stock options), outright ownership of the firm’s equity, pension rights, performance-based dismissal provisions, and long-term incentive plans.

2.3.4 CEO/Chair Duality

CEO duality is a contentious issue that has attracted significant public and academic scrutiny. In his study Sampson (1992) found that 75% to 80% of U.S. firms combined the CEO and chair roles into one position. However, Grinstein & Valles (2008) showed a significant jump in the number of S&P 500 companies splitting CEO/chair roles. They report that 31% of S&P 1000 firms in 2004 separated the CEO/chair roles, a marked increase from the 24% reported in 2000. They argued that corporate scandals, such as Enron and WorldCom, and the 2001 recession raised the alarm for more board vigilance and decentralization of power.

Critics of CEO duality argue that duality compromises board effectiveness in monitoring the CEO. They assert that dual CEOs are more likely to pursue selfish interests that are inconsistent with shareholders’ values. Proponents of CEO duality assert that a combined CEO/chair structure provides directional clarity and judgment that is lacking within an independent leadership structure. Separation of CEO and chair may limit CEO entrepreneurism in ventures that can increase firm value because the CEO’s decisions are consistently monitored and thus affect performance.

2.4 Transparency and Accountability

Transparency and accountability are two closely related issues that are crucial, not only in enhancing the disclosure and auditing standards of a firm, but also in developing the regulatory organ’s capacity to monitor and discipline the firm’s governance practices. Therefore, it is imperative for a firm to make its financial and non-financial information available and easily accessible to outsiders in order that everyone can make informed decisions. Effective disclosures enable existing as well as prospective investors, to evaluate the management’s past performance, forecast the firm’s future cash flow and to decide whether the risk profile of a firm is within an acceptable level (Foo et al., 2000; Gul et al., 2000). Thomas et al., (2002) note
that information to shareholders is one of the most important aspects of corporate governance, as it reflects the degree of transparency and accountability of the corporations towards its shareholders. The quality of a firm’s disclosures tends to be determined by the development of the capital market and the standards of accounting and auditing practices of a country. Whilst Claessens and Fan (2002) emphasise the quality auditing and professional integrity of the external auditors, it is commented that weak enforcement of accounting and auditing standards restrains quality auditing.

2.5 Determinants of Information Asymmetry

The main factors affecting the asymmetry of information between the managers and the investors resulting from risky securities are namely: the trading volume, the volatility of stock returns, and the stock price. Trading volume influences information asymmetry as the interplay of supply and demand determines the transaction price of each stock security. Securities are traded for cash and thus buyers must have available money and sellers must have stocks and the outcome, that is the payment and delivery of securities, takes place immediately after negotiation. Liao (2009) points out that the trading volume is closely linked with various measures of asymmetric information and this volume decreases when the earnings are announced. Additionally Byard et al. (2006) found that the inverse of the average daily trading volume positively influenced the asymmetry of information.

Stock return measures are also highlighted as determining information asymmetry. Blackwell et al., (1990) use residual volatility in daily stock returns as another proxy for information asymmetry. As Kyle (1985) pertaining the transactions of the informed and the insiders’ expected trading benefits, they are positively related to non-specific assessments of the company’s value. Insofar as the residual volatility of stock returns reflects some uncertainty about the company’s value, the problem of information asymmetry increases. Fee and Thomas (1999) have mentioned some uncertainty factors for companies such as the rates fixed by the Federal Reserve that are simultaneously relative to both insiders and outsiders. If the insiders’ transactions exceed the abnormal outputs, the superfluous information disclosure entirely does not remove the informational advantage of the leaders (Harris, 1994). There is thus a close connection between stock return and information asymmetry.
Several studies have shown that the share price explains a significant part of the information asymmetry. Comerton-Forde and Rydge (2006) in their study found that the share price is positively associated with this information asymmetry and Attig et al. (2006) noted that the share price is a vector of information, so it negatively affects the information asymmetry. Stoll (1978) posits that the trading volume and the incurred risk affect the cost of detention of market makers. He also notes that the stock price is a proxy for the unobservable minimum cost. In his empirical test stoll (1978) found that the bid-ask spread negatively affected the trading volume while the stock price positively influenced the variability of returns.

The proxy to be used to measure information asymmetry, as the dependent variable, is the bid-ask prices, spread (SPREAD). The relation between the extents of informed trading and bid-ask spreads was first discussed in (Bagehot, 1971). Bagehot (1971) argues that market makers trade with two kinds of traders informed and uninformed. While the market maker loses to informed traders, he recoups these losses from uninformed traders by increasing the bid-ask spread. Thus, a high level of informed trading leads to higher bid-ask spreads. Bagehot’s (1971) intuition was subsequently modeled by Kyle (1985), and Glosten and Milgrom (1985).

### 2.6 Empirical Review

It has long been recognized that greater managerial ownership generates greater alignment of the interests of shareholders and managers, and mitigates the agency problems between the two parties (Jensen and Meckling, 1976; Demsetz, 1983). Agency theory predicts that there is a positive association between management interests and the level of voluntary disclosure. Warfield et al (1995) provided that evidence supporting this contention in their findings that the extent of shareholding by management is positively associated with the amount of information disclosed about earnings. The above reasoning suggests that firms with higher Board Ownership will be associated with greater levels of disclosures and hence lower degree of information asymmetry.

Drawing from Fama and Jensen (1983) a large body of empirical evidence finds that outside directors who are independent of management’s influence help enhance shareholder value by protecting shareholder interests against managerial opportunism (Hermalin and Weisbach, 2001). Focusing on financial reporting issues in particular, (Beasley, 1996; Dechow et al.,
1996; Klein, 2002) found that outside directors are effective monitors of managerial actions. Beasley (1996) argued and provided evidence that the proportion of outside directors is positively related to the board’s ability to influence disclosure decisions.

Chen and Jaggi (2000) found empirical evidence of a positive relationship between Board independence and disclosure (including mandatory disclosure). Foo and Zain (2010) examined the association between bids-ask spread, a market-based measure of information asymmetry, and board characteristics among 227 firms listed on the Main Board of Bursa Malaysia. The results revealed that board independence is negatively related to the level of information asymmetry. Based on the foregoing discussion, it can be inferred that the proportion of outside directors in the board might have a positive impact on disclosure practices, thus leading to lower degree of information asymmetry.

Fama and Jensen (1983) pointed out that CEO duality signals the absence of separation of decision control and decision management. The result of CEO duality is the concentration of decision-making power, which could constrain board independence and reduce its ability to execute its oversight and governance roles Gul and Leung, (2004), and proved detrimental to disclosure levels and quality, especially voluntary disclosure (Ho and Wong, 2001). Huafang and Jianguo (2007) provided evidence that in increase in independent directors increases corporate disclosure and CEO duality is associated with lower disclosure. Byard et al (2006) reported that CEO duality is negatively associated with analysts’ forecast accuracy. The authors conclude that CEO duality increases information asymmetry.

2.7 Summary of Literature Review

From the studies reviewed there different interests among researchers, some analyzing corporate governance components together and others separately. Whilst a majority of corporate governance literature centers on individual governance components, a recent literature is based all related issues of corporate governance and its effects on various aspects of the organization, ranging from strategy, profitability, performance, disclosure, cost of capital, return on investment among many other aspects of the firm. Empirical studies reviewed indicate how individual governance components e.g. ownership structures, board composition, board
independence and disclosure quality and overall governance standards such as corporate governance index are associated with the firm’s valuation as well as operating performance.

Empirical evidence reviewed of the influence of individual corporate governance mechanisms various aspects of the firms is highly indicative that indeed corporate governance mechanisms do influence the success of any organization. This chapter undertook a review literature relevant to this research with the aim of getting views and opinions on investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The chapter specifically covers the theoretical foundation and the Determinants of corporate governance. Corporate governance being a relatively new area, its development has been affected by various disciplines. The main theory that has affected its development however most naturally seems to rest in the agency theory. However the stakeholders theory is coming in more into play as companies increasingly grow and become aware that they cannot operate in isolation and that they need to have a wider regard to the stakeholder constituency.

The process of the growth of a firm takes time and this is because firms have to develop the necessary capabilities to cope with growth. Entrepreneurial growth and managerial resources are inseparable and as such corporate governance and monitoring mechanisms continue to be a key component to the success of firms in both the local and the global economy (Foo and Zain, 2010). Organizations must therefore continually review their governance structures, their effect on performance and as such align them to global trends (Izan et al., 2006).
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter has covered the research design, population, sample, data collection and data analysis, which describes the firms and variables, included in the study and applied statistical techniques in investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors.

3.2 Research design

This study was conducted using explanatory research design. According to Mugenda and Mugenda (2010) exploratory research explores the why questions which in effect involved developing a causal explanation which could either be direct or indirect relationship between variables, that is, the effect of one thing on another and more specifically, the effect of one variable on another. Mugenda and Mugenda (2010) contends that exploratory research has the advantage of being relatively cheap and it will be considered for the study so as to establish the effect of corporate governance on information asymmetry of companies listed in NSE.

3.3 Target population

The target population of this study was all the companies listed at the Nairobi Securities Exchange. There are 62 listed companies at the Nairobi Securities Exchange from which the data will be drawn.

3.4 Sampling

The sample of the study involved the target population of the companies listed in the NSE. The researcher used the purposive sampling techniques. This is where the optimum sample size was a result of purposively selecting firms that were already listed by the year 2003; this is to allow a ten year analysis of data. The sample firms were adequate to fulfill the requirements of efficiency, representativeness and reliability. Unnecessarily large sample size would bring about data duplicity besides having cost and time implications while a small sample size would not be representative. The sample size was of 32 companies listed at the Nairobi Securities Exchange.

A simple random technique was used to select one staff from public relations or corporate
affairs department from each company on whom primary data was collected. This sampling technique is suitable for use since every firm in had an equal chance of being selected and thus the sampling technique eliminated bias. Secondary data was collected from company’s’ and NSE’s and companies’ websites and prospectus among others.

### 3.5 Data Collection

The study used both primary and secondary data sources in gathering data for analysis. The primary data source was semi-structured questionnaires. The questionnaires were both open and close-ended questions (Munn and Drever, 2004). A pilot test was conducted to field test the reliability and the validity of the instruments (Kothari, 2004). The data from the pilot test was analyzed using informative presentation tables and graphs.

### 3.6 Data Analysis

The study used multiple linear regression equation and the method of estimation was Ordinary Least Squares (OLS) so as to establish the relationship between corporate governance and information asymmetry. Ordinary least squares (OLS) is a method for estimating the unknown parameters in a linear regression model by minimizing the sum of squared vertical distances between the observed responses in the dataset, and the responses predicted by the linear approximation, thus, providing minimum-variance mean-unbiased estimation (Hayashi, 2000).

The proxy to be used to measure information asymmetry, as the dependent variable, is the bid-ask spread (SPREAD). The relation between the extents of informed trading and bid-ask spreads was first discussed in (Bagehot, 1971). Bagehot (1971) argues that market makers trade with two kinds of traders informed and uninformed. While the market maker loses to informed traders, he recoups these losses from uninformed traders by increasing the bid-ask spread. Thus, a high level of informed trading leads to higher bid-ask spreads. Bagehot’s (1971) intuition was subsequently modeled by Kyle (1985), and Glosten and Milgrom (1985). Specifically,

\[
\text{SPREAD} = \frac{1}{D_{i,t}} \sum (\text{ASK}_i - \text{BID}_i) / (\text{ASK}_i + \text{BID}_i)
\]

Where: \(D_{i,t}\) is the number of days in year \(t\) for firm \(i\) for which closing daily bids (\(\text{BID}_i\)) and closing daily asks (\(\text{ASK}_i\)) are available.
ASK is the price at which an investor (seller) is willing to sell, and BID is the price at which the investor (buyer) is willing to buy. Numerous studies starting from (Demsetz, 1968; Bagehot, 1971) have used bid–ask spread to proxy for information asymmetry between informed traders and liquidity traders.

Corporate board characteristics: the variables that represent corporate board characteristics are Board Ownership, board independence and CEO duality. Board Ownership is computed as the proportion of executive share ownership to total shares of the firm. Board independence (BIND) is measured as the proportion of non-executive (independent) directors on board. CEO duality (CEO) is measured as a dummy variable, assigned 1 if the chief executive officer (or managing director) additionally occupies the position of the chairman of the board, or 0 if otherwise.

Several factors that are relevant to bid-ask spread as control variables were selected in multiple-regression models. Among of these factors are firm size, Stock return volatility, ROE and growth opportunity. Large firms may face less information asymmetry because they tend to be more mature firms, have established and time-tested disclosure policies and practices, and receive more attention from the market and regulators (Harris, 1994). Stock return volatility was included, because market makers increase the spread to make up for the uncertainty associated with volatile stocks. ROE is included on the expectation that income-generating firms disclose more information to communicate investors of their good performance (Wallace et al, 1994). Therefore it is expected that a negative relationship between firm Profitability and information asymmetry. Another important control variable is growth opportunity (GWTH), High-growth firms have greater information asymmetry because Firms with favorable future prospects are less likely to provide sensitive operating information in order to protect their competitive advantages and avoid attracting new entrants or increased competition from existing competitors (Liao, 2009). The ratio of market-to-book value of equity to proxy for growth opportunities was used.

To investigate the association between corporate governance characteristics and information asymmetry, the researcher used the following ordinary least squares (OLS) regression
$$\text{SPREAD}_{i,t} = \beta_1 \text{BOWN}_{i,t} + \beta_2 \text{BIND}_{i,t} + \beta_3 \text{DUAL}_{i,t} + \beta_4 \text{FSIZE}_{i,t} + \beta_5 \text{VOL}_{i,t} + \beta_6 \text{ROE}_{i,t} + \beta_7 \text{GWTH}_{i,t} + \alpha$$

For firm i at the end of year t, where:

**SPREAD** = defined as annual relative bid-ask spread using daily closing bids and asks.

**BOWN**= Board Ownership defined as proportion of executive share ownership to total shares of the firm.

**BIND** = percentage of independent non-executive directors on board.

**DUAL** = a numerical number (1) will be assigned if CEO also serves as Chairman, and (0) if not.

**FSIZE** = firm size defined as natural log of firm’s total assets.

**VOL** = Volatility defined as the standard deviation of daily security returns.

**ROE** = return on equity defined as income before tax and interest to total equity.

**GWTH** = growth prospect defined as the market value of equity divided by book value of equity.

**$\alpha$**= the error term.

### 3.6.1 Operationalization of the Variables

Data from the NSE was analyzed to determine the SPREAD that is the difference between the daily price that the company shares are being sold at the NSE and the price at which the buyer buys at. From company prospectus, publications were analyzed and a percentage of shares owned by the directors of the company as a proportion of the total issue of share for each year were collected to determine BOWN. Information regarding board members was collected from company prospectus and publications which was reviewed each year. BIND was the number of independent non-executive directors calculated as a proportion of the total number of board members. Information regarding chief executive officer was drawn from the yearly company prospectus; publications were reviewed to find DUAL. If the chief executive officer also serves as a chairman, a numerical value of 1 was assigned; if not the number 0 was assigned.

Figures on total assets was taken from the companies’ published audited financial statement determine FSIZE and ROE. From the balance sheet at the end of each year of analysis, the total
assets and equity were gotten, while the income before tax and interest was collected for the income statements. Statistics from the daily securities prices was collected to find the difference between the daily security prices, this difference was analyzed to determine the VOL. Market value of equity was calculated by valuing the total number of shares issued by the company using the market price at the end of each year while the book value of equity was the balance sheet value of equity at year end to get growth (GWTH).
CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

This has presented data collected using questionnaires. The purpose of the study was to investigate how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The primary data was collected using a questionnaire as the data collection instrument while secondary data was collected from NSE’s and companies’ websites and prospectus. The study targeted 32 respondents. 23 questionnaires out of 32 were completed and returned giving a response rate of 72%. This response rate was good enough and conforms to that recommended by Mugenda and Mugenda (2003).

4.2 General Information

4.2.1 Major Background

The study sought to find out the major background of the respondents in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th>Major background</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Management</td>
<td>48%</td>
</tr>
<tr>
<td>Accounting/Finance</td>
<td>30%</td>
</tr>
<tr>
<td>Other</td>
<td>22%</td>
</tr>
</tbody>
</table>

Figure 4. 1: Major Background

The study findings indicated that majority (48%) of the respondents were in the business management, 30 % had the accounting/finance background while 22% had other backgrounds.
4.2.2 Interaction between Managers and Investors

The study sought to establish whether there is interaction between managers and investors (shareholders?) the organization. The findings are presented in the table below.

Figure 4.2: Interaction between Managers and Investors

From the study findings, majority (52%) of the respondents indicated that there is interaction between managers and investors the organization and 48% of the respondents indicated that there no is interaction between managers and investors the organization.

4.2.3 Forms of Interaction

The study sought to establish the forms of interaction between managers and investors (shareholders) the organization. The findings are presented in the table below.

Figure 4.3: Forms of interaction

The study findings established that majority (39%) of the companies used main stream media
as forms of interaction between managers and investors (shareholders), 30% of the companies used Annual General meetings as forms of interaction between managers and investors, 17% of the companies used company newsletters as forms of interaction between managers and investors, 9% of the companies used company websites as forms of interaction between managers and investors and 4% of the companies used company websites as forms of interaction between managers and investors.

4.3 Board Independence

4.3.1 Number of Members’ Board of Directors

The study sought to establish the number of members’ board of directors in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th>No of Board Members</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2-5 members</td>
<td>13%</td>
</tr>
<tr>
<td>6-10 members</td>
<td>52%</td>
</tr>
<tr>
<td>11-20 members</td>
<td>35%</td>
</tr>
</tbody>
</table>

Figure 4.4: Board Independence

From the study findings, majority (52%) of the respondents indicated that there are between 6-10 board of directors members in the organization, 35% indicated that there are between 11-20 board of directors members in the organization while 13% indicated that there are between 2-5 board of directors members in the organization.

4.3.2 Composition of Board Members

The study sought to describe the composition of board members in the organization. The findings are presented in the table below.
Table 4. 1: Composition of Board Members

<table>
<thead>
<tr>
<th>Composition of Board Members</th>
<th>Frequency</th>
<th>Percent %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive directors only</td>
<td>4</td>
<td>17</td>
</tr>
<tr>
<td>Non executive Directors only</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Mix of both Executive &amp; Non executive</td>
<td>18</td>
<td>78</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100</td>
</tr>
</tbody>
</table>

The study findings established that most (78%) board members in the organization are a mix of both executive & non executive, 17 % of the board members are executive directors while as 4 % of the board members are non executive directors.

4.3.3 Strongest Voice

The study sought to establish the strongest voice in the selection of Non executive directors in the organization. The findings are presented in the table below.

![Strongest voice chart](image)

**Figure 4. 5: Strongest Voice**

According to the study findings 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, 39% of the respondents indicated that the controlling shareholder have the strongest voice in the
selection of Non executive directors while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors.

**4.3.4 Attendance rate for the board meetings**

The study sought to establish the attendance rate for the board meetings in the organization. The findings are presented in the table below.

Table 4.2: Attendance rate for the board meetings

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>51-75%</td>
<td>5</td>
</tr>
<tr>
<td>75-89%</td>
<td>11</td>
</tr>
<tr>
<td>90-100%</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
</tr>
</tbody>
</table>

According to the study findings 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%.

**4.4 CEO/Chair Duality**

**4.4.1 Independence of Chairman of the Board**

The study sought to establish whether the Chairman of the Board was an independent, non-affiliated director in the organization. The findings are presented in the table below.
Figure 4.6: Independence of the Chairman of the Board

From the study findings, majority (52%) of the respondents agreed that the Chairman of the Board was an independent, non-affiliated director in the organization while 48% of the respondents agreed that he was not an independent, non-affiliated director in the organization.

4.4.2 C.E.O as Chairman

The study sought to establish whether the C.E.O is a chairman of the company. The findings are presented in the table below.

Table 4.3: C.E.O as chairman

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>10</td>
<td>43%</td>
</tr>
<tr>
<td>No</td>
<td>13</td>
<td>57%</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 57% of the respondents indicated the C.E.O as the chairman of the company while as 43% of the respondents indicated the C.E.O as not the chairman of the company.
4.5 Board Ownership

4.5.1 Directors’ Remuneration

The study sought to establish whether the company has a written procedure or policies on directors’ remuneration. The findings are presented in the table below.

**Table 4.4: Directors’ Remuneration**

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>23</td>
<td>100</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100</td>
</tr>
</tbody>
</table>

From the study findings, all (100%) of the respondents agreed the company has a written procedure or policies on directors’ remuneration.

4.5.2 Independent Director’s Remuneration

The study sought to establish whether the independent director’s remuneration included share options. The findings are presented in the table below.

**Figure 4.7: Independent Director’s Remuneration**

From the study findings, most (74%) of the respondents agreed that the independent director’s remuneration includes share options while as 26% of the respondents did not agree that the independent director’s remuneration included share options.
4.5.3 Non Executive Director’s Remuneration

The study sought to establish whether the non-executive director’s remuneration include share options. The findings are presented in the table below.

![Pie chart showing 52% Yes and 48% No]

Figure 4.8: Non-Executive Director’s remuneration

According to the study findings 52% of the respondents indicated that the non-executive director’s remuneration include share options while as 48% of the respondents indicated that the non-executive director’s remuneration does not include share options.

4.5.4 Share Options

The study sought to establish whether the CEO/Chairman given share options in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>8</td>
<td>35%</td>
</tr>
<tr>
<td>No</td>
<td>15</td>
<td>65%</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

Table 4.5: Share Options

According to the study findings 65% of the respondents indicated that the CEO/Chairman not given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman was given share options in the organization.
4.5.5 CEO Compensation

The study sought to establish whether the board reviewed CEO compensation annually. The findings are presented in the table below.

![Figure 4.1: CEO Compensation](image)

From the study findings, most (61%) of the respondents agreed the board reviewed CEO compensation annually while as 39% of the respondents did not agree that the board review CEO compensation annually.

4.6 Disclosure/Communication

The study sought to establish whether the firms disclose the following in the firm’s web page. The findings are presented in the table below.

**Table 4.6: Disclosure/Communication**

<table>
<thead>
<tr>
<th>Disclosure/Communication</th>
<th>Yes</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarterly financial statement</td>
<td>9</td>
<td>39%</td>
</tr>
<tr>
<td>Directors selling or buying shares in the firm</td>
<td>4</td>
<td>17%</td>
</tr>
<tr>
<td>Directors reports</td>
<td>15</td>
<td>65%</td>
</tr>
<tr>
<td>Audited Annual reports</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their Directors selling or buying shares in the
4.7 Multiple Regression Analysis

The study adopted simple regression guided by the following model:

\[ Y = \beta_0 + \beta_1 (X_1) + \beta_2 (X_2) + \beta_3 (X_3) + \varepsilon \]

Where:

- \( Y \) is the dependent variable representing information asymmetry between managers and investors (\( X_1 \)): Board Ownership Concentration is measured by proportion of ownership held by the main shareholder of institutional nature of the quoted company.
- (\( X_2 \)): Board Independence is measured by the proportion of non-executive directors inside the board (non-executive directors / total directors).
- (\( X_3 \)): CEO Duality is measured by a dummy value of 1 of the company CEO also pairs up as the Board Chair.
- \( \varepsilon \): Standard Error term.

The above model was tested and analyzed to determine its suitability to determine the relationship between corporate governance variables above and information asymmetry and the results tabulated below;

**Table 4.7: Model Summary**

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.387⁷</td>
<td>.7005</td>
<td>.687</td>
<td>.23665</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Board Ownership, Board Independence and CEO Duality

Author: Research data (2014)

From table 4.7, R indicates that there exist a moderate relationship between the independent variables i.e CEO duality, board independence and Board Ownership, and the dependent variable information asymmetry. The coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables) R Square equals 0.7, that is, 70 percent aggregate information asymmetry can be explained through the
combined linear effects of Board Ownership, Board Independence and CEO Duality. In order to test the significance of the model, the study conducted an Analysis of Variance. The findings were as shown below:

**Table 4.8: Analysis of Variance**

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Regression</td>
<td>3</td>
<td>5</td>
<td>.331</td>
<td>5.911</td>
<td>.003a</td>
</tr>
<tr>
<td>Residual</td>
<td>49</td>
<td>40</td>
<td>.056</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>45</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: Constant, Board Ownership, Board Independence and CEO Duality
b. Dependent Variable: Information asymmetry

Author: Research data (2014)

The ANOVAs results, the probability value of .003 were obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry.

**Table 4.9: Coefficients of determination**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>-5.08</td>
<td>-5.23</td>
<td>-6.16</td>
<td>0.048</td>
</tr>
<tr>
<td>Board Ownership</td>
<td>-5.53</td>
<td>0.10</td>
<td>.140</td>
<td>.002</td>
</tr>
<tr>
<td>Board Independence</td>
<td>-6.94</td>
<td>1.027</td>
<td>.110</td>
<td>.000</td>
</tr>
<tr>
<td>CEO Duality</td>
<td>2.98</td>
<td>.476</td>
<td>0.39</td>
<td>.001</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Information asymmetry

Author: Research data (2014)
\[ Y = -5.08 - 5.53X_1 - 6.94X_3 + 0.020X_4 + 2.98X_5 \]

where \( Y \) = Information asymmetry

\( B_0 \) = intercept (defines value of Information asymmetry without inclusion of predictor variables)

\( X_1 \) = Board Ownership

\( X_2 \) = Board Independence

\( X_3 \) = CEO Duality

Table 4.9 presents results of the simple linear regression of Aggregate Information asymmetry on Board Ownership, Board Independence and CEO Duality. From the findings, the coefficients of aggregate Information asymmetry is negative and significant, indicating that holding Board Ownership, Board Independence and CEO Duality constant Information asymmetry will be -5.08. The study also found that a unit increase in Board Ownership will cause a 5.53 decrease in information asymmetry, further a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, and a unit increase in CEO Duality will further lead to an increase in information asymmetry by a factor of 2.98.

4.8 Interpretation of Results

The study revealed that majority (52%) of the respondents agreed that Chairman is the of the Board an independent, non-affiliated director in the organization while 48% of the respondents agreed that is not of the Board an independent, non-affiliated director in the organization. 57% of the respondents indicated that the C.E.O as the chairman of the company while as 43% of the respondents indicated that the C.E.O is not the chairman of the company. This means that majority of the firms are adopting the CMA proposal to have CEO and Chair being independent. 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%. From the findings, 52% of the respondents indicated that the non executive director’s remuneration include share options while as 48% of the respondents indicated that the non executive director’s remuneration does not include share options.

According to the study findings, 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the
CEO/Chairman given share options in the organization. From the study findings, most (61%) of the respondents agreed the board review CEO compensation annually while as 39% of the respondents did not agreed the board review CEO compensation annually. Board ownership continue being an incentive used by investors to align the interests of the managers to those of the shareholders. 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their Directors selling or buying shares in the firms’ statement in the firm’s web page, 65% of the firms disclose their Directors reports in the firm’s web page and all (100%) of the firms disclose their Audited annual reports in the firm’s web page.

The findings on the coefficient of determination indicated that R Square equals 0.7, that is, aggregate information asymmetry explain 70 percent of Board Ownership, Board Independence and CEO Duality. In order to test the significance of the model, the study conducted an Analysis of Variance. The findings on the ANOVAs results indicate that the probability value of .003 was obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry. From the findings, the coefficients of aggregate Information asymmetry is negative and significant, indicating that holding Board Ownership, Board Independence and CEO Duality constant Information asymmetry will be -5.08. The study also found that a unit increase in Board Ownership will cause a 5.53 decrease in information asymmetry, further a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, and a unit increase in CEO Duality will further lead to an increase in information asymmetry by a factor of 2.98.

Inferential statistics such as non parametric test which include analysis of variance (ANOVA) were used to test the significance of the overall model at 95% level of significance. According to Mugenda (2008) analysis of variance is used because it makes use of the F – test in terms of sums of squares residual.
CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of key data findings, conclusions drawn from the findings highlighted and policy recommendations that were made. The conclusions and Recommendations drawn were in quest of addressing research objectives of how a firm’s corporate governance affects the level of information asymmetry between managers and investors.

5.2 Summary of Findings

A fundamental issue addressed in this research was to examine the effect of corporate governance on information asymmetry between managers and investors of companies listed in the NSE. Corporate governance attributes examined in this paper are CEO/Chair duality and board independence and Board Ownership. The study finds that there exists a relationship between corporate governance and information asymmetry between managers and investors as discussed below.

5.2.1 Board Independence

From the study findings table 4.6, majority (52%) of the respondents indicated that there are between 6-10 board of directors members in the organization while figure 4.4 shows 13% indicated that there are between 2-5 board of directors members in the organization. The study further established that most (78%) board members in the organization are a mix of both executive & non executive, 17% of the board members are executive directors while as 4% of the board members are non executive directors. 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, 39% of the respondents indicated that the controlling shareholder have the strongest voice in the selection of Non executive directors while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors. According to the study findings 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board
meetings was between 51-75%.

Further analysis from the multiple regression indicated that the coefficients of aggregate Information asymmetry was significant and negatively related, indicating that a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, while the level of significance was ≤5%. These results collaborated with previous research that found that non-executive directors act as a reliable mechanism to diffuse agency conflicts between managers and owners (Fama & Jensen 1983). They are viewed as providing the necessary checks and balances needed to enhance board effectiveness (Franks, Mayer, & Renneboog, 2001). The results correspond to Chen & Jaggi (2000) who provide empirical evidence of the relationship between the proportion of non-executive directors on the board and corporate disclosure. The results of the research findings verify the relevance of non-executive directors as a governance mechanism that enhances the board’s capacity to ameliorate agency conflict between owners and managers.

5.2.2 CEO Duality

From the study findings, most 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman given share options in the organization. 61% of the respondents agreed the board review CEO compensation annually while as 39% of the respondents did not agreed the board review CEO compensation annually. 39 % of the firms disclose their quarterly financial statement in the firm’s web page, 17 % of the firms disclose their Directors selling or buying shares in the firm statement in the firm’s web page, 65 % of the firms disclose their Directors reports in the firm’s web page and all (100 %) of the firms disclose their Audited annual reports in the firm’s web page. Majority (52%) of the respondents agreed that Chairman is the of the Board an independent, non-affiliated director in the organization while 48% of the respondents agreed that is not of the Board an independent, non-affiliated director in the organization. 57 % of the respondents indicated that the C.E.O as the chairman of the company while as 43 % of the respondents indicated that the C.E.O is not the chairman of the company.

From the findings of the regression analysis, aggregate Information asymmetry is positive and
significant in relation to CEO duality, indicating that information asymmetry increased with an increase in CEO/Chair Duality. The results indicated a 2.98 coefficient at <0.5% significance level. Within the context of corporate governance, the major issue often discussed is whether the chair of the board of directors and CEO positions should be held by different persons (dual leadership structure) or by one person (unitary leadership structure). Agency theory suggests that the combined functions (unitary leadership structure) can significantly impair the boards’ most important function of monitoring, disciplining and compensating senior managers. It also enables the CEO to engage in opportunistic behavior because of his/her dominance over the board. The results are consistent with Sampson (1992) who empirically studied the relationship between corporate governance and disclosure quality and found that the extent of disclosure was higher in firms with dual leadership structures.

5.2.3 Board Ownership

From the study findings, all (100%) of the respondents agreed the company has a written procedure or policies on directors’ remuneration. Most (74%) of the respondents agreed that the independent director’s remuneration include share options while as 26% of the respondents did not agreed that the independent director’s remuneration include share options. 52% of the respondents indicated that the non executive director’s remuneration include share options while as 48% of the respondents indicated that the non executive director’s remuneration does not include share options. According to the study findings out 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman given share options in the organization.

According to the study findings, 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors. 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%.

From the findings of the regression analysis, Board Ownership was negative and significant in
relation to aggregate information asymmetry, indicating that information asymmetry decreased with an increase in Board Ownership. The results indicated a -5.53 coefficient at <0.5% significance level. The results support the agency theory predicts that there is a positive association between management interests and the level of voluntary disclosure. Warfield et al (1995) provided that evidence supporting this contention in their findings that the extent of shareholding by management is positively associated with the amount of information disclosed about earnings. The above reasoning suggests that firms with higher Board Ownership will be associated with greater levels of disclosures and hence lower degree of information asymmetry.

The findings on the ANOVAs results indicate that the probability value of .003 was obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry.

5.3 Conclusions
The relevance of corporate governance cannot be over-emphasized since it constitutes the organizational climate for the internal activities of a company. Corporate governance brings new outlook and enhances a firm’s corporate entrepreneurship and competitiveness. The study examined the role of corporate governance characteristics i.e. board composition, board independence and CEO/Chair duality and its effect on information asymmetry between managers and investors in companies listed at the NSE in Kenya.

From table 4.9, it was evident that there is a negative relationship between Board Independence information asymmetry, since their coefficient estimates are -6.94 at 0.00 the level of significance. It can be concluded therefore that from the study the level Board Independence significantly affected information asymmetry between managers and investors. These research findings are consistent with earlier research by Kihara (2006) who observed that unlike inside directors, outside directors are better and able to challenge the CEO hence a minimum of three outside directors is required on the board. It also concurs with Jensen (1993) who voices his concern that, lack of independent leadership makes it difficult for boards to respond to failure in top management team. The study concluded that board members in the organization are a mix of both executive & non executive and that the board or its nominated committee has the strongest voice in the selection of Non executive directors.
On CEO/ chair duality the findings revealed a positive coefficient of 2.98 thus a positive relationship to information asymmetry between managers and investors. The significance level was 0.002. Data collected revealed that the CEO/chairman proposed share options in the organization while as the board review CEO compensation annually. The study concluded that CEO duality is the other corporate governance index that is significantly related to the information asymmetry. This result is consistent with Gul and Leung (2004) who found that CEO duality is positively associated with international firm acquisition. His research showed that, international acquisition had a significant impact on shareholder value. He found a positive relationship between a firm leadership structure and its announcement of foreign acquisitions. Huafang and Jianguo (2007) provided evidence that CEO duality is associated with lower disclosure.

In addition the study also concluded that a unit increase in Board Ownership will cause a -5.53 decrease in information asymmetry, meaning that there exists a negative relationship between the two at a significance level of 0.001. The company's have a written procedure or policies on directors’ remuneration and that the non executive director’s remuneration include share options also, the firms disclose their directors reports in the firm’s web page while all of the firms disclose their Audited annual reports in the firm’s web page. Foo and Zain (2010) examined the association between bids-ask spread, a market-based measure of information asymmetry, and board characteristics among 227 firms listed on the Main Board of Bursa Malaysia. The results revealed that board independence is negatively related to the level of information asymmetry.

5.4 Limitation of the Study

The model may misestimate outcomes, because it assumes that corporate governance characteristics affect information asymmetry. The proposed indicators of corporate governance characteristics i.e. Board Ownership, Board Independence and CEO Duality may have some limitations. Whilst their use can be theoretically justified, neither construct can be accurately measured empirically.

If other corporate governance characteristics contribute to the integrity of information asymmetry, then parameter estimates may be biased. Given that the model is tested using
archival data, the data are likely to contain the influences of several factors that are not accounted for in the model. Isolating the impact of the constructs on the market’s reaction may prove difficult. The model thus applies only to large firms where there is a clear separation between ownership and management.

5.5 Recommendations
This study aimed at investigating how a firm’s corporate governance, i.e Board Ownership, board independence and CEO/chair duality affects the level of information asymmetry between managers and investors. The need to carry out this study arose from the fact that listing of companies in the NSE has continued to increase and corporate governance is a key requirement that has to be adhered. A research gap thus existed as limited researches from those reviewed had been done on the effect of corporate governance on the information asymmetry of listed companies in Kenya’s Nairobi Securities Exchange (NSE).

From the findings and conclusions, the study recommends the need for effective corporate governance practices at senior managerial level of quoted companies in Kenya to contribute to reduced information asymmetry and hence improve on actual firm liquidity and avert possible collapse of public organizations in Kenya. It is clear from the findings that corporate governance does have an effect on information asymmetry between managers and investors. The government should therefore enforce the measures it has laid down to ensure listed companies are following them so that the recommended governance structures are followed. The concerned ministries should also be very keen in the supervisory role through the relevant committees to ensure that all regulations are enforced as required e.g. books of accounts are well kept and audited as they should be.

In the Kenyan context, over the past few years there have been concerns, especially among the regulators, that companies are performing poorly and some failing partly due to weak corporate governance structure, and one of such attributes is the combined role of board chair and CEO. The concern was that such enormous powers vested in an individual make the board ineffective in its oversight and monitoring role. For example, with regard to the board leadership the Capital Markets Authority (CMA) in the Guidelines of Corporate Governance Practices, expressed a view that companies should consider separating the role of the chair and CEO, and
where the two roles are combined, to present the rationale for such a leadership structure in the annual report to the shareholders. In addition, by 1997, the Central Bank of Kenya initiated a review of banks’ board structures and as part of the review urged the companies in the financial sector to separate the roles of board chair and CEO. It appears most companies embraced this advice from the regulators and changed their board leadership structure such that 43% have separated the role of board chair and CEO. Thus, because of this substantial change in the board leadership structure, there was limited differentiation among sample firms for this variable to have statistical significance in the pooled regression analysis.

An opportunity arises for further research in the development of an experiment that would identify how average investors measure information asymmetry. This is because it is unclear whether investors use abnormal accruals, as measured by aggregate accruals approach, as a representation of information asymmetry. The complexity of such models suggests that the average investor is unlikely to use this measure. The researcher also recommends future researchers to explore association between corporate governance characteristics and information asymmetry for non-listed companies in Kenya and large family ran private companies in Kenya.
REFERENCES


Kesner, I. F. & Dalton, D. R. (1986). Boards of directors and the checks and (im)balances of the


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APPENDIX I: LETTER OF INTRODUCTION.
August 09th 2014.
Mary Wanjiku Ndungo
C/o University of Nairobi
P.O. Box 30197 00100
Nairobi.
Dear Respondents,

RE: ASSESSING THE EFFECT OF CORPORATE GOVERNANCE ON INFORMATION ASYMMETRY BETWEEN MANAGERS AND INVESTORS:
I am a postgraduate student at the University Of Nairobi School of Business. I am undertaking the above research project in partial fulfillment of the requirements for the award of the MBA degree. In order to achieve this, I humbly request your assistance in filling the attached questionnaire to generate data for the study. Any information you provide is purely for the purposes of this project thus your responses will be treated in strict confidence and in no circumstances will your name be mentioned in the report. Further confidentiality will be ensured through the necessary coding of the survey findings. A copy of the research report will be submitted to you upon request.

Your assistance to this regard will be highly appreciated.

Thank you in advance,

Yours Sincerely,

Mary Ndungo
M.B.A STUDENT

Dr Ogilo
SUPERVISOR
APPENDIX II: QUESTIONNAIRE

SECTION A

This section of the questionnaire refers to background and general information regarding your company. Although we are aware of the sensitivity of the questions in this section, the information will allow us to compare different respondents. Once again, I assure you that your response will remain anonymous. Your cooperation is appreciated.

1. What is your company’s name?

……………………………………………………………………

2. Indicate your major background (You may choose more than one if applicable
   a. Business Management [ ] b. Accounting/Finance [ ] c. Other: Please indicate--------

3. What is the main business of the company?

……………………………………………………………………

4. How long has your company been in existence?
   a. 0-5 years [ ] 6-10 years [ ] Over 10 years [ ]

5. Is there interaction between managers and investors (shareholders?)
   Yes [ ] No [ ]

6. If yes, in what forms?
   Annual General Meetings [ ] Company Newsletters [ ] Mainstream Media (Radio, Television, Newspapers) [ ] Company Website [ ] Social Media/Platforms [ ]
   Any other (Please Specify) [ ]

……………………………………………………………………

……………………………………………………………………

SECTION B

This section of the questionnaire explores aspects of Board within your organization.

1. Board Independence

7. How many members of the board of directors do you have in your company?
   a. 2-5 [ ] b. 6-10 [ ] c. 11-20 [ ] c. More than 20 [ ] (please indicate)

………………

8. Which of the following describes the composition of your board members:
   a. Executive directors only [ ] b. Non executive Directors only. c. Mix of both a & c [ ]

10. If your answer above is c, please indicate the number of each
   Executive ........
Non Executive (Independent) ……

11. Who is the strongest voice in the selection of Non executive directors?
   a. Board or its nominated Committee [ ] b. CEO c. Controlling Shareholder

12. On average what is the attendance rate for the board meetings?
   a. 90-100% [ ] b. 75-89% c. 51-75%

II. CEO/Chair Duality

13. Is the Chairman of the Board an independent, non-affiliated director?
   Yes [ ] No [ ]

9. Is the C.E.O , a chairman of the company
   Yes [ ] No [ ]

10. Does either of the two above in (Q11) act on behalf of the other
    Yes [ ] No [ ]

III. Board Ownership

11. Does your company have a written procedure or policies on directors remuneration
    Yes [ ] No [ ]

12. Does the independent director’s remuneration include share options?
    Yes [ ] No [ ]

13. Does the Non executive director’s remuneration include share options?
    Yes [ ] No [ ]

14. Is the CEO/Chairman given share options?
    Yes [ ] No [ ]

15. Does the board review CEO compensation annually
    Yes [ ] No [ ]

IV. Disclosure/Communication

16 Does your firm disclose the following in the firm’s web page?
   (i) Quarterly financial statement    Yes [ ] No [ ]
   (ii) Audited Annual reports        Yes [ ] No [ ]
   (iii) Directors reports            Yes [ ] No [ ]
   (iv) Directors selling or buying shares in the firm  Yes [ ] No [ ]

Thank you for your co-operation in completing this questionnaire. Kindly return the questionnaire as specified in the cover letter.
APPENDIX III: GUIDE TO COLLECT SECONDARY DATA

Asymmetric information variables

SPREAD (+)-The annual mean value of the daily percentage spread between bid and ask prices

VOLATILITY (+)-The annual average standard deviation of the day-over-day difference in the daily price change

VOLUME (-) - The annual average of daily market value of trading volume

Corporate governance variables

BSIZE (-) - The number of directors serving on the board of directors

NONEXESIZE (-)-The number of non-executives serving on the board of directors

SPLIT (-)-A dummy variable that takes on a value of one if the CEO and Chairman are different persons, zero otherwise

NONEXECHAIR (-)-A dummy variable that takes on a value of one if the chairman is a non-executive, zero otherwise
### Secondary data collection sheet

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<tbody>
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<td></td>
<td>ASK-HIGH</td>
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<td>VOLATILITY (+):</td>
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</tr>
<tr>
<td>BSIZE (-):</td>
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<tr>
<td>NONEXESIZE (-):</td>
<td>NON-EXEC DIRECTORS</td>
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<tr>
<td>SPLIT (-):</td>
<td>1=CEO &amp; DIRECTOR ARE SAME ZERO OTHERWISE</td>
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<td>NONEXECHAIR (-):</td>
<td>1=CHAIRMAN IS NON-EXEC ZERO OTHERWISE</td>
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</table>
EFFECTS OF CORPORATE GOVERNANCE ON INFORMATION ASYMMETRY BETWEEN MANAGERS AND INVESTORS IN FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

BY

MARY WANJIKU NDUNGO
D61/70574/2007

A RESEARCH PROJECT REPORT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER 2014
DECLARATION

This is my original work and has not been presented for award of any degree in any university.

Signed....................................…                   Date.................................... ...........…
Mary Ndungo

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

Signed............................................. .…               Date.............................. ...............…
Lecturer,
Department of Finance & Accounting,
School of Business,
Dr. Fredrick Ogilo
DEDICATION

This research project report is dedicated to my Dad and Mum Mr. and Mrs. Absalom Ndungo who have stood by me, believed in me and gave me motivation during my academic pursuits and the research work.

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ACKNOWLEDGEMENTS

First, all glory and honor goes to Almighty God. He has given me good health and the finances needed to successfully complete this project. Through the process I have continuously drawn strength from the knowledge that God has a good plan for me and that my destiny was and remains in His hands. Without Him I can do nothing.

I would like to express my deep appreciation to my supervisor, Dr. Fredrick Ogilo for the insightful guidance and assistance at every stage of writing this research project. I will be eternally indebted to him for persevering with me as my advisor throughout the time it took me to complete this research project. The faculty members of staff at the University of Nairobi Mombasa campus, who generously give their time and expertise to better my work, I thank them for their contribution and their good-natured support.

I must acknowledge as well the many friends, colleagues, students and other librarians who assisted, advised, and supported my research and writing efforts over the years. Especially, I need to express my gratitude and deep appreciation to my special friend Mr. Douglas Bariu, whose friendship, knowledge, and wisdom has supported and enlightened me over the many years of our friendship. He consistently helped me keep perspective on what is important in life and showed me how to deal with reality.
LIST OF ACRONYMS

NSE- Nairobi Stock Exchange
CMA- Capital Markets Authority
CBK- Central Bank of Kenya
CEO- Chief Executive Officer
CAPM- Capital Asset Pricing Model
CDS account- Central Depository and Settlement account
SIIA- Software and Information Industry Association
FTSE- Financial Times Securities Exchange
ATS- Automated Trading System
FISD- Financial Information Services Division
ROE- Return on Investment
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1.1.3 Corporate Governance and Information Asymmetry ......................................... 3  
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ABSTRACT

This study aimed at investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The specific objectives of the study were to find out the effect of Board Ownership on the information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange, to investigate how board independence influences information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange and to determine how CEO duality affects information asymmetry between managers and investors in firms listed at NSE. This study was conducted using explanatory research design. The target population was 62 listed companies at the Nairobi Securities Exchange from which the data was drawn. The sample comprised of 32 firms listed in the NSE by the year 2003. Secondary data was collected using a questionnaire which contained both open and closed ended questions. A pilot test was first conducted to test the reliability and the validity of the questionnaire as an instrument. A simple random technique was used to select one staff from the corporate affairs department from each company who were the respondents. Secondary data was collected from companies’ websites, publications and data bought from the NSE. Secondary data collected was analyzed using multiple linear regression equation and the method of estimation was Ordinary Least Squares (OLS) so as to establish the relationship between corporate governance variables and information asymmetry. In order to test the significance of the model, the study conducted an analysis of variance. The results of the ANOVAs test indicate a significant value of .003 and a confidence 99 percent which was obtained indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry. Results from the coefficient of determination test indicated that R Square equals 0.7, that is, changes in aggregate information asymmetry could be explained up to 70 percent by the linear relationship between Board Ownership, Board Independence and CEO/Chair Duality. Findings from the data analyzed and tabulated from the questionnaires collected revealed 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 100% of the respondents indicated that their board consisted of both executive and non executive member and as such exercised some level of independence. Most (61%) of the respondents agreed the board review CEO compensation annually and 65% indicated that this compensation included share options. 39 % of the firms disclose their quarterly financial statement in the firm’s web page, 17 % of the firms disclose their directors selling or buying shares in the firms statement or in the firm’s web page, 65 % of the firms disclosed their directors reports in the firm’s web page and all (100 %) of the firms disclose their audited annual reports in the firm’s web page. From the results of the ordinary least square (OLS), Board Ownership and Board Independence were significantly negatively related to information asymmetry i.e. coefficients of -5.53 and - 6.94 respectively while CEO/Chair duality was positively related to information asymmetry at +2.98. The levels of significance for all the variables were, 0.002, 0, and 0.001 respectively indicating a more than 97% confidence level. The results agree with Raheja (2005) and Myerson (1987) who found the existence of significant relationship between corporate governance variables aforementioned above in firms. The study recommends future researchers to study the association between corporate governance characteristics and information asymmetry for non-listed companies in Kenya and large family ran private companies in Kenya.
CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Corporate governance is the system that defines how organizations are to be directed and controlled by the agents. It’s a set of relationships between company directors, shareholders and other stakeholder’s as it addresses the powers of directors and of controlling shareholders over minority interest, the rights of employees, rights of creditors and other stakeholders (Muriithi, 2009). Dechow et al. (1996) defines corporate governance as an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity (Dechow, 1996). It is viewed as ethics and a moral duty of firms and is the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity, corporate accountability and transparency with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders (Gul & Leung, 2004).

The information asymmetry is rooted in the Agency Theory which explains problems arisen from the separation of ownership and management (Jensen and Meckling, 1979). This problem also inevitably transcends in corporate governance systems, where managers of the company (board of directors) are in possession of rather complete information on functioning of the company, which outside shareholders do not have. Since information asymmetry leads to ineffective decisions in corporate governance system, an effective information policy should be implemented to provide easy and equal access to information not only to shareholders, but also for all stakeholders (Ferma and Jensen, 1983). The optimal corporate governance system aims to give shareholders confidence that their company is managed efficiently, to create the highest possible profit and to preserve a firm’s reputation (Glosten and Milgrom, 1985).

The Nairobi Securities Exchange (N.S.E) is home to the largest companies in Kenya as well as several multinational firms cross listed in other global markets. The clamor for efficient governance structures and disclosure has continued to be of interest for both local and foreign investors. This paper intends to evaluate the effect of the firm’s corporate governance structures on one important firm characteristic- asymmetric information, that is the extent to which
managers know more about a firm’s value than does the rest of the world. The study will focus on firms listed in the Nairobi securities exchange.

1.1.1 Corporate Governance

The concept of governance is not new. It is as old as human civilization. Simply defined it is the process of decision-making and the process by which those decisions are implemented. Governance can be used in several contexts such as corporate governance, international governance, national governance and local governance (Liao, 2001). Having defined governance as the process of decision making and implementation, a further analysis of governance focuses on the formal and informal actors involved in decision-making and implementing the decisions made as well as the formal and informal structures that have been set in place to arrive at and implement the decision.

Corporate governance refers to the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs (Klein, 2002). Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment. Governance is a mechanism for monitoring the actions, policies and decisions of corporations. Governance involves the alignment of interests among the stakeholders.

1.1.2 Information Asymmetry

Information asymmetry can be defined as Information differences across investors (or groups of investors), and between investors and managers. This information differential has been a long standing concern among security exchange regulators and as such led them to enact regulations regarding fair disclosures which are intended to equalize information across investors by preventing companies from making disclosures to select groups of investors and analysts. Barako et al. (1998) assert that selective disclosure allows those have the advantage of certain market information beforehand to make a profit or avoid a loss at the expense of those kept in the dark. This practice leads to loss of investor confidence particularly small investors become
unwilling to invest in the fear that insiders gain at their expense; this, in turn, increases firms’ cost of capital to the extent that the risk in the economy has to be borne by fewer investors.

The issues of whether and how information differences across investors affects prices and the cost of capital cannot be addressed in conventional models of asset pricing, such as the Capital Asset Pricing Model (CAPM), this is because these models generally assume investors have homogeneous beliefs. Various studies that have developed models of capital market equilibrium where investors have heterogeneous information, reach different conclusions regarding the effects of information on the cost of capital and price of shares. Leland (1992) finds that allowing insider trading will, on average, increase stock prices despite the fact that the presence of insiders increases information asymmetry in the economy. Although he does not express his analysis in terms of cost of capital, higher stock prices on average are equal to a decrease in firms’ cost of capital. In contrast, O’Hara (2003) and Easley and O’Hara (2004) conclude that information asymmetry will increase firms’ cost of capital. These papers argue that less informed traders recognize they are at an information disadvantage and will try to hold assets where their disadvantage is less. This drives down the price of securities with high degrees of asymmetry.

1.1.3 Corporate Governance and Information Asymmetry

Corporate governance has become an issue of importance worldwide. Corporations have a vital role to play in promoting economic development and social progress. It is the engine of growth internationally, and increasingly responsible for providing employment, public and private services, goods and infrastructure. The efficiency and accountability of the corporation is now a matter of both private and public interest. Good corporate governance structures are essential in order to attract investors, by assuring them that their investments will be secure and managed in a transparent and accountable manner, as well as creates competitive and efficient companies and markets (Qian et al, 2009).

A key ingredient of an efficient market is information. Information is a stream of data coming to an entity, which may be converted into a resource of knowledge to help in a decision making process. The optimal decision depends on the access to relevant information. In the context of capital markets, corporate insiders generally have superior information about the current
condition and future prospects of the firm, compared to outside investors. The existence of information asymmetries across investors can lead to adverse private and social consequences including low investor participation, high transaction costs, thin markets and decreased gains from trade (Lev, 1988). Recognizing the adverse consequences of information asymmetry and agency problems, researchers have suggested several solutions, among which corporate governance is an important mechanism (Jensen and Meckling, 1976; Shleifer and Vishny, 1986).

The role of corporate governance is to align the interests of managers with those of shareholders through appropriate bonding and monitoring. In particular, the board of directors, elected by the shareholders, is charged with evaluating and disciplining the management team. Within their fiduciary duty to shareholders, directors have a governance responsibility to ensure greater transparency when it is in the shareholders’ interests. Since shareholders, in general, are outsiders who are at an information disadvantage about the company, corporate governance principle demand an effective and representative board of directors may be able to move the managers toward disclosing more information to the market participants and in effect eliminating and or smoothing market anomalies.

1.1.4 Nairobi Securities Exchange

The equity market in Kenya is not young but exhibits the characteristics of an underdeveloped but developing securities market. Market players have less information compared to those in developed economy. These characteristics essentially make this market relatively volatile. Nairobi Securities Exchange’s (NSE) equity market differs from those developed markets in such characteristics on firm levels as the ownership structure and corporate governance standards. The World Bank classifies NSE as both an emerging and a frontier market. A frontier market refers to a relatively small and liquid market even by the emerging market standards (Nganga, 2003).

The Nairobi Stock Exchange was set up in 1953 in Kenya, as a regional exchange for Kenya, Tanganyika, Uganda and Zanzibar. After independence in these countries, the exchange became Kenya’s national stock exchange. The stock market has developed over the years with 54 listed companies by the close of 2009. Nairobi Stock Exchange has also moved from the open-outcry trading system to Automated Trading System (ATS) in order to improve the Market’s both
informational and functional efficiency. The exchange has three market tiers: main investments market segments, alternative market segment and fixed income securities segment (NSE, 2009).

In 2011, the Nairobi Stock Exchange Limited changed its name to the Nairobi Securities Exchange Limited. The change of name reflected the strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments. In the same year, the equity settlement cycle moved from the previous T+4 settlement cycle to the T+3 settlement cycle. This allowed investors who sell their shares, to get their money three (3) days after the sale of their shares. The buyers of these shares will have their CDS accounts credited with the shares. At the same time, it became a member of the Financial Information Services Division (FISD) of the Software and Information Industry Association (SIIA). Later, the delayed index values of the FTSE NSE Kenya 15 Index and the FTSE NSE Kenya 25 Index were made available on the NSE website www.nse.co.ke. The new initiative gives investors the opportunity to access current information and provides a reliable indication of the Kenyan equity market’s performance during trading hours (NSE, 2012).

1.2 Research Problem

Corporate governance has been an important part of Company Law for many decades even before its various codes were drawn. This owes to separation of ownership and management of companies whereby fiduciary relationship exist between the shareholders as the principals or owners and directors as the agents or management (Muriithi, 2009). One important influence of governance is information disclosure. Existing literature suggests that a firm’s asymmetric information environment has an important relation with governance mechanisms. A number of papers make the case that the intensity of board monitoring should decrease with the extent of asymmetric information. For example, Raheja (2005) models the size and composition of the board and demonstrates that firms optimally employ less independent boards when it is difficult for outsiders to verify projects. Harris and Raviv (2008) also argue that an insider - controlled board may be optimal when insiders have important information relative to that of outsiders.

Recognizing the adverse consequences of information asymmetry and agency problems, researchers have suggested several solutions, among which corporate governance is an
important mechanism (Jensen & Meckling, 1976; Shleifer & Vishny, 1986). The role of corporate governance is to align the interests of managers with those of shareholders through appropriate bonding and monitoring. In particular, the board of directors, elected by the shareholders, is charged with evaluating and disciplining the management team.

In Kenya, a number of problems relating to corporate governance have been identified. The problems range from errors, mistakes to outright fraud. The origins of the problem range from concentrated ownership, weak incentives, poor protection of minority shareholders, to weak information standards (Mwangi, 2012). With such an environment in the background, the interest of both the minority shareholders and creditors could be compromised and managed to be skewed towards the interest of such block shareholders. Consequently, the issue of information asymmetry arises. Companies have crumbled right in the eyes of shareholders who all along had little or no information regarding the downfall, yet they are the owners Bagehot (1971) thus the need to monitor corporate governance structures in organizations. As earlier intimated the Kenya Capital Market Authority is doing a lot to enforce corporate governance structure and disclosure requirement so as to create investor confidence and as such there has been an upsurge of information disclosed by corporate to meet the needs of local and foreign investors (Mwangi, 2012).

In Kenya prior researches have studied the link between corporate governance and its effect on company performance, return on investment, and information disclosure among other factors as well as analyzing different governance structures in different industries. Alice (2008) while studying the relationship between corporate governance and return on investment (ROE), found out that there was a positive relationship between ROE, board size and board composition. These research findings concurred with Kihara (2006) who observed that unlike inside directors, outside directors are better and able to challenge the CEO hence a minimum of three outside directors were required on the board. Izan, Hancock and Barako (2006) studied the relationship between corporate governance and voluntary disclosure in Kenyan companies and concluded that the presence of an audit committee was a significant factor associated with the level of voluntary disclosure, and board independence was found to be significantly negatively associated with the extent of voluntary disclosure. In contrast, board leadership structure appeared not to have a significant influence on the level of voluntary disclosure by companies.
The above studies among others though have studied effects of corporate governance, this paper seeks to contribute to the body of research and directly examine the relationship between corporate governance and its effect on information asymmetry in the emerging Kenyan securities market. A research gap exists as limited researches have been done on the effect of corporate governance on the information asymmetry of listed companies in Kenya’s Nairobi Securities Exchange (NSE).

The need to carry out this study arose from the fact that listing of companies in the NSE has continued to increase and corporate governance is a key requirement that has to be adhered. Shareholders are increasingly becoming educated and informed about how the securities exchange market works. They are now more than ever aware that disclosure information has an influence the value of their investments (Diamond and Verrecchia, 1991). It was therefore important to assess if the corporate governance structures put in place by the listed firms have an impact on information asymmetry between managers and investors. This paper sought to answer the questions: Do firms’ governance structures through Board Ownership affect information asymmetry between managers and investors? Does board dependence influence information asymmetry between stockholders and managers? Does CEO duality have an effect on the level of information asymmetry between managers and investors?

1.3 Objectives of the Study

This study aimed at investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The study was guided by the following specific objectives:

i. To find out the effect of Board Ownership on the information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

ii. To investigate how board independence influences information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

iii. To determine how CEO duality affects information asymmetry between managers and investors in firms listed at Nairobi Securities Exchange.

1.4 Value of the Study

The findings of this study would help managers to evaluate and appreciate what benefits they
could accrue as a result of disclosure of board processes as well as implementing solid corporate governance structures. They will understand how strategic use of corporate governance can increase and create value for the same investors, which is the main goal for the listed companies. Shareholders will realize the importance of demanding as well ensuring corporate governance structures are functional within the organization. They will understand how variables such as board Independence, CEO/Chair duality, and Board Ownership information asymmetry between them and their managers, as well as how information available to them can affect their decision making as investors. They also in annual general meetings will be in a position to demand transparency and be privy to board processes.

The stock market regulator (Capital Market Authority) will also use the findings in the implementation and development of regulations aimed at executing its mandate of promoting market confidence, investor protection and access to financial services within capital markets in Kenya and the region through effective regulation and innovation. Researchers and scholars also get valuable reference material for future studies who would wish to venture into this area of study. Findings from this study have laid a basis for empirical evidence on the effects of corporate governance on information asymmetry.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents the theoretical literature and examines the various theories that contribute to and inform corporate governance, its determinants i.e. Board Ownership, independence and CEO/chair duality. It will also review extant empirical literature relating to corporate governance and information asymmetry.

2.2 Theoretical Review

The theories upon which the concept of corporate governance draws its foundation and the areas it encompasses, date form much earlier. These theories are also drawn from a variety of disciplines such as finance, law, organizational behavior among others.

2.2.1 Agency Theory

The agency theory identifies the agency relationship between an agent and a principle (Jensen & Meckling, 1979; Ferma & Jensen, 1983). Jensen and Meckling (1979) assume that as agents do not own the corporation’s resources, they may commit ‘moral hazards’ (such as shirking duties to enjoy leisure and hiding inefficiency to avoid loss of rewards) merely to enhance their own personal wealth at the cost of their principals. There also develops a problem of information asymmetry whereby the principle and the agent have access to different levels of information, in reality this means that the principle will be at a disadvantage because the agent has more information.

In the context of corporate governance, agency theory views corporate governance mechanisms especially board of directors as being an essential monitoring device to ensure that any problem that may be brought about by the agency conflict may be minimized (Gul and Leung 2004). In theory, the board of directors is directly elected by shareholders at the company’s annual general meeting (AGM). If these directors wish to stay in their jobs they take decisions which maximize the wealth of their shareholders. In his literature review, Harris (1994) contends that company boards have evolved as part of the market solution to the problem of contracting within organizations. Fama and Jensen (1983) argued that effective corporate boards would be
composed largely of outside independent directors holding managerial positions in other companies. They argued that effective boards had to separate the problems of decision management and decision control. However, if the CEO was able to dominate the board, separation of these functions would be more difficult, and shareholders would suffer as a result. Outside directors, he contended, are able to separate these functions and exercise decision control, since reputational concerns, and perhaps any equity stakes, provides them with sufficient incentive to do so. Corporate boards should act as monitors in disagreements amongst internal managers and carry out tasks involving serious agency problems.

2.2.2 Transaction Cost Economies

This theory views the firm itself as a governance structure. It further emphasizes that the choice of an appropriate governance structure can help align the interests of directors and shareholders. This theory looks at the various investments projects available to a firm and the various ways in which these projects can be cost effectively financed either through debt of equity. According Williamson’s (1988) argument, the solution to the problem of costly financing of highly specific assets with debt is to be found in the invention of equity.

In his literature review Lev (1988) contends that the equity governance structure has three important properties. First, similarly to Agency Theory shareholders bear a residual claiming status. Second, the equity contract lasts for the duration of the life of the corporation. And third, a safeguard in the form of a board of directors is created and awarded to equity-holders. According to this view, the board bears a decision-review and monitoring relation to the firm’s management, including the review and monitoring of management’s investment policy.

2.2.3 Stakeholders Theory

The shareholder model of corporate governance relies on the assumption that shareholders are morally and legally entitled to direct the corporation since their ownership investment is an extension of their natural right to own private property (Beasely, 1996). Byard(2006) in his literature review however notes that the idea that the shareholders govern the corporation is largely a fiction’, because in reality executives exercise the highest power. Dechow et al. (1996) argue that executives can and should be made more accountable and responsive to some groups other than themselves. Stakeholders’ theory takes into account a wider group of constituents
rather than focusing on shareholders, then the governance structure may provide for some direct representation of the stakeholder groups (Shleifer and Vishny, 1997).

One premise of the stakeholder’s theory is that the stakeholders have vested interests in the firm. Shareholders on the other hand have a residual interest on the firm, that is, a right to the free cash flow ones all the stakeholders (debt holders, employees, suppliers) have been paid. Freeman (1984) posits that successful managers must systematically attend to the interests of various stakeholder groups. This “enlightened self-interest” position has been expanded upon by Chen (2000) who believes that the interests of stakeholders have inherent worth irrespective of whether these advance the interests of shareholders. Under this viewpoint, the success of a corporation is not merely an end in itself but should also be seen as providing a vehicle for advancing the interests of stakeholders other than shareholders. It is therefore in the shareholders best interest to ensure that all the firm’s resources are utilized to their maximum effect and thus benefiting even the stakeholders. Stakeholder and shareholders may require the firm to have different corporate governance structures and monitoring mechanisms as they deem favorable to secure their interests (Claessens, 2003)

2.2.4 Stewardship Theory

In this theory, the directors of the firm are viewed as stewards of the company’s assets. They are such inclined to act in the best interest of the shareholders (Donaldson, 1990). They argue that unlike the agency theory whose thrust was an accent on managerial “opportunism” by having a board chair different form the CEO and using incentives to bind the CEO to the shareholders interests, theirs stresses on the benefit of having facilitative authority structures that unified the role of the CEO and Chair held by one person. The emphasis was not on placing management under ownership control but empowering managers to autonomously execute decisions.

It is to be noted that corporate governance continues to develop and draw its framework from a multiple of disciplines. The main theory however from which it has mainly drawn it development is the agency theory. All other theories come into play as companies increasingly become aware that they cannot operate in isolation thus the emergence and inclusion of other theories highlighted above (Donaldson 1990).
2.3 Determinants of Corporate Governance

Corporate governance being the process of decision making and implementation, it also focuses on the formal and informal parties involved in both decision-making and implementation of the decisions made. These formal and informal structures that have to be set in place to arrive at successful implementation are based on three indicators of the governance structures, these being Board Ownership, board independence and CEO duality.

2.3.1 Board Ownership

Baghat et al. (2002) propose that Board Ownership is a measure of corporate governance and found that it had a direct relation to corporate performance. They argue that Incentive-based economic models of managerial behavior motivate governance features and structures. In agency models, a conflict of interests between managers and shareholders cause managers to take actions that are costly to shareholders. Contracts are not sufficient enough to stop managers from engaging in pricey activities if shareholders are unable to observe managerial behavior directly. Board Ownership structures thus come into play. Ownership by the manager is used to induce managers to act in a manner that is consistent with the interest of shareholders.

Proponents of the adverse selection models on the other hand are motivated by the hypothesis of differential innate ability that cannot be observed by shareholders. What this means is, ownership may be used to bring on revelation of the manager's private information about cash flow or her ability to generate cash flow, which cannot be observed directly by shareholders (Myerson, 1987). From the above two models, some features of corporate governance may be interpreted as a characteristic of the contract that governs relations between shareholders and managers. Governance is affected by the same unobservable features of managerial behavior or ability that are linked to ownership and eventually performance.

2.3.2 Board Independence

The board of directors and executive management are two significant components of a firm’s governance progression. Several intimately related governance issues of the board and management include the responsibility, structure and independence of the board, and the management contract. The board seems to be an imperative internal device for resolving the agency tribulations, since it is primarily responsible for recruiting and monitoring the executive
management to defend the interests of the shareholders and other stakeholders. Prowse (1994) notes that the board makes a connection between managers and investors by taking a leadership role. He also suggests that an assessment of the board (or board sub-committees) can help establish performance criteria that can be used to achieve the corporate objective and to align the performance of the directors with the interest of the shareholders. A related literature also refers to board structure and independence as important governance components. Denis and McConnell (2003) regard a smaller board as an important determinant of corporate governance and firm performance. Solomon et al. (2003) and Tsui and Gul (2000) opine that the outside or non-executive directors play an important governance role in relation to the welfare of the investors, especially non-controlling shareholders.

The presence of outside directors improves the degree of corporate answerability and creates a balance of power between the CEO and the board (Denis and McConnell, 2003; Ricart et al., 1999). Likewise, the OECD (2003) observes that independent non-executive directors can exercise unbiased judgment in relation to the conflicts of interest among different stakeholders. This presence of independent non-executive directors seems to have an important implication in family-based governance, as Solomon et al. (2003) consider founding family dominance as a negative aspect of corporate governance. The issue of CEO duality (the CEO and board chairperson being the same individual) appears to constrain board independence, because there is a possibility of conflict of interests. Daily and Dalton (1997) and Kesner and Dalton (1986) mention that separate board structure can enhance board independence and shareholder value.

However, a separate board does not necessarily ensure better governance, as Daily and Dalton (1997) argue, the chairperson in a separate board structure might possess his/her own interest in the firm’s governance. Corporate interlocking is another inter-organisational strategy for managing the resource interdependencies such as, strategic alliances, mergers and acquisitions (Ong et al., 2003). Whilst the presence of the same individual on the boards of several firms can create firm value, it can yield a negative influence on the firm’s governance because of the potential for conflicts of interests between firms. Aside from monitoring the executive management, the board is also responsible for designing the management contract that minimises the degree of agency conflicts. Several studies (Prowse, 1994; Becht et al., 2002; McColgan, 2001) mention that a management contract aligns personal interest of the managers
with that of the shareholders and provides managers with the incentives to maximize firm value. It is suggested that a value enhancing management contract should include: basic salary components, performance-based cash bonuses and profit-based salary revisions, stock participation plan (e.g. stock options), outright ownership of the firm’s equity, pension rights, performance-based dismissal provisions, and long-term incentive plans.

2.3.4 CEO/Chair Duality

CEO duality is a contentious issue that has attracted significant public and academic scrutiny. In his study Sampson (1992) found that 75% to 80% of U.S. firms combined the CEO and chair roles into one position. However, Grinstein & Valles (2008) showed a significant jump in the number of S&P 500 companies splitting CEO/chair roles. They report that 31% of S&P 1000 firms in 2004 separated the CEO/chair roles, a marked increase from the 24% reported in 2000. They argued that corporate scandals, such as Enron and WorldCom, and the 2001 recession raised the alarm for more board vigilance and decentralization of power.

Critics of CEO duality argue that duality compromises board effectiveness in monitoring the CEO. They assert that dual CEOs are more likely to pursue selfish interests that are inconsistent with shareholders’ values. Proponents of CEO duality assert that a combined CEO/chair structure provides directional clarity and judgment that is lacking within an independent leadership structure. Separation of CEO and chair may limit CEO entrepreneurism in ventures that can increase firm value because the CEO’s decisions are consistently monitored and thus affect performance.

2.4 Transparency and Accountability

Transparency and accountability are two closely related issues that are crucial, not only in enhancing the disclosure and auditing standards of a firm, but also in developing the regulatory organ’s capacity to monitor and discipline the firm’s governance practices. Therefore, it is imperative for a firm to make its financial and non-financial information available and easily accessible to outsiders in order that everyone can make informed decisions. Effective disclosures enable existing as well as prospective investors, to evaluate the management’s past performance, forecast the firm’s future cash flow and to decide whether the risk profile of a firm is within an acceptable level (Foo et al., 2000; Gul et al., 2000). Thomas et al., (2002) note
that information to shareholders is one of the most important aspects of corporate governance, as it reflects the degree of transparency and accountability of the corporations towards its shareholders. The quality of a firm’s disclosures tends to be determined by the development of the capital market and the standards of accounting and auditing practices of a country. Whilst Claessens and Fan (2002) emphasise the quality auditing and professional integrity of the external auditors, it is commented that weak enforcement of accounting and auditing standards restrains quality auditing.

2.5 Determinants of Information Asymmetry

The main factors affecting the asymmetry of information between the managers and the investors resulting from risky securities are namely: the trading volume, the volatility of stock returns, and the stock price. Trading volume influences information asymmetry as the interplay of supply and demand determines the transaction price of each stock security. Securities are traded for cash and thus buyers must have available money and sellers must have stocks and the outcome, that is the payment and delivery of securities, takes place immediately after negotiation. Liao (2009) points out that the trading volume is closely linked with various measures of asymmetric information and this volume decreases when the earnings are announced. Additionally Byard et al. (2006) found that the inverse of the average daily trading volume positively influenced the asymmetry of information.

Stock return measures are also highlighted as determining information asymmetry. Blackwell et al., (1990) use residual volatility in daily stock returns as another proxy for information asymmetry. As Kyle (1985) pertaining the transactions of the informed and the insiders’ expected trading benefits, they are positively related to non-specific assessments of the company’s value. Insofar as the residual volatility of stock returns reflects some uncertainty about the company’s value, the problem of information asymmetry increases. Fee and Thomas (1999) have mentioned some uncertainty factors for companies such as the rates fixed by the Federal Reserve that are simultaneously relative to both insiders and outsiders. If the insiders’ transactions exceed the abnormal outputs, the superfluous information disclosure entirely does not remove the informational advantage of the leaders (Harris, 1994). There is thus a close connection between stock return and information asymmetry.
Several studies have shown that the share price explains a significant part of the information asymmetry. Comerton-Forde and Rydge (2006) in their study found that the share price is positively associated with this information asymmetry and Attig et al. (2006) noted that the share price is a vector of information, so it negatively affects the information asymmetry. Stoll (1978) posits that the trading volume and the incurred risk affect the cost of detention of market makers. He also notes that the stock price is a proxy for the unobservable minimum cost. In his empirical test stoll (1978) found that the bid-ask spread negatively affected the trading volume while the stock price positively influenced the variability of returns.

The proxy to be used to measure information asymmetry, as the dependent variable, is the bid-ask prices, spread (SPREAD). The relation between the extents of informed trading and bid-ask spreads was first discussed in (Bagehot,1971). Bagehot (1971) argues that market makers trade with two kinds of traders informed and uninformed. While the market maker loses to informed traders, he recoups these losses from uninformed traders by increasing the bid-ask spread. Thus, a high level of informed trading leads to higher bid-ask spreads. Bagehot’s (1971) intuition was subsequently modeled by Kyle (1985), and Glosten and Milgrom (1985).

2.6 Empirical Review

It has long been recognized that greater managerial ownership generates greater alignment of the interests of shareholders and managers, and mitigates the agency problems between the two parties (Jensen and Meckling, 1976; Demsetz, 1983). Agency theory predicts that there is a positive association between management interests and the level of voluntary disclosure. Warfield et al (1995) provided that evidence supporting this contention in their findings that the extent of shareholding by management is positively associated with the amount of information disclosed about earnings. The above reasoning suggests that firms with higher Board Ownership will be associated with greater levels of disclosures and hence lower degree of information asymmetry.

Drawing from Fama and Jensen (1983) a large body of empirical evidence finds that outside directors who are independent of management’s influence help enhance shareholder value by protecting shareholder interests against managerial opportunism (Hermalin and Weisbach, 2001). Focusing on financial reporting issues in particular, (Beasley, 1996; Dechow et al.,
1996; Klein, 2002) found that outside directors are effective monitors of managerial actions. Beasley (1996) argued and provided evidence that the proportion of outside directors is positively related to the board’s ability to influence disclosure decisions.

Chen and Jaggi (2000) found empirical evidence of a positive relationship between Board independence and disclosure (including mandatory disclosure). Foo and Zain (2010) examined the association between bids-ask spread, a market-based measure of information asymmetry, and board characteristics among 227 firms listed on the Main Board of Bursa Malaysia. The results revealed that board independence is negatively related to the level of information asymmetry. Based on the foregoing discussion, it can be inferred that the proportion of outside directors in the board might have a positive impact on disclosure practices, thus leading to lower degree of information asymmetry.

Fama and Jensen (1983) pointed out that CEO duality signals the absence of separation of decision control and decision management. The result of CEO duality is the concentration of decision-making power, which could constrain board independence and reduce its ability to execute its oversight and governance roles Gul and Leung, (2004), and proved detrimental to disclosure levels and quality, especially voluntary disclosure (Ho and Wong, 2001). Huafang and Jianguo (2007) provided evidence that an increase in independent directors increases corporate disclosure and CEO duality is associated with lower disclosure. Byard et al (2006) reported that CEO duality is negatively associated with analysts’ forecast accuracy. The authors conclude that CEO duality increases information asymmetry.

2.7 Summary of Literature Review

From the studies reviewed there different interests among researchers, some analyzing corporate governance components together and others separately. Whilst a majority of corporate governance literature centers on individual governance components, a recent literature is based all related issues of corporate governance and its effects on various aspects of the organization, ranging from strategy, profitability, performance, disclosure, cost of capital, return on investment among many other aspects of the firm. Empirical studies reviewed indicate how individual governance components e.g. ownership structures, board composition, board
independence and disclosure quality and overall governance standards such as corporate governance index are associated with the firm’s valuation as well as operating performance.

Empirical evidence reviewed of the influence of individual corporate governance mechanisms various aspects of the firms is highly indicative that indeed corporate governance mechanisms do influence the success of any organization. This chapter undertook a review literature relevant to this research with the aim of getting views and opinions on investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The chapter specifically covers the theoretical foundation and the Determinants of corporate governance. Corporate governance being a relatively new area, its development has been affected by various disciplines. The main theory that has affected its development however most naturally seems to rest in the agency theory. However the stakeholders theory is coming in more into play as companies increasingly grow and become aware that they cannot operate in isolation and that they need to have a wider regard to the stakeholder constituency.

The process of the growth of a firm takes time and this is because firms have to develop the necessary capabilities to cope with growth. Entrepreneurial growth and managerial resources are inseparable and as such corporate governance and monitoring mechanisms continue to be a key component to the success of firms in both the local and the global economy (Foo and Zain, 2010). Organizations must therefore continually review their governance structures, their effect on performance and as such align them to global trends (Izan et al., 2006).
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter has covered the research design, population, sample, data collection and data analysis, which describes the firms and variables, included in the study and applied statistical techniques in investigating how a firm’s corporate governance affects the level of information asymmetry between managers and investors.

3.2 Research design

This study was conducted using explanatory research design. According to Mugenda and Mugenda (2010) exploratory research explores the why questions which in effect involved developing a causal explanation which could either be direct or indirect relationship between variables, that is, the effect of one thing on another and more specifically, the effect of one variable on another. Mugenda and Mugenda (2010) contends that exploratory research has the advantage of being relatively cheap and it will be considered for the study so as to establish the effect of corporate governance on information asymmetry of companies listed in NSE.

3.3 Target population

The target population of this study was all the companies listed at the Nairobi Securities Exchange. There are 62 listed companies at the Nairobi Securities Exchange from which the data will be drawn.

3.4 Sampling

The sample of the study involved the target population of the companies listed in the NSE. The researcher used the purposive sampling techniques. This is where the optimum sample size was a result of purposively selecting firms that were already listed by the year 2003; this is to allow a ten year analysis of data. The sample firms were adequate to fulfill the requirements of efficiency, representativeness and reliability. Unnecessarily large sample size would bring about data duplicity besides having cost and time implications while a small sample size would not be representative. The sample size was of 32 companies listed at the Nairobi Securities Exchange.

A simple random technique was used to select one staff from public relations or corporate
affairs department from each company on whom primary data was collected. This sampling technique is suitable for use since every firm in had an equal chance of being selected and thus the sampling technique eliminated bias. Secondary data was collected from company’s’ and NSE’s and companies’ websites and prospectus among others.

3.5 Data Collection

The study used both primary and secondary data sources in gathering data for analysis. The primary data source was semi-structured questionnaires. The questionnaires were both open and close-ended questions (Munn and Drever, 2004). A pilot test was conducted to field test the reliability and the validity of the instruments (Kothari, 2004). The data from the pilot test was analyzed using informative presentation tables and graphs.

3.6 Data Analysis

The study used multiple linear regression equation and the method of estimation was Ordinary Least Squares (OLS) so as to establish the relationship between corporate governance and information asymmetry. Ordinary least squares (OLS) is a method for estimating the unknown parameters in a linear regression model by minimizing the sum of squared vertical distances between the observed responses in the dataset, and the responses predicted by the linear approximation, thus, providing minimum-variance mean-unbiased estimation (Hayashi, 2000).

The proxy to be used to measure information asymmetry, as the dependent variable, is the bid-ask spread (SPREAD). The relation between the extents of informed trading and bid-ask spreads was first discussed in (Bagehot, 1971). Bagehot (1971) argues that market makers trade with two kinds of traders informed and uninformed. While the market maker loses to informed traders, he recoups these losses from uninformed traders by increasing the bid-ask spread. Thus, a high level of informed trading leads to higher bid-ask spreads. Bagehot’s (1971) intuition was subsequently modeled by Kyle (1985), and Glosten and Milgrom (1985). Specifically,

\[ \text{SPREAD} = \frac{1}{D_{it}} \sum \left( \frac{\text{ASK}_i - \text{BID}_i}{\text{ASK}_i + \text{BID}_i} \right) \]

Where: \( D_{it} \) is the number of days in year t for firm i for which closing daily bids (\( \text{BID}_i \)) and closing daily asks (\( \text{ASK}_i \)) are available.
ASK is the price at which an investor (seller) is willing to sell, and BID is the price at which the investor (buyer) is willing to buy. Numerous studies starting from (Demsetz, 1968; Bagehot, 1971) have used bid–ask spread to proxy for information asymmetry between informed traders and liquidity traders.

Corporate board characteristics: the Variables that represent corporate board characteristics are Board Ownership, board independence and CEO duality. Board Ownership is computed as the proportion of executive share ownership to total shares of the firm. Board independence (BIND) is measured as the proportion of non-executive (independent) directors on board. CEO duality (CEO) is measured as a dummy variable, assigned 1 if the chief executive officer (or managing director) additionally occupies the position of the chairman of the board, or 0 if otherwise.

Several factors that are relevant to bid-ask spread as control variables were selected in multiple-regression models. Among of these factors are firm size, Stock return volatility, ROE and growth opportunity. Large firms may face less information asymmetry because they tend to be more mature firms, have established and time-tested disclosure policies and practices, and receive more attention from the market and regulators (Harris, 1994). Stock return volatility was included, because market makers increase the spread to make up for the uncertainty associated with volatile stocks. ROE is included on the expectation that income-generating firms disclose more information to communicate investors of their good performance (Wallace et al, 1994). Therefore it is expected that a negative relationship between firm Profitability and information asymmetry. Another important control variable is growth opportunity (GWTH), High-growth firms have greater information asymmetry because Firms with favorable future prospects are less likely to provide sensitive operating information in order to protect their competitive advantages and avoid attracting new entrants or increased competition from existing competitors (Liao, 2009). The ratio of market-to-book value of equity to proxy for growth opportunities was used.

To investigate the association between corporate governance characteristics and information asymmetry, the researcher used the following ordinary least squares (OLS) regression
For firm i at the end of year t, where:

\[ \text{SPREAD}_{i,t} = \beta_1 \text{BOWN}_{i,t} + \beta_2 \text{BIND}_{i,t} + \beta_3 \text{DUAL}_{i,t} + \beta_4 \text{FSIZE}_{i,t} + \beta_5 \text{VOL}_{i,t} + \beta_6 \text{ROE}_{i,t} + \beta_7 \text{GWTH}_{i,t} + \alpha \]

\[ = \beta_1 \text{BOWN}_{i,t} + \beta_2 \text{BIND}_{i,t} + \beta_3 \text{DUAL}_{i,t} + \beta_4 \text{FSIZE}_{i,t} + \beta_5 \text{VOL}_{i,t} + \beta_6 \text{ROE}_{i,t} + \beta_7 \text{GWTH}_{i,t} + \alpha \]

\[ \text{SPREAD} = \text{defined as annual relative bid-ask spread using daily closing bids and asks.} \]
\[ \text{BOWN} = \text{Board Ownership defined as proportion of executive share ownership to total shares of the firm.} \]
\[ \text{BIND} = \text{percentage of independent non-executive directors on board.} \]
\[ \text{DUAL} = \text{a numerical number (1) will be assigned if CEO also serves as Chairman, and (0) if not.} \]
\[ \text{FSIZE} = \text{firm size defined as natural log of firm’s total assets.} \]
\[ \text{VOL} = \text{Volatility defined as the standard deviation of daily security returns.} \]
\[ \text{ROE} = \text{return on equity defined as income before tax and interest to total equity.} \]
\[ \text{GWTH} = \text{growth prospect defined as the market value of equity divided by book value of equity.} \]
\[ \alpha = \text{the error term.} \]

\[ \text{3.6.1 Operationalization of the Variables} \]

Data from the NSE was analyzed to determine the SPREAD that is the difference between the daily price that the company shares are being sold at the NSE and the price at which the buyer buys at. From company prospectus, publications were analyzed and a percentage of shares owned by the directors of the company as a proportion of the total issue of share for each year were collected to determine BOWN. Information regarding board members was collected from company prospectus and publications which was reviewed each year. BIND was the number of independent non-executive directors calculated as a proportion of the total number of board members. Information regarding chief executive officer was drawn from the yearly company prospectus; publications were reviewed to find DUAL. If the chief executive officer also serves as a chairman, a numerical value of 1 was assigned; if not the number 0 was assigned.

Figures on total assets was taken from the companies’ published audited financial statement determine FSIZE and ROE. From the balance sheet at the end of each year of analysis, the total
assets and equity were gotten, while the income before tax and interest was collected for the income statements. Statistics from the daily securities prices was collected to find the difference between the daily security prices, this difference was analyzed to determine the VOL. Market value of equity was calculated by valuing the total number of shares issued by the company using the market price at the end of each year while the book value of equity was the balance sheet value of equity at year end to get growth (GWTH).
CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

This has presented data collected using questionnaires. The purpose of the study was to investigate how a firm’s corporate governance affects the level of information asymmetry between managers and investors. The primary data was collected using a questionnaire as the data collection instrument while secondary data was collected from NSE’s and companies’ websites and prospectus. The study targeted 32 respondents. 23 questionnaires out of 32 were completed and returned giving a response rate of 72%. This response rate was good enough and conforms to that recommended by Mugenda and Mugenda (2003).

4.2 General Information

4.2.1 Major Background

The study sought to find out the major background of the respondents in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th>Major background</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Management</td>
<td>48%</td>
</tr>
<tr>
<td>Accounting/Finance</td>
<td>30%</td>
</tr>
<tr>
<td>Other</td>
<td>22%</td>
</tr>
</tbody>
</table>

Figure 4.1: Major Background

The study findings indicated that majority (48%) of the respondents were in the business management, 30% had the accounting/finance background while 22% had other backgrounds.
4.2.2 Interaction between Managers and Investors

The study sought to establish whether there is interaction between managers and investors (shareholders?) the organization. The findings are presented in the table below.

![Interaction between Managers and Investors](image)

**Figure 4. 2: Interaction between Managers and Investors**

From the study findings, majority (52%) of the respondents indicated that there is interaction between managers and investors the organization and 48% of the respondents indicated that there no is interaction between managers and investors the organization.

4.2.3 Forms of Interaction

The study sought to establish the forms of interaction between managers and investors (shareholders) the organization. The findings are presented in the table below.

![Forms of interaction](image)

**Figure 4. 3: Forms of interaction**

The study findings established that majority (39%) of the companies used mainstream media
as forms of interaction between managers and investors (shareholders), 30% of the companies used Annual General meetings as forms of interaction between managers and investors, 17% of the companies used company newsletters as forms of interaction between managers and investors, 9% of the companies used company websites as forms of interaction between managers and investors and 4% of the companies used company websites as forms of interaction between managers and investors.

### 4.3 Board Independence

#### 4.3.1 Number of Members’ Board of Directors

The study sought to establish the number of members’ board of directors in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th>No of Board Members</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2-5 members</td>
<td>13%</td>
</tr>
<tr>
<td>6-10 members</td>
<td>52%</td>
</tr>
<tr>
<td>11-20 members</td>
<td>35%</td>
</tr>
</tbody>
</table>

**Figure 4.4: Board Independence**

From the study findings, majority (52%) of the respondents indicated that there are between 6-10 board of directors members in the organization, 35% indicated that there are between 11-20 board of directors members in the organization while 13% indicated that there are between 2-5 board of directors members in the organization.

#### 4.3.2 Composition of Board Members

The study sought to describe the composition of board members in the organization. The findings are presented in the table below.
Table 4.1: Composition of Board Members

<table>
<thead>
<tr>
<th>Composition of Board Members</th>
<th>Frequency</th>
<th>Percent %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive directors only</td>
<td>4</td>
<td>17</td>
</tr>
<tr>
<td>Non executive Directors only</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Mix of both Executive &amp; Non executive</td>
<td>18</td>
<td>78</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100</td>
</tr>
</tbody>
</table>

The study findings established that most (78%) board members in the organization are a mix of both executive & non executive, 17% of the board members are executive directors while as 4% of the board members are non executive directors.

4.3.3 Strongest Voice

The study sought to establish the strongest voice in the selection of Non executive directors in the organization. The findings are presented in the table below.

Figure 4.5: Strongest Voice

According to the study findings 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, 39% of the respondents indicated that the controlling shareholder have the strongest voice in the
selection of Non executive directors while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors.

4.3.4 Attendance rate for the board meetings

The study sought to establish the attendance rate for the board meetings in the organization. The findings are presented in the table below.

Table 4.2: Attendance rate for the board meetings

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>51-75%</td>
<td>5</td>
</tr>
<tr>
<td>75-89%</td>
<td>11</td>
</tr>
<tr>
<td>90-100%</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
</tr>
</tbody>
</table>

According to the study findings 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%.

4.4 CEO/Chair Duality

4.4.1 Independence of Chairman of the Board

The study sought to establish whether the Chairman of the Board was an independent, non-affiliated director in the organization. The findings are presented in the table below.
Figure 4.6: Independence of the Chairman of the Board

From the study findings, majority (52%) of the respondents agreed that the Chairman of the Board was an independent, non-affiliated director in the organization while 48% of the respondents agreed that he was not an independent, non-affiliated director in the organization.

4.4.2 C.E.O as Chairman

The study sought to establish whether the C.E.O is a chairman of the company. The findings are presented in the table below.

Table 4.3: C.E.O as chairman

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>10</td>
<td>43%</td>
</tr>
<tr>
<td>No</td>
<td>13</td>
<td>57%</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 57% of the respondents indicated the C.E.O as the chairman of the company while as 43% of the respondents indicated the C.E.O as not the chairman of the company.
4.5 Board Ownership

4.5.1 Directors’ Remuneration

The study sought to establish whether the company has a written procedure or policies on directors’ remuneration. The findings are presented in the table below.

Table 4.4: Directors’ Remuneration

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>23</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
</tr>
</tbody>
</table>

From the study findings, all (100%) of the respondents agreed the company has a written procedure or policies on directors’ remuneration.

4.5.2 Independent Director’s Remuneration

The study sought to establish whether the independent director’s remuneration included share options. The findings are presented in the table below.

Figure 4.7: Independent Director’s Remuneration

From the study findings, most (74%) of the respondents agreed that the independent director’s remuneration includes share options while as 26% of the respondents did not agree that the independent director’s remuneration included share options.
4.5.3 Non Executive Director’s Remuneration

The study sought to establish whether the non-executive director’s remuneration include share options. The findings are presented in the table below.

![Pie chart showing 52% Yes and 48% No]

**Figure 4.8: Non-Executive Director’s remuneration**

According to the study findings 52% of the respondents indicated that the non-executive director’s remuneration include share options while as 48% of the respondents indicated that the non-executive director’s remuneration does not include share options.

4.5.4 Share Options

The study sought to establish whether the CEO/Chairman given share options in the organization. The findings are presented in the table below.

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>8</td>
<td>35%</td>
</tr>
<tr>
<td>No</td>
<td>15</td>
<td>65%</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

Table 4.5: Share Options

According to the study findings 65% of the respondents indicated that the CEO/Chairman not given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman was given share options in the organization.
4.5.5 CEO Compensation

The study sought to establish whether the board reviewed CEO compensation annually. The findings are presented in the table below.

![Figure 4.1: CEO Compensation](image)

From the study findings, most (61%) of the respondents agreed the board reviewed CEO compensation annually while as 39% of the respondents did not agree that the board review CEO compensation annually.

4.6 Disclosure/Communication

The study sought to establish whether the firms disclose the following in the firm’s web page. The findings are presented in the table below.

**Table 4.6: Disclosure/Communication**

<table>
<thead>
<tr>
<th>Disclosure Category</th>
<th>Yes</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarterly financial statement</td>
<td>9</td>
<td>39%</td>
</tr>
<tr>
<td>Directors selling or buying shares in the firm</td>
<td>4</td>
<td>17%</td>
</tr>
<tr>
<td>Directors reports</td>
<td>15</td>
<td>65%</td>
</tr>
<tr>
<td>Audited Annual reports</td>
<td>23</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to the study findings 39% of the firms disclose their quarterly financial statement in the firm’s web page, 17% of the firms disclose their Directors selling or buying shares in the
firm’s statement in the firm’s web page, 65% of the firms disclose their Directors reports in the firm’s web page and all (100%) of the firms disclose their Audited annual reports in the firm’s web page.

4.7 Multiple Regression Analysis

The study adopted simple regression guided by the following model:

\[ Y = \beta_0 + \beta_1 (X_1) + \beta_2 (X_2) + \beta_3 (X_3) + \varepsilon \]

Where:

- \( Y \) is the dependent variable representing information asymmetry between managers and investors (\( X_1 \)): Board Ownership Concentration is measured by proportion of ownership held by the main shareholder of institutional nature of the quoted company.
- \( X_2 \): Board Independence is measured by the proportion of non-executive directors inside the board (non-executive directors / total directors).
- \( X_3 \): CEO Duality is measured by a dummy value of 1 of the company CEO also pairs up as the Board Chair.
- \( \varepsilon \): Standard Error term.

The above model was tested and analyzed to determine its suitability to determine the relationship between corporate governance variables above and information asymmetry and the results tabulated below;

### Table 4.7: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.387a</td>
<td>.7005</td>
<td>.687</td>
<td>.23665</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Board Ownership, Board Independence and CEO Duality

Author: Research data (2014)

From table 4.7, R indicates that there exist a moderate relationship between the independent variables i.e CEO duality, board independence and Board Ownership, and the dependent variable information asymmetry. The coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables) R Square equals 0.7, that is, 70 percent aggregate information asymmetry can be explained through the
combined linear effects of Board Ownership, Board Independence and CEO Duality. In order to test the significance of the model, the study conducted an Analysis of Variance. The findings were as shown below:

**Table 4.8: Analysis of Variance**

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Regression</td>
<td>3</td>
<td>5</td>
<td>.331</td>
<td>5.911</td>
<td>.003a</td>
</tr>
<tr>
<td>Residual</td>
<td>49</td>
<td>40</td>
<td>.056</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>45</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: Constant, Board Ownership, Board Independence and CEO Duality

b. Dependent Variable: Information asymmetry

Author: Research data (2014)

The ANOVAs results, the probability value of .003 were obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry.

**Table 4.9: Coefficients of determination**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>-5.08</td>
<td>-5.23</td>
<td>-6.16</td>
<td>0.048</td>
</tr>
<tr>
<td>Board Ownership</td>
<td>-5.53</td>
<td>0.10</td>
<td>.140</td>
<td>.002</td>
</tr>
<tr>
<td>Board Independence</td>
<td>-6.94</td>
<td>1.03</td>
<td>.110</td>
<td>.000</td>
</tr>
<tr>
<td>CEO Duality</td>
<td>2.98</td>
<td>.476</td>
<td>0.39</td>
<td>.001</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Information asymmetry

Author: Research data (2014)
Y = -5.08 -5.53X1 -0.42X2 -6.94X3 +0.020X4 +2.98X5

where Y = Information asymmetry

B0 = intercept (defines value of Information asymmetry without inclusion of predictor variables)

X1 = Board Ownership

X2 = Board Independence

X3 = CEO Duality

Table 4.9 present results of the simple linear regression of Aggregate Information asymmetry on Board Ownership, Board Independence and CEO Duality. From the findings, the coefficients of aggregate Information asymmetry is negative and significant, indicating that holding Board Ownership, Board Independence and CEO Duality constant Information asymmetry will be -5.08. The study also found that a unit increase in Board Ownership will cause a 5.53 decrease in information asymmetry, further a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, and a unit increase in CEO Duality will further lead to an increase in information asymmetry by a factor of 2.98.

4.8 Interpretation of Results

The study revealed that majority (52%) of the respondents agreed that Chairman is the of the Board an independent, non-affiliated director in the organization while 48% of the respondents agreed that is not of the Board an independent, non-affiliated director in the organization. 57% of the respondents indicated that the C.E.O as the chairman of the company while as 43% of the respondents indicated that the C.E.O is not the chairman of the company. This means that majority of the firms are adopting the CMA proposal to have CEO and Chair being independent. 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%. From the findings, 52% of the respondents indicated that the non executive director’s remuneration include share options while as 48% of the respondents indicated that the non executive director’s remuneration does not include share options.

According to the study findings, 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the
CEO/Chairman given share options in the organization. From the study findings, most (61%) of the respondents agreed the board review CEO compensation annually while as 39% of the respondents did not agreed the board review CEO compensation annually. Board ownership continue being an incentive used by investors to align the interests of the managers to those of the shareholders. 39 % of the firms disclose their quarterly financial statement in the firm’s web page, 17 % of the firms disclose their Directors selling or buying shares in the firms’ statement in the firm’s web page, 65 % of the firms disclose their Directors reports in the firm’s web page and all (100 %) of the firms disclose their Audited annual reports in the firm’s web page.

The findings on the coefficient of determination indicated that R Square equals 0.7, that is, aggregate information asymmetry explain 70 percent of Board Ownership, Board Independence and CEO Duality. In order to test the significance of the model, the study conducted an Analysis of Variance. The findings on the ANOVAs results indicate that the probability value of .003 was obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry. From the findings, the coefficients of aggregate Information asymmetry is negative and significant, indicating that holding Board Ownership, Board Independence and CEO Duality constant Information asymmetry will be -5.08. The study also found that a unit increase in Board Ownership will cause a 5.53 decrease in information asymmetry, further a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, and a unit increase in CEO Duality will further lead to an increase in information asymmetry by a factor of 2.98.

Inferential statistics such as non parametric test which include analysis of variance (ANOVA) were used to test the significance of the overall model at 95% level of significance. According to Mugenda (2008) analysis of variance is used because it makes use of the F – test in terms of sums of squares residual.
CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of key data findings, conclusions drawn from the findings highlighted and policy recommendations that were made. The conclusions and Recommendations drawn were in quest of addressing research objectives of how a firm’s corporate governance affects the level of information asymmetry between managers and investors.

5.2 Summary of Findings

A fundamental issue addressed in this research was to examine the effect of corporate governance on information asymmetry between managers and investors of companies listed in the NSE. Corporate governance attributes examined in this paper are CEO/Chair duality and board independence and Board Ownership. The study finds that there exists a relationship between corporate governance and information asymmetry between managers and investors as discussed below

5.2.1 Board Independence

From the study findings table 4.6, majority (52%) of the respondents indicated that there are between 6-10 board of directors members in the organization while figure 4.4 shows 13% indicated that there are between 2-5 board of directors members in the organization. The study further established that most (78%) board members in the organization are a mix of both executive & non executive, 17 % of the board members are executive directors while as 4 % of the board members are non executive directors. 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, 39% of the respondents indicated that the controlling shareholder have the strongest voice in the selection of Non executive directors while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors. According to the study findings 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board
meetings was between 51-75%.

Further analysis from the multiple regression indicated that the coefficients of aggregate Information asymmetry was significant and negatively related, indicating that a unit increase in board independence will lead to a decrease in information asymmetry by a factor of 6.94, while the level of significance was ≤5%. These results collaborated with previous research that found that non-executive directors act as a reliable mechanism to diffuse agency conflicts between managers and owners (Fama & Jensen 1983). They are viewed as providing the necessary checks and balances needed to enhance board effectiveness (Franks, Mayer, & Renneboog, 2001). The results correspond to Chen & Jaggi (2000) who provide empirical evidence of the relationship between the proportion of non-executive directors on the board and corporate disclosure. The results of the research findings verify the relevance of non-executive directors as a governance mechanism that enhances the board’s capacity to ameliorate agency conflict between owners and managers.

5.2.2 CEO Duality

From the study findings, most 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman given share options in the organization. 61% of the respondents agreed the board review CEO compensation annually while as 39% of the respondents did not agreed the board review CEO compensation annually. 39 % of the firms disclose their quarterly financial statement in the firm’s web page, 17 % of the firms disclose their Directors selling or buying shares in the firm statement in the firm’s web page, 65 % of the firms disclose their Directors reports in the firm’s web page and all (100 %) of the firms disclose their Audited annual reports in the firm’s web page. Majority (52%) of the respondents agreed that Chairman is the of the Board an independent, non-affiliated director in the organization while 48% of the respondents agreed that is not of the Board an independent, non-affiliated director in the organization. 57 % of the respondents indicated that the C.E.O as the chairman of the company while as 43 % of the respondents indicated that the C.E.O is not the chairman of the company.

From the findings of the regression analysis, aggregate Information asymmetry is positive and
significant in relation to CEO duality, indicating that information asymmetry increased with an increase in CEO/Chair Duality. The results indicated a 2.98 coefficient at <0.5% significance level. Within the context of corporate governance, the major issue often discussed is whether the chair of the board of directors and CEO positions should be held by different persons (dual leadership structure) or by one person (unitary leadership structure). Agency theory suggests that the combined functions (unitary leadership structure) can significantly impair the boards’ most important function of monitoring, disciplining and compensating senior managers. It also enables the CEO to engage in opportunistic behavior because of his/her dominance over the board. The results are consistent with Sampson (1992) who empirically studied the relationship between corporate governance and disclosure quality and found that the extent of disclosure was higher in firms with dual leadership structures.

5.2.3 Board Ownership

From the study findings, all (100%) of the respondents agreed the company has a written procedure or policies on directors’ remuneration. Most (74%) of the respondents agreed that the independent director’s remuneration include share options while as 26% of the respondents did not agreed that the independent director’s remuneration include share options. 52% of the respondents indicated that the non executive director’s remuneration include share options while as 48% of the respondents indicated that the non executive director’s remuneration does not include share options. According to the study findings out 65% of the respondents indicated that the CEO/Chairman given share options in the organization while as 35% of the respondents indicated that the CEO/Chairman given share options in the organization

According to the study findings, 48% of the respondents indicated that the board or its nominated committee have the strongest voice in the selection of Non executive directors, while 13% of the respondents indicated that the CEO have the strongest voice in the selection of Non executive directors. 48% of the respondents indicated that the attendance rate for the board meetings was between 75-89%, 30% of the respondents indicated that the attendance rate for the board meetings was between 90-100% while 22% of the respondents indicated that the attendance rate for the board meetings was between 51-75%.

From the findings of the regression analysis, Board Ownership was negative and significant in
relation to aggregate information asymmetry, indicating that information asymmetry decreased with an increase in Board Ownership. The results indicated a -5.53 coefficient at <0.5% significance level. The results support the agency theory predicts that there is a positive association between management interests and the level of voluntary disclosure. Warfield et al (1995) provided that evidence supporting this contention in their findings that the extent of shareholding by management is positively associated with the amount of information disclosed about earnings. The above reasoning suggests that firms with higher Board Ownership will be associated with greater levels of disclosures and hence lower degree of information asymmetry.

The findings on the ANOVAs results indicate that the probability value of .003 was obtained which indicates that the regression model was significant in predicting the relationship between corporate governance characteristics and information asymmetry.

5.3 Conclusions
The relevance of corporate governance cannot be over-emphasized since it constitutes the organizational climate for the internal activities of a company. Corporate governance brings new outlook and enhances a firm’s corporate entrepreneurship and competitiveness. The study examined the role of corporate governance characteristics i.e. board composition, board independence and CEO/Chair duality and its effect on information asymmetry between managers and investors in companies listen at the NSE in Kenya.

From table 4.9, it was evident that there is a negative relationship between Board Independence information asymmetry, since their coefficient estimates are -6.94 at 0.00 the level of significance. It can be concluded therefore that from the study the level Board Independence significantly affected information asymmetry between managers and investors. These research findings are consistent with earlier research by Kihara (2006) who observed that unlike inside directors, outside directors are better and able to challenge the CEO hence a minimum of three outside directors is required on the board. It also concurs with Jensen (1993) who voices his concern that, lack of independent leadership makes it difficult for boards to respond to failure in top management team. The study concluded that board members in the organization are a mix of both executive & non executive and that the board or its nominated committee has the strongest voice in the selection of Non executive directors.
On CEO/chair duality the findings revealed a positive coefficient of 2.98 thus a positive relationship to information asymmetry between managers and investors. The significance level was 0.002. Data collected revealed that the CEO/chairman proposed share options in the organization while as the board review CEO compensation annually. The study concluded that CEO duality is the other corporate governance index that is significantly related to the information asymmetry. This result is consistent with Gul and Leung (2004) who found that CEO duality is positively associated with international firm acquisition. His research showed that, international acquisition had a significant impact on shareholder value. He found a positive relationship between a firm leadership structure and its announcement of foreign acquisitions. Huafang and Jianguo (2007) provided evidence that CEO duality is associated with lower disclosure.

In addition the study also concluded that a unit increase in Board Ownership will cause a -5.53 decrease in information asymmetry, meaning that there exists a negative relationship between the two at a significance level of 0.001. The company's have a written procedure or policies on directors’ remuneration and that the non executive director’s remuneration include share options also, the firms disclose their directors reports in the firm’s web page while all of the firms disclose their Audited annual reports in the firm’s web page. Foo and Zain (2010) examined the association between bids-ask spread, a market-based measure of information asymmetry, and board characteristics among 227 firms listed on the Main Board of Bursa Malaysia. The results revealed that board independence is negatively related to the level of information asymmetry.

5.4 Limitation of the Study

The model may misestimate outcomes, because it assumes that corporate governance characteristics affect information asymmetry. The proposed indicators of corporate governance characteristics i.e. Board Ownership, Board Independence and CEO Duality may have some limitations. Whilst their use can be theoretically justified, neither construct can be accurately measured empirically.

If other corporate governance characteristics contribute to the integrity of information asymmetry, then parameter estimates may be biased. Given that the model is tested using
archival data, the data are likely to contain the influences of several factors that are not accounted for in the model. Isolating the impact of the constructs on the market’s reaction may prove difficult. The model thus applies only to large firms where there is a clear separation between ownership and management.

5.5 Recommendations

This study aimed at investigating how a firm’s corporate governance, i.e Board Ownership, board independence and CEO/chair duality affects the level of information asymmetry between managers and investors. The need to carry out this study arose from the fact that listing of companies in the NSE has continued to increase and corporate governance is a key requirement that has to be adhered. A research gap thus existed as limited researches from those reviewed had been done on the effect of corporate governance on the information asymmetry of listed companies in Kenya’s Nairobi Securities Exchange (NSE).

From the findings and conclusions, the study recommends the need for effective corporate governance practices at senior managerial level of quoted companies in Kenya to contribute to reduced information asymmetry and hence improve on actual firm liquidity and avert possible collapse of public organizations in Kenya. It is clear from the findings that corporate governance does have an effect on information asymmetry between managers and investors. The government should therefore enforce the measures it has laid down to ensure listed companies are following them so that the recommended governance structures are followed. The concerned ministries should also be very keen in the supervisory role through the relevant committees to ensure that all regulations are enforced as required e.g. books of accounts are well kept and audited as they should be.

In the Kenyan context, over the past few years there have been concerns, especially among the regulators, that companies are performing poorly and some failing partly due to weak corporate governance structure, and one of such attributes is the combined role of board chair and CEO. The concern was that such enormous powers vested in an individual make the board ineffective in its oversight and monitoring role. For example, with regard to the board leadership the Capital Markets Authority (CMA) in the Guidelines of Corporate Governance Practices, expressed a view that companies should consider separating the role of the chair and CEO, and
where the two roles are combined, to present the rationale for such a leadership structure in the annual report to the shareholders. In addition, by 1997, the Central Bank of Kenya initiated a review of banks’ board structures and as part of the review urged the companies in the financial sector to separate the roles of board chair and CEO. It appears most companies embraced this advice from the regulators and changed their board leadership structure such that 43% have separated the role of board chair and CEO. Thus, because of this substantial change in the board leadership structure, there was limited differentiation among sample firms for this variable to have statistical significance in the pooled regression analysis.

An opportunity arises for further research in the development of an experiment that would identify how average investors measure information asymmetry. This is because it is unclear whether investors use abnormal accruals, as measured by aggregate accruals approach, as a representation of information asymmetry. The complexity of such models suggests that the average investor is unlikely to use this measure. The researcher also recommends future researchers to explore association between corporate governance characteristics and information asymmetry for non-listed companies in Kenya and large family ran private companies in Kenya.
REFERENCES


Kesner, I. F. & Dalton, D. R. (1986). Boards of directors and the checks and (im)balances of the


APPENDIX I: LETTER OF INTRODUCTION.

August 09th 2014.
Mary Wanjiku Ndungo
C/o University of Nairobi
P.O. Box 30197 00100
Nairobi.

Dear Respondents,

RE: ASSESSING THE EFFECT OF CORPORATE GOVERNANCE ON INFORMATION ASYMMETRY BETWEEN MANAGERS AND INVESTORS:

I am a postgraduate student at the University Of Nairobi School of Business. I am undertaking the above research project in partial fulfillment of the requirements for the award of the MBA degree. In order to achieve this, I humbly request your assistance in filling the attached questionnaire to generate data for the study. Any information you provide is purely for the purposes of this project thus your responses will be treated in strict confidence and in no circumstances will your name be mentioned in the report. Further confidentiality will be ensured through the necessary coding of the survey findings. A copy of the research report will be submitted to you upon request.

Your assistance to this regard will be highly appreciated.

Thank you in advance,

Yours Sincerely,

Mary Ndungo
M.B.A STUDENT

Dr Ogilo
SUPERVISOR
APPENDIX II: QUESTIONNAIRE

SECTION A

This section of the questionnaire refers to background and general information regarding your company. Although we are aware of the sensitivity of the questions in this section, the information will allow us to compare different respondents. Once again, I assure you that your response will remain anonymous. Your cooperation is appreciated.

1. What is your company’s name?

2. Indicate your major background (You may choose more than one if applicable
   a. Business Management [ ] b. Accounting/Finance [ ] c. Other: Please indicate--------

3. What is the main business of the company?

4. How long has your company been in existence?
   a. 0-5 years [ ] 6-10 years [ ] Over 10 years [ ]

5. Is there interaction between managers and investors (shareholders?)
   Yes [ ] No [ ]

6. If yes, in what forms?
   Annual General Meetings [ ] Company Newsletters [ ] Mainstream Media (Radio, Television, Newspapers) [ ] Company Website [ ] Social Media/Platforms [ ]
   Any other (Please Specify) [ ]

   …………………………………………………………………………………………………
   …………………………………………………………………………………………………

SECTION B

This section of the questionnaire explores aspects of Board within your organization.

I. Board Independence

7. How many members of the board of directors do you have in your company?
   a. 2-5 [ ] b. 6-10 [ ] c. 11-20 [ ] c. More than 20 [ ] (please indicate)

     ……………

8. Which of the following describes the composition of your board members:
   a. Executive directors only [ ] b. Non executive Directors only. c. Mix of both a & c [ ]

10. If your answer above is c, please indicate the number of each
   Executive ………
Non Executive (Independent) ……

11. Who is the strongest voice in the selection of Non executive directors?
   a. Board or its nominated Committee [ ]  b. CEO c. Controlling Shareholder

12. On average what is the attendance rate for the board meetings?
   a. 90-100% [ ]  b. 75-89%  c. 51-75%

II. CEO/Chair Duality

13. Is the Chairman of the Board an independent, non-affiliated director?
   Yes [ ]  No [ ]

9. Is the C.E.O, a chairman of the company
   Yes [ ]  No [ ]

10. Does either of the two above in (Q11) act on behalf of the other
    Yes [ ]  No [ ]

III. Board Ownership

11. Does your company have a written procedure or policies on directors remuneration
    Yes [ ]  No [ ]

12. Does the independent director’s remuneration include share options?
    Yes [ ]  No [ ]

13. Does the Non executive director’s remuneration include share options?
    Yes [ ]  No [ ]

14. Is the CEO/Chairman given share options?
    Yes [ ]  No [ ]

15. Does the board review CEO compensation annually
    Yes [ ]  No [ ]

IV. Disclosure/Communication

16 Does your firm disclose the following in the firm’s web page?
   (i) Quarterly financial statement Yes [ ]  No [ ]
   (ii) Audited Annual reports Yes [ ]  No [ ]
   (iii) Directors reports Yes [ ]  No [ ]
   (iv) Directors selling or buying shares in the firm Yes [ ]  No [ ]

Thank you for your co-operation in completing this questionnaire. Kindly return the questionnaire as specified in the cover letter.
APPENDIX III: GUIDE TO COLLECT SECONDARY DATA

Asymmetric information variables

SPREAD (+)-The annual mean value of the daily percentage spread between bid and ask prices

VOLATILITY (+)-The annual average standard deviation of the day-over-day difference in the daily price change

VOLUME (-) - The annual average of daily market value of trading volume

Corporate governance variables

BSIZE (-) - The number of directors serving on the board of directors

NONEXESIZE (-)-The number of non-executives serving on the board of directors

SPLIT (-)-A dummy variable that takes on a value of one if the CEO and Chairman are different persons, zero otherwise

NONECHAIR (-)-A dummy variable that takes on a value of one if the chairman is a non-executive, zero otherwise
<table>
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<th>NO</th>
<th>YEAR</th>
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<th>2</th>
<th>3</th>
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<tbody>
<tr>
<td>SPREAD (+):</td>
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<td>ASK-HIGH</td>
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<td>BID-LOW</td>
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<td>VOLATILITY (+)-</td>
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<td>VOLUME (-)</td>
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<td>NONEXESIZE (-)-</td>
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<td>NON-EXEC DIRECTORS</td>
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<td>1=CEO &amp; DIRECTOR ARE SAME ZERO OTHERWISE</td>
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<td>NONEXECHAIR (-)-</td>
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Secondary data collection sheet