INFLUENCE OF CHIEF EXECUTIVE OFFICERS (CEO’S) COMPENSATION ON PERFORMANCE OF COMPANIES QUOTED AT THE NAIROBI SECURITIES EXCHANGE

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ABSTRACT

Globally, for instance in America, The Enron scandal was revealed in October 2001, and eventually led to the bankruptcy of the Enron Corporation, an American energy company and the dissolution of Arthur Anderson, which was one of the largest audit and accountancy firm in the world. Locally, data available from NSE revealed that Uchumi supermarkets Limited, was put under statutory receivership in the year 2006. The evidence cited that Uchumi Supermarket was a case of misappropriation of funds by the top management. Would C.E.O compensation be the cause of the problem? The general objective of this research is to analyze the influence of (CEOs) compensation on performance of companies quoted at Nairobi Securities Exchange. The study adopted descriptive research. The population of interest in this study consisted of all the CEOs of companies quoted in the NSE. Using simple random sampling, a sample of 183 was selected at random from a target population of 840 employees in the 10 sectors of NSE. The data was analysed using SPSS and the Microsoft excel to generate quantitative reports. The research...
concludes that, most of the total incentives of CEO are stock based incentives, which is greater than pay based incentives. Positive relationship exists between the cash-flow ownership of the largest shareholder and firm value. Cash compensation is negatively related to the percentage of stockholdings of insider directors and executives. Research concludes that directors need less fixed cash compensation since they already benefit directly from the value of their shares

**Key Words:** CEO Compensation, tenure, ownership structure, corporate governance

**Introduction**

According to disclosures on the annual reports of listed companies, CEO compensation can be divided into salaries, allowances, cash bonuses and fees for services as directors. Another key benefit obtained by directors is the ease of access to loans with all the listed banks having advanced loans to their directors (NSE, 2012). Executive compensation in Kenya has received increasing attention, and this is a longitudinal study of Kenyan executives’ pay, providing an assessment of the influence of the CEOs compensation on performance of companies quoted in the NSE. In the Kenyan banking scene for example executive remuneration has not come under massive spotlight perhaps due to the nature of CEO compensation (Barako et al, 2006).

**Statement of the Problem**

According to the World Bank (WB), Kenya has only 54 listed companies with a market capitalization that constitute 34% of GDP (WB, 2007). This is relatively small when compared to South Africa which has 668 listed companies with a market capitalization that constitute 132% of GDP (WB, 2007). The Kenyan Capital Market Authority (CMA) issued guidelines on corporate governance practices for publicly listed companies in 2002.
Locally, data available in NSE show that Uchumi supermarkets Limited was put under statutory receivership in the year 2006 (NSE, 2012). The evidence cited that Uchumi Supermarket was a case of misappropriation of funds by the top management, (NSE, 2012). According to Business Daily Nation dates Tuesday 24th September 2009 page 28 (Bankelele, 2009), Nyaga Stockbrokers Ltd was put under statutory management due to conflict of interest by management of the company. Over 70,000 investors are estimated to have lost Kshs 1.3 billion which may not be recovered.

The boardroom war in CMC motors led to the company’s shares being suspended at the Nairobi Securities Exchange (NSE) (Sirken, 2012). This saw the removal of three directors including its former chairman and major shareholder, with the help of the courts. The Capital Markets Authority barred directors of CMC Holdings found to have violated capital market rules or breached corporate governance regulations from sitting in the boards of public companies. An audit done by South African auditor that was hired by the Capital Markets Authority revealed that, the troubled motor company, found that it had illegal offshore accounts worth more than Sh250 million. Would C.E.O compensation be the contributor of these scandals?

**Specific Objectives**

The specific objectives of this study will be:

1) To determine the how CEO tenure affect their performance

2) To establish how CEO monetary rewards affect their performance

3) To find out how CEO ownership structure affect organization performance
4) To establish how corporate governance influences CEO performance

**Significance of the Study**

The findings of the study are hoped to be of significance not only to the commercial banks listed in the NSE, but also to scholars. The study may be of benefit to the management of the companies by providing data and information that are not readily available to them to enable them come up with effective CEOs in order to achieve its goal.

This study will be of great importance to the future researchers who will be pursuing or researching similar topics and will help them widen their scope of study and increase their knowledge.

**Conceptual Framework**

Mugenda (2008) defines conceptual framework as a concise description of the phenomenon under study accompanied by a graphical or visual depiction of the major variables of the study. Miles and Huberman (1994) define a conceptual framework as a written or visual presentation that: explains either graphically, or in narrative form, the main things to be studied – the key factors, concepts or variables - and the presumed relationship among them. In this study, the independent variables are CEO tenure, CEO monetary rewards, CEO ownership structure and Corporate governance while the dependent is the CEOs Performance.

**Empirical Framework and Critique of Existing Literature**

Some factors are intuitively important for the performance of an executive staff. These factors arise from the notion that executive contracts should be designed to maximize firm value in a
market economy. For instance, job mobility of CEOs. When different firms compete for CEOs, each firm has incentive to design contracts to increase the retention probability. Thus, changes in the market conditions can affect the executive compensation by affecting the severity of competition for CEOs (Shi, 2011). Baker et al. (2004) argue that money actually lowers employee motivation, by reducing the "intrinsic rewards" that an employee receives from the job. Similarly, Shi (2011) concludes that "Getting people to chase money produces nothing but people chasing money. Using money as a motivator leads to a progressive degradation in the quality of everything produced."

Askary and Doucouliagos (2005) argue that the Australian banking sector, boards are not captured by CEOs. They argue that directors’ pay in the Australian banking sector is driven mainly by the size of the bank, board composition and lags in pay. Specifically, larger banks provide a higher pay, on average, to directors, while those banks with a larger proportion of outside directors pay less. As noted by Oswald and Jehera (2005), the relationship between executive ownership and firm performance has been extensively investigated by scholars, most typically from an agency theory perspective. The separation of ownership and control, and the resulting conflict of interests between owners (principals) and manager (agents), has been the heart of the agency theory (Jensen & Murphy, 2004).

According to Robinson (2008), employee compensation increases staff morale leading the achievement of group goals. It reconciles the objectives of the group with those of its members so that each one of them is motivated to make his or her best contribution towards the accomplishment of goals and utilization of resources. Managers, therefore, should make sure that workers know their jobs well and work most efficiently. Although this is true, the authors failed
to show how staff recognition affects performance of broadcasting organizations. The existing body of knowledge is not sufficient enough to explain the effects of CEOs compensation in performance. This study intends to explore on the effects of executive compensation on performance.

**Research Gap**

There is an extensive amount of literary research devoted to the issues of CEO performance. Nevertheless, the bulk of such research tends to concentrate on motivation and employees compensation; very limited studies have provided research on the effect of executive compensation. This paper fills this gap; it intends to incorporate an analysis of the four variables in the research questions to explain the effects of CEOs compensation on the performance of an organization.

**Research Design and Methodology**

The study adopted a descriptive research. According to Mugenda (2008), such a research design is used to obtain information concerning the current state to describe what exists in respect to variables or conditions in a situation. This method was considered appropriate because the study involved interacting with the population of interest for them to assess the influence of CEO’S compensation on the performance of companies quoted in the NSE (Mugenda, 2008). The population of interest in this study consisted of all the CEOs of the firms quoted at the Nairobi Stock Exchange (N.S.E).
There are 56 companies listed on the NSE in various sectors where the target population was obtained. The target population for this study was all the 56 listed firms. A population of 840 management staff was identified from three levels of management which included at least 3 top managers, 5 middle level managers and 7 lower management staff from each of the 56 listed companies in the 10 sectors of the Nairobi Securities Exchange. Using simple random sampling, a sample of 183 was selected at random from a target population of 840 employees. According to Mugenda & Mugenda (2003) a sample size of at least 10% of the total target population is considered sufficient. The study collected both primary and secondary data. The primary data was gathered through a semi-structured questionnaire which was administered by the researcher to facilitate a probing inquiry and to minimize variation in data collection procedures and ensure consistency. The questionnaire had both open and closed ended questions.

**Research Findings and Discussion**

The study found out that money actually lowers employee motivation, by reducing the "intrinsic rewards" that an employee receives from the job. Positive relationship exists between the cash-flow ownership of the largest shareholder and firm value.

The study also found that money actually lowers employee motivation, by reducing the "intrinsic rewards" that an employee receives from the job. The study found that merit systems decrease motivation because managers systematically mismanage pay-for-performance programs.

It was also clear found that firms are mostly characterized by dispersed ownership to a very great extent. The study also indicated that positive relationship exists between the cash-flow ownership of the largest shareholder and firm value. This relates to literature review by...
Claessens, Djankov, and Lang (2000) who found out that positive relationship exists between the cash-flow ownership of the largest shareholder and firm value.

**Regression Analysis**

The regression analysis shows a strong relationship $R=0.912$ and $R^2=0.831$, which means that only 83.1% of the CEO compensation factors can be explained by all the predictor variables jointly. A further test on the beta coefficients of the resulting model, the coefficient $\beta_1=2.193$, $\beta_2=1.688$, $\beta_3=0.876$ and $\beta_4=0.398$ are all significantly greater than 0 with p values $0.001$, $0.0019$, $0.004$ and $0.0025$ respectively which are all less than $p=0.05$.

The regression equation which holds as $(Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon)$

Whereby $Y$ = CEO Performance

$X1$ = CEO tenure

$X2$ = CEO monetary rewards,

$X3$ = CEO ownership structure

$X4$ = Corporate governance

The equation becomes:

$Y = 3.636 + 2.193X_1 + 1.688X_2 + 0.876X_3 + 0.398X_4 + \epsilon$

**Conclusion**

From the study the research concluded that, most of the total incentives of CEO are stock based incentives, which greater than pay based incentives and that CEO are stock based incentives, which are three times greater than pay based incentives. The study also concluded that Money
actually lowers employee motivation, by reducing the "intrinsic rewards" that an employee receives from the job. Positive relationship exists between the cash-flow ownership of the largest shareholder and firm value. The study also concluded that most firms apparently resist introducing bonus-based compensation plans with enough financial "action" to have a major motivational effect; this is because monetary rewards are counterproductive. Finally the study concluded that pyramid structures and cross-holdings improve corporate control. Positive relationship exists between the cash-flow ownership of the largest shareholder and firm value. However, when the control rights of the largest shareholder exceed its cash-flow ownership, firm value falls.

**Recommendations**

The research recommends that since there is no significant relationship between CEO tenure and pay, the company should resolve to other form of remuneration to cash compensation. The study also recommends that since there are benefits of tying pay to performance firms should introduce bonus-based compensation plans with enough financial "action" to have a major motivational effect. This is because monetary rewards are counterproductive. Additionally, the study recommends that merit systems decrease motivation because managers systematically mismanage pay-for-performance programs, therefore firms should use non-monetary measures since money actually lowers employee motivation, by reducing the "intrinsic rewards" that an employee receives from the job. Finally, the study also recommends the use of pyramid structures and cross-holdings since they improve corporate control. Cash-flow ownership of the largest shareholder and firm values should be looked in to by company in order to improve performance of a company since there exist a positive relationship between the two.
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