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CORPORATE GOVERNANCE AND FIRMS MARKET VALUE: A CASE STUDY OF INSURANCE SECTOR COMPANIES LISTED AT NAIROBI SECURITIES EXCHANGE

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ABSTRACT

The objective of this study was to determine the effect of corporate governance on market value of insurance sector companies listed at Nairobi securities exchange. This study presummed that the relationship between corporate governance and firm's market value of insurance companies listed at NSE is not significant. The research is anchored on agency, stewardship and stakeholders theory of corporate governance. Descriptive research design was employed in this study. The target population in this study consisted of all six (6) insurance sector companies listed at NSE. This study used secondary panel data which consisted of time series and cross sections sourced from published annual financial statements on the company's websites and NSE hard books. In the analysis correlation analysis, descriptive statistics and multiple regression analysis were employed. The findings clearly showed that the relationship between market value (log of market capitalization) and corporate governance comprehensive score was found to be positive and significant which implies that by increasing board composition and diversity, board remuneration, board transparency, increasing audit functions and setting CEO term and carrying out evaluation increases the market value of insurance sector companies.

KEYWORDS: Insurance Sector, Market Value, Corporate Governance, Nairobi Securities Exchange

1.0 INTRODUCTION

Corporate governance is defined as the application of management practice, compliance with laws, rules and regulations, and adoption of ethical standards for effective management, distribution of wealth and discharge of social responsibility for sustainable development of stakeholders (Ramaksrishnan, 2017). According to Cadbury (1992) corporate governance is a system that is used in controlling and directing corporations concerned with the structures and the process by which those influenced or interested on the general well-being of a corporation take measures protecting stakeholder's interests. The wealth of shareholders will not be maximized by managers unless there is adoption of better governance practices to safeguard shareholders value in large companies. Corporate governance codes strives to improve the operational and financial efficiency and effectiveness of companies as a result of proper structural supervision and control which helps to align the managers interest to that of shareholders. This helps to minimize agency conflicts (Shleifer & Vishny, 1997). Good governance is defined by effective and efficient corporate structure, increased disclosures and transparency, reduced agency conflicts and monitoring costs and enhanced confidence directed to protect the interest of stakeholders. Poorly governed firms face serious challenges to attract funding due to poor corporate governance structure which directly influences the market size and value of firms. Effective corporate governance systems provides transparency, fairness, and accountability which enhances potential and current investors' confidence which makes them believe that they will get good investment returns by investing in the company. The insurance industry has embraced the rapid growth in the information technology, research, innovation and creativity to expand its capacity in exploiting the existing market domestically and globally. The Kenyan insurance industry is governed by the Insurance Act and regulated by the Insurance Regulatory Authority (IRA). The Kenyan market is speedily growing in comparison with its regional counterparts with dominance to insurance activities across the East African Community (EAC). This study will measure population parameters for all insurance companies listed at NSE to ensure true measure of population and eliminate any potential bias occurring through sampling techniques. This study seeks to address the research question: What is the effect of corporate governance metrics on the market value of insurance companies listed at Nairobi Securities Exchange?

2.0 LITERATURE REVIEW

2.1.1 AGENCY THEORY

Theoretical positions have clearly explained governance control issues but there is no practical solution of theories which can be applied to reconcile increasing developments in developing countries. Jensen & Meckling (1976) developed agency theory to describe association between two parties such as principal and agent, seller and buyers, employers and employees and companies and creditors. An agency relationship arises when one or more parties known as principal(s) contract another known as agent to act on their behalf. The contract involves delegation of some authority to agents in decision making. Conflict arises between principals and agents when the managers fail to maximize shareholders wealth as expected. Agency cost theory suggests that ownership separation and management leads to natural conflicts of interest because to safeguard shareholders wealthy they have to incur monitoring and controlling costs to align their interests with agents' (Jensen & Meckling, 1976). Agency theory also believes that corporate governance is mainly concerned with agency conflicts between management and shareholders which is used by investors to shield themselves against insiders.

2.1.2 STAKEHOLDERS THEORY

According to Freeman (1989) stakeholder theory documents that organizations includes parties within and without that have different and defined interest in the financial performance and status of a company in a particular period of time and thus management should work to safeguard that interest by ensuring there is a balance in the interest of all stakeholders factored in their decisions. The principal-agent association defined in the stakeholder theory is aligned with interest conflict on resource allocation. According to Kock et al. (2012) management and stakeholders' interests sometimes differ but the external environment helps in alignment of their interests. This can be through regulation by the government or corporate guidance making provision for a basis that is legitimate for stakeholders to define their management wishes and potentially create a dilemma in decision-making for managers.

2.1.3 STEWARDSHIP THEORY

Stewardship theory on the other hard suggest that agents act as stewards of the shareholders wealth and thus there is no justification to incur monitoring and controlling costs because management work faithfully to safeguard the interests of owners (Donaldson, 1990). Stewardship theory presents a management model in which managers are believed to be good stewards to act in owners' best interest (Donaldson & Davis, 1991). Where wealth of shareholders is maximized, the utilities of stewards are also maximized since the success of an organization serves the firm requirements enabling managers to have a mission that is clear (Smallman, 2004). Stewardship theory finds a relationship that is strong between firm success and managers. Stewards maximize and protect the wealth of shareholders through performance. Successful performance improvement satisfies stakeholders whose interests are well served when organizational wealth is increased (Davis, Schoorman & Donaldson, 1997). The theory assumes that managers are stewards who are trustworthy and focus on betterment of the firm rather than their own interests.

2.2 EMPIRICAL REVIEW

Hussein (2012) conducted a study investigating the effects CG practices and perception have on financial distress and performance of UAE national banks. The study adopted a modified questionnaire. Findings indicated that UAE banks knew the importance of transparency, disclosure, and executive compensation to shareholders and other stakeholders, and the overseeing role of appointed directors. The results indicated that the of UAE's national banks' corporate governance practices were acceptable and recommendable. Further, results revealed a positive association that is significant between CG practices of UAE national banks, transparency, disclosure, shareholder interests, director roles and performance levels of UAE national banks.

Hassan, Saadi and Halbouni (2013) conducted a study investigating effects CG mechanisms have on financial performance of listed firms in the United Arab Emirates (UAE). A sample of 95 financial and non-financial sectors UAE listed firms was used. The study adopted cross-section regression analysis to test significance between disclosure that is voluntary, CEO duality, audit type board committee and size, and performance in controlling firm characteristics like; industry type, listing years, size and leverage. Results showed that disclosure that is voluntary; board size and duality of CEOs have significant influence on an accounting-based measure of performance. Findings also revealed that size was the only control variable influencing performance significantly.

Sarra & Taktak (2014) researched on association between ownership structure and Islamic banks' performance, with a special attention to the identity of the block investor (foreign, family, institutional and state). Regression analysis was conducted used to test shareholder impact and concentration degree on Islamic banks performance, using a panel data sample of 53 banks. Results revealed 49 percent ownership concentration, state shareholders ranked second followed by family shareholders. Further, the study showed that there exists a correlation that is negative between ownership concentration and Islamic banks' performance.

Outa & Waweru (2016) examined impacts corporate governance (CG) guidelines compliance had on financial performance and value of Kenyan quoted firms from 2002 to 2014. The study used panel data of 520-firm year's observations between 2005 and 2014 to test the hypothesis whether compliance with CG guidelines issued in 2002 by Capital Markets Authority (CMA) improved firm financial performance and firm value. The findings showed that compliance with CG Index which is an aggregate of all the CG guidelines related the performance and value of a firm directly and positively. The results also found that evaluation of the board is associated with performance positively and significantly.

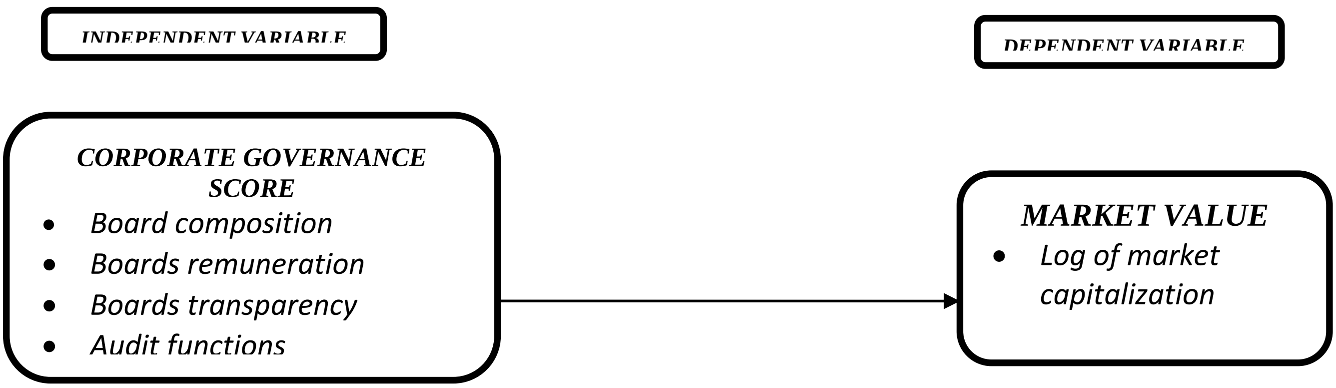
Malik and Makhdoom (2016) carried out a study determining effects CG practices had on financial outcomes of Fortune Global 500 Companies, thus covering the impact of geographical differences (USA and non-USA) as well. This study used quantitative research in light of the positivist paradigm using deductive thinking, and secondary data collection. Results found a strong positive association between CG and performance while smaller board sizes were found to generate better firm performance due to increased efficiency and reduced formalities with a frequency of board meetings have also been found to have an inverse association with performance.

A study carried out by Orazalin, Mahmood and Lee (2016) to investigate the impact of different dimensions of CG practices like board characteristics, ownership structures, corporate disclosure and CEO education on operating performance of Russian banks before, during and after financial crises. Data were derived from financial statements, while CG mechanisms were derived from the annual reports available on banks' accessible websites. This study found that CG impacts the performance of banks positively before and after financial crisis. This is because financial crisis experienced in Russian banks forced them to improve their CG practices resulting to better operating performance and better control and management after the crisis.

2.3 CONCEPTUAL FRAMEWORK

Conceptual framework can be defined as a set of broad ideas and principles from relevant inquiry fields used in structuring subsequent presentations. Corporate governance is presumed to influence financial performance. This assumption is supported by Agency theory showed which defines internal CG influence on financial performance. Previous research on links between CG and financial performance of companies is conflicting, inconclusive, and ambiguous showing positive, negative or unrelated relationships.

Figure 2.1 Conceptual Framework



2.4 CONCEPTUAL HYPOTHESIS

H_O: This study presummed that the relationship between corporate governance and firm's market value of insurance companies listed at NSE is not significant.

3.1 RESEARCH DESIGN

Descriptive research design was employed to determine the influence of corporate governance practices on the market value of insurance sector companies listed at NSE.

3.2 TARGET POPULATION

Target population in this research comprised of all six (6) insurance companies listed at NSE as at 31st December 2016. This research used panel data which consist of time series and cross sections to improve on the quality and quantity of the data.

3.3 DATA COLLECTION

Secondary data was sourced from published annual and financial statements of insurance firms listed at NSE website or extracted from NSE hand books. The targeted statement includes statement of financial position, income statement and available account notes during 2012-2016. To examine effectiveness of CG proxies such as; board composition, boards transparency, boards remuneration, audit functions, CEO term and evaluation data was obtained using score card approach developed from the published financial reports. Composite or comprehensive score which is the measure of CG index was used based on regression weighting mean between the respondent's CG metrics which is given by (A*1) + (B*0.5) + (C*0) where A (Full CG compliant), B (Partial CG compliant) and C (Non-CG compliant). Higher score means better CG. This provides comprehensive measures of the extent to which a company has adopted best recommended practices as revealed in CG annual reports.

3.4 DATA ANALYSIS

The data was analyzed using descriptive statistics and inferential statistics such as correlation analysis and multiple regression analysis. SPSS version 22 was used in this research to analyze data. Hausman test was undertaken to determine the appropriate model for this study.

3.4.1 MULTIPLE REGRESSION MODEL

The multiple linear regressions were given as follows:

$$\mathbf{MV_{it} = \alpha + \beta_1 CGI_{it} + \mu_{it}}$$

Where:

$\mathbf{MV_{it}}$ = Market value of the company measured by the log of market capitalization

$\mathbf{CGI_{it}}$ = Comprehensive score of corporate governance metrics

$\boldsymbol{\mu}$ = Error term

4.0 RESULTS AND DISCUSSION

The study used both descriptive statistics (measures of central tendency and standard deviations) and inferential statistics such as correlation and regression in the analysis.

4.1 DESCRIPTIVE STATISTICS OF THE VARIABLES

Descriptive statistic was carried out to establish the measures of central tendency of the corporate governance score and market value variables. These include mean, standard deviation, minimum and maximum values for all the variables under study. The results are as shown in Table 4.1 below.

Table 4.1 Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Corporate governance score	50	.10	.92	.6585	.15640
Market value	50	6.78	11.86	9.7328	.99892
Valid N (listwise)	50				

Table 4.1 above shows descriptive statistics of corporate governance comprehensive score and market value included in this study. The market value measured by the log of market capitalization has a lowest value of 6.78 and highest value of 11.86. Majority of the companies have a mean of 9.7328. The average of independent or explanatory variables explained by corporate governance comprehensive score was 0.6585 with low ratio of 0.10 and high ratio 0.92. Comprehensive governance score was found to have the lowest standard deviation of 0.16 with market value having the highest standard deviation of 0.998.

4.2 INFERENTIAL STATISTICS

Inferential statistics performed includes correlation and regression analysis. This study used correlation analysis to test the relationship between the variables while regression was used to test the relationship between independent variables and dependent variable.

4.2.1 CORRELATION COEFFICIENTS TESTS

Pearson correlation was used to test the association between corporate governance metrics score and market value of insurance companies listed at Nairobi Securities Exchange. The findings are presented in table 4.2 below.

Table 4.2 Correlations between Corporate Governance Comprehensive Score and Market Value

		Market value	Corporate governance score
Market value	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	50	
Corporate governance score	Pearson Correlation	.328*	1
	Sig. (2-tailed)	.020	
	N	50	50

*. Correlation is significant at the 0.05 level (2-tailed).

Table 4.2 above shows that the relationship between market value (log of market capitalization) and corporate governance comprehensive score was found to be positive and significant (**β**= .328, p>0.05). This means that by increasing board composition and diversity, board remuneration, board transparency, increasing audit functions and setting CEO term and carrying out evaluation increases the market value of insurance sector companies.

4.2.2 MULTIVARIATE REGRESSION TESTS

Multivariate regression analysis was used to test the relationship between the independent variables and the dependent variable. The findings of multivariate regression analysis are presented in table 4.3, 4.4 and 4.5 below.

Table 4.3 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.328[a]	.108	.089	.95333

a. Predictors: (Constant), Corporate governance score

The results show R^2 value of 10.8% variation of explanatory variables on market value expressed by log of market capitalization. This study documents that corporate governance score accounts for smaller percentage of the total market value measured by log of market capitalization of the companies listed at Nairobi Securities Exchange.

Table 4.4 Analysis of Variance (ANOVA)

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	5.270	1	5.270	5.798	.020[b]
1	Residual	43.624	48	.909		
	Total	48.894	49			

a. Dependent Variable: Market value

b. Predictors: (Constant), Corporate governance score

Using a significance level of 5%, the numerator df =1 and denominator df =48, critical value 2.74, Table 4.4 above shows F value as 5.798. This confirms that the multiple regression model used in this study is statistically significant at 0.020. This means that the multiple regression models developed using the corporate governance metrics can be generally applied to explain the effect of independent variables on the market value of companies listed at Nairobi Securities Exchange as measured by log of market capitalization.

Table 4.5 Testing Coefficients using Regression Analysis

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	8.352	.589		14.178	.000
	Corporate governance score	2.097	.871	.328	2.408	.020

a. Dependent Variable: Market value

Considering 5% acceptable significance level, explanatory variable with a significant value more than 5% is assumed not statistically significant. The findings shows that corporate governance comprehensive score was found to be statistically significant (**β**= 2.097, p= .020) which means that increase in corporate governance score would result to increase in companies market value of insurance sector companies. Thus, a unit increase in corporate governance score would results to 2.097 units increase to the market value of insurance sector company score. The regression model is given by; $\mathbf{Y = 8.352 + 0.328X_1}$.

4.3 CONCLUSIONS

This study documents that the relationship between market value (log of market capitalization) and corporate governance comprehensive score is positively significant. Further this study found that corporate governance variables significantly influences the total market value measured by log of market capitalization of the companies listed at Nairobi Securities Exchange and that the multiple regression model used in this study is statistically significant.

This study does not support findings by Sarra & Taktak (2014) which showed that there exists a correlation that is negative between ownership concentration and Islamic banks' performance. The findings of this study are in agreement with findings of the study undertaken by Hussein (2012) which revealed a positive association that is significant between CG practices of UAE national banks, transparency, disclosure, shareholder interests, director roles and performance levels of UAE national banks. Hassan, Saadi and Halbouni (2013) showed that disclosure that is voluntary; board size and duality of CEOs have significant influence on an accounting-based measure of performance. Outa & Waweru (2016) found that evaluation of the board is associated with performance positively and significantly.

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