EFFECT OF EXECUTIVE COMPENSATION ON RISK TAKING AMONG LISTED COMMERCIAL BANKS IN KENYA

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Effect of Executive Compensation on Risk Taking among Listed Commercial Banks in Kenya

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DECLARATION

This thesis is my original work and has not been presented for a degree in any other University.

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DEDICATION

To my sweetheart, Charles Oginda for his unrelenting support, dedication and encouragement throughout my PHD studies.

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ABBREVIATIONS

ANOVA	Analysis of Variance
CBK	Central Bank of Kenya
CMA	Capital Markets Authority
ERM	Enterprise Risk Management
EVA	Economic Value Added
FDIC	Federal Deposit Insurance Corporation
LTIS	Stock-Based Plan
MVA	Manufacturing Value Added
NSE	Nairobi securities exchange
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
ROE	Return on Equity

DEFINITION OF KEY TERMS

Compensation is the total amount of the monetary and non-monetary pay provided to an employee by an employer in return for work performed as required. Compensation is based on: market research about the worth of similar jobs in the marketplace, employee contributions and accomplishments, the availability of employees with like skills in the marketplace, the desire of the employer to attract and retain a particular employee for the value they are perceived to add to the employment relationship, and the profitability of the company or the funds available in a non-profit or public sector setting, and thus, the ability of an employer to pay market-rate compensation (Heathfield, 2010)

Executive compensation is financial compensation received by an officer of a firm. It is typically a mixture of salary, bonuses, shares of and/or call options on the company stock, benefits, and perquisites, ideally configured to take into account government regulations, tax law, the desires of the organization and the executive, and rewards for performance (Maijoor & Vanstraelen, 2006).

Executive Fixed Salary is a fixed amount of money or compensation paid to an employee by an employer in return for work performed. An employee who is paid a salary is expected to complete a whole job in return for the salary. The salaried employee or employee who is paid by salary does not track hours worked and is not paid for overtime. Salary is determined by market pay rates for people doing similar work in similar industries in the same region. Salary is also determined by the pay rates and salary ranges established by an individual employer. Salary is also affected by the number of people available to perform the specific job in the employer's employment locale (Heathfield, 2010).

Risk is a natural element of business and community life. It is a condition that raises the chance of losses/gains and the uncertain potential events which could manipulate the success of financial institutions (Crowe *et al*, 2009).

Share Ownership benefits plan in which employees own a percentage of their company's shares, which are bought and managed for them by a trust (Firth, Fung, & Rui, 2007).

Executive Allowances Money that a company or government agency provides to an employee for a specific purpose, such as transportation, healthcare costs or a flexible spending account. Benefit allowances administered to employees can be distributed through regular payroll.(Buck, Bruce, Main, & Udueni , (2003).

Executive bonus is compensation over and above the amount of pay specified as a base salary or hourly rate of pay. The base amount of compensation is specified in the employee offer letter, in the employee personnel file, or in a contract. Bonus pay can be distributed randomly as the company can afford to pay a bonus, or the amount of the bonus pay can be specified by contract. Bonus pay that is specified by contract is used most frequently to reward executives (Buck, Bruce, Main & Udueni, 2003).

Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. Beta is used in the capital asset pricing model (CAPM), which calculates the expected return of an asset based on its beta and expected market returns. Beta is also known as the beta coefficient.(Brealey & Myers, 2003).

Commercial banks: type of financial institution that provides services such as accepting deposits, making business loans, and offering basic investment products."Commercial bank" can also refer to a bank, or a division of a large bank, which more specifically deals with deposit and loan services provided to corporations or large/middle-sized business - as opposed to individual members of the public/small business - retail banking, or merchant banks.(Gathua, Ngumi, & Kiragu, 2013)

ABSTRACT

Risk is a natural element of business and community life. It is a condition that raises the chance of losses/gains and the uncertain potential events which could manipulate the success of financial institutions. Firms that implement executive compensation plans based on performance generally create more ambitious and difficult strategies. Compensation crisis and risk especially in the financial industry can result from people who are rewarded with large bonuses for gaming the system, creating artificial value, obfuscating, and taking on excessive levels of risk, all without sufficient skepticism or scrutiny. There has been a debate on executive compensation among regulators, practitioners, and academicians. Some studies find no evidence that compensation affected financial firms' performance during the global crisis. Others find various links between managerial compensation and financial firms' risk-taking behavior. The main objective of this study was to determine the effect of executive compensation on risk taking among listed commercial banks in Kenya. Specific objectives were to Assess the effect of executive share ownership on risk taking among the listed commercial banks in Kenya, to establish the effect of executive fixed salary on risk taking among the listed commercial banks in Kenya, to determine the effect of other executive allowances on risk taking among the listed commercial banks in Kenya and finally to examine the influence of executive annual bonuses on risk taking among listed commercial banks in Kenya. The study used an Epistemology research philosophy, causal research design was adopted whereby panel data approach was used. The target population for this study was the 11 listed banks on the NSE. Secondary Data for the year 2010 to 2015 was collected from the NSE handbook. Data collected was analyzed using descriptive statistics which included means and standard deviations. Inferential statistics such as Pearson correlation and panel regression was also used. The results were presented in form of tables, figures, charts, graphs and trend lines. Based on the findings, the study concluded that Share Ownership and risk taking are positively and insignificantly related. Regression analysis indicated that Executive Fixed Salary and risk taking were negatively and significantly related. Executive Allowances and risk taking were negatively and significantly related. Regression analysis results indicated that Executive Annual Bonuses and risk taking were negatively and significantly related. Based on the findings the study recommended that banks should pursue optimum compensation policies, which will ensure minimum cost to the bank.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Executive compensation is presently one of the most interesting and innovative fields of research in the finance area. It was only in the 1990s, with the growth of the world economy, that shareholders felt the need to contract executives and give them incentives to make firms' stock market growth increasingly faster each year. Academics and researchers started searching for the best form of compensation to motivate these executives. It was not only the values that mattered, but also the way in which executives were paid: with more short term compensation (salary or bonus) or more long term compensation (stock options, restricted stocks, long-term incentives plans) or even with other forms of compensation like perks, and the impact of these compensation policies on all the fields of finance (Paolo, 2008).

Executive compensation has been addressed in numerous studies. Scholars have examined executive pay and structure in various contexts such as principal-agent-theory (Garen, 1994), corporate governance Kang, Kumar and Lee (2006), performance (Jensen & Murphy, 1990), and risk taking (Coles, Daniel, & Naveen, 2006). Intuitively, the pay is closely tied to the extent of executive risk taking in a company: Agency theory assumes that shareholders (principals) expect CEOs (agents) to take actions in their favored interest, hence to maximize shareholder-value (Coles, Daniel, & Naveen, 2006).

Risk is a natural element of business and community life. It is a condition that raises the chance of losses/gains and the uncertain potential events which could manipulate the success of financial institutions (Crowe, Ostry, Kim, Chamon & Ghosh, 2009). Excessive risk-taking is viewed as a contributing factor to the market turmoil that erupted in the United States around mid-2007. Among the most frequently debated channels that have propagated the accumulation of risky exposures are ill-designed

compensation policies, capital regulation, originate-to-distribute business model, low short-term interest rates, and others.

The bursting of the dotcom bubble in 2000 and the ensuing corporate scandals triggered a collapse of well-known companies such as Enron, WorldCom, and Adelphia, resulting in massive destruction of shareholder wealth as well as damage to other stakeholders. The end of a housing bubble and the subprime debacle led to a shutdown of the credit markets and the failures of venerable financial institutions such as Lehman Brothers and Merrill Lynch. The2008 financial crisis spread rapidly around the world. These landmark episodes have drawn attention to the high levels of executive compensation, and to the possibility that the structure of executive pay plans may have contributed to the post-1990s bubbles, corporate scandals, and recent financial crisis (Michael, Dalida, Prabhala, & Lemma, 2011).

When analyzing the relationship between firm risk taking and CEO compensation structure, it is important to keep in mind that conventional management compensation schemes motivates risk taking by only looking at return, without regard for the risk(s) accepted in generating it (Segerstrom, 2008). The same author then further argues that this incomplete approach regarding executive compensation can be seen as a reason for the subprime lending binge, which in retrospect has been identified as one partial cause for the financial meltdown during the recent financial crisis. Since the recent economic crisis originated primarily from the financial industry, and then in later stages developed into a more widespread economic crisis, it is the executive compensation practices in the financial sector that have been the most criticized (Segerstrom, 2008).

At this point it is necessary to note an important difference between the risk attitude of executives and shareholders: Whereas the latter usually hold a broadly diversified portfolio, their aim is to maximize gains, thus shareholders prefer more risk taking. The former, who cannot diversify their portfolio as easily as shareholders, are committed with most of their wealth to their corporation trying to avoid high risks (risk-averse) in order to prevent private losses, (Sanders & Hambrick, 2007). One

approach to mitigate the agency problem is to adjust the interests of shareholders with the inducements of CEOs, by awarding "appropriate incentives" in managerial compensation. This action ultimately results in influencing risk behavior, emphasizing the existing link between the compensation structure (agency problem) and risk taking.

There are numerous studies regarding the compensation structure and its determinants. This part presents a brief overview of hitherto findings in prior studies, which predominantly investigate the influence of executive compensations on risk taking. Whereas most studies support a positive relationship between CEO compensation and risk taking, some feature only partial support or even the opposite.

1.1.1 Global Perspective on Executive Compensation and Risk Taking

Over the past years we have witnessed that executives are being incentivized more and more to take riskier investment decisions in order to increase short-term shareholders' value. This practice has increased the overall riskiness of corporations and the global economic system (Sharma, 2012). While both CEOs and shareholders are risk averse, only CEOs stay risk-averse with respect to the firm's performance because shareholders can become risk-neutral by diversifying away the idiosyncratic risk by investing in a portfolio of stocks. Hence, risk-neutral shareholders encourage CEOs to take risky investment decisions because these risky projects create value to the firm and gains to the shareholders. CEOs with no incentive packages are risk averse because their compensation, reputation, job security and future career are associated with the firm that they manage and this cannot be diversified. So a risk averse CEO prefers to run the firm in a stable and predictable way.

The 2008 financial crisis raised serious criticism of the US capitalism model, particularly regarding corporate governance on executive compensation (Bebchuk Cohen, & Spamann, 2010; Hoskisson, Castleton & Withers, 2009; Mintzberg, 2009). As a major explanation for executive compensation, agency theory has been challenged by the dysfunctional Wall Street practices (Mintzberg, 2009; Walson, 2009) and criticized as under-socialized for its inability to explain cross country

differences (Bruce, Buck, & Main, 2005; Filatotchev & Allcock, 2010). On the other hand, researchers find that agency theory has greater generalizability due to its abstraction from context (Gomez-Mejia, Larraza-Kintana, & Makri, 2003; Jian, Kent & Todd, 2010).

From a theoretical point of view, the compensation structures have implications for both the managerial risk-taking as well as the agency relation between executives and shareholders. When the use of equity-based compensation increases, the interests of executives and shareholders converges, thereby decreasing the agency cost in the classical principal-agent model. However, due to their option-like claim on the assets of the firm, shareholders of leveraged institutions have an incentive to increase the risk. Performance conditions have the effect of making the release of equity-based awards uncertain on the date of grant. In the US on the other hand, such awards are normally only accompanied by a mandatory deferral period with no risk of non-payment except in the case of personal resignation. In consequence, equity-based incentives may value less by executives in the UK than in the US. Conyon, Fernandes, Ferreira, Matos and Murphy (2010) emphasize that the problem with excessive compensation and managerial rent extraction in the UK are generally considered to be less problematic than in the US. However, the use of performance conditions may create a strong incentive for risk-taking, since awards become harder to earn.

Bolton, Mehran and Shapiro (2011) assessed the relationship between executive compensation and risk taking in financial institutions, which are supposed to maintain low risks in their operations. According to authors, managerial risk taking can be reduced by linking executive compensation to default risk by using debt like compensation such as deferred pay and pension. Similarly, Carpenter (2000) addressed the issue of risk averse CEOs being compensated with stock options and found that stock options do not always lead to greater risk seeking. Kempf, Ruenzi and Thiele (2009) studied the influence of incentives on managerial risk taking. Their conclusion suggested that managerial risk taking depends upon the relative importance that incentives comprise in the overall compensation package. Low

(2009) worked on vega and the risk-taking relationship and found that the firm risk taking is low in firms with low vega and that vega is an efficient mechanism to encourage managerial risk taking.

Core and Guay (2009) and Mehran and Rosenberg (2008) find various links between managerial compensation and financial firms' risk-taking behavior. Recently, the four-major federal bank regulatory agencies—the Federal Reserve, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the Federal Deposit Insurance Corporation (FDIC)—jointly issued final guidance on incentive compensation. The goal of the guidance is to prevent two kinds of behavior by banks: pursuing short-term profits at the expense of the long-term financial health of the organization, and taking imprudent or excessive risks that could jeopardize the safety and soundness of the organization (Jian, Kent & Todd, 2010).

Bhattacharyya and Morrill (2008) performed Tobit analysis in relation to managerial compensation and dividend payout in the US firms over the period 1992-2001 so as to document empirical support for hypothesis arising from his model developed in 2007.Consistent with the prediction of the Bhattacharyya's model, a positive (negative) relationship between earning retention ratio (dividend payout ratio) and managerial compensation was found. In China, a study by Ernst and Young (2006) found a positive relationship between the growing non-performing loans, bank failures and executive compensation.

Carpenter (2000) counters common research results and strengthens the impression of complexity of option pay, arguing that "...option compensation does not strictly lead to greater risk seeking." Likewise, Ross (2004) notes that granting options to managers – omitting additional requirements on utility functions – does not lead to bigger managerial risk taking, hitherto findings show that different components of executive pay are complex and have multiple implications on risk taking as for instance stock options, showing nuanced and sophisticated relations. Up-to datedness is shown by the quantity of research in this field, providing a wealth of findings, even though sometimes in an altered manner. For that reason, the following more precise

questions arise, speaking of CEO compensation and risk taking: Firstly, why and how exactly do the single components of CEO pay, if at all, impact managerial risk taking? Secondly, which elements of executive compensation could thereof be determined as incentives for managers to increase risk taking?

There are a few studies that have examined the opposite direction of the relationship, but they have not used firm risk taking and excess compensation in their model. For instance, Coles, Daniel and Naveen (2006) examine the relationship between vega and riskier policy choices. After controlling for delta they found that the higher prior vega encourages and the delta discourages managerial risk taking. As well, they found that riskier policy choices lead to compensation structures with higher vega and lower delta. Garen (1994), Aggarwal and Samwick (2002), Himmelberg, Daniel and Naveen (1999), and Jin (2002) found the inverse relationship between firm risk and pay-performance sensitivity (delta). According to these studies, the variance of firm performance is an extremely important determinant of compensation, as implied by the principal-agent model.

1.1.2 Regional Perspective on Executive Compensation and Risk Taking

Rajgopal and Shevlin (2002) find that the sensitivity of a CEO's option-based pay is positively linked to the variation of future cash flows from exploration activities for a sample of mining firms. This result is consistent with options leading to increased risk-taking. Further evidence that executive option grants lead to greater risk-taking is provided by Chen, Steiner and Whyte (2006) who find that the standard deviation of a firm's stock returns, along with measures of a firm's systematic and idiosyncratic risk, are increasing in the options held by executives. Coles, Daniel and Nuveen (2006) and Low (2009) assess vega, the dollar change in a CEO's option holdings for a 1% change in stock return volatility, and find that a higher sensitivity leads to riskier policy choices, more investment in R&D, and increased total, systematic, and idiosyncratic risk.

Similarly, Armstrong and Vashishtha (2011) find evidence that executive stock options (ESOs) positively correlate with total firm risk. Cohen, Krishnamoorthy, and

Wright (2002), detect a significant and positive relationship between increases in ESOs and subsequent increases in firm risk. Furthermore, Dong, Wang and Xie, (2010) detect evidence that executive managers with higher sensitivity to stock return volatility, arising from their option holdings, tend to prefer liabilities over equity (regardless of firm leverage) as financing pattern. This preference is consistent with one of their hypotheses, e.g. indicating inflated risk taking by executives aiming at the value maximization of their equity holdings.

Gao and Shrieves (2002) argued that the components of executive compensation influence earnings management. Any changes in the design of compensation contracts will potentially lead to a change in managers' actions. For example, an over-emphasis on incentives in compensation contracts will expose executives to higher risk. To reach a certain level of pre-required accounting performance, executives shift to risky management by managing and manipulating earnings, risks and information disclosure. Shareholders are trying to discover the optimal mechanism by which to maximize their best benefits and are, as such, aligning the interests of executive with the goals of the firm. There is evidence that the components of executive compensation encourage executives to manage corporate information since asymmetrical information exists between shareholders and managers.

Shaw and Zhang (2010) found that CEO bonus compensation was less sensitive to poor earnings performance than it was to good earnings performance. They suggested that CEOs get rewards even with poor firm performance. Similarly, Fahlenbrach and Stulz (2011) found no evidence to support the proposition that banks with CEOs whose incentives were not well aligned with the interests of their shareholders performed worse.

Diamond and Rajan (2009) stated that CEOs are compensated based on the profits they produce and this can have negative influences on other firms. Some large financial firms can make large return in a reasonable way but this compels the other financial firms to catch up with the large firms. Executives in relatively smaller

financial firms might take excessive risks to improve the performance and profits of firms. Even if managers of smaller firms recognize that the projects they invest are negative NPV projects, a desire to skyrocket their stock prices and own wealth might make them to estimate the projects as great opportunities for them. These phenomena in financial industry lead financial firms to default and make the whole economy riskier. It implies that systemic risk might be increased, which means that it would cause the collapse of the entire economy.

1.1.3 Local Perspective on Executive Compensation and Risk Taking

In the Kenyan environment, the executive remuneration has not come under massive spotlight perhaps due to the nature of CEO compensation. The Kenyan Companies Act sets the general framework for financial accounting and reporting by all registered companies in Kenya, and stipulates the basic minimum requirements with regard to financial reporting. Due to the limited details of the Act, financial reporting and regulation are supplemented by pronouncements of the Institute of Certified Public Accountants Kenya (Barako, Hancock, & Izan, 2006).

Unlike in the US, where publicly listed firms are required to disclose information on top five executives' compensation, Kenyan listed firms have typically publicly disclosed only aggregated total compensation of a firm's board of directors. This compensation is limited to cash compensation as share option issues have not come into play yet as such the NSE disclosure on shares is limited to bonus and rights issues to the general investing public (Muriuki, 2005).

According to disclosures on the annual reports of listed companies, CEO compensation in the Kenyan listed companies 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 companies having advanced loans to their directors. In view of the absence of stock option advancements to the executive as a major incentive, the relationship between stock performance and CEO compensation may be weak as the stock market performance is not a determinant of the level of executive pay. This is more so given that for most

listed companies the payment of executives may not be material in amount and is insignificant in its impact on price and as such it is not subjected to the materiality rule (Muriuki, 2005)

Molonko (2004) examined the effects of between board characteristics and board compensation in determining firm profitability in the banking industry in Kenya. The study used a sample of 30 banks for the period between 1999-2003. The study sought to explore whether board size, proportion of non-executive directors, CEO duality and board total compensation affected performance in terms of ROA, ROE and profit before tax. Board compensation and firm size were found to be positively and significantly influential to bank profitability. The effects of board size and proportion of non-executive directors were found to be negative and statistically insignificant. The negative effect indicated that board structure had not contributed to the reduction of agency costs in the banking industry in Kenya.

Muriungi (2014) investigated the relationship between auditing and performance of state corporations in Kenya the findings indicated that Audit committee increase the integrity and efficiency of the audit processes in public organisations, as well as the system of internal controls and financial reporting in the parastatals in Kenya. The findings further indicated that Parastatals heads and employees submit themselves to appropriate external scrutiny in the parastatals and in majority of them the heads and employees are responsible for their decisions and actions, including their stewardship of public funds.

Aduda (2011) did a study on the relationship between executive compensation and firm performance in the Kenyan banking sector. The general objective of this study was to measure the relationship between executive compensation and firm performance among the commercial banks listed at the Nairobi Stock Exchange. The study adopted a causal research design by examining the relationship between executive compensation and financial performance among the commercial banks listed at the Nairobi stock exchange. The target population comprised of the nine commercial banks listed at the Nairobi stock exchange as at December 2008. A

census survey was conducted of the listed commercial banks. The study employed secondary data which was obtained from the financial statements of the commercial banks. Regression results for the whole banking sector revealed that size is negatively and significantly related to the determination of executive pay. This is contrary to the findings of Rosen (1985) that found pay-for-firm size elasticity to be positive and the estimated elasticity was not significantly different from 0.3 that is, $\beta = 0.3$. In this study, the overall sensitivity of executive compensation to bank size was -0.0238, that is, $\beta = -0.0238$. With regard to firm performance, two explanatory variables were tested namely return on assets (ROA) and relative performance to industry ROE which was essentially used to identify the firms that were able to register above industry average returns on equity. Thus the study found a negative non-significant relationship between executive compensation and performance of commercial banks in Kenya.

Gathua, Ngumi and Kiragu (2013) examined the relationship between executive compensation and risk among commercial banks in Kenya. This study used descriptive survey research design. Data on executive remuneration was the average of four years (2008-2011) while primary data on the dependent variables was collected through the questionnaire during the period from July 2012 and concluded in August 2012. The findings of the regression analysis show that executive compensation explains a very small variation of 0.07% of the changes in the non-performing loans among Kenyan commercial banks. The p value was found to be 0.869 which is significantly different from zero at level of significance of 0.05. This shows that executive compensation does not lead to variations in the level of non-performing loans among Kenyan commercial banks. Further, on if executive compensation influences practices of creative accounting among commercial banks in Kenya, the level of significance on is 0.7688 and is significantly different from zero and hence larger than a significance level of 0.05. It can therefore be concluded that executive compensation does not encourage accounting malpractices among Kenyan commercial banks.

1.1.4 Listed Banks at the Nairobi Securities Exchange, Kenya

The Nairobi security exchange (NSE, 2012) was established in 1954 as a voluntary association of stock brokers with the objective to facilitate mobilization of resources to provide long term capital for financing investments. Through stringent listing requirements the market promotes higher standards of accounting, resource management and transparency in the management of business. The NSE is regulated by Capital Markets Authority (CMA, 2012) which provides surveillance for regulatory compliance. The exchange has continuously lobbied the government to create conducive policy framework to facilitate growth of the economy and the private sector to enhance growth of the stock market (Ngugi & Njiru, 2005). The NSE is also supported by the Central Depository and Settlement Corporation (CDSC) which provides clearing, delivery and settlement services for securities traded at the Exchange. It oversees the conduct of Central Depository Agents comprised of stockbrokers and investments banks which are members of NSE and Custodians (CDSC, 2004). These regulatory frameworks are aimed to sustain a robust stock market exchange that supports a cogent and efficient allocation of capital allowing price discovery to take place freely based on the market forces.

Banks are unique as addition to the above the central bank of Kenya act cap 491 also oversees their licensing and licensing procedure. The central bank of Kenya gets involved in the activities of the commercial banks in order to protect the interest of the investors, clients‟ money and ensuring sanity in the industry e.g. regulation of interest rates, levels of credit of specified banks, setting monetary policies and foreign exchange dealings control. (Central bank of Kenya act cap 491). Other pieces of legislation that guide banks are: the constitution of Kenya 2010, the banking act chapter 488 1st Jan 2013, the national payment system act 2011. As part of the CBK monitoring commercial banks its memorandum to banks requires that independent directors should constitute not less than one third (1/3) of the total members of the board, from the previous 50% or more from 2013.The independent directors are expected to provide checks and balances in the boards.

According to the Central Bank of Kenya, there are 43 licensed commercial banks in Kenya. Three of the banks are public financial institutions with majority shareholding being the Government and state corporations. The rest are private financial institutions. Of the private banks, 27 are local commercial banks while 13 are foreign commercial banks (CBK, 2012). However our study adopted 11 banks listed at the NSE.

1.2 Statement of the Problem

A major criticism of executive pay packages has been that they incentivize excessive risk-taking which contributes to the financial turmoil. To respond to these concerns, governments and regulators have taken steps to restrict executive pay arrangements in regulated industries. However, there is still ongoing debate in the financial literature and among policymakers regarding how has executive pay contributed to bringing about the 2008 financial crisis, how to fix compensation structure and if pay structures should be reformed, what role if any should the government play in bringing about such reforms (Alon &Yoram, 2010).

Many studies when attempting to find causal relationships between CEO pay and risk taking find mixed evidence (Spitz-Oener, 2006). Mueller and Spitz-Oener (2006) examine 356 German financial service firms and find a link between pay and company risks in that a higher percentage of managerial ownership shares correlate positively with increases in firm risks. Lam and Chng (2006) find that managerial stock options correlate positively with firm risks. There are other studies (Sloan, 1993; Carpenter & Sanders, 2002; Kerr & Bettis, 1987) that find a strong relationship between risk measures and executive compensation. Chesney, Stromberg and Wagner (2012) find a strong negative relationship between the abnormal CEO compensation and excessive risk-taking for the group of banks that do not report their Tier 1 ratio (predominantly, investment banks). Palia and Porter (2004) examine data for U.S. holding companies and find that the increases in salary and bonus components of managerial compensation were associated with lower risk.

Hagendorff, Saunders, Steffen and Vallascas (2015) find an empirical support to this idea, showing that higher bonuses entail a lower default risk.

Rudolph (2009) carried a survey in the health insurance sector in United States of America found out that the risks that were previously considered unrelated in the health insurance industry blew up the market, with balance sheet items pummeled by liquidity, interest rate, and credit risks. Some of the publicly traded companies recorded drop in stock prices by 50 percent. This situation made many of the companies to reduce their staff, leading to low income to firms that were dealing with health insurance. The emergence of risks not previously affecting the health sector and drop in stock prices for quoted companies could be attributed to weak risk management.

The statistics available shows that risk facing firms in Kenya was increasing while traditional risks were evolving. A study by Price Water House Coopers in 2011 on risk in Kenya showed that majority (81 %) of the chief executive officers (CEOs) interviewed from various firms felt that risk to their organizations was increasing and traditional risks were evolving (PWC, 2012). Waweru and Kisaka (2011) found out that implementation of ERM by firms in Kenya was low and therefore could be attributed to weak performance of firms in Kenya. Nyang'aya (2012) found out that traditional risks such as operational, regulatory and market risk were key risks affecting firms. Majority (95 %) of the respondents indicated that operation risk was facing the firms, followed by regulatory failure at 89 percent and market risks at 83 percent.

Most studies in Kenya have concentrated on Executive Compensation, Ownership structure and Bank performance and not on the risk taking component. Such studies include Aduda (2011) who did a study on the relationship between executive compensation and firm performance in the Kenyan banking sector. Asala (2012) did a study on the determinants of executive compensation in Kenya for firms listed on the Nairobi Securities Exchange. Mululu (2005) did a study on the relationship

between board activity and firm performance of firms quoted on the Nairobi Stock Exchange.

This study intends to delve into how executive compensation influences the systematic risk among listed commercial banks in Kenya by evaluating how various compensation types; such as share ownership, fixed salary, allowances and annual bonuses affects the riskiness in the banks stocks.

1.3 Objectives of the study

1.3.1 General Objective

The main objective of the study is to determine the effect of executive compensation on risk taking among listed commercial banks in Kenya.

1.3.2 Specific Objectives

In addressing the general objective, this study pursued the following specific objectives;

i. To Assess the effect of executive share ownership on risk taking among the listed commercial banks in Kenya
ii. To establish the effect of executive fixed salary on risk taking among the listed commercial banks in Kenya
iii. To determine the effect of other executive allowances on risk taking among the listed commercial banks in Kenya
iv. To examine the influence of executive annual bonuses on risk taking among listed commercial banks in Kenya

1.4 Research Hypotheses

Based on the specific objectives, the study sought to test the following null hypotheses;

H_{01}: Executive share ownership has no effect on risk taking among the listed commercial banks in Kenya

H_{02}: Executive fixed salary has no effect on risk taking among the listed commercial banks in Kenya

H_{03}: Executive allowances has no effect on risk taking among the listed commercial banks in Kenya

H_{04}: Executive annual bonuses have no effect on risk taking among listed commercial banks in Kenya

1.5 Significance of the Study

Risk is a natural element of business and community life. It is a condition that raises the chance of losses/gains and the uncertain potential events which could manipulate the success of financial institutions (Crowe, Ostry, Kim, Chamon & Ghosh, 2009) Thus, the study will, be beneficial to the following groups of persons due to its informational value.

The findings of this study can be of help to the boards of listed companies not only in Kenya but in other parts of the world in evaluating the importance of executive compensation and its effect on risks. Boards of listed companies are becoming more aware of the importance of executive compensation in this era and this study will add impetus to knowledge on the link between executive compensation and risk taking.

One of the outputs of this study is policy recommendations. Such policy recommendations can be used by government policy makers into policy making process. Through the findings and recommendations of this study the government is able to structure well targeted policies and regulations for executive compensation in order to create the desired economic outcomes and impacts.

Researchers and academicians are key stakeholders of this study. This study will add value to the existing body of knowledge which has been advanced in prior periods by

researchers. This study also explored and suggested various research gaps which can trigger further research by scholars. The final research will be available as a one stop document for scholars interested in research in the area of executive compensation or related areas. Students with special interest regarding executive remuneration will also benefit from the findings of this study.

1.6 Scope of the Study

According to the Central Bank of Kenya, there are 43 licensed commercial banks in Kenya. Three of the banks are public financial institutions with majority shareholding being the Government and state corporations. The rest are private financial institutions. Of the private banks, 27 are local commercial banks while 13 are foreign commercial banks (CBK, 2012).

The study comprised only 11 of them which are listed in the Nairobi Securities exchange having met the conditions of listing and applied for the same. The study therefore did not explore non listed commercial banks regardless of their size and influence in the sector and economy. The time frame of the study was from 2010 to 2015.

1.7 Limitations of the Study

A number of limitations were faced during the study. The empirical analysis in this thesis is limited to include financial banks listed on the Nairobi securities exchange. Furthermore, the study was limited to only consider publicly available information about the firms in our investigation sample.

The six -year period covered by the study might be considered inadequate to sufficiently provide in-depth and exhaustive understanding of the relationship between executive compensation and risk taking of commercial banks listed in NSE Kenya. Further, in the process of collecting the secondary data, the researcher experienced instances whereby some firms had data for some years missing; resulting to situations of unbalanced panels. Furthermore, the study

acknowledges that secondary data; which was gathered from audited financial statements and annual reports of listed non-financial firms could also have contained errors. Considering the cited limitations, the possibility of arriving at a biased conclusion on the study was real. However, steps to mitigate these limitations were taken as described in chapter three.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter provides a review of the main risk taking theories that informs the study and offers an understanding of how executive compensation affects the risk taking of firms listed in the NSE. Further, the chapter presents a conceptual relationship between executive compensation and risk taking. The chapter also examines the empirical literature that investigate the relationship between the study variables and concludes by critiquing the existing literature and identifying the gap (s) relevant for the study. This chapter also presents a review of literature related to the study variable. It entails literature on executive share ownership, executive fixed salary, executive allowances, and executive annual bonuses. The section is divided into: theoretical review conceptual framework, empirical review, critique of literature, knowledge gap and summary.

2.2 Theoretical Review

According to Trochim (2006), and Tormo (2006), a theoretical framework guides research, determining what variables to measure, and what statistical relationships to look for in the context of the problems under study. Thus, the theoretical literature helps the researcher see clearly the variables of the study; provides a general framework for data analysis; and helps in the selection of applicable research design. The Theory guides every aspect of research, from formulation of the research question through operationalization and discussion.

2.2.1 Principal Agent Theory

The principal-agent problem was first written about in the 1970s by theorists from the fields of economics and institutional theory. Michael Jensen of Harvard's Business School and William Meckling of the University of Rochester published a

paper in 1976 outlining a theory of ownership structure that would be designed in such a way as to avoid what they defined as agency cost and its relationship to the issue of separation and control. These issues are central to the principal-agent problem. The separation of control occurs when a principal hires an agent, and the costs that the principal incurs while dealing with an agent can be defined as agency costs. These agency costs can come from setting up monetary or moral incentives set up to encourage the agent to act in a particular way.

A more widespread acceptance of the concept of agency costs and principal agent theory, formalized by Jensen and Meckling (1976) can be seen as the starting point for the modern executive compensation research. In short the agency theory identifies the separation between ownership (shareholders) and control (management) as the main reason to why executive compensation systems need to be designed such that they achieve an alignment of interests between the owners and the management of the firm. Related to this the following is argued; "The principal can limit divergences from his interest by establishing appropriate incentives for the agent" (Jensen & Meckling, 1976. p. 308). The principal agent theory has a strong focus on so-called agency costs, which can be seen as the driving factor for how the executive compensation system should be structured from a theoretical point of view. According to this theory the executive compensation system should be structured such that the agency costs that the shareholders have to bear, originating from differences in interests between the agents, are minimized.

Donaldson (1990) criticized the agency theory dominance in terms of methodology individualism, narrow-defined motivation model, regressive simplification, disregarding other research, ideological framework, organizational economics and corporate governance's defensiveness.

Focus of agency theory's studies is individual consistent with rational, economic model of human behavior. However, absolute explication of every organizational activity should not be considered as equivalent to individual activity and that represents essential critic of structuralism.

It is extremely important to stress that Williamson's axiom about opportunistic agent's behavior over time has gained many different forms and interpretations. Williamson (1985) identified opportunistic behavior of the minority of individuals, the not majority. "Individual sometimes acts opportunistically and trustworthiness is hardly ex ante transparent. Therefore, it is compulsory to conduct ex ante screening and develop ex post assurance mechanisms or, in contrary, opportunistic individual will exploit circumstances towards less opportunistic individual." Since organizations cannot completely identify and eliminate opportunism, the fundamental proposition is that opportunism is possible and therefore control mechanisms are initiated. However, it is important to stress out that even in circumstances of highly specific assets, where the probability of opportunism is extremely high, there are individuals who will give priority to cooperation and trust and will not initiate opportunistic behavior (Hill, 1990).

This theory is relevant to our study in that it explores the role of the principal in this case the directors or other executives in relationship to the firm risk taking behaviour of the bank. This theory further envisages the role of directors as the sole proprietors of the firm's risk taking behaviors.

2.2.2 Resource Dependence Theory

The resource dependence perspective stems from streams in economics and sociological research (Zahra & Pearce, 1989). Proponents of this perspective see boards of directors as a means to manage external dependency (Pfeffer & Salancik, 1978), decrease environmental uncertainty (Pfeffer, 1982), and reduce transaction Costs associated with environmental interdependency (Williamson, 1984).

There are three core ideas of the theory: (1) social context matters; (2) organizations have strategies to enhance their autonomy and pursue interests; and (3) Power (not just rationality or efficiency) is important for understanding internal and external actions of organizations. The emphasis on power, and a careful articulation of the explicit repertoires of tactics available to organizations, is a hallmark of resource

dependence theory that distinguishes it from other approaches, such as transaction cost economics.

Pfeffer and Salancik (1978) determined three factors that influence the level that dependence organizations have on particular resources. First, the overall importance of the resource to the firm is critical in determining the resource dependence of the firm. Second, the scarcity of the resource is also a factor. The scarcer a resource is the more dependent the firm becomes. Finally, another factor influencing resource dependence is the competition between organizations for control of that resource. Together, all three of these factors act to influence the level of dependence that an organization has for a particular resource. Resource dependence theory also suggests that a firm's strategic options are determined to a great extent by the environment. Since firms are dependent on the environment for resources, they need to enact strategies that will allow them to acquire these resources. Therefore, the external environment has already been determined for these firms, and they experience little strategic choice. However, those who support the notion of managerial choice have argued that some organizations are more effective than others in the same environments, thus proving that strategic choice does exist. The conflicts are related to sharing the economic resources and the lack of confidence, these conflicts between the shareholders and managers being considered in the literature to be the root of creative accounting. One of the scarce resources is good management and hence they are remunerated to keep them in a company in order to pursue shareholder interests. This kind of shareholders-management interaction is debated by Demski (1994), and further by Christensen and Feltham (2005).

Recently, resource dependence theory has been under scrutiny in several review and meta-analytic studies: Hillman, Withers and Collins (2009); Davis and Cobb (2010); Drees and Heugens (2013); Sharif and Yeoh (2014). Which all indicate and discuss the importance of this theory in explaining the actions of organizations, by forming interlocks, alliances, joint ventures, and mergers and acquisitions, in striving to overcome dependencies and improve an organizational autonomy and legitimacy. While resource dependence theory is one of many theories of organizational studies

that characterize organizational behavior, it is not a theory that explains an organization's performance per se. But still in many ways, resource dependence theory predictions are similar to those of transaction cost economics, but it also shares some aspects with institutional theory (Nienhuser, 2008).

The relevance of this theory simply opinionates that the bank has limited resources and by extension the directors will have to choose the risk that will have more beneficial returns in a world of many opportunity costs.

2.2.3. Equity Theory

Equity theory focuses on determining whether the distribution of resources is fair to both relational partners. Equity is measured by comparing the ratio of contributions (or costs) and benefits (or rewards) for each person. Considered one of the justice theories, equity theory was first developed in the 1960s by J. Stacy Adams, a workplace and behavioral psychologist, who asserted that employees seek to maintain equity between the inputs that they bring to a job and the outcomes that they receive from it against the perceived inputs and outcomes of others (Adams, 1963). The belief is that people value fair treatment which causes them to be motivated to keep the fairness maintained within the relationships of their co-workers and the organization. The structure of equity in the workplace is based on the ratio of inputs to outcomes. Inputs are the contributions made by the employee for the organization.

Boivie, Bednar and Barker (2015) posit that what is most desirable about equity theory in terms of explaining executive compensation is that equity theory has been applied at both the individual and team levels of analysis. Equity theory offers predictions about how individuals react to over-reward and under-reward situations. Gomez-Mejia, Makri and Larraza (2003) confirm that equity theory has played a predominant role in traditional compensation theory and practice.

Criticism has been directed toward both the assumptions and practical application of equity theory. Scholars have questioned the simplicity of the model, arguing that a

number of demographic and psychological variables affect people's perceptions of fairness and interactions with others. Furthermore, much of the research supporting the basic propositions of equity theory has been conducted in laboratory settings, and thus has questionable applicability to real-world situations (Huseman, Hatfield & Miles, 1987). Critics have also argued that people might perceive equity/inequity not only in terms of the specific inputs and outcomes of a relationship, but also in terms of the overarching system that determines those inputs and outputs. Thus, in a business setting, one might feel that his or her compensation is equitable to other employees', but one might view the entire compensation system as unfair (Carrell & Dittrich, 1978).

According to equity theory, individuals make subjective assessments of the ratio of their inputs (effort) and outcomes (compensation) to those of referent others, and experience dissonance when the Relationship between Long-Term Incentives and Corporate Performance. Gerakos, Ittner and Moers (2013) assert that employees seek to maintain equity between the inputs they provide and the outputs they receive in comparison to the perceived inputs and outputs of others. The theory thus suggests that executive directors will be more aggressive in risk taking if they feel that the rewards they get measure up to the risks they take.

2.2.4 Legitimacy Theory

Suchman (1995) adopted a broad definition of legitimacy, defining it as a generalized perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed system of norms, values, beliefs and definitions. This particular definition of legitimacy asserts that a social contract exists between the entity and society. Maintaining legitimacy is an issue organizations are faced with constantly. Organizations need to provide assurances to society about their ongoing performance through warm signals such as speeches or long term contracts (Ashforth & Gibbs, 1990). This contributes to maintaining a social contract with society. Part of maintaining legitimacy is also to prevent or overcome challenges to legitimacy. A crisis management plan should be established

and ready to be used should a crisis occurs. Past accomplishments gained from legitimacy also need to be protected and built upon (Suchman, 1995). Ultimately, no entity is able to completely satisfy society's expectations but maintaining legitimacy is about communicating with audiences and letting them know what is happening. There are several problems associated with legitimacy.

Ashforth and Gibbs (1990) termed it the double edge of legitimation and suggested that a low level of legitimacy should not be seen as a lack of legitimacy but rather a challenge that needs to be dealt with. When legitimacy is problematic, the entity faces criticism by society which may lead to less capacity of resources to defend legitimacy (Ashforth & Gibbs, 1990). In this case, the organization should attempt to repair its legitimacy by re-building up its credibility with its audience. A good example of a legitimacy problem in the US is to do with executive compensation in recent times. CEO salaries in US have reached high levels, creating legitimacy problems with the public, some of which whom believe that CEOs, through their hard work deserve high salaries while others believe that CEOs don't work hard and therefore don't deserve high salaries.

The theory fits the study in that legitimacy given to directors to carry out their roles in risk taking must conform to, a generalized perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed system of norms, values, beliefs and definitions.

2.2.5 Stewardship Theory

Stewardship Theory, developed by Donaldson and Davis (1991 & 1993) is a new perspective to understand the existing relationships between ownership and management of the company. This theory arises as an important counterweight to agency Theory. Though this theory addresses some of the reductionist assumptions of Agency Theory, it suffers from being static as it considers the relationship of principal agent at a single point in time and assumes no learning of individuals as a result of their interactions.

Stewardship theory argues against the opportunistic self-interest assumption in agency theory. Stewardship theory assumes that managers do not always act in self-interested ways and in a situation of interest conflict they often place the interests of their firms above their own interests (Zajac & Westphal, 2004). For example, this perspective claims that managers are essentially trustworthy individuals and therefore good stewards of the resources entrusted to them (Donaldson & Davis, 1991). Mintzberg (2009) argues that the current US system of executive bonuses rewards senior managers who represent the most prominent form of legal corruption that has been undermining our large corporations and bringing down the global economy. Mintzberg (2009) radically suggests that anyone insisting on bonuses should be dismissed from an executive position, because he or she is missing the steward leadership attitude required for a sustainable enterprise.

The relevance of this theory is that managers are essentially trustworthy individuals and therefore good stewards of the resources entrusted to them in banking operations and therefore will act on the best interests of the firm.

2.2.6 Valence, Instrumentality, Expectancy (VIE) Theory

Vroom's theory assumes that the "choices made by a person among alternative courses of action are lawfully related to psychological events occurring contemporaneously with the behavior" (Vroom, 1964, p. 15).

This is basically saying that people's behavior results from conscious choices among alternatives, and these choices are systematically related to psychological processes, particularly perception and the formation of beliefs and attitudes (Pinder, 1984). There are three mental components that are seen as instigating and directing behavior.

These are referred to as Valence, Instrumentality, and Expectancy. These three factors are the reason why the expectancy theory is referred to as the VIE theory. Vroom (1964) defined the term valence as the affective (emotional) orientations people hold with regard to outcomes.

An outcome in this case is said to be positively valent for an individual if she/he would prefer having it or not. The most important feature of people's valences concerning

work-related outcomes is that they refer to the level of satisfaction the person expects to receive from them, not from the real value the person actually derives from them. As in other models, there is the emphasis on the level of motivation and the outcome of performance. Performance as an outcome as defined by Vroom is the degree to which the individual believes that performing at a particular level will lead to the attainment of a desired outcome. Work effort results in a variety of outcomes, some of them directly, and some of them indirectly and can include pay, promotion, and other related factors

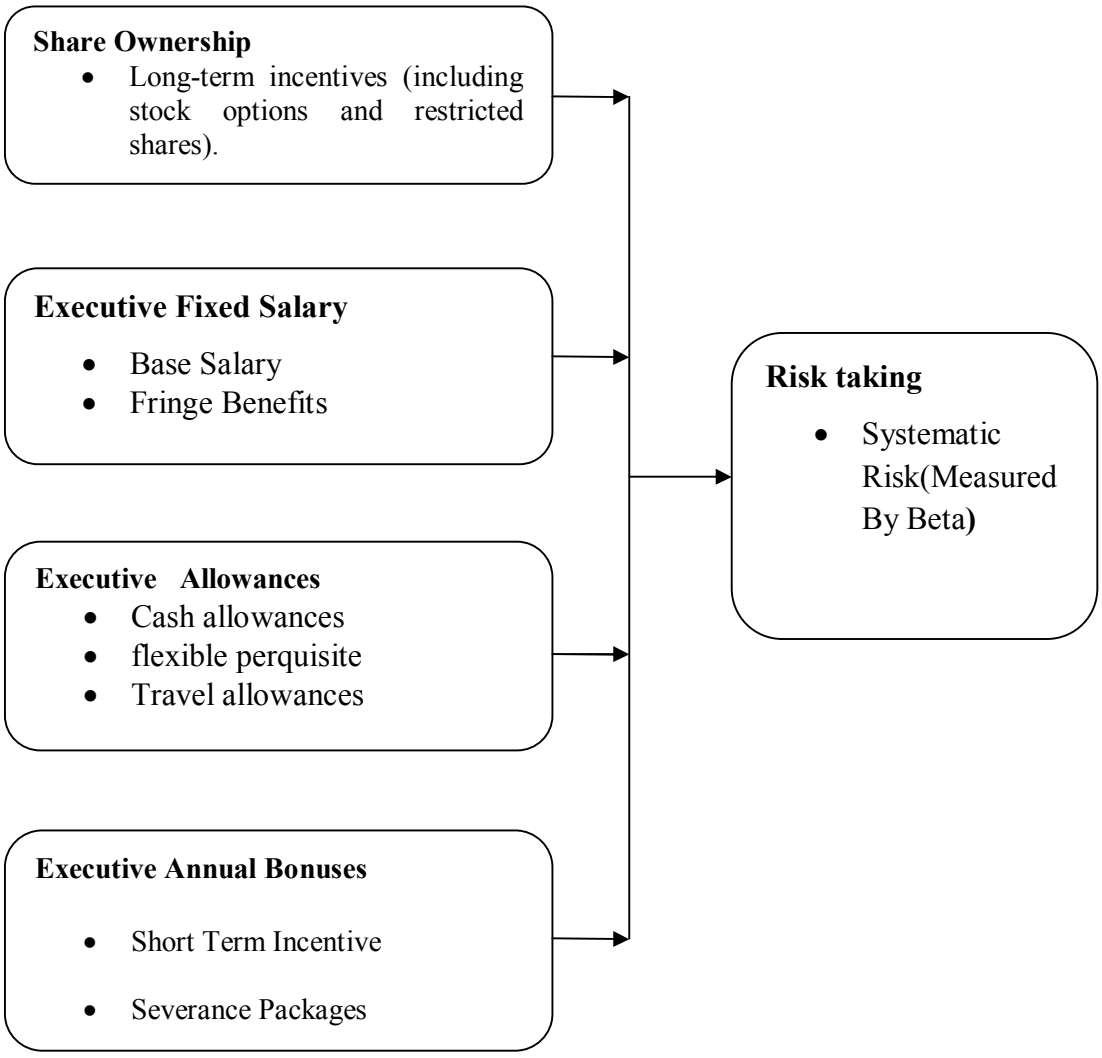
Instead of focusing merely on individual needs, VIE (Valence, Instrumentality, Expectancy) theory looks at the role of motivation in the overall work environment. The theory, which was conceived by Victor Vroom, argues that people are motivated to work when they believe that their efforts in the workplace will result in a desired outcome. Vroom assumed this belief is threefold (Robbins & Judge, 2008).

Expectancy: one's expectation that exerting a given amount of effort will lead to good performance. Instrumentality: individual's confidence that good performance will be rewarded. Valence: the belief that the offered reward/outcome will satisfy a desirable need or wish of the individual. The motivational effect will then depend on the combination of these three beliefs, i.e. the level of confidence one has in the fulfillment of all three stages. Greenberg and Baron (2003) suggest that managers strengthen the linkage between employees' expectations and actual result. In congruence with the three stages of VIE theory, they first call employers to enhance the possibility that employees' efforts will lead to good performance. This can be achieved by taking care of staff growth and advancement, or more specifically by training. Second, they recommend managers to administer a rewarding and recognition system which is directly linked to performance. And third, this system should be flexible to ensure that it is positively valent to employees.

Wright (2001) believes that especially in the public sector employees d to perceive low level of instrumentality, i.e. weak relationship between rewards and performance. For that reason, he urges public managers to emphasize the mission valence and the task importance that are associated with the work in public sector. The main deficit of Vroom's theory is that it gives the impression that people act on a rational basis after assessing the situation and the potential outcomes. Only in real life seldom do people hold complicated calculations as VIE theory suggests. More of humans make decisions with limited rationality and let emotions play a significant role in their decisions (Landy & Conte, 2010).The theory is relevant to our study as it looks at the role of motivation in the overall work environment.

2.3 Conceptual Framework

A conceptual framework aims to broadly define a number of key terms and concepts that can be used in identifying and debating the issues. The conceptual framework developed for this research is indeed to assist the researcher to develop awareness and understanding of the effects of executive compensation on risk taking among listed banks in Kenya. The framework has been adopted for its potential usefulness as a tool to assist the researcher to make meaning of subsequent findings. The conceptual framework was therefore based on one dependent variable and four independent variables as shown diagrammatically in Figure 2.1 that illustrates the conceptualized relationship between the explanatory and dependent variables. The conceptual framework shows how variables interact in a diagram format.



Independent Variables **Dependent Variable**

Figure 2.1: Conceptual Framework

2.4 Empirical review

Taylor (2007) points out that literature review is a critical and an evaluative summary of the themes, issues and arguments of a specific clearly defined research topic obtained from the published and unpublished literature. A literature review is an account of what has been published on a topic by accredited scholars and researchers. In writing the literature review, your purpose is to convey to your reader what knowledge and ideas have been established on a topic, and what their strengths and weaknesses are. As a piece of writing, the literature review must be defined by a guiding concept (e.g., the research objective, the problem or issue you are discussing or your argumentative thesis).

2.4.1 Executive Fixed Salary (Fees)

Aduda (2011) conducted a study to examine the relationship between executive compensation and firm performance among the commercial banks listed on the Nairobi Stock Exchange (NSE). The findings of the study suggested that accounting measures of performance are not key considerations in determining executive compensation among the large commercial banks in Kenya and that size is a key criterion in determining executive compensation as it was significantly but negatively related to compensation.

Scholt and Smith (2012) carried out a study on executive remuneration and company performance in South Africa. All the variables had positive regression coefficients, except for EBITDA. Total assets and turnover were significant at the 0.01 level and share price at the 0.05 level. Although EBITDA has a negative regression coefficient, it was only significant at the 0.10 level. The R-square indicated that 34% of the variation in executive remuneration was explained by the set of company performance indicators. The study found that there was a strong relationship between executive remuneration and some company performance indicators, such as total assets, turnover and share price for companies listed on the AltX.

Fatemi, Desai and Katz (2003) in their study examined the relationship between executive compensation and measures of firm performance that capture economic profits earned by the firm (EVA and MVA). They adopted a multivariate regression model in a bid to ascertain the correlation between firm performance and executive compensation. Their finding was that executive compensation is positively related to the level of risk borne by the firm and MVA is a significant determinant of executive compensation. At the same time the relationship between EVA and compensation was weak.

The empirical relationship between executive pay and performance starts from the influential study by Jensen and Murphy (1990), who first identified the pay performance puzzle: that there is little relationship between these variables. For UK firms, Conyon, Gregg and Machin (1995), Main, Bruce and Buck (1996), Conyon (1997) and Benito and Conyon (1999) confirmed these low pay-performance sensitivities (PPS), with typical elasticities of around 0.15. Fernandes, Ferreira, Matos and Murphy (2009) report that the positive relationship between CEO pay and firm size documented in the U.S. is pervasive across all countries, although the pay-size elasticity is higher in the U.S. than elsewhere. In a comparison of US and UK firms, Conyon and Murphy (2000) found a pay-size relationship of 0.32 for US firms and 0.2 for UK firms.

In Kenya, Gathua, Ngumi and Kiragu (2013) examined the relationship between executive compensation and risk taking among commercial banks in Kenya, The study found that executive compensation has insignificant relationship with risk taking among commercial banks in Kenya. Risk taking was measured by use of non-performing loans, money laundering, creative accounting and dividend pay-out. A further study to establish the determinants of executive compensation among commercial banks in Kenya is therefore recommended. The management of commercial banks should continue to enhance controls within operational areas that can pose a risk to the bank. Management actions should continue to be reviewed to ensure that they do not affect the banks business adversely.

Aktar, Sachu and Ali (2012) highlighted that ineffectiveness and inequity in reward management systems contribute to corporate malpractices. Biegelman and Bartow (2012), Cascarino (2013) agree that non-commensurate reward systems are strong rationalization for employees to commit fraud. Ibar and Khan (2015) found a strong association between reward and performance. Globally, executive and top organizational leadership's compensation consist of monthly salary, bonuses, and long term compensation comprising of equity and stock (Liu, Padgett & Varotto, 2014). According to Palmon, Santoro and Straus (2009) incentives are aimed at aligning the interest of the top leadership and those of the firm thereby minimizing conflict of interest and opportunity cost. Empirical studies have linked top organizational leadership to fraud (Jones & Wu, 2011). Conyon and He (2016) examined the relationship between CEO compensation and corporate fraud, the study found a correlation between executive compensation and fraud, the lower the executive compensation the higher the incidences of fraud. Other studies have found a negative association between compensation and performance (Nyaoga, Basweti & Tarus, 2014) Swagerman and Terpstra (2007) investigated executive pay structure in Netherlands, the study concluded that base pay is still an essential component of executive compensation due to its being risk free. Conyon and He (2016) studied the effect of executive remuneration in China, the study found that fixed pay tend to decrease after enforcement action by China Securities and Regulatory Commission. On the contrary, Casby, Song and Tapon (2007) found pay for performance to achieve higher results than fixed salary compensation such as salary.

2.4.2 Executive Allowances

Remuneration to executives serves as an incentive that affects decisions made and Strategies adopted by an executive, both of which affect firm performance. It has a motivational effect and is an indicator of value for executives. It is a means for executives to realize rewards for their efforts. In corporate context, executives participate in the firm's profitability. Therefore, when executive makes sound decisions and engages in profitable strategies, the executive and the organization realize financial enrichment (Finkelstein & Boyd, 1998).

Pay component entice executives to engage in activities that produce problems for the firm. Cash bonuses tied to accounting numbers may motivate executive to manipulate the timing of revenues and expenses to maximize their compensation. It focuses executives on short term performance which may be detrimental to the long term health of the firm (Sigler, 2011). Rewarding top management with different forms of stock compensation may not tie the executive's efforts to company performance closely enough. The stock price may rise or fall from market forces and not from moves of the company's executives. This is especially true with stock options. The manager can become wealthy by being in the right place at the right time and not by the merits of his performance. This could actually offer a disincentive to work hard if the stock price rises regardless of effort. Problems may also occur if the stock price declines after executive stock options are issued putting the options being way out of the money. Empirical evidence on fund performance suggests that higher incentives correlate with riskier investment strategies (Massa & Patgiri, 2009.) as well as superior performance (Agarwal, Daniel & Naik, 2009).

2.4.3 Executive Share Ownership

Earlier studies in the area of CEO compensation and the relationship with firm risk taking level have mainly been focused on the industrial sector. However, due to the regulation and the governmental protection in the banking industry, the results cannot be generalized to also hold for financial institutions. One study that show evidence of the differences in the compensation structure between the banking industry and other industries is the paper "CEO compensation and bank risk: Is compensation in banking structured to promote risk taking?" by Houston and James (1995) where the moral hazard hypothesis, predicting that the CEO compensation is structured to encourage risk taking, is examined. By using Forbes annual survey of executive compensation from 1980 to 1990, data from 134 commercial banks were obtained. Comparing the level of CEO compensation in the banking industry with the CEO compensation level in other industries, they find that on the average a bank CEO received less cash compensation, less compensation in option or stock plans,

and a lower level of salary than CEOs in other industries. They also find that cash compensation in the banking industry is more sensitive to the overall performance of the firm. Finally they find no evidence that equity based compensation is used to promote risk taking in the US banking market. However, they find evidence for a positive and significant relationship between equity based incentives and the value of the bank's charter. They also use the CAMEL rating in order to identify weakly capitalized institutions but find no significant difference in their CEO compensation structure.

The article by Houston and James (1995) differs from other studies in the area, with respect to the regression model used for the empirical analysis. The authors use the CEO compensation as the dependent variable and the risk level of the company as one of the explanatory variables. They then specifically control for firm size, recent performance, the firm's investment opportunity set, and CEO experience. The main focus of their analysis is therefore the structure of the compensation packages in the US banking industry and in the same time testing structural differences between industries by comparing with the executive compensation structure used in other business sectors.

Another approach is used in the article "Corporate control, bank risk taking, and the health of the banking industry" by Anderson and Fraser (2000). They examine the impact of managerial shareholdings and other measures of option based compensation for the firm risk taking in the banking industry. The model used for the empirical analysis by Anderson and Fraser (2000) is estimated in two separate stages, and in the first step measures of total, systematic, idiosyncratic and interest rate risk are generated. In the second stage each of the market based risk measure from the first stage is regressed against CEO compensation expressed either as proportion of option based compensation as a fraction of total compensation or as the accumulated value of option-based compensation. Several control factors are also included in the second stage regression model, those are; total asset, capital ratio, non-interest income, and a geographic diversification dummy. The data set used consists of 150 commercial banks in the US market for the years between 1987 and 1994. Relative to

other industries, this article shows proof of an increase in the usage of option-based compensation in the banking industry. Contrary to the results presented by Houston and James (1995), the results from this study provide evidence that managerial shareholdings, and therefore also indirectly the use of option based compensation, affect the risk taking level of banks. With background of these findings Anderson and Fraser (2000) therefore conclude that regulatory oversight of the managerial compensation structure is needed in the banking industry.

As pointed out by Wright, Ferris, Sarin and Awasthi (1996), shareholders with significant stakes in a company can shape the nature of its corporate risk-taking, which may affect a firm's ability to compete and eventually its survival. Excessive risk-taking by firms may result in massive bankruptcies, causing repercussion that is felt in the whole economy.

Firth, Fung and Rui (2007) conducted a study to ascertain how ownership and corporate governance structure influence chief executive pay in China's listed firms. The focus of their study was on nonfinancial companies listed in Shanghai and Shenzhen Stock Exchanges between 1998 and 2000. They employed regression analysis to test the relation between pay, performance, ownership, and boardroom variables. The findings of their study indicated that ROA as a prime measure of performance is related to CEO remuneration.

Firms that implement executive compensation plans based on performance generally create more ambitious and difficult strategies (Dow & Raposo, 2005) than companies that do not give this kind of compensation to their executives, and when the adoption of these compensation plans for CEOs is announced to the market, shareholders' wealth generally increases. In most cases, the market will respond positively because it believes that the CEO will develop efforts to increment the firm's stock market value to the level that will guarantee that stock options will be exercised (Dow & Raposo, 2005).

Related to bankers' compensation, Anderson and Fraser (2000) find that managerial ownership in banks is positively related to risk-taking, but that this relationship

became negative (managerial ownership reduces risk-taking) in conjunction with regulatory changes in the United States around 1990. However, Westman (2014) finds that managerial ownership in European banks that benefit from government safety net had a negative impact on the banks' performance during the recent financial crisis. Specifically, he found a positive impact of management ownership in small diversified banks and non-traditional banks, the monitoring of which is challenging due to their opacity. The impact is negative in traditional banks and large diversified banks, indicating that shareholders induce managers to take risk where the safety net creates incentives for risk-shifting to debt holders and taxpayers. These findings had implications for both academic research as well as policy making particularly in the domain of corporate governance.

Leaven and Levine (2007) show that banks' risk-taking may be determined at the level of a board that strongly represents shareholders' interests. They focused on conflicts between bank managers and owners over risk, and we show that bank risk taking varies positively with the comparative power of shareholders within the corporate governance structure of each bank. Moreover, we show that the relation between bank risk and capital regulations, deposit insurance policies, and restrictions on bank activities depends critically on each bank's ownership structure, such that the actual sign of the marginal effect of regulation on risk varies with ownership concentration. These findings show that the same regulation had different effects on bank risk taking depending on the bank's corporate governance structure.

On the other hand, shareholders with a large block of shares in one company are expected to have lower utility of risk-taking than it could be if the shareholders had a (well-diversified) portfolio. In addition, large shareholders may be risk-averse because they value their private benefits of control and in order to secure them they will invest in safe projects (John, Litov & Yeung, 2008).

In relation to performance according to Javid and Iqbal (2008), the identity of ownership matters more than the concentration of ownership. This is so

because ownership identity shows the behavior and interests of the owners. Ongore (2011) argues that the risk-taking behavior and investment orientation of shareholders have great influence on the decisions of managers in the day-to-day affairs of firms. According to Ongore (2011), the concept of ownership can be defined along two lines of thought: ownership concentration and ownership mix. The concentration refers to proportion of shares held (largest shareholding) in the firm by few shareholders and the later defines the identity of the shareholders. The dominant shareholders have the power and incentive to closely monitor the performances of the management. This in turn has two further consequences in relation to firm performance. On the one hand, close monitoring of the management can reduce agency cost and enhance firm performance. On the other hand, concentrated ownership can create a problem in relation to overlooking the right of the minority and also affect the innovativeness of the management (Ongore, 2011).

2.4.4 Executive Annual Bonuses

Bruce, Skovoroda, Fattorusso and Buck (2007) carried out a study on executive bonuses and firm performance in the U.K. by investigating executive bonuses for the period 2001 to 2003. Their main finding demonstrated that executive bonuses are related to higher total shareholder returns. Crumley (2008) examined the relationship between firm performance and CEO compensation in the U.S. commercial banking industry. The sample of his study covered 36 firms in the U.S commercial banking industry for the period 2002-2003. His results exhibited a weak relationship between CEO remuneration and firm performance.

Erkens, Hung and Matos (2009) examine corporate governance policies in 306 financial Institutions across 31 countries during the credit crisis. In contrast to the evidence for US banks, they find that financial firms that used CEO compensation contracts with a heavier emphasis on non-equity incentives (bonuses) rather than equity-based compensation) performed worse during the crisis and took more risk before the crisis.

Fahlenbrach and Stulz (2011) show that "banks with higher option compensation and a larger fraction of compensation in cash bonuses for their CEOs did not perform worse during the crisis. They investigate whether bank performance during the credit crisis of 2008 was related to CEO incentives and share ownership before the crisis and whether CEOs reduced their equity stakes in their banks in anticipation of the crisis. There was no evidence that banks with CEOs whose incentives were better aligned with the interests of their shareholders performed better during the crisis and evidence that these banks actually performed worse both in terms of stock returns and in terms of accounting return on equity (ROE). Further, banks with higher option compensation and with a larger fraction of compensation given in the form of cash bonuses did not have worse performance during the crisis. All these results held for banks that received TARP assistance as well as other banks that did not. The incentives of non-CEO top executives are unrelated to bank performance during the crisis. Bank CEOs did not reduce their holdings of shares in anticipation of the crisis or during the crisis; there is also no evidence that they hedged their equity exposure. Consequently, they suffered extremely large wealth losses as a result of the crisis.

The Looming Compensation Crisis especially in the financial industry, resulted in that; people were rewarded with large bonuses for gaming the system, creating artificial value, obfuscating, and taking on excessive levels of risk, all without sufficient skepticism or scrutiny (Burnison, 2009). This statement naturally raises the question if there is any evidence supporting that compensation practices in the financial sector induce excessive risk taking behavior. For example in the US, for a variety of reasons (such as protecting small savers and eliminating destabilizing bank runs), governments guarantee bank deposits up to a particular dollar threshold. In the absence of deposit insurance, creditors would be more inclined to force banks to hold significantly higher levels of capital and engage in activities with reasonable amounts of risks. With deposit insurance, managers at insured financial institutions are less concerned about bank runs, and they may also have more opportunities to take excessive or imprudent risks since creditors are less incentivized to monitor them. The premiums paid by banks for deposit insurance are meant to counteract the problems that were introduced by the provision of government deposit guarantees, as

are mandatory supervision and regulation of bank activities by government agencies—but these countermeasures may be only a partial antidote.

Thanassoulis (2012) considers the effect of bankers' compensation structure on the banks' default probabilities. Bonuses are valuable as a risk-sharing tool, but a bank specific limit on the maximum share of bonuses of the balance sheet can reduce banks' default risk. Interestingly, he finds that stringent banker-specific bonus caps can also increase banks' default risk. In a subsequent paper, Thanassoulis (2014) argues that bonus caps can be a better regulatory device to reduce bank risk than a higher capital requirement, which would reduce bank lending to borrowers.

According to Armstrong and Vashishtha (2012) there is empirical evidence on the impact of bonus of top organizational leadership on risk taking, their study show that the higher the bonus the lower the default risk which demonstrate managerial effectiveness. Han and Shen (2007) examined the relationship of performance based bonus on employee's inducement to innovation and performance efficiency. The study found strong correlations and therefore concluded that commensurate bonus payment increases employee efficiency and innovativeness thereby decreasing the operational gaps.

Armstrong and Taylor (2014) stated that there are cautions of moral hazards associated with bonus payments. A study conducted in the United States by Angeli and Gitay (2015) concluded that poorly aligned incentives facilitate excessive risk-taking behaviours by the executives, the study therefore recommended that risk-adjusted return metrics, prudential metrics, strategic metrics and conduct metrics be adopted while awarding or deciding on executive bonus payments. The study opined that perfect alignment between risk and reward enhances safety, soundness and stability of financial systems.

2.4.5 Risk Taking

Laeven and Levine (2007) studied risk-taking and ownership in banks and documented a positive relationship. They found that banks with more powerful

owners tend to take greater risks. This was consistent with theories predicting that equity holders have stronger incentives to increase risk than no shareholding managers and debt holders and that large owners with substantial cash flows have the power and incentives to induce the bank's managers to increase risk-taking. However, their study does not examine the portfolio of ownership stakes.

Many studies when attempting to find causal relationships between CEO pay and risk taking find mixed evidence (Spitz-Oener, 2006). Mueller and Spitz-Oener (2006) examined 356 German financial service firms and find a link between pay and company risks in that a higher percentage of managerial ownership shares correlate positively with increases in firm risks. Lam and Chng (2006) find that managerial stock options correlate positively with firm risks. There are other studies (Sloan, 1993; Carpenter & Sanders, 2002; Kerr & Bettis, 1987) that find a strong relationship between risk measures and executive compensation. Chesney, Stromberg and Wagner (2012) find a strong negative relationship between the abnormal CEO compensation and excessive risk-taking for the group of banks that do not report their Tier 1 ratio (predominantly, investment banks).

Also, Murphy (2012) finds only little evidence that the pay structures provide incentives for risk-taking among top-level banking executives. There is some evidence of value-destroying performance-measurement problems for lower-level traders, brokers and loan officers. The regulatory reforms imposed in TARP and Dodd-Frank have largely focused on punishing perceived excesses in top-level executive pay, and have not served to reduce risk, improve pay or protect taxpayers. Overall, while incentives for bankers can clearly be improved through well-functioning corporate governance, further government intervention will likely be counterproductive to both shareholders' and taxpayers' interest.

Ozkan (2007) found a positive and significant link between CEO cash compensation and firm performance. He also noted a positive but not significant relationship between total compensation and firm performance. Kajola

(2008), found a positive and significant relationship between Profit Margins and chief executive status. Al-Heizan (2009), found a significant relationship between market value per share and the percentage of stock options granted to the total number of shares outstanding. He also noted less significant relationship between market value per share and stock based compensation.

According to Ellul and Yerramilli (2013) risk-taking among US banks depends on the strength and independency of risk management function. Excessive risk-taking is viewed as a contributing factor to the market turmoil that erupted in the United States around mid-2007. Among the most frequently debated channels that have propagated the accumulation of risky exposures are ill-designed compensation policies, capital regulation, originate-to-distribute business model, low short-term interest rates, and others.

Argarwal and Samwick (1999) report that the level of firm risk (firm return variance) is an important determinant of the level of remuneration and that this is robust across other measures of firm risk. Failure to allow for firm risk wills under-estimate the true pay-performance relationship. Garen (1994) showed that firms with higher levels of risk (as measured by betas from a regression of firms' return on the market return) paid their executives more in salary and less in incentive payments. This is consistent with standard principal-agent theory since risk-averse executives should demand higher base salaries and less performance-related pay when risk is high, in order to avoid bearing the firm's idiosyncratic risk. Core and Larcker (1999), Conyon and Murphy (2000), and Garvey and Milbourn (2003) have all incorporated some measure of firm risk into models specifying the determination of executive pay. Aggarwal and Samwick (1999) and Garvey and Milbourn (2003) found that riskier firms tend to have lower pay-performance relationships and a smaller proportion of their pay as incentive based pay.

Cain, McKeon and Solomon (2015) show that risk-taking in corporations depends also on the CEO's personal risk preferences on top of the compensation-based risk-taking incentives. Hagendorff, Saunders, Steffen and Vallascas (2015) show

evidence that management style also affects risk-taking in banks. Leisen (2015) studies dynamic risk-taking incentives and a bonus scheme that gives a socially optimal level of risk-taking. His paper studied dynamic risk taking by a risk-averse manager who receives a bonus; the company may default on its contractual obligations (debt and fixed compensation). He shows that risk taking is time independent, and is summarized by the so-called risk aversion of derived utility. He highlighted the importance of dynamic aspects and provides a foundation for common qualitative discussions that are based on characteristics of bonus functions. He cautioned that deferral of fixed compensation may increase risk taking. Finally, we motivate a new bonus scheme that incentivizes the manager to implement the socially optimal risk level.

FSA (2009a) identified potential market failures in the structures of remuneration practices in financial services, and suggested that an emphasis on short-term profits by institutional investors had encouraged executive remuneration to be focused on "variable compensation" (bonuses) related to the most recent earnings, without any consideration of the exposure to risk-taking. In addition variable compensation schemes tend to be pro-cyclical, since down-side bonuses are capped at zero. These practices were sustained by pressures in the labour market and weak remuneration committees. In response to these perceived market failures, Walker (2009b) recommended a series of changes to remuneration practices: alignment of compensation and its risks made the responsibility of remuneration committees; transparency of the process and levels of executive pay; deferral of incentive payments; and performance criteria related to long-term profitability. These recommendations and eight key principles on executive remuneration identified in FSA (2009b) were enacted in an updated code for UK banks and building societies that became effective from January 2010.

2.5 Critique of Existing Literature

There is an extensive literature available on the determinants of executive compensation but the findings among the studies are not compatible with each other. Overall, most of the academic works on the determinants of CEO compensation emphasizes on economic determinants like firm size (measured in terms of total assets or sales), firm performance (measured by sales, profits, ROE, ROA, stockholders wealth) giving controversial and mixed results that lack the value of their practical applicability in firms.

The contradicting results in the previous literature have been widely discussed and several explanations for them have been given. Houston and James (1995) explain the contracting results in earlier studies by the differences in the methodology and differences in which type of CEO compensation that are measured. Mullins (1992) argues that some findings are largely attributable to their failure to adequately control for bank size. Finally, Garen (1994) states that the empirical literature on CEO compensation packages generally fails to specify a model on which hypotheses can be based and tested, with respect to its determinants. In the article by Garen (1994) a principal agent model is used in order to determine how well it is explains variations in executive compensation structure. Garen (1994) results are therefore consistent with the principal agent model, but both the significance of the findings are weak and the explanatory power of the overall model is low. Related to this the author states that principal agent model has clear implications for executive compensation structure but that many issues related to the determination of CEO pay still remain unsolved.

It is evident from review of literature that even in situations where similar indicators of executive compensation have been employed, conflicting empirical results have been provided. Specifically, while some studies have provided for a negative effect, others have shown positive relationship; while others have postulated null relationship. This lack of convergence implies that the manner in which executive compensation influences risk taking is inconclusive.

Another major criticism of executive pay packages has been that they incentivize excessive risk taking which contribute to the financial turmoil of firms. Further critics argue that when analyzing the relationship between firm risk taking and CEO compensation structure, it is important to keep in mind that conventional management compensation schemes motivates risk taking by only looking at return, without regard for the risk(s) accepted in generating it.

Most studies in Kenya have concentrated on Executive Compensation and Ownership structure and Bank performance and not on the risk taking component. Such studies include Aduda (2008) and Ongore (2011). This study intends to delve into how executive compensation influences the systematic risk among listed commercial banks in Kenya by evaluating how various compensation types; such as share ownership, fixed salary, allowances and annual bonuses affects the riskiness in the banks stocks.

2.6 Research Gap

Many studies when attempting to find causal relationships between CEO pay and risk taking find mixed evidence (Spitz-Oener, 2006). Mueller and Spitz-Oener (2006) examined 356 German financial service firms and find a link between pay and company risks in that a higher percentage of managerial ownership shares correlate positively with increases in firm risks. Lam and Chng (2006) find that managerial stock options correlate positively with firm risks. There are other studies (Sloan, 1993; Carpenter & Sanders, 2002; Kerr & Bettis, 1987) that find a strong relationship between risk measures and executive compensation. Chesney, Stromberg and Wagner (010) find a strong negative on share ownership and risk taking. This study wholly sought to exemplify effect of executive compensation on risk taking among listed commercial banks in Kenya.

Swagerman and Terpstra (2007) investigated executive pay structure in Netherlands, the study concluded that base pay is still an essential component of executive compensation due to its being risk free. Conyon and He (2016) studied the effect of executive remuneration in China, the study found that fixed pay tends to decrease

after enforcement action by China Securities and Regulatory Commission. On the contrary, Casby, Song and Tapon (2007) found pay for performance to achieve higher results than fixed salary compensation such as salary.

In Kenya, Gathua, Ngumi and Kiragu (2013) examined the relationship between executive compensation and risk taking among commercial banks in Kenya, the study concluded the executive compensation has no correlation with risk taking .Rewards are used by leaders to reinforce behavior of the subordinates (Ngui, 2014). Aktar, Sachu and Ali (2012) highlighted that ineffectiveness and inequity in reward management systems contribute to corporate malpractices. Biegelman and Bartow (2012), Cascarino (2013) agree that non-commensurate reward systems are strong rationalization for employees to commit fraud.

Ibar and Khan (2015) found a strong association between reward and performance. Globally, executive and top organizational leadership's compensation consist of monthly salary, bonuses, and long term compensation comprising of equity and stock (Liu, Padgett & Varotto, 2014). According to Palmon, Santoro and Straus (2009) incentives are aimed at aligning the interest of the top leadership and those of the firm thereby minimizing conflict of interest and opportunity cost. Empirical studies have linked top organizational leadership to fraud (Jones & Wu, 2011).Conyon and He (2016) examined the relationship between CEO compensation and corporate fraud, the study found a correlation between executive compensation and Fraud, the lower the executive compensation the higher the incidences of fraud. Other studies have found a negative association between compensation and performance (Nyaoga, Basweti & Tarus, 2014) Murphy (2012) finds only little evidence that the pay structures provide incentives for risk-taking among top-level banking executives. This study however wholly sought to exemplify effect of executive compensation on risk taking among listed commercial banks in Kenya.

2.7 Summary

This chapter reviewed the various theories that explain the independent and dependent variables. The first theory was principal agent theory. This theory is

relevant to our study in that it explores the role of the principal in this case the directors or other executives in relationship to the firm risk taking behaviors. This theory further envisages the role of directors as the sole proprietors of the firm's risk taking behaviors. The second theory was resource dependent theory which importance is highlighted on the fact banks have limited resources and by extension the directors will have to choose the risk that will have more beneficial returns in a world of many opportunity costs. The third theory was equity theory which can be summarized as behavioral in the sense that executive directors will be more aggressive in risk taking if they feel that the rewards they get measure up to the risks they take. legitimacy theory allows the directors to carry out their roles in risk taking must conform to, a generalized perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed system of norms, values, beliefs and definitions. The relevance of stewardship theory is that managers are essentially trustworthy individuals and therefore good stewards of the resources entrusted to them in banking operations and therefore will act on the best interests of the firm. Finally valence, instrumentality, expectancy (vie) theory looked at the role of motivation in the overall work environment. The chapter also posits the conceptual framework which presented diagrammatically the independent variables showing the specific constituents that influence a particular variable.

There are several empirical studies of executive compensation. However a significant portion of the studies have concentrated in developed countries especially the United States of America. There are just a handful of studies on executive compensation in Africa and a serious paucity in Kenya. This study therefore comes in handy to cover this pertinent gap in literature. Among the literature reviewed there was none found for Kenya despite there being many concerns about executive pay and the role they play in managing risks in the face of several corporate collapses. This study is unique due to its concentration on listed commercial banks.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter provides a description of the methods and approaches adopted in carrying out this study. It covers the research design, target population, census, data collection, and analysis techniques as well as methods of testing the suitability of the data. The chapter also specifies the empirical model estimated by the study and provides the techniques to analyze the model.

3.2 Research design

The ontology of this research is informed by objectivism given the nature of data which is publicly available from the Nairobi Securities Exchange as well as the capital markets authority. The Epistemology of this research is also leaning towards a positivist view. The researcher therefore generated a research strategy to collect these data that was used to test the existing theory and develop hypotheses. These hypotheses were tested and confirmed, in whole or part, or refuted, leading to the further development of theory which then may be tested by further research and the research is undertaken as far as possible in a value freeway. (Saunders, 2011).

The study adopted a causal research design by examining the relationship between executive compensation and risk taking among the commercial banks listed at the Nairobi securities exchange. To achieve this the study employed a panel data approach and analyzed the effect of executive compensation on risk taking among listed commercial banks at the Nairobi Securities Exchange during the period 2010 to 2015. The period was when most listed commercial banks attempted to comply with the capital markets authority corporate governance requirements. Panel data estimation technique was adopted because it took care of heterogeneity associated with different securities allowing for individual specific variables. Also, by combining time series of cross sectional observations, panel data gives more

informative data, more variability, less collinearity among variables, more degrees of freedom and more efficiency. Besides, panel data minimizes the bias that can result if individual securities are aggregated.

3.3 Target Population

The target population comprised of the eleven commercial banks listed at the Nairobi securities exchange as at December 2015 as indicated in CMA bulletin 2015. The eleven commercial banks were chosen as the unit of study as banks have more risk taking behavior due to competition with other banks and also due to nature of their operations as they tend to offer new product in the market. Also the same banks were chosen because of ease of getting information. The study however did not adopt banks not listed on the NSE because risk taking is not as evident as public listed banks. This could be attributed to the fact public scrutiny in listed banks is higher.

3.4 Sampling Frame

Kothari (2004) defined a sampling frame as a list of all the items where a representative sample is drawn for the purpose of a study. The sampling frame for this study comprised all the 11 commercial banks listed in NSE as at 31st December 2015 (NSE, 2015).

3.5 Census

Census method involves an exhaustive enumeration of the units constituting the target population (Kothari, 2004). Since the target population comprised 11 commercial banks listed in NSE, a census of all the firms study was conducted for the study. According to Mugenda and Mugenda (2003), a census is preferred where the population is small and manageable. Further, census method enhances validity of the collected data by eliminating errors associated with sampling (Saunders, Lewis, & Thornhill, 2009). A census survey was conducted of the listed commercial banks, namely, Barclays Bank of Kenya, CFC Stanbic Bank, Housing Finance group, Co-operative Bank, Diamond Trust Bank, Equity Bank, Kenya

Commercial Bank, National Bank, NIC Bank, Standard Chartered Bank, Investment and Mortgages Bank.

3.6 Data Collection Instrument

The study employed secondary data that was extracted from audited financial statements and annual reports of individual listed commercial banks over the 6-year period, 2010 to 2015. Collection of data was accomplished by means of the secondary data collection instrument specified in Appendix iv. The instrument aided in collection of accounting data necessary to compute Beta. In addition, data relating to executive share ownership, executive fixed salary, executive allowances, and executive annual bonuses was collected.

3.7 Data Collection Procedure

Collection of data involved visiting the websites of the listed commercial banks and downloading the published financial statements for the 6 years period studied. Using the data collection instrument, the information on specific components was keyed in for each firm for every year. In order to verify the authenticity of the collected data, the same was cross-checked by using the hand book summaries obtained from NSE website for the period of study. Where differences were noted, the data obtained from the published financial statements was given preference considering that the same had been published for public consumption. The data was then uploaded in Excel program and converted into ratios. The ratios were then converted into panels ready for analysis.

3.8 Pilot Study

The study employed secondary data that was collected by means of pre-designed instrument specified under appendix iv. The instrument was designed by the help of experts in finance who includes Lecturers in the Finance field and Finance Managers. To ensure that the instrument captured all the necessary information, the instrument was discussed with the experts prior to data

collection and the necessary review done. Having agreed on the adequacy of the instrument, no further piloting was conducted on the instrument prior to data collection.

3.9 Descriptive Statistics

Descriptive Statistics was used in transforming the raw data into a form that can easily be understood and interpreted. The first form of analysis involves computation of averages, frequency distributions and percentage distributions (Adejimi, Oyediran & Ogunsanmi, 2011). Descriptive statistics such as, mean and frequencies was used to perform data analysis. Descriptive statistics was used to derive conclusions and generalizations regarding the population. The mean scores were used to rate the factors, share ownership, executive fixed salary, executive allowances and executive annual bonuses in order of their importance. Standard deviation of each of the factors was calculated to measure the variability of the responses

3.10 Diagnostic Tests

3.10.1 Testing Multicollinearity:

Before modeling the regression, multicollinearity test was first performed. This is usually done so as to avoid spurious regression results. According to William, Grajales and Kurkiewicz (2013), multicollinearity refers to the presence of correlations between the predictor variables. In severe cases of perfect correlations between predictor variables, multicollinearity can imply that a unique least squares solution to a regression analysis cannot be computed (Field, 2009). Multicollinearity inflates the standard errors and confidence intervals leading to unstable estimates of the coefficients for individual predictors (Belsley, Kuh & Welsch, 1980). Multicollinearity was assessed in this study using the variance inflation factors (VIF). According to Field (2009) VIF values in excess of 10 is an indication of the presence of Multicollinearity

3.10.2 Testing Normality

The study used the graphical method (Histogram) to test for normality to ensure that residuals of regression models are normally distributed. This is to ensure that the variables used in the analysis are distributed normally. To further verify the above results, Jarque-Bera test which is a more conclusive test than the graphical method was conducted. The null hypothesis under this test is that the disturbances are not normally distributed. If the p-value is less than 0.05, the null of normality at the 5% level will be rejected.

3.10.3 Autocorrelation

Since the data involves both cross section and time-series, it raises the suspicion of the existence of serial correlation. The presence of serial correlation indicates that the variables in the model violate the assumptions of the regression (Anderson & Fraser, 2000). To cater for serial correlation, the Woodridge test for autocorrelation was employed. Serial correlation is a common problem experienced in panel data analysis and has to be accounted for in order to achieve the correct model specification. According to Wooldridge (2003), failure to identify and account for serial correlation in the idiosyncratic error term in a panel model would result into biased standard errors and inefficient parameter estimates. The null hypothesis of this test is that the data has no serial correlation tested at 5% level of significance.

3.10.4 Testing Heteroscedasticity

The error terms from a regression model must have a constant variance called Homoskedastic. Modified wald test was used to test for heteroskedasticity. The null hypothesis in the test is that error terms have a constant variance (i.e. should be Homoskedastic) at 5% significance levels.

3.10.5 Panel Unit Root Test

In view of the fact that panel data have both cross-sections and time series dimensions, there is need to test for stationary of the time series because the

estimation of the times series is based on the assumption that the variables are stationary. Estimating models without taking into account the non-stationary nature of the data would lead to unauthentic results (Gujarati, 2003). Unit root tests were thus conducted using the Levin, Lin and Chu Statistics (LLC) at 5% level of significance to establish whether the variables were stationary or non-stationary. The purpose of this was to avoid spurious regression results being obtained by using non-stationary series.

3.11 Data Processing and Analysis

Data analysis is a practice in which raw data is ordered and organized so that useful information can be extracted from it (Saunders 2011). Quantitative measurements involved statistical inference through application of inductive reasoning (Creswell, Plano Clark, Gutmann & Hanson, 2003).

The study employed secondary data which was obtained from the financial statements of the commercial banks, weekly share prices and market indices from 2010-2015 obtained from the NSE. A simple regression model was used to obtain the beta for each bank and thereafter a panel data regression was performed to establish the causal relationship between the systematic risk and various approaches of compensation outlined in the objectives.

The systematic risk of a security is a function of the total risk of a security as measured by the standard deviation of the security returns, the standard deviation of the returns from the market portfolio, and the correlation of the security's returns with those of all other securities in the market. One useful measure of the systematic risks of a security *j* is the value called ***beta .Beta*** is a measure of the volatility of a security returns relative to the returns of a broad based market portfolio *m.*

In practice, beta may be computed as the slope of regression line between periodic (usually, yearly, quarterly, or monthly) rates of return on the market portfolio (as measured by a market index) and periodic rates of return for security *j,* as follows *:*

$$K_{j=}a_{j} +\beta_{jr}m_{+}e_{j}$$

Where k_{j} is the periodic percentage holding period rate of return for security j; a_{j} is a constant term determined by the regression; βj is the computed historical beta for security j; rm is the periodic percentage holding period rate of return for the market index and e_{j} is a random error term.

Generally, three techniques may be adopted by researchers to specify and estimate panel regression models: Pooled Regression Model, Fixed Effect Model, and the Random Effects Model. Pooled regression model is also known as the constant coefficients model with reference to both the intercept and slope. It is the simplest among the three models in panel data analysis. It is however the most restrictive as it disregards the space and time dimensions of pooled data. It is best suited in situations where there is neither significant cross-sectional or temporal effects and involves pooling all the data and running an ordinary least square (OLS) regression model. The major problem with this model is that it does not distinguish between the various cross sections involved in the study; i.e. by pooling all the firms, we deny the heterogeneity or individuality that may exist among them (Gujarati, 2003). The general presentation for pooled regression model may be made as follows:

$$Y_{it} = \alpha_i + \sum_{i=1}^{n} \beta_i X_{it} + \mu_{it} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (1)$$

Where; Y_{it} is the regressand

X_{it}=vector of the regressor variables

βI s the coefficient of the regressor variable

I Refer to the firm and t is time

Fixed effect model estimation on the other hand involves designing the regression model that allows for the intercept to vary across space (individual firms) with the slope coefficients remaining constant; hence the term “fixed effects”. By so doing, the model captures the differences in individual characteristics of the entities being studied such as management style or philosophy hence improving the reliability of the regression results (Gujarati, 2003). This is achieved by employing the mean differencing or differential intercept dummies technique; hence the term least-squares dummy variable (LSDV) model. Under this study, the fixed effect model with time invariant intercept term may be designed as follows:

$$Y_{it} = \alpha_i + \sum_{i=1}^{n} \beta_i X_{it} + \mu_{it} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (2)$$

Where;

Y_{it} Is the regressand,

X_{it} is the vector of regressor variables,

β_i is the coefficient of the regressor variable,

i refers to the firm and t is the time

The LSDV model form could be expressed as follows:

$Yit= \alpha1+\alpha2D_{2i}+\alpha3D3i+\alpha nDni+\beta1X1it+\beta2X2it+\mu it$... (3)

Where;

Di= is the dummy variable that equals to 1 if the observation X belongs to firm I and 0 otherwise and ranges from 1 to n-1.

Another way of specifying the fixed effect model involves designing the regression model that allows for the intercept to vary across both space (individual firms) and time with the slope coefficients remaining constant. By so doing, the model captures not only he cross-sectional characteristics such as differences in management style or philosophy but also time-induced differences such as technological changes, regulatory and/or tax policy changes, and external effects such as wars or other conflicts. Under this study, the fixed effect model with time variant intercept term may be designed as follows:

$Y_{it}=\alpha 1+\alpha 2D2i+\alpha 3D3i+\alpha nDni+\lambda 0+\lambda 1Dum1t+.....+\lambda tDumt+\beta 1X1it+\beta 2X2it+\mu it...$ (4)

Where:

D_i= is the dummy variable that equals to 1 if the observation

X belongs to firm i,

0 otherwise and ranges from 1 to n-1.

Dum $_t$= is the time dummy variable that equals to 1 if the observation belongs to year t, 0 otherwise and ranges from years 2010 to 2015.

Nonetheless, it is notable that despite the advantages of the fixed effect model, introducing too many dummy variables, usually results in reduction of degrees of freedom hence problems of further statistical analysis.

Secondly, numerous variables in a regression model normally leads to the possibility of multicollinearity, which might make precise estimation of one or more parameters difficult.

Unlike the fixed effect model that assumes a unique intercept for individual firms with respect to space, time or both, random effects models assume that all the 11 firms involved in the study have an intercept that has a universal mean value

equivalent to α_i. Effectively, the differences in their individual features is captured by the intercept term which is reflected as deviations from the mean termα_i. Starting with Equation (2) above, the intercept value for an individual company is expressed as

$$\alpha_i t = \alpha_i + \varepsilon i,$$

where=1,2……11……(5)

Where εi being the random error term of mean equal to zero and variance of $\sigma^2\varepsilon$.

Substituting Equation (5) into (2), we obtain

$Y_{it}=\alpha 1+\beta 1X1it+\beta 2X2it+\varepsilon i+\mu it$..... (6)

But taking;

$\pi it=\varepsilon i+\mu it$……..……(7)

Equation 8 is estimated as follows:

$Yit= \alpha 1+\beta 1X1it+\beta 2X2it+\pi it$..... (8)

From the above, it can be deduced that the composite error term consists of two components, which is the firm-specific, error component, and the which is the combined time series and cross-section error component. For this reason, this model is also called error components model (ECM).

In contrast to FEM, REM is parsimonious in that it does not result in loss of degrees of freedom. This is because one does not have to estimate n cross-sectional intercepts but just only the mean value of the intercept and its variance.

To determine which model provides superior results between the random effects and fixed effects models, Hausman test was undertaken. This

involves sequentially estimating both models (starting with FEM) against the alternative hypothesis that the random effect model is appropriate at 5% confidence level. The Hausman test provided a chi-square value and a corresponding p-value which formed the basis of accepting or rejecting the null as appropriate.

3.12 Statistical Model

Model specification involves coming up with a combination of study variables that represents the empirical relationship between the dependent, and explanatory variables. This was done in line with the conceptual framework illustrated under section 2.3.

$Y = \alpha + \beta_1X_1+\beta_2X_2+ \beta_3X_{3+}\ \beta4X_4+ \mu$ ……………………………………………….(9)

Where: Y = risk taking

α = the Y intercept;

X_1= executive fixed salary

X_2= executive allowances

X_3= executive share ownership

X_4= executive annual bonuses

μ = error term which is assumed to be normal in distribution with mean zero and variance.

CHAPTER FOUR

RESULTS AND DISCUSSION

4.1 Introduction

This chapter presented the results from analysis and the findings with regard to the study objectives. In addition, the following were presented in the chapter; data analysis and presentation, descriptive statistics, diagnostics tests; Multicollinearity test, panel unit root tests, normality tests, Heteroskedasticity, Auto correlation, Fixed or Random Effects, Hausman test. Secondary data was obtained from financial statements. To achieve this the study employed a panel data approach and analyzed the effect of executive compensation on risk taking among listed commercial banks at the Nairobi Securities Exchange during the period 2010 to 2015.

4.2 Descriptive Results

Results in table 4.1 below indicate the summary descriptive statistics of executive compensation. The mean for risk taking was Mean was -3.241953, executive share ownership had mean of -5.364723 while executive fixed salary posted a mean of -5.748071, results also indicated that executive allowance mean was -5.006054 and finally executive annual bonus mean was-3.501647. The median results for risk taking was -2.956512 while share ownership was -5.465080 further results indicated that executive fixed salary had median of-5.783875,executive allowance had 4.850131and final results for executive annual bonus was -3.344894. The findings for the minimum for risk taking was -6.907755, the share ownership results were -11.69074, executive fixed salary had a minimum of -7.190170, executive allowance posted minimum of -7.013729 while finally executive annual bonus had a minimum of -5.289961.The Std. Dev. for risk taking was 1.129280, the executive share ownership was 2.723703, executive fixed salary had a 0.959553 executive allowance posted minimum of 1.083835 and final results for executive annual bonus had a minimum of 0.885060. Results indicated that the skewedness for risk taking was -0.779062, the executive share ownership results was -0.771240, executive

fixed salary had a finding of 0.723555 executive allowance posted a skewedness of -0.032440 finally executive annual bonus had a skewedness of -0.267186

Kurtosis results for risk taking was 3.817902, results also showed that the executive share ownership was 3.563198, executive fixed salary had a kurtosis of 3.103318executive allowance posted a kurtosis of 2.536946 and final kurtosis results for executive annual bonus was 2.017326. The sum results for Risk taking was -197.7591, executive share ownership results showed that it was -327.2481, executive fixed salary had a sum of -350.6323, executive allowance posted a sum of -305.3693 finally executive annual bonus results indicated that it was -213.6004.The Sum Sq. Dev for Risk taking was 76.51635, the executive share ownership was 445.1135, executive fixed salary had a finding of 55.24447, executive allowance posted Sum Sq. Dev of 70.48193 and finally annual bonus had a Sum Sq. Dev of 46.99989. The overall observations were 61.

Table 4.1: Descriptive Results

	Risk taking	**Exe. Share ownership**	**Exe Fixed salary**	**Executive allowances**	**Exe Annual bonuses**
Mean	-3.241953	-5.364723	-5.748071	-5.006054	-3.501647
Median	-2.956512	-5.465080	-5.783875	-4.850131	-3.344894
Maximum	-1.164752	-1.581548	-3.267040	-2.329769	-1.980718
Minimum	-6.907755	-11.69074	-7.190170	-7.013729	-5.289961
Std. Dev.	1.129280	2.723703	0.959553	1.083835	0.885060
Skewness	-0.779062	-0.771240	0.723555	-0.032440	-0.267186
Kurtosis	3.817902	3.563198	3.103318	2.536946	2.017326
Sum	-197.7591	-327.2481	-350.6323	-305.3693	-213.6004
Sum Sq. Dev.	76.51635	445.1135	55.24447	70.48193	46.99989
Observations	61	61	61	61	61

4.3 Panel Data Specification Tests

To determine the suitability of the panel data for statistical analysis, various tests were conducted. The tests that aimed at establishing if the panel data fulfilled the cardinal requirements of classical linear regression analysis included: normality test, panel unit root test, multicollinearity test, panel-level heteroscedasticity test as well as serial correlation test. Where violation to these assumptions were detected, appropriate remedies were applied. In addition, panel cointegration test was conducted to determine if the variables used in the study had a long run association. This section therefore presents the results of various diagnostic tests carried out on the data together with the relevant remedial treatment undertaken to ensure suitability of the data.

4.3.1 Multicollinearity Test

According to Field (2009) VIF values in excess of 10 is an indication of the presence of Multicollinearity. The results in Table 4.2 present variance inflation factors results and were established to be 1.26 which is less than 10 and thus according to Field (2009) indicates that there is no Multicollinearity.

Table 4.2: Multicollinearity Test

Variable	VIF	1/VIF
Executive Allowances	1.42	0.702867
Executive Fixed Salary	1.4	0.715789
Executive Share Ownership	1.14	0.877389
Executive Annual Bonus	1.08	0.93021
Mean VIF		1.26

4.3.2 Panel Unit Root Tests

Most economic variables are usually non-stationary in nature and prior to running a regression analysis. Unit root tests were thus conducted using the LLC test to establish whether the variables were stationary or non-stationary. The purpose of this is to avoid spurious regression results being obtained by using non-stationary series. Results in Table 4.3 indicated that all variables are stationary (i.e. absence of unit roots) at 5% level of significance.

Table 4.3: Unit Root

Variable Name	Statistic(Adjusted)	P-Value	Comment
Risk Taking	-6.51485	0.000	Stationary
Executive Share Ownership	-2.16193	0.0153	Stationary
Executive fixed Salary	-6.89990	0.000	Stationary
Executive Allowances	-1.66840	0.0476	Stationary
Executive Bonus	-3.50427	0.0002	Stationary

4.3.3 Heteroskedasticy Test

Modified wald test was used to test for heteroskedasticity. The null hypothesis in the test is that error terms have a constant variance (i.e. should be Homoskedastic). The results in the Table 4.4 below indicate that the error terms are homoscedastic, given that the p-value is more than the 5% (0.07),hence the null hypothesis of constant variance was accepted.

Table 4.4: Heteroskedastic Test

	Modified Wald test for group wise heteroskedasticity in fixed effect regression model
	H0: sigma(i)^2 = sigma^2 for all i
chi2 (11) =	323.76
Prob>chi2 =	0.07

4.3.4 Normality Tests

The test for normality was first investigated using the graphical method as indicated in figure 4.1. The results in the figure indicate that the residuals are normally distributed.

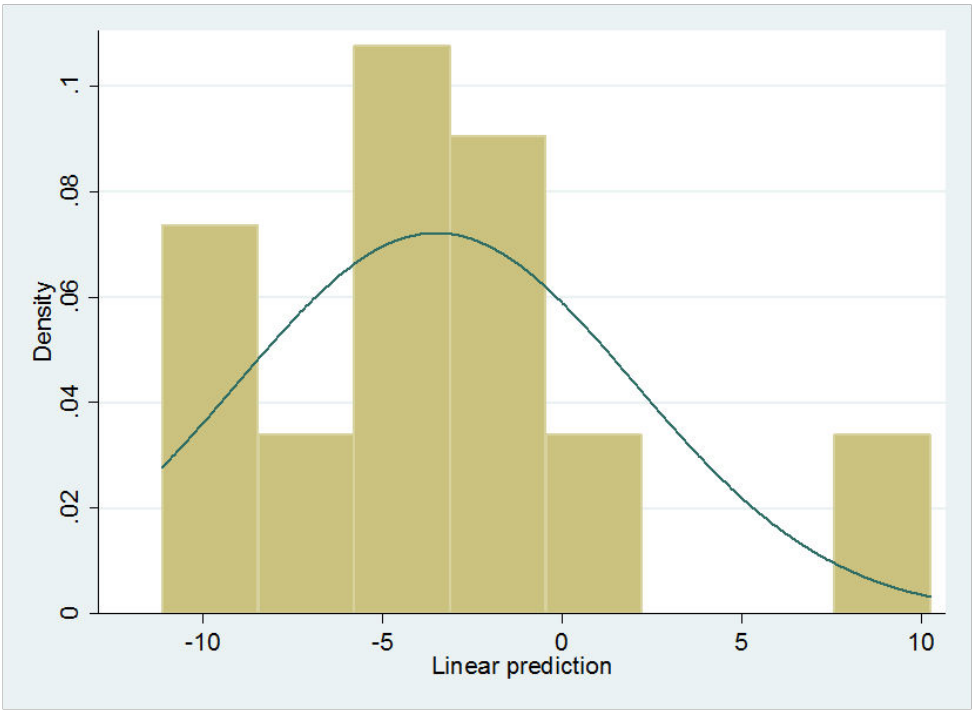


Figure 4.1: Normality Distribution

To further verify the above results, Jarque-Bera test which is a more conclusive test than the graphical method was conducted. The results are as presented in table 4.5. The null hypothesis under this test is that the disturbances are not normally distributed. If the p-value is less than 0.05, the null of normality at the 5% level will be rejected. Given that the p-value is less than 5% for the residual, the null hypothesis is rejected and thus the conclusion that the residuals are normally distributed.

Table 4.5: Jarque-Bera test

	Risk taking	Exe. Share ownership	Exe Fixed salary	Executive allowances	Exe Annual bonuses
Jarque-Bera	7.870817	6.853443	5.349707	0.555680	3.180141
Probability	0.019538	0.032493	0.0068917	0.00757418	0.0203911
Observations	61	61	61	61	61

4.3.5 Autocorrelation

To establish whether or not the residual is serially correlated over time, Wooldridge test for autocorrelation was conducted. The null hypothesis is that no first order serial /auto correlation exists. The results are as indicated in Table 4.6 below and therefore the null hypothesis of no autocorrelation is accepted and therefore residuals are not auto correlated (p-value=0.1010).

Table 4.6: Autocorrelation Tests

Wooldridge test for autocorrelation in panel data
H0: no first-order autocorrelation
F(1, 30) = 2.864
Prob > F = 0.1010

4.4 Exploratory Data analysis

Data analysis began with the exploration of the study data. Exploration study analysis examined heterogeneity across the firms and over time. Exploratory data analysis was done using graphs to examine the trend of risk taking within and across the firms. Figure 4.2 shows the empirical growth of risk taking over the 5 years. The empirical growth plot reveal that for most firms' risk taking trend has been on the fluctuating over time this could be attributed to environmental factors and the changing regulatory environment over this period.

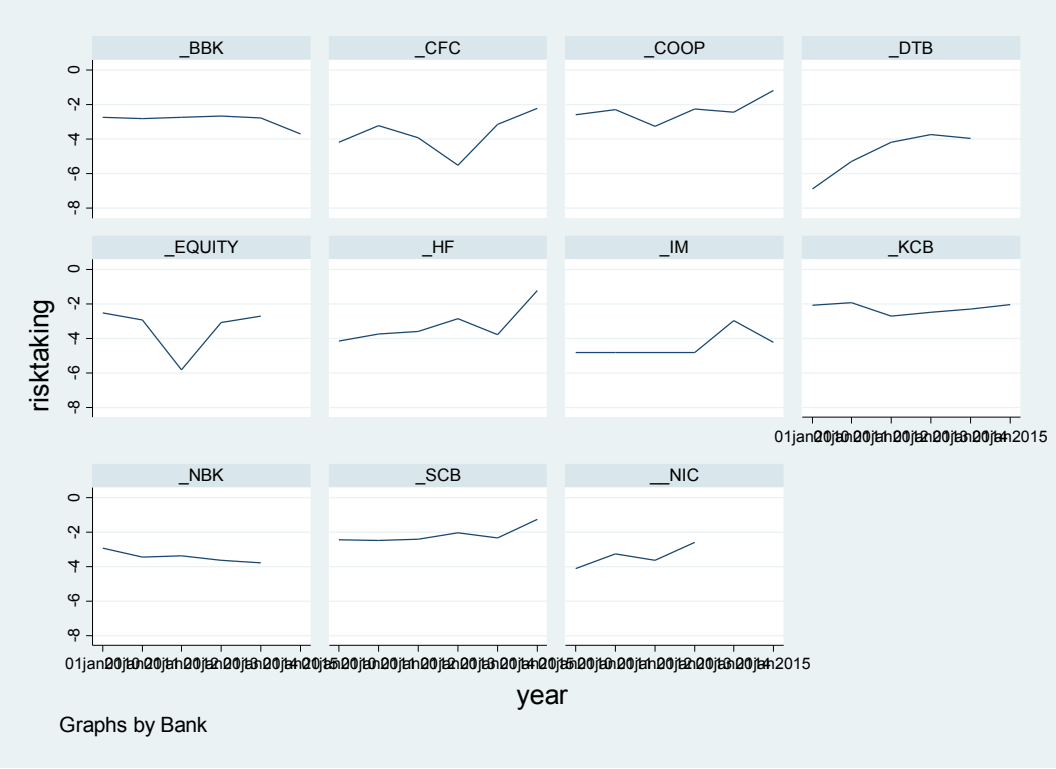


Figure 4.2: Exploratory Data Analysis

4.5 Correlation Analysis

Correlation coefficient values ranging between -1 and 1 measures the degree to which two variables are linearly related with the higher magnitude indicating higher degree of association between two variables. Adejimi, Oyediran and Ogunsanmi (2011) observed that that a correlation coefficient of magnitude 0.3–0.5 shows a medium linear dependence between two variables while 0.5 to 1.0 shows a strong linear dependence.

The correlation results in Table 4.7 below indicate that executive share ownership was positively associated to risk taking among commercial banks listed in NSE (r= 0.061, p=0.638). Similarly, executive fixed salary was negatively associated to risk taking (r=-0.097, p=0.456). Executive allowances were negatively associated to risk taking (r= -0.238, p=0.063). Also, executive annual bonuses had a negative association to risk taking (r= -0.486, p=0.0001).

Table 4.7: Correlation

Correlation

Probability	Risk Taking	Share Ownership	Fixed Salary	Allowances	Annual Bonuses
Risk Taking	1.000000				

Exe.Share Ownership	0.061340	1.000000			
	0.6386	-----			
Exe.Fixed Salary	-0.097039	0.323776	1.000000		
	0.4569	0.0109	-----		
Exe.Allowances	-0.238903	-0.270677	-0.495063	1.000000	
	0.0637	0.0349	0.0000	-----	
Exe.Annual Bonuses	-0.486013	0.033505	0.137091	-0.260706	1.000000
	0.0001	0.7977	0.2921	0.0424	-----

4.6 Test for Fixed and Random Effects

When performing panel data analysis, one has to determine whether to run a fixed effects model or a random effects model. Whereas the fixed effect model assumes firm specific intercepts and captures effects of those variables which are specific to each firm and constant over time, the random effect model assumes that there is a single common intercept and it varies from firm to firm in a random manner (Baltagi, 2005). To determine which of these two models is appropriate, coefficients were estimated by both fixed and random effects. Hausman's specification test (1978) was used to determine whether fixed or random effect should be used. Depending on the nature of αi , two models can be distinguished, first is the Random Effect Model which assumes that αi are random variables uncorrelated with vit. The second model is the Fixed Effects Model which assumes that the αi are individual fixed parameters. The results of both the random and fixed effects model are presented in the table 4.8 and table 4.9 respectively.

Table 4.8: Random Effects Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Exe. Share Ownership	-1.730807	0.940152	-1.840987	0.0729
LN_X1(-1)	1.746552	0.940653	1.856744	0.0705
Exe. Fixed Salary	-0.509771	0.242056	-2.106008	0.0414
LN_X2(-1)	0.046977	0.242663	0.193590	0.8475
Exe. Fixed Allowances	-0.340626	0.163437	-2.084148	0.0434
LN_X3(-1)	-0.208777	0.204147	-1.022680	0.3125
Exe. Annual Bonuses	-0.623036	0.350704	-1.776529	0.00831
LN_X4(-1)	-0.026215	0.348855	-0.075147	0.9405
C	-10.79776	1.831242	-5.896413	0.0000
	Effects Specification			
			S.D.	Rho
Cross-section random			0.262373	0.1012
Idiosyncratic random			0.781886	0.8988
	Weighted Statistics			
R-squared	0.400993	Mean dependent var		-2.572490
Adjusted R-squared	0.284114	S.D. dependent var		0.969457
S.E. of regression	0.807351	Sum squared resid		26.72446
F-statistic	3.430833	Durbin-Watson stat		1.885004
Prob(F-statistic)	0.004140			
	Unweighted Statistics			
R-squared	0.472655	Mean dependent var		-3.165766
Sum squared resid	28.70348	Durbin-Watson stat		1.755039

Table 4.9: Fixed Effects Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Exe. Share Ownership	-1.465951	1.592231	-0.920690	0.3643
Ln_X1(-1)	2.078906	1.539838	1.350081	0.1868
Exe. Fixed Salary	-0.749848	0.331873	-2.259440	0.0310
Ln_X2(-1)	-0.176179	0.304278	-0.579006	0.5668
Exe. Fixed Allowances	-0.298443	0.198314	-1.504902	0.1425
Ln_X3(-1)	0.055183	0.282628	0.195248	0.8465
Exe. Annual Bonuses	-0.118443	0.421348	-0.281104	0.7805
Ln_X4(-1)	0.281269	0.462907	0.607613	0.5479
C	-5.878363	14.22044	-0.413374	0.6822

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.651816	Mean dependent var	-3.165766
Adjusted R-squared	0.449645	S.D. dependent var	1.053954
S.E. of regression	0.781886	Akaike info criterion	2.627748
Sum squared resid	18.95171	Schwarz criterion	3.354317
Log likelihood	-46.69370	Hannan-Quinn criter.	2.904430
F-statistic	3.224078	Durbin-Watson stat	2.226267
Prob(F-statistic)	0.002056		

4.6.1 The Hausman Test for Model Effect Estimation

The Hausman test was employed to determine the most suitable model for this study. The null hypothesis is that the fixed effect model is appropriate and the alternative hypothesis is that Random effect estimation models is suitable tested at 5% significance level. The Chi-square test statistic is 10.703576 with an insignificant probability of 0.2191 which means that the null hypothesis is rejected in favor of the

Random effects model. Therefore, we accept the random effects model as suitable for this study. The Hausman test results were presented in table 4.10.

Table 4.10: Hausman test

Correlated Random Effects - Hausman Test

Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	10.703576	8	0.2191

4.7 Panel Regression Analysis

The regression model helps to explain the magnitude and direction of relationship between the variables of the study through the use of coefficients like the beta coefficient and the level of significance.

The results presented in table 4.11 presented the fitness of model used of the regression model in explaining the study phenomena. Share ownership, executive fixed salary, executive allowance and executive annual bonuses were found to be satisfactory variables in explaining risk taking. This is supported by coefficient of determination also known as the R square of 40%. This means that Share ownership, executive fixed salary, executive allowance and executive annual bonuses explain 40 %of the variations in the dependent variable which is risk taking. This results further means that the model applied to link the relationship of the variables was satisfactory.

In statistics significance testing the p-value indicates the level of relation of the independent variable to the dependent variable. If the significance number found is

less than the critical value also known as the probability value (p) which is statistically set at 0.05, then the conclusion would be that the model is significant in explaining the relationship; else the model would be regarded as non-significant.

Table 4.11 provides the results on the analysis of the variance (ANOVA). The results indicate that the overall model was statistically significant. Further, the results imply that the independent variables are good predictors of performance. This was supported by aF-statistic 0f 3.430 and a p value (0.004) which was less than the conventional probability of 0.05 significance level.

The constant C had a coefficient of -10.8 with a significant probability value of 0.0000 which is significant at 1 percent level of significance. This therefore means that the independent variables jointly have a negative slope.

4.7.1 Executive Share Ownership and risk taking

Table 4.11 provides Regression of coefficients results. Executive Share Ownership and risk taking are negatively and insignificant related (r = -1.73087, p=0.0729). Thus one unit increase in share ownership led to an insignificant decrease in the dependent variable denoted as risk taking by -1.73087 units. This seems to agree with Murphy (2012) who finds only little evidence that the pay structures provide incentives for risk-taking among top-level banking executives.

Leaven and Levine (2009) disagrees as the results from their study show that banks' risk-taking may be determined at the level of a board that strongly represents shareholders' interests. They focused on conflicts between bank managers and owners over risk, and they showed that bank risk taking varies positively with the comparative power of shareholders within the corporate governance structure of each bank. Moreover, they showed that the relation between bank risk and capital regulations, deposit insurance policies, and restrictions on bank activities depends critically on each bank's ownership structure, such that the actual sign of the marginal effect of regulation on risk varies with

ownership concentration. These findings show that the same regulation had different effects on bank risk taking depending on the bank's corporate governance structure.

Anderson and Fraser (2000) also disagree as the results from their study provides evidence that managerial shareholdings, and therefore also indirectly the use of option based compensation, affect the risk taking level of banks.

4.7.2 Executive Fixed Salary and risk taking

Table 4.11 provides Regression of coefficients results. Executive Fixed Salary and risk taking are negatively and significantly related (r = -0.509771, p=0.0414). Thus an increase in one unit of executive salary led to a decrease of the dependent variable risk taking by 0.509771 units.

Swagerman and Terpstra (2007) agrees with our findings when they investigated executive pay structure in Netherlands, the study concluded that base pay is still an essential component of executive compensation due to its being risk free.

These results agree with Scholt and Smith (2012) who carried out a study on executive remuneration and company performance in South Africa. The study found that there was a strong relationship between executive remuneration and some company performance indicators, such as total assets, turnover and share price for companies listed on the AltX.

However the results disagree with , Gathua, Ngumi and Kiragu (2013) who examined the relationship between executive compensation and risk taking among commercial banks in Kenya, The study found that executive compensation has insignificant relationship with risk taking among commercial banks in Kenya.

4.7.3 Executive Allowances and risk taking

Table 4.11 provides Regression of coefficients results .Executive Allowances and risk taking were negatively and significantly related (r=- -0.340626, p=0.0434), thus

an increase in one unit of executive allowances led to a decrease of risk taking by 0.340626 units.

This mirrors Massa and Patgiri, (2009) whose Empirical evidence on fund performance suggests that higher incentives correlate with riskier investment strategies.

Garen (1994) disagrees with our results in that firms with higher levels of risk (as measured by betas from a regression of firms' return on the market return) paid their executives more in salary and less in incentive payments.

4.7.4 Executive Annual Bonuses and risk taking

Table 4.11 provides Regression of coefficients results .Executive Annual Bonuses and risk taking were negatively and significantly related (r=-0.623036, p=0.00831).Thus an increase in one unit of the dependent variable executive annual bonuses led to a decrease of risk taking by 0.623036 units.

This findings resonates with Thanassoulis (2012) who considers the effect of bankers' compensation structure on the banks' default probabilities. Bonuses are valuable as a risk-sharing tool, but a bank specific limit on the maximum share of bonuses of the balance sheet can reduce banks' default risk. Interestingly, he finds that stringent banker-specific bonus caps can also increase banks' default risk. In a subsequent paper, Thanassoulis (2014) argues that bonus caps can be a better regulatory device to reduce bank risk than a higher capital requirement, which would reduce bank lending to borrowers.

The Findings further agree with Fahlenbrach and Stulz (2011) who shows that "banks with higher option compensation and a larger fraction of compensation in cash bonuses for their CEOs did not perform worse during the crisis.

This agrees with Bruce, Skovoroda, Fattorusso and Buck (2007) who carried out a study on executive bonuses and firm performance in the U.K. by investigating

executive bonuses for the period 2001 to 2003. Their main finding demonstrated that executive bonuses are related to higher total shareholder returns.

Armstrong and Vashishtha (2012) also agrees to our results that there is empirical evidence on the impact of bonus of top organizational leadership on risk taking, their study show that the higher the bonus the lower the default risk which demonstrate managerial effectiveness.

Table 4.11: Random Effects Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Exe.Share Ownership	-1.730807	0.940152	-1.840987	0.0729
Exe.Fixed Salary	-0.509771	0.242056	-2.106008	0.0414
Exe.Fixed Allowances	-0.340626	0.163437	-2.084148	0.0434
Exe.Annual Bonuses	-0.623036	0.350704	-1.776529	0.00831
C	-10.79776	1.831242	-5.896413	0.0000
	Effects Specification			
			S.D.	Rho
Cross-section random			0.262373	0.1012
Idiosyncratic random			0.781886	0.8988
	Weighted Statistics			
R-squared	0.400993	Mean dependent var		-2.572490
Adjusted R-squared	0.284114	S.D. dependent var		0.969457
S.E. of regression	0.807351	Sum squared resid		26.72446
F-statistic	3.430833	Durbin-Watson stat		1.885004
Prob(F-statistic)	0.004140			
	Unweighted Statistics			
R-squared	0.472655	Mean dependent var		-3.165766
Sum squared resid	28.70348	Durbin-Watson stat		1.755039

$Y = \alpha + \beta 1X1 - \beta 2X2 - \beta 3X3 - \beta 4X4 + \varepsilon$

Where: Y = risk taking

α = the Y intercept;

x_1= executive share ownership

x_2= executive fixed salary

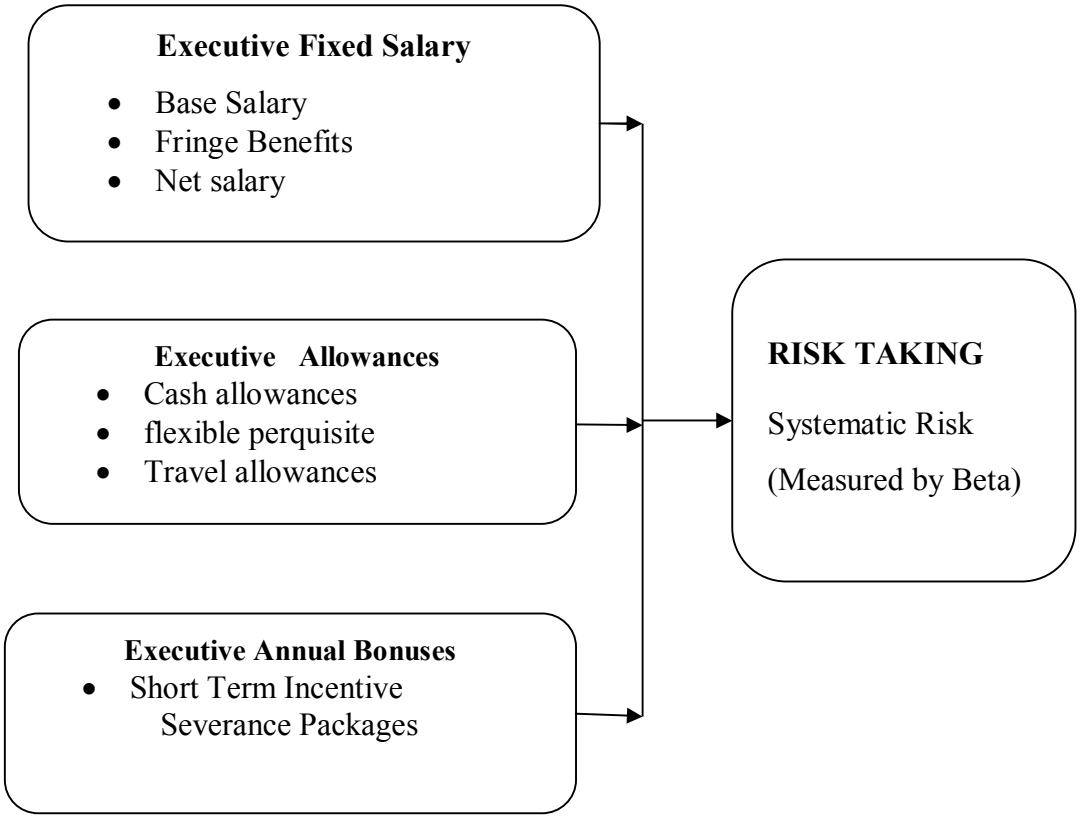
X_3= executive allowances

X_4= executive annual bonus

ε = error term which is assumed to be normal in distribution with mean zero and variance (б)

Optimal model

Y =-10.79776-1.730807 executive share ownership -0.509771 executive fixed salary -0.340626 executive allowances -0.623036 executive annual balance.



Independent Variables **Dependent Variable**

Figure 4.3: Revised conceptual model

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter deals with the summary of the findings, the conclusion and recommendations. This was done in line with the objectives of the study. Areas of further research were suggested and limitations of the study were taken into account.

5.2 Summary of Findings

The primary objective of the study was to investigate the effects of executive compensation on risk taking among banks listed at NSE .The study specifically sought to establish the effects of share ownership, executive fixed salary, executive allowances, and executive annual bonuses on risk taking among banks listed at NSE.

5.2.1 Executive Share Ownership

The first objective of the study was to assess the effect of executive share ownership on risk taking among the listed commercial banks in Kenya.

Executive Share Ownership and risk taking are negative and insignificantly related (r = -1.73087, p=0.0729). Thus one unit increase in share ownership led to an insignificant decrease in the dependent variable denoted as risk taking by -1.73087 units.Regression analysis indicated Share Ownership and risk taking are negative and insignificantly related. The hypothesis results indicated that Share Ownership has no effect on risk taking among the listed commercial banks in Kenya.

5.2.2 Executive Fixed Salary

The second objective of the study was to establish the effect of executive fixed salary on risk taking among the listed commercial banks in Kenya.

Executive Fixed Salary and risk taking are negative and significantly related (r = -0.509771, p=0.0414). Thus an increase in one unit of executive salary led to a decrease of the dependent variable risk taking by 0.509771 units.

Regression analysis indicated that Executive Fixed Salary and risk taking were negatively and significantly related. The hypothesis results indicated that executive fixed salaries affects risk taking among the listed commercial banks in Kenya.

5.2.3 Executive Allowances

The third objective of the study was to determine the effect of other executive allowances on risk taking among the listed commercial banks in Kenya.

Executive Allowances and risk taking were negative and significantly related (r=-0.340626, p=0.0434), thus an increase in one unit of executive allowances led to a decrease of risk taking by 0.340626 units.

Regression analysis indicated that Executive Allowances and risk taking were negative and significantly related. The hypothesis results indicated that executive allowances affects risk taking among the listed commercial banks in Kenya.

5.2.4 Executive annual bonuses

The fourth objective of the study was to determine examine the influence of executive annual bonuses on risk taking among listed commercial banks in Kenya.

Executive Annual Bonuses and risk taking were negatively and significantly related (r=-0.623036, p=0.00831). Thus an increase in one unit of the dependent variable executive annual bonuses led to a decrease of risk taking by 0.623036 units.

Regression analysis indicated that Executive Annual Bonuses and risk taking were negative and significantly related. The hypothesis results indicated that executive annual bonuses affects risk taking among listed commercial banks in Kenya.

5.3 Conclusion of the Study

The study concludes that Executive Share Ownership does not influences risk taking in that there is a positive relationship but insignificant. That means even if banks increase directors share ownership it will not have any effect on risk taking.

The study also concludes that there is a negative and significant relationship between executive fixed salary and risk taking. Thus, banks might want to raise their executive salary bases on their staff as this will automatically lead to decreased risk.

Banks might also be advised to increase the executive allowances of their executive staff as results show that executive allowances have a negative but significant effect on risk taking. Banks thus should entice their staff with huge allowances expecting a decrease in risk.

The study also concludes that executive annual bonus and risk taking have a negative and significant relationship. Thus, executive annual bonus should be increased so as to reduce risk.

5.4 Recommendations

The study recommendations are in line with the objectives, findings and conclusions of the study. This study recommends that on Executive Share Ownership banks should not increase director's shares as this will have no effect on risk taking. It was also recommended that banks might want to raise their executive salary bases on their executive staff as this will automatically lead to decreased risk in banks. The study recommended that banks should entice their staff with huge allowances as this will decrease risk. The study also recommends executive annual bonus should be considered incrementally while determining executive compensation perks as it has a decreasing effect on risk among banks listed on NSE.

5.5 Suggested Areas for Further Study

The study sought to assess the effect of executive compensation on risk taking among listed commercial banks in Kenya therefore, another area for further studies could consider the effect of executive compensation on risk taking among other sectors.

This study sought to provide empirical understanding on the effect of executive compensation on risk taking among listed commercial banks in Kenya. In accomplishing this study focused only on the firms that were listed in NSE as at 31st December 2015. However, the practice world over is to have only the best performing corporation endorsed for listing in the bourse. This tendency may result in biased research finding and conclusions concerning the topic of study. As a way of verifying the study results, similar study could be carried out among companies which are not listed in NSE such as the SMEs.

Further, this study was undertaken within the Kenyan context and represents the background of an emerging market with unique characteristics in economic, regulator and political fronts. In addition, the 11 commercial banks listed in Kenya could be considered few and hence less representative in wider jurisdictions. The choice of the geographical scope was informed by time and budgetary constraints facing the researcher. The applicability of the study results may therefore be restrictive In this regard, the study recommends a similar study be carried out within larger jurisdiction that could present unique economic and regulatory dynamics.

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APPENDICES

Appendix I: List of Banks in NSE

i. National Bank

ii. HF Group

iii. CFC Bank

iv. KCB Group

v. Barclays Bank

vi. NIC Bank

vii. DTB Bank

viii. Co-op Bank

ix. I&M Bank

x. Standard Chartered

xi. Equity Group

Source :(NSE, 2015)

Appendix 11: Output Results

ANNEXES

Unit root tests

Beta

Panel unit root test: Summary

Series: LN_BETA

Date: 09/29/16 Time: 14:43

Sample: 2010 2015

Exogenous variables: Individual effects

Automatic selection of maximum lags

Automatic lag length selection based on SIC: 0

Newey-West automatic bandwidth selection and Bartlett kernel

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-6.51485	0.0000	11	50
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-0.40208	0.3438	10	47
ADF - Fisher Chi-square	20.5715	0.5473	11	50
PP - Fisher Chi-square	22.6681	0.4207	11	50

** Probabilities for Fisher tests are computed using an asymptotic Chi -square distribution. All other tests assume asymptotic normality.

X1

Panel unit root test: Summary

Series: LN_X1

Date: 09/29/16 Time: 14:44

Sample: 2010 2015

Exogenous variables: Individual effects

Automatic selection of maximum lags

Automatic lag length selection based on SIC: 0

Newey-West automatic bandwidth selection and Bartlett kernel

Balanced observations for each test

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-2.16193	0.0153	11	55
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-0.15036	0.4402	11	55
ADF - Fisher Chi-square	22.2363	0.4459	11	55
PP - Fisher Chi-square	20.4813	0.5530	11	55

** Probabilities for Fisher tests are computed using an asymptotic Chi -square distribution. All other tests assume asymptotic normality.

X2

Panel unit root test: Summary

Series: LN_X2

Date: 09/29/16 Time: 14:44

Sample: 2010 2015

Exogenous variables: Individual effects

Automatic selection of maximum lags

Automatic lag length selection based on SIC: 0

Newey-West automatic bandwidth selection and Bartlett kernel

Balanced observations for each test

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-6.89990	0.0000	11	55
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-1.16740	0.1215	11	55
ADF - Fisher Chi-square	33.9683	0.0495	11	55
PP - Fisher Chi-square	49.5716	0.0007	11	55

** Probabilities for Fisher tests are computed using an asymptotic Chi -square distribution. All other tests assume asymptotic normality.

X3

Panel unit root test: Summary

Series: LN_X3

Date: 09/29/16 Time: 14:45

Sample: 2010 2015

Exogenous variables: Individual effects

Automatic selection of maximum lags

Automatic lag length selection based on SIC: 0

Newey-West automatic bandwidth selection and Bartlett kernel

Balanced observations for each test

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-1.66840	0.0476	11	55
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	1.07284	0.8583	11	55
ADF - Fisher Chi-square	15.9816	0.8168	11	55
PP - Fisher Chi-square	18.5360	0.6738	11	55

** Probabilities for Fisher tests are computed using an asymptotic Chi -square distribution. All other tests assume asymptotic normality.

X4

Panel unit root test: Summary

Series: LN_X4

Date: 09/29/16 Time: 14:46

Sample: 2010 2015

Exogenous variables: Individual effects

Automatic selection of maximum lags

Automatic lag length selection based on SIC: 0

Newey-West automatic bandwidth selection and Bartlett kernel

Balanced observations for each test

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-3.50427	0.0002	11	55
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-0.32338	0.3732	11	55
ADF - Fisher Chi-square	23.2978	0.3851	11	55
PP - Fisher Chi-square	31.6348	0.0838	11	55

** Probabilities for Fisher tests are computed using an asymptotic Chi -square distribution. All other tests assume asymptotic normality.

Pooled model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LN_X1	-1.735622	1.001159	-1.733613	0.0905
LN_X1(-1)	1.744220	1.001856	1.740988	0.0892
LN_X2	-0.490175	0.250077	-1.960097	0.0568
LN_X2(-1)	0.067878	0.254159	0.267068	0.7908
LN_X3	-0.336191	0.168281	-1.997795	0.0524
LN_X3(-1)	-0.240875	0.205694	-1.171034	0.2483
LN_X4	-0.725807	0.362144	-2.004194	0.0517
LN_X4(-1)	0.031021	0.357364	0.086804	0.9312
C	-10.89805	1.669043	-6.529522	0.0000

R-squared	0.475968	Mean dependent var	-3.165766
Adjusted R-squared	0.373718	S.D. dependent var	1.053954
S.E. of regression	0.834078	Akaike info criterion	2.636570
Sum squared resid	28.52315	Schwarz criterion	2.980734
Log likelihood	-56.91425	Hannan-Quinn criter.	2.767630
F-statistic	4.654936	Durbin-Watson stat	1.819668
Prob(F-statistic)	0.000422		

Regression results

Hausman test

Correlated Random Effects - Hausman Test

Equation: EQ01

Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	10.703576	8	0.2191

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
LN_X1	-1.465951	-1.730807	1.651315	0.8367
LN_X1(-1)	2.078906	1.746552	1.486273	0.7851
LN_X2	-0.749848	-0.509771	0.051549	0.2903
LN_X2(-1)	-0.176179	0.046977	0.033700	0.2241
LN_X3	-0.298443	-0.340626	0.012617	0.7073
LN_X3(-1)	0.055183	-0.208777	0.038203	0.1769
LN_X4	-0.118443	-0.623036	0.054541	0.0307
LN_X4(-1)	0.281269	-0.026215	0.092583	0.3122

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-5.878363	14.22044	-0.413374	0.6822
LN_X1	-1.465951	1.592231	-0.920690	0.3643
LN_X1(-1)	2.078906	1.539838	1.350081	0.1868
LN_X2	-0.749848	0.331873	-2.259440	0.0310
LN_X2(-1)	-0.176179	0.304278	-0.579006	0.5668
LN_X3	-0.298443	0.198314	-1.504902	0.1425
LN_X3(-1)	0.055183	0.282628	0.195248	0.8465
LN_X4	-0.118443	0.421348	-0.281104	0.7805
LN_X4(-1)	0.281269	0.462907	0.607613	0.5479

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.651816	Mean dependent var	-3.165766
Adjusted R-squared	0.449645	S.D. dependent var	1.053954
S.E. of regression	0.781886	Akaike info criterion	2.627748
Sum squared resid	18.95171	Schwarz criterion	3.354317
Log likelihood	-46.69370	Hannan-Quinn criter.	2.904430
F-statistic	3.224078	Durbin-Watson stat	2.226267
Prob(F-statistic)	0.002056		

Random effects model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LN_X1	-1.730807	0.940152	-1.840987	0.0729
LN_X1(-1)	1.746552	0.940653	1.856744	0.0705
LN_X2	-0.509771	0.242056	-2.106008	0.0414
LN_X2(-1)	0.046977	0.242663	0.193590	0.8475
LN_X3	-0.340626	0.163437	-2.084148	0.0434
LN_X3(-1)	-0.208777	0.204147	-1.022680	0.3125
LN_X4	-0.623036	0.350704	-1.776529	0.00831
LN_X4(-1)	-0.026215	0.348855	-0.075147	0.9405
C	-10.79776	1.831242	-5.896413	0.0000

Effects Specification

	S.D.	Rho
Cross-section random	0.262373	0.1012
Idiosyncratic random	0.781886	0.8988

Weighted Statistics

R-squared	0.400993	Mean dependent var	-2.572490
Adjusted R-squared	0.284114	S.D. dependent var	0.969457
S.E. of regression	0.807351	Sum squared resid	26.72446
F-statistic	3.430833	Durbin-Watson stat	1.885004
Prob(F-statistic)	0.004140		

Unweighted Statistics

R-squared	0.472655	Mean dependent var	-3.165766
Sum squared resid	28.70348	Durbin-Watson stat	1.755039

Fixed effects model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LN_X1	-1.465951	1.592231	-0.920690	0.3643
LN_X1(-1)	2.078906	1.539838	1.350081	0.1868
LN_X2	-0.749848	0.331873	-2.259440	0.0310
LN_X2(-1)	-0.176179	0.304278	-0.579006	0.5668
LN_X3	-0.298443	0.198314	-1.504902	0.1425
LN_X3(-1)	0.055183	0.282628	0.195248	0.8465
LN_X4	-0.118443	0.421348	-0.281104	0.7805
LN_X4(-1)	0.281269	0.462907	0.607613	0.5479
C	-5.878363	14.22044	-0.413374	0.6822

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.651816	Mean dependent var	-3.165766
Adjusted R-squared	0.449645	S.D. dependent var	1.053954
S.E. of regression	0.781886	Akaike info criterion	2.627748
Sum squared resid	18.95171	Schwarz criterion	3.354317
Log likelihood	-46.69370	Hannan-Quinn criter.	2.904430
F-statistic	3.224078	Durbin-Watson stat	2.226267
Prob(F-statistic)	0.002056		

Appendix 111: Beta Results

var01	id01	beta	ln_beta	ln_x1	ln_x2	ln_x3	ln_x4	x1	x2	x3	x4
_BBK	2010-01-01	0.065	-2.73336801	-4.298754	-4.84471183	-5.45781639	-3.83311109	0.01358548	0.00786989	0.00426285	0.02164218
_BBK	2011-01-01	0.061	-2.79688141	-4.30985318	-6.80527992	-5.05898241	-3.67559923	0.01343552	0.00110791	0.00635202	0.02533422
_BBK	2012-01-01	0.065	-2.73336801	-4.30348594	-6.85716388	-4.92082274	-3.7722002	0.01352134	0.00105189	0.00729313	0.0230014
_BBK	2013-01-01	0.07	-2.65926004	-4.29457828	-6.88019167	-4.86528832	-3.69550938	0.01364232	0.00102795	0.00770961	0.0248348
_BBK	2014-01-01	0.062	-2.78062089	-4.29279875	-4.8089682	-6.36921605	-4.01593735	0.01366662	0.00815627	0.0017135	0.01802605
_BBK	2015-01-01	0.025	-3.68887945	-4.30855291	-4.97430428	-6.56539328	-3.87569204	0.013453	0.00691333	0.00140827	0.02073998
_CFC	2010-01-01	0.015	-4.19970508	-6.4699043	-6.78856878	-4.58417807	-3.34489437	0.00154937	0.00112658	0.01021214	0.03526394
_CFC	2011-01-01	0.04	-3.21887582	-6.50332775	-6.76165002	-4.8501305	-3.2092191	0.00149844	0.00115732	0.00782736	0.04038814
_CFC	2012-01-01	0.02	-3.91202301	-6.57255371	-6.63911995	-4.82881586	-2.95235272	0.00139822	0.00130818	0.00799598	0.05221671
_CFC	2013-01-01	0.004	-5.52146092	-6.54629702	-6.81651884	-4.61155593	-3.17254726	0.00143542	0.00109553	0.00993635	0.04189674
_CFC	2014-01-01	0.043	-3.14655516	-6.60232326	-7.01189443	-4.65484353	-3.07095422	0.00135721	0.0009011	0.0095154	0.04637688
_CFC	2015-01-01	0.109	-2.2164074	-6.48903764	-7.19016978	-4.38417775	-2.95066885	0.00152001	0.00075396	0.01247314	0.05230471
_COOP	2010-01-01	0.075	-2.59026717	-3.48566556	-4.75320812	-6.80022013	-2.44708314	0.03063336	0.00862398	0.00111353	0.08654566
_COOP	2011-01-01	0.103	-2.27302629	-3.4542466	-4.86813896	-7.01372909	-2.7777304	0.03161111	0.00768766	0.00089945	0.06217947
_COOP	2012-01-01	0.038	-3.27016912	-3.43889856	-5.30442518	-6.52344231	-3.10640979	0.03210002	0.00496955	0.00146861	0.04476137
_COOP	2013-01-01	0.106	-2.24431618	-3.46094703	-5.11782632	-6.30211069	-3.30866214	0.03140001	0.00598903	0.00183243	0.03656506
_COOP	2014-01-01	0.087	-2.44184716	-3.48023337	-5.13672689	-5.82399947	-2.93671384	0.03080022	0.00587689	0.00295576	0.05303974
_COOP	2015-01-01	0.312	-1.16475209	-3.47699902	-5.1999834	-6.56094028	-3.47743026	0.0309	0.00551666	0.00141456	0.03088668
_DTB	2010-01-01	0.001	-6.90775528	-6.57150164	-6.04833759	-4.27457662	-2.32286801	0.00139969	0.00236179	0.01391794	0.09799214
_DTB	2011-01-01	0.005	-5.29831737	-6.5555347	-6.35469234	-4.43783283	-2.27146848	0.00142222	0.00173857	0.01182153	0.10316058
_DTB	2012-01-01	0.015	-4.19970508	-6.653095	-6.50726251	-4.23877652	-2.41218971	0.00129002	0.00149256	0.01442523	0.08961884
_DTB	2013-01-01	0.024	-3.72970145	-6.63688033	-6.68883825	-4.55931767	-2.5887643	0.00131111	0.00124473	0.0104692	0.0751128
_DTB	2014-01-01	0.019	-3.9633163	-6.70708477	-6.76678103	-4.61562869	-2.58443766	0.00122222	0.0011514	0.00989596	0.07543849

_DTB	2015-01-01	-0.589	#N/A	-4.26874557	-6.74994929	-4.40417409	-2.55840125	0.01399933	0.00117094	0.0122262	0.07742843
_EQUITY	2010-01-01	0.082	-2.50103603	-5.42111295	-3.29451008	-6.00017639	-3.91184602	0.00442222	0.03708621	0.00247832	0.02000354
_EQUITY	2011-01-01	0.054	-2.91877123	-5.46508047	-3.46544794	-6.31417487	-4.12553435	0.004232	0.031259	0.00181046	0.01615486
_EQUITY	2012-01-01	0.003	-5.80914299	-5.43732404	-3.26704007	-6.70541625	-3.69166573	0.00435111	0.03811909	0.00122426	0.02493044
_EQUITY	2013-01-01	0.046	-3.07911388	-5.46083368	-4.13970308	-6.75770729	-2.16132862	0.00425001	0.01592758	0.00116189	0.115172
_EQUITY	2014-01-01	0.068	-2.68824757	-5.46554118	-3.82537524	-6.74964872	-2.35052748	0.00423005	0.02181025	0.00117129	0.09531887
_EQUITY	2015-01-01	-0.56	#N/A	-3.09395781	-3.94506028	-7.35325051	-2.71750011	0.04532222	0.01935005	0.00064051	0.06603964
_HF	2010-01-01	0.016	-4.13516656	-5.61166329	-5.64040409	-4.64999612	-3.29751057	0.00365499	0.00355143	0.00956164	0.0369751
_HF	2011-01-01	0.024	-3.72970145	-5.52143064	-5.95180816	-3.88413404	-3.17603188	0.00400012	0.00260113	0.02056563	0.041751
_HF	2012-01-01	0.028	-3.57555077	-5.52589295	-5.87682886	-4.61078975	-3.08712283	0.00398231	0.00280366	0.00994396	0.04563306
_HF	2013-01-01	0.058	-2.84731227	-5.55449532	-6.78814724	-5.47654539	-3.60040422	0.00387002	0.00112706	0.00418376	0.02731268
_HF	2014-01-01	0.023	-3.77226106	-5.55705903	-6.02812397	-5.2843332	-3.15841686	0.00386011	0.00241001	0.00507041	0.04249296
_HF	2015-01-01	0.291	-1.23443201	-5.59370312	-6.44641973	-6.953547	-3.14225813	0.00372122	0.00158619	0.00095524	0.04318517
_IM	2010-01-01	0.008	-4.82831374	-6.83078989	-5.59812222	-5.06337838	-2.40103995	0.00108	0.00370481	0.00632416	0.09062366
_IM	2011-01-01	0.008	-4.82831374	-6.82055873	-5.03447051	-5.2019403	-1.98071821	0.00109111	0.00650964	0.00550587	0.13797011
_IM	2012-01-01	0.008	-4.82831374	-6.82864655	-4.36013756	-5.29430164	-2.23758708	0.00108232	0.01277663	0.00502012	0.10671569
_IM	2013-01-01	0.008	-4.82831374	-6.25943696	-5.11788559	-5.30427548	-2.48288266	0.00191232	0.00598867	0.0049703	0.08350217
_IM	2014-01-01	0.052	-2.95651156	-6.83802215	-5.09371619	-4.92633073	-2.45432934	0.00107222	0.00613518	0.00725307	0.0859208
_IM	2015-01-01	0.0147	-4.21990779	-6.82596128	-5.53857147	-2.32976936	-2.52482867	0.00108523	0.00393214	0.09731819	0.08007203
_KCB	2010-01-01	0.125	-2.07944154	-1.73971205	-6.32796606	-5.80030285	-4.50768601	0.17557095	0.00178566	0.00302664	0.01102394
_KCB	2011-01-01	0.148	-1.91054301	-1.75155687	-5.77711507	-5.83493647	-4.59759396	0.17350361	0.00309764	0.00292361	0.01007605
_KCB	2012-01-01	0.066	-2.71810054	-1.70180969	-5.83618365	-3.51128438	-4.81445028	0.18235322	0.00291997	0.02985854	0.00811168
_KCB	2013-01-01	0.083	-2.48891467	-1.75318579	-5.68387309	-5.75010959	-4.80542165	0.17322122	0.00340036	0.00318243	0.00818525
_KCB	2014-01-01	0.102	-2.28278247	-1.75833044	-5.48692834	-5.39877083	-4.90070125	0.17233234	0.00414054	0.00452214	0.00744136
_KCB	2015-01-01	0.129	-2.04794287	-1.77530218	-5.76142737	-5.43624148	-3.81031335	0.16943224	0.00314662	0.00435582	0.02214124
_NBK	2010-01-01	0.054	-2.91877123	-1.58696506	-5.94348233	-4.22982139	-3.27442395	0.20454545	0.00262288	0.01455499	0.03783866

_NBK	2011-01-01	0.032	-3.44201938	-1.58154766	-5.63448965	-4.57170833	-3.40160016	0.20565657	0.0035725	0.01034028	0.03331991
_NBK	2012-01-01	0.034	-3.38139475	-1.60827147	-5.52942908	-4.25999592	-3.41384108	0.20023342	0.00396825	0.01412236	0.03291453
_NBK	2013-01-01	0.026	-3.64965874	-1.59235843	-5.78387493	-3.99235275	-3.41208382	0.20344523	0.00307677	0.01845624	0.03297242
_NBK	2014-01-01	0.023	-3.77226106	-1.58166646	-5.79999909	-4.82531947	-3.23019439	0.20563213	0.00302756	0.00802399	0.03954981
_NBK	2015-01-01	-0.06	#N/A	-1.58653113	-5.70530053	-4.80189944	-3.66206383	0.20463423	0.00332828	0.00821413	0.02567946
_SCB	2010-01-01	0.087	-2.44184716	-11.6512684	-6.6162057	-4.29688581	-4.46502484	8.708E-06	0.0013385	0.01361088	0.01150441
_SCB	2011-01-01	0.085	-2.46510402	-11.6501207	-6.78548544	-4.13848581	-4.62276029	8.718E-06	0.00113006	0.01594698	0.00982564
_SCB	2012-01-01	0.09	-2.40794561	-11.6398502	-6.89869941	-4.28747602	-4.65288159	8.808E-06	0.0010091	0.01373956	0.00953409
_SCB	2013-01-01	0.129	-2.04794287	-11.649662	-6.67178712	-4.26336221	-4.76413473	8.722E-06	0.00126613	0.0140749	0.00853027
_SCB	2014-01-01	0.096	-2.34340709	-11.6503501	-6.75474411	-4.19077903	-4.85791841	8.716E-06	0.00116534	0.01513449	0.00776663
_SCB	2015-01-01	0.288	-1.2447948	-11.6907372	-6.71259976	-4.12693614	-4.73299776	8.371E-06	0.0012155	0.01613223	0.00880005
__NIC	2010-01-01	0.016	-4.13516656	-4.74093974	-5.55985513	-3.15329784	-4.58011959	0.00873044	0.00384933	0.04271104	0.01025367
__NIC	2011-01-01	0.038	-3.27016912	-4.76507815	-5.82235894	-3.22631694	-4.69462629	0.00852222	0.00296061	0.03970346	0.00914428
__NIC	2012-01-01	0.026	-3.64965874	-4.73984449	-5.4406658	-3.15877299	-5.18523193	0.00874001	0.0043366	0.04247783	0.00559864
__NIC	2013-01-01	0.075	-2.59026717	-4.70941999	-5.21367149	-3.10787574	-5.28996078	0.00901	0.00544166	0.0446958	0.00504196
__NIC	2014-01-01	-0.011	#N/A	-4.75327327	-5.05447669	-3.26555164	-5.32455067	0.00862342	0.00638071	0.03817587	0.00487054
__NIC	2015-01-01	-0.197	#N/A	-4.78669145	-5.08355395	-3.28238394	-5.52806266	0.00834001	0.00619784	0.03753866	0.00397368

Appendix IV: Secondary Data Collection Instrument

Variable	Description	2010	2011	2012	2013	2014	2015
Executive Fixed Salary	Executive Fixed Salary/total operating expenses						
Executive Share Ownership	Executive Share Ownership/total number of shares						
Executive Bonuses	Executive Bonuses /total operating expenses						
ExecutiveAllowances	Executive Allowances/total operating expenses						
Beta	Company weekly returns						
Beta	NSE 20 share index returns (Market Returns)						