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This paper discusses the impact of corporate control on shareholder value creation for sampled companies in the Nairobi Stock Exchange. Through a discussion using related literature sources, it demonstrates the threefold principal-agent relationship among individual minority shareholders, institutional majority shareholders and the board of directors. It examines the theoretical framework of internal and external corporate-control mechanisms for firms listed in the Nairobi Stock Exchange with concentrated ownership structure. The paper also establishes the controlling capability of controlling shareholders, identity of controlling shareholders and stock incentives for the board/executives. In addition, it reveals the link between the proportion of traded shares and the minority shareholders. The paper will provide insight to understand the relationship between corporate control and firm profitability as well as dividend payout, and lay a basis for future theory building on corporate governance.

Keywords: Corporate control, shareholder value, agency theory, related party transactions, insider trading

INTRODUCTION

Berle and Means (1932) defined corporate control as “the actual right to choose the members of the board of directors of a company or the majority of the members whether through the exercise of legal powers or by bringing pressure to bear.” In his entry for “market for corporate control” in the New Palgrave Dictionary of Money and Finance, Michael Jensen (1992) wrote that the definition of corporate control was the authority to employ and dismiss managers at the highest level and to determine their remuneration.

Following the recent cases where minority shareholders in Kenya have virtually lost confidence with the stock market as a result of huge capital losses incurred, the interests in corporate control for firms listed in the Nairobi Stock Exchange have gained further momentum (Mureithi, 2009). As such, understanding the various specific challenges faced by corporate control is of both practical importance and theoretical significance. Until 2003, the Nairobi stock Exchange was more of a members club consisting of 18 brokerage firms who also heavily traded within the market with little regulatory interference. Issuance of a series of initial public offers (IPOs) that peaked between 2003 and 2008, created great interest amongst small individual investors who queued to purchase shares in a number of companies that made IPOs. This in turn led to higher levels of activity in the secondary market as fund managers also made efforts to cash in on the newly expanded market. However, lack of adequate regulation and continued traditional approach to control of corporations by directors and other representatives of large shareholders have led to loss of investor confidence in the Nairobi Stock Market amongst the small individual investors (Mureithi, 2009). This has not been helped much by the perception that majority shareholders control the listed companies at the detriment of small investors. Past studies on corporate control concentrated mainly on the principal-agent conflicts due to information asymmetry between boards of directors and executives and the ensuing opportunism of executives in the European and US capital markets (Eisenhardt, 1989; Finkelstein and Daveni, 1994; Mallette and Fowler, 1992). In Kenya studies on corporate control have not explicitly examined the impact of corporate control by large shareholders on the shareholder value
creation hence the need for this concept paper which can be used as an anchor for researching on the same.

More recent studies have focussed on corporate governance and control of listed companies (Taurdingana et al., 2008; Kariuki et al., 2011; Juma 2010). The cases in Kenya where small investors in the stock market lost substantial amounts of money due to conflict of interests by brokerage firms and large shareholders and lack of adequate information on the happenings in the Nairobi Stock exchange call for further review of the mechanisms at play in the stock exchange. IPOs bought from Kenyan firms like Kenya Electricity Generating Company (Kengen), Safaricom Kenya Ltd and Mumias Sugar Company Ltd, speak volumes on how disadvantaged small investors are when it comes to protection of their investments in the Nairobi Stock Exchange. The Business Daily (Monday, 19th April 2011) raised the issue of mass exodus by small individual stockholders and attributed it to the control disadvantages they face. In this paper, we examine the linkage between corporate control and shareholder value creation in the company settings of Kenya.

Shareholders value
Most publicly listed firms around the world have concentrated equity holders like families, non-financial firms, and banks (La Porta et al., 1999). In Kenya's developing corporate world, the highly concentrated ownership structure, coupled with insider trading of shares and conflict of interest of majority shareholders and brokerage firms lead to uncertainty in shareholder value, which offer a unique context for further theorizing the agency problem (Kariuki et al., 2011). In this paper, shareholder value is defined as company's value to its shareholders that is, market capitalization and is demonstrated by profitability and dividend payout trends. Shareholders who own huge chunks of shares are referred to as blockholders. Block ownership is motivated both by the shared benefits of control: blockholders have the incentive and the opportunity to increase a firm's expected cash flows that accrue to all shareholders; and by the private benefits of control: blockholders have the incentive and the opportunity to consume corporate benefits to the exclusion of smaller shareholders (Holderness, 2003). An outside blockholder, for instance, has a different set of incentives than does a CEO blockholder. Blockholders have the incentive to improve management, but they also have the incentive to consume corporate resources. Blockholders that are corporations present a set of issues not found with those who are individuals. (Holderness, 2003)

Principal-agent relationships and insider trading
In concentrated markets with substantial insider trading by brokers, directors and large shareholders, the conflicts of interest between small individual investors and boards/executives are common. Insider trading gives an undue edge to big individual and institutional investors over small individual investors who lack access to confidential company information from the insiders (Mwanza, 2007). Such information may, in some extreme cases, cost the acquirer and retail traders may not be able, in most cases, to bear this cost (African Executive, 2006). In 2006 a major shareholder in Uchumi Supermarkets was taken to court and charged when he allegedly sold his shares based on insider information. Reports indicated that a day before the collapse of Uchumi Supermarkets in 2006, a well-known net worth investor disposed of a huge chunk of the firm's shares. The next day, the firm was declared bankrupt and was suspended from trading in the Nairobi Stock Exchange (NSE). Capital Markets Authority pursued the major shareholder in 2006, for selling shares with prior knowledge of imminent closure of the one-time major retail supermarket (Daily Nation, 16th March, 2010). Insider trading entails use of non-public material information to make a buy, sell or hold decision. This information is usually set to give undue advantage to an investor.

By investing in companies listed in the stock exchange investors enjoy the benefits of diversification; they are more willing to invest far more money at far lower expected rates of return than they would be if they had to “put all of their eggs in one basket.” Along with the massive economic and social benefits of public companies come costs. The costs that result from separating the investing and management functions are called "agency costs" because the managers and directors of public companies are the agents of the investor-shareholders. Because these agents are deploying the shareholders' money rather than their own when they manage the corporation, they can benefit themselves by acting in their own interests rather than in the interests of the shareholders (Macey, 2008).

Given that the costs of monitoring boards/executives directly are extremely high for small individual shareholders, they either align the interests of boards/executives with them through incentive contracts or choose to focus on corporate control during the annual general meetings. In contrast, the costs of monitoring board/executives for large shareholders are low thus they have enough incentives to monitor board/executives directly and alleviate the opportunism problem thereby. It is therefore eminent that the presence of a large shareholder would be beneficial to small individual shareholders in respect to monitoring boards/executives in that they may act as joy riders – they may entrust the large shareholder to monitor boards/executives for them. However, nothing comes for free and so large shareholders' self-interest and opportunism may lead to benefit-seeking – they would take advantage of small individual investors by their controlling and informational
advantages. This implies that a threefold principal-agent relationship exists in listed firms with concentrated ownership structures.

The first is the principal-agent relationship between small minority shareholders and the board of directors, which is also the fundamental principal-agent conflicts in markets with diverse ownership structures, mostly referring to the western capital markets. The board of directors is in a better position than minority shareholders in this case, because minority shareholders actually cannot monitor the board directly due to the high costs involved.

The second is the principal agent relationship between majority shareholders and the board of directors. Majority shareholders are in a better position in this case, because the costs for them to monitor, assess or dismiss the board are relatively low. So there are dual principals for the board, if the two principals have conflicting objectives or decisions (Dharwadkar et al., 2000; Su et al., 2008; Young et al., 2003), the board would be in a dilemma, and it would have to choose a suitable action.

The third is the principal-agent relationship between minority shareholders and majority shareholders. Also, minority shareholders remain in a better position in this case because of their controlling and informational advantages. Thus minority shareholders are in the weakest position in the entire relationship.

The minority shareholders can actually benefit from the alleviation of opportunistic behaviour of boards/executives by majority shareholders’ monitoring at the expense of advantages seized by majority shareholders. So we can deem this relationship as: minority shareholders entice majority shareholders to monitor the board/executives, as a cost, they are subject to the being taken advantage of by majority shareholders. Theoretically, whether minority shareholders suffer loss from being taken advantage of depends on their benefits and expenses from their agency contract with majority shareholders. On the other hand, benefits are seized by majority shareholders through the action of the board.

As a result of having two principals for the board, if the two principals have conflicting objectives or decisions, the board would be in a dilemma, and it would have to choose an appropriate action which makes majority shareholders seize reasonable advantages. As a result, majority shareholders could not take advantage of minority shareholders discretionarily, the motivation and capability for them to benefit and the maximum gains they could seize depends on the objectives and constraints of all the three players. Nevertheless, because their gains can be deemed as the costs, minority shareholders pay to majority shareholders for their monitoring the board, we can infer that the more effectively majority shareholders can monitor the board; the more advantages they demand, and with the higher motivation they will take advantage.

Rarely-traded shares
A large portion of issued shares held by institutional investors and large shareholders is rarely-traded in the NSE in Kenya. There are two types of rarely-traded shares: Kenya government shares and majority (block) shares held by large investors. Government shares are held by government agencies. Majority shares are held by individual and non-individual legal persons. Legal-Person and State shares are similar in cases where the legal persons are ultimately controlled by the State and both types of shares are rarely traded. Until recently, the Government held shares in many companies (including Safaricom, Muvias, Kenya Commercial Bank (KCB), and so on,) but did not sell these shares. Government policy to divest from ownership of business entities has since seen the government dispose of substantial blocks of shares in the last 8 years. However, Legal-Person shares can be held by both private and State-controlled entities and both domestic and foreign entities; actually a large portion outstanding shares of private or foreign controlled listed companies are also Legal-Person shares and thus rarely traded. Large shareholders are usually the original owners of the business entities and usually have sold or issued a small percentage of shares in a bid to obtain funds to finance their expansionary strategies e.g. through rights issues where they renounce their rights. They therefore do not sell their shares thus leaving individual shareholders as the main participants in the daily buying and selling of shares. Consequently, the principal conflicts are between trading shareholders (usually small individual investors) and non-trading shareholders (the State, State-owned enterprises (SOEs), or private individual large shareholders and legal persons) in Kenya.

Heterogeneity of objectives
There are two sources of minority shareholders’ value: dividends and capital gains. However, the minority shareholders is in the weakest position amongst the three, so they have inadequate strength to “pressure corporate insiders to disgorge cash” (La Porta et al., 2000). Kenyan firms mostly have a conservative dividend payout policy. Therefore, the only value for minority shareholders is capital gains, and their only objective is the rise of stock price.

Because the State shares and/or Legal-Person shares held by the majority shareholders are rarely traded, they are not concerned about the stock prices on a day to day basis. However, majority shareholders have other economic, social and political objectives.

First, although majority shareholders could not obtain capital gains, they could control the cash flow discretionarily, thus economically they wish to maximize the cash flow of the listed firm. Lin, Cai, and Li (1998) argued that under information asymmetry, SOEs managers can use state-imposed policy burdens as
excuses of poor performance and make the State accountable for it. The argument implies that turnover-performance sensitivity of SOEs decreases as policy burdens increase and that such impact depends on the extent of information asymmetry.

Secondly, majority shareholders, who are the government agencies or SOEs, have many social and political objectives, and SOEs also undertake many policy burdens (Lin et al., 1998). Even privately controlled legal persons have close connections with the government agencies or SOEs, thus have certain political objectives. But we conjecture that for majority shareholders who are privately controlled legal persons, their economic objectives dominate their political objectives, whereas for majority shareholders who are the government agencies or SOEs, their political objectives dominate their economic objectives.

Directors also have multiple objectives in Kenya’s listed firms. As in the classical principal agent model, agent (director) makes decisions through trade-off between his income and effort, so directors have economic objectives. However, with an ownership structure dominated by state and corporate institutions, it follows that the boards of most listed companies would be dominated by state and large corporate representatives, while board seats occupied by small individual investors will be few. Most of the State representatives are political appointees; they could be promoted to a higher position in the government or political parties in the future. So these directors are concerned more about their political future rather than merely income. Although economic performance is now an indicator, when the government is assessing its officials, political performance plays a more important role. Since these State representatives are appointed by majority shareholders - the government agencies or SOEs, majority shareholders could use turnover as a means to directly control them.

Related party transactions and firm value
Related party transactions (RPTs) are direct measure for expropriation, whether they are value-destroying or value-creating depends on the trade-off between the benefits the minority shareholders could gain from and the costs they must pay for the agency contract between minority shareholders and majority shareholders. However, because Kenya’s majority shareholders have multiple objectives rather than purely economic objectives, they are likely to demand more benefits than their counterparts in other countries, other things being equal. As such, the costs are more likely to exceed the benefits in Kenya.

Corporate governance and related party transactions
The political objectives such as resolving the policy burden of the parent SOEs are the dominant objectives for majority shareholders of State controlled listed firms, whereas the economic objectives are the dominant objectives for the majority shareholders of non-State controlled listed firms. Thus the former would have stronger motivation to take advantage of small shareholders in order to resolve their policy burden aside from achieving their economic goals. On the other hand, directors of State controlled listed firms have no options other than being officials, they are more prone to be effectively controlled and monitored by their superior institutions. So other things being equal, majority shareholders of State controlled listed firms would have more controlling capability than their counterparts of non-State controlled listed firms. Whereas the more effectively majority shareholders can monitor the board; the more gains they demand, and with the higher motivation they tend to take advantage of small shareholders.

As analyzed, benefits are seized by majority shareholders through the action of the board, whereas there are two principals for the board, if the two principals have conflicting objectives or decisions, the board would be in a dilemma, and it would have to choose a suitable action which makes majority shareholders seize reasonable benefits. To some extent stock incentives would economically align interests of the board with minority shareholders, inducing them taking suitable actions through which majority shareholders could seize less benefits.

Measuring shareholder value
Shareholder value has become an increasingly important demand among investors now more than ever. The theory of Economic Value Added has traditionally suggested that every company’s primary goal is to maximize the wealth of its shareholders, which should be a given since it is the shareholders that own the company and any sensible investor expects a good return on his or her investment. In the past, however, other methods such as Return on Investment and Earnings per Share (EPS) have been the most important performance measurement systems and have been used in determining bonus-based incentives even though they do not correlate well with shareholder value creation (Mäkeläinen, 1998). With the recent surge in prices in the Nairobi Stock Exchange (NSE), 2003 to 2005 and then the decline 2006 to 2010, it is not hard to imagine why shareholder value-based measures, especially Economic Value Added, have become increasingly important topics of discussion.

The most popular value-based measure today is Economic Value Added (EVA) which has grown rise to debate about its ability to accurately measure shareholder value. Proponents for EVA have not acknowledged or discussed the faults of EVA, while lavishing praise on the concept as an indispensable management tool. On the other hand, very little criticism has come about that has dealt with the problems of EVA, and the criticism that has come about has kept to fairly insignificant details (Mäkeläinen, 1998).
Analysis shows that the Nairobi Stock exchange is predominantly controlled by Corporate and Government Shareholders who hold between 50 and 92% of shares in many sampled companies (NSE, 2012). These are the main players who influence corporate decisions leaving minority shareholders at their mercy. Depending on the interests of the majority shareholders dividends may or may not be declared. The government controlled companies such as National Bank of Kenya have historically made losses or very minimal profits and rarely declare dividends. This may be attributed to governance issues as the key shareholder representatives may have had interests that were diverse from those of the minority shareholders (Tauringana et al., 2008). The foreign owned companies have had a healthy growth in profitability over time thus giving better returns and dividends and even facilitating capital gains to all their shareholders. There is also a thin line between representatives of the major shareholders (directors) and the majority shareholders hence decisions related to corporate controls are vested in the majority shareholders who enforce them through their appointees to the board of directors.

Major corporate shareholders control the share market at the NSE and hugely contribute to decisions made by directors and managers of the concerned companies. This is directly reflected in the trend of profitability and dividends achieved each year. Minority shareholders have little or no role to play in key decisions affecting the companies in which they have invested in shares. This is well displayed by the many years of non-declaration of dividends evident in companies like National Bank of Kenya and low dividend declarations by most locally owned companies such as Kenya Commercial Bank (KCB), who prefer finance expansions across the region to issuing generous dividends. The contrast is that a clear policy of declaring significant amounts of dividends appears to be the case for sampled foreign owned companies such as Barclays, Bamburi, Standard Chartered Bank and even East African Breweries.

CONCLUSION
In this paper, a case of minority individual shareholders depending on the influence of large corporate majority shareholders to realize growth in the economic value of their investments in shares of companies listed in the Nairobi Stock Exchange has been put forward. It was found that corporate control influence shareholder value creation. The likelihood, as well as frequency and intensity of related party transactions are positively associated with the controlling capability of the controlling shareholders of listed companies and negatively associated with the directors/executives stock ownership. These findings could have a profound effect on other researchers by providing new insights into thinking how the corporate control occurs.

In view of the discussion of the principle-agent relationship, the paper suggests that of the three players—the majority shareholders, the minority shareholders and the board, majority shareholders are in the strongest position, minority shareholders are in the weakest position, the board is in the middle. It also suggests that the more effectively majority shareholders can monitor the board; the more gains they demand, and with the higher motivation they are to expropriate. The only objective of minority shareholders is seen to be the rise of stock prices. For majority shareholders who are non-State controlled legal persons, their economic objectives dominate their political objectives, whereas for majority shareholders who are the government agencies or the SOEs, their political objectives dominate their economic objectives.

REFERENCES
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