FACTORS INFLUENCING RELATIONSHIP INVESTING IN KENYA: A CASE OF THE CAPITAL MARKETS

BY

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UNITED STATES INTERNATIONAL UNIVERSITY AFRICA

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MAKOPA MWASARIA

A Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the Degree of Masters in Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY AFRICA

SPRING 2017
DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed __________________________  Date: __________________________
Makopa Mwasaria (ID 650046)

This project has been presented for examination with my approval as the appointed supervisor.

Signed __________________________  Date: __________________________
Dr. Peter Kiriri

Signed __________________________  Date: __________________________
Dean, Chandaria School of Business
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ABSTRACT

The main objective of this study was to determine the factors that influence relationship investing in the Kenyan capital markets. Specifically the study sought to determine how the regulatory and policy environment, the corporate governance practices and the level of investor participation influence relationship investing in the Kenyan capital markets. In addition, it sought to determine the effect of shareholder composition on the same.

The study was a descriptive research. The population for the study comprised of players in the Kenyan capital markets who include: stockbrokers, investment banks, fund managers, investment advisors, custodians & authorized depositories, listed companies, securities exchanges, and central depositories. Stratified random sampling was employed to select a sample of 73 firms from the strata. Three regulators (Securities Exchange, Central Depository and Settlements Corporation and Capital Markets Authority) were also involved. A combination of primary and secondary data was used with primary data being collected using a questionnaire that contained both structured, semi-structured questions as well as open-ended questions and a structured interview guide. The data collected was analyzed both quantitatively and qualitatively.

On regulatory and policy environment, the study revealed that the regulatory framework in Kenya restricts shareholder influence with the laws failing to address the role of shareholders in business decisions. It was further revealed that were unaddressed legal and regulatory issues regarding relationship investing in the Kenyan capital markets. Legal and regulatory barriers may hinder institutional shareholders from actively participating in shareholder activism.

On corporate governance practices, study revealed that the respondents strongly agreed that effective communication is important for maintaining relationships with stakeholders and that the impact of the company’s operations on society and the environment should be considered by the board of management. The study further revealed that the adoption of international standards in corporate governance maximizes shareholder value while at the same time promoting and protection of shareholder rights. Mandatory voting by institutional investors, if adopted, would address the challenges that relationship investing seeks to address in listed companies. Relationship investing was found to be an ultimate solution to frequent board and internal wrangles amongst listed firms. However, the respondents
disagreed that relationship investing interfered with transparency and accountability of the board to the shareholders.

It was established that active shareholder participation should be encouraged especially from Institutional investors. The findings also showed that it would be appropriate for pension funds, through their investment managers, to play a role in the corporate governance of the listed companies they invested. It was also found that shareholders’ participation in major decisions should be made mandatory for all listed companies, that shareholder solicitation of proxy votes should be allowed for listed firms. The study further established that institutional and block shareholders should be accorded preferential treatment than for the minority and foreign shareholder. Finally, the study established that the interest of shareholders to participate in governance issues is purely to ensure return of investment and sustained dividend pay-out.

On the shareholder composition, the study revealed that efforts should be directed at ensuring that firms grow in size with increased number of owners. The managers should be protected from unnecessary direct interference by the shareholders as a way of enhancing firm performance. The level of concentration in shareholding was found to affect the performance of a company in the capital markets with concentrated ownership and control systems leading to poor corporate performance. The study further established that there was a significant relationship between ownership concentration and firm performance in the Kenyan capital markets. Majority of the respondents indicated that there were unaddressed issues regarding shareholders’ composition and relationship investing. Such issues included poor shareholding structure, impatience in the investors, and lack of clear measure in regards to shareholding structures.

The study therefore concludes that the Kenyan capital market faces issues in corporate governance which has affected relationship marketing in Kenyan capital markets. In addition the study concluded that investor participation is key to relationship investing in Kenyan markets. In addition, it concluded that the Kenyan capital market has faced issues in regulation and policy in regards to relationship investing and finally that regulatory and policy environment are a key factor in relationship investing in Kenyan capital markets.

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DEDICATION

I dedicate this report to my dear wife Carolyne, our daughter Upendo and my grandfather and great friend Prof. OLE Mbatia.

May God Almighty bless you abundantly.
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<tr>
<td>AGM</td>
<td>Annual General Meeting</td>
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<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
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<tr>
<td>CFO</td>
<td>Chief Finance Officer</td>
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<tr>
<td>CMA</td>
<td>Capital Markets Authority</td>
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<td>EGM</td>
<td>Extraordinary General Meeting</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<td>NIRI</td>
<td>National Investor Relations Institute</td>
</tr>
<tr>
<td>NSE</td>
<td>Nairobi Securities Exchange</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<tr>
<td>RCCG</td>
<td>Rock Center for Corporate Governance</td>
</tr>
<tr>
<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
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<td>UK</td>
<td>United Kingdom</td>
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background to the Study

Investment (or investing) is the flow of capital which is used for productive purposes. There is a great emphasis on investment for being the primary instrument of economic growth and development for a country. Investment means an increase in capital spending and it helps in creating a robust economy. Investment is a component of aggregate demand. There are a large number of investment instruments available today. Some of them are marketable and liquid while others are non-marketable and illiquid. There are instruments which are highly risky while others are almost riskless. The investors choose avenues, depending upon their specific need, risk appetite, and return expected (Shafi, 2014).

When the historical development of the theories on investment activities is examined, it is discovered that the traditional portfolio approach was the dominant approach in the market until the 1950s. Although this approach lacked a scientific base, it is seen that it was the dominant view in the market for a long time due to the fact that its feasibility was relatively easy (Statman, 2014). In the traditional investment conception, the investors think that they can decrease the risk just by increasing the number of investment instruments they have without considering the relations between the yields of investment instruments. In the traditional investment approach, the investors are recommended to invest in the instruments with a high yield possibility; however, they are not informed about how the risk will be measured. What is assigned importance in the traditional investment conception is how investors should behave instead of studying how they behave (İsłamoğlu1, Apan and Ayvali, 2015).

World over, institutional investors and hedge funds control trillions of investment dollars and own nearly 50% of the equity in each and every stock market. Their large equity holdings increasingly make them one of the larger shareholders of the listed (or even the non-listed) firms. Anecdotal evidence also suggests that managers actively cooperate with institutions in the monitoring process. It is routine for firm managers and senior management to meet with analysts and institutional investors and otherwise invest substantial time, effort, and
resources in order to reduce the frictions to monitoring. The active cooperation by management in the monitoring process is the central aspect on which relationship investing is defined. Relationship investing — the committed partnering of a company with one or more of its biggest shareholders — has been touted as a way for shareholders to invest more for the long term than for quick profits (Skinulis, 2013). Previous researchers have linked relationship investing to shareholder activism (e.g. Darius, 2006). Activism can be “defensive” or “offensive” (Armour and Cheffins, 2012). Defensive activism takes place when investors holding a stake in a company (e.g., pension funds and mutual funds) become dissatisfied with corporate performance or corporate governance practices and thus react by lobbying for relevant changes. This can be done behind the scenes or publicly challenging management; for example, activists can propose the election of directors they support. This type is defensive in the sense that activist seek to protect pre-existing investments. In offensive activism investors lacking a substantial stake in a company, build up their holdings offensively on the assumption that organizational changes will overcome failures and, thus, maximize shareholder returns. Investors will agitate for change if management does not react and take the initiative.

Relationship investing is premised on the need for sound corporate governance practices to ensure that corporate firms remain profitable and thus shareholder value is guaranteed. Governance and performance go side by side. Improved governance leads to improved performance, which results in corporate success. This relation gained enormous attention by scholars and a lot of research has been conducted on the relationship between corporate governance and performance of firms (Hermalin and Weisbach, 2003; Shleifer and Vishny, 1997). Ownership structure is considered as a significant mechanism in corporate performance and its importance cannot be overlooked in boosting up the firm performance.

In Kenya, the capital markets are regulated by the Capital Markets Authority (CMA); as defined in the Capital Markets Act (Cap. 485) of the Kenyan laws. In 2002, the Capital Markets Authority developed guidelines for good corporate governance practices by public listed companies in Kenya in response to the growing importance of governance issues both in emerging and developing economies and for promoting growth in domestic and regional capital markets. The guidelines recognize the role of good governance in corporate performance, capital formation and maximization of shareholders’ value as well as
protection of investors’ rights. Key highlights of the guidelines that touches on shareholders’ interests include: the right of every shareholder to ask questions, seek clarification on the Company’s performance as reflected in the annual reports and accounts or in any matter that may be relevant to the Company’s performance or promotion of shareholders’ interests and to receive explanation by the directors and/or management; and institutional investors are particularly encouraged to make direct contact with the Company’s senior management and board members to discuss performance and corporate governance matters as well as vote during the annual general meetings of the Company (CMA, 2002). The guidelines are silent on how the management and the investors should engage in making of strategic decisions other than the vote at the annual general meeting.

1.2 Statement of the Problem
Globalization and financial breakdown of many corporate conglomerates in the developed world engrossed the attention of researchers and policy makers towards the need and importance of an effective corporate governance system for resolving the agency conflict between the stakeholders and managers, and hence a firms’ success. Among corporate governance mechanisms, how ownership is structured between all the shareholders of a firm is considered to be of much importance. During the last couple of decades, regulators, investors, policy makers and other capital market participants have been increasingly focusing on the need for firms of having an effective monitoring and accountability system of corporate governance in order to minimize this misalignment of interests between shareholders and managers, commonly known as the agency problem. Relationship investing has emerged as one of the likely solution to effective monitoring of corporate governance practices and strategy execution at the firm level. In Kenya, relationship investing is implemented, albeit informally, mainly by pension fund managers, block shareholders (through proxies or nominee accounts), or directly by institutional investors.

Empirical evidence in regard to the factors influencing relationship investing in the Kenyan capital markets is not well researched or systematically documented. Previous studies have not focused on the factors influencing relationship investing in Kenya as a whole but on some of the factors considered to contribute to it. For example Musango (2016) carried out research on Shareholder Protection and Shareholder Intervention in Kenya: A Study on Shareholder Activism, Miring’u (2011) analyzed the effects of corporate governance on
performance of commercial state corporations in Kenya. There are no known studies that have researched on factors influencing relationship in Kenya. This study was therefore motivated to bridge the gap in knowledge by determining the factors that would be considered to influence relationship investing in Kenya.

1.3 Purpose of the Study
The purpose of this study was to determine the factors that influence relationship investing in the Kenyan capital markets.

1.4 Research Questions
The study seeks to answer the following research questions
1.4.1 How does the regulatory and policy environment influence relationship investing in the Kenyan capital markets?
1.4.2 How do corporate governance practices influence relationship investing in the Kenyan capital markets?
1.4.3 How does the level of investor participation influence relationship investing in the Kenyan capital markets?
1.4.4 What is the effect of shareholder composition on relationship investing in the Kenyan capital markets?

1.5 Significance of the Study
1.5.1 Capital Market Investors
The study will provide information to both retail and institutional investors on the key issues that can be used to build an investor-management relationship for monitoring processes and making of key strategic decisions

1.5.2 Government and Capital Markets Agencies
The findings of the study will also seek to inform the Government and the policy makers in the Ministry of Finance (the National Treasury) on the issues that guide relationship investing in Kenya; which will further help in drafting of policies geared towards guiding the extent to which investors should be involved in making of key investment decisions in the capital markets.
1.5.3 Investment Advisers
The study will inform the investment advisers and fund managers on the key aspects that would drive effective relationship investing in Kenya, away from the traditional shareholder activism which is common amongst fund managers and large block investors.

1.5.4 Researchers and Academicians
The findings of this research provided the much needed guidance to researchers and people in academic field who might need to research on relationship investing in Kenya and beyond. The research attempted to close the literature gaps as well as add to the existing knowledge in the area of relationship investing in developing economies, as far as solutions to the currently existing challenges. This study will help build a foundation in a vital area of study that will give benefits to all the stakeholders

1.6 Scope of the Study
The scope of the study was all the market intermediaries and participants, including the securities exchange and the central depository and settlement system and all the other persons licensed under the Capital Markets Act as at 30th June 2016. These included the Nairobi Securities Exchange; the Central Depository and Settlement Corporation; Investment Banks; Stockbrokers; Dealers; Investment Advisers; Fund Managers; Authorized Securities Dealers; Authorized Depositories (Custodians); Credit Rating Agencies; and Venture Capital Companies. The data was collected over a 4 week period from 17th October 2016. The duration it took listed companies to respond to the questionnaires given saw the scope of this study limited to a selected number of market participants

1.7 Definition of Terms
1.7.1 Relationship Investing
This refers to the committed partnering of a company with one or more of its biggest shareholders as a way for shareholders to invest more for the long term rather than for quick profits (Skinulis, 2013).

1.7.2 Shareholder Activism
Shareholder activism refers to the active influence on firm policy and practices through the use of ownership position (Sjöström, 2008).
1.7.3 Corporate governance
Corporate governance is a set of policies and mechanisms that affect how a firm is operated efficiently and profitably. This system of corporate governance ranges from practices and institutions, from accounting standards and laws concerning financial disclosure, to executive compensation and shareholdings, to size and composition/independence of corporate boards as well as patterns of shareholdings in the corporation (Javid and Iqbal, 2007).

1.7.4 Investor participation
This is the level of engagement an investor has with a company that they are invested in. This includes attending general meetings, exercising their proxy vote, participating in right issues and any other corporate action (Dwyer, 2014).

1.7.5 Shareholder composition
This is the composition of investors and shareholders (owners) which normally is generally made up of individuals with various diverse demographic profiles, groups and institutions such as pension schemes and even government all of whose interests, goals, investment horizons and capabilities may vary considerably (Agyei and Owusu, 2014).

1.7.6 Capital Markets
Capital markets consist mainly of Stock (equity) and Debt markets. The capital market provides an avenue for raising the long-term financing needs of business through equity and long term debt by attracting investors with a long term investment horizon. (Saunders and Cornett, 2014).

1.7.7 Policy and Regulatory Environment
Regulatory and policy environment are the laws rules and regulations put in place by a state or other government entity to control the behavior and actions of business activities (Javid and Iqbal, 2007).

1.8 Chapter Summary
An overview of relationship investing in the capital markets as given at the beginning of this chapter, the statement of the problem, the outlined objectives and the significance of the study shows that the shareholder interest can influence various strategic decisions that a listed firm and the capital markets in general are likely to make. The rest of the report was
organized as follows: Chapter two provides a review of empirical literature the effect of the regulatory and policy environment; corporate governance practices; investors’ participation or influence; and effect of agency costs. Chapter three gave details on methodological approaches that was applied in executing the study. Chapter four will be a presentation of the findings from the field research. This chapter will provide a basis from which the conclusions of the study were drawn. Chapter five provided a discussion of findings, conclusions and recommendations.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction
The purpose of the literature review is to set the study subject in a broader context through investigation of the relevant literature and other sources. The review covers the issues related to: regulatory and policy environment; corporate governance practices; level of investor participation; and shareholders’ composition. The past studies and relevant literature in the area has been analyzed critically, highlighting the key areas in the reviews.

2.2 Effect of Regulatory and Policy Environment on Relationship Investing
Shareholders are the ultimate owners of public companies and should therefore have the final say in decisions such as corporate restructuring, changes in top management, payout policy, or governance structures. The proxy process is one of the means for shareholders to impose their (value generating) suggestions. Some studies regard shareholder-initiated proxy proposals as a useful tool of corporate governance and the proposal sponsors as valuable monitoring agents (e.g. Bebchuk, 2012). Others argue that the same proposals have no real control benefits due to their nonbinding nature (e.g. Xu, 2012). The corporate governance role of shareholder proposals should heavily depend (i) on the extent to which laws and regulations support shareholder access to the proxy process, and (ii) the rules and practicalities of proxy solicitation (Cziraki, 2012).

2.2.1 Shareholder Activism
In the US and Canada, the practice of advocating changes in corporate management’s policies and practices by filing shareholder resolutions, voting on shareholder resolutions and informal behind-the-scenes dialogue with management is known as shareholder activism, while in the UK it is called as responsible engagement (Lydenberg, 2007). A shareholder activist is the one who does not long for corporate control yet is instrumental in changing the status quo through voice. Second, his activism normally pertains to issues of social policy or corporate governance reforms. In advanced economies, institutional investors act as a safeguard against unscrupulous promoters and hence are able to protect the interest of small investors (Activist Insight, 2014); however, in countries such as India,
institutional investors often seem intimidated by powerful promoters (The Economic Times, 2011). Therefore, one needs to examine whether institutional investors can work as a proxy of small-shareholder activism (Standard & Poor’s, 2011) in India.

Recent academic studies suggest that, by and large, activists are good for companies. An analysis of around 2,000 interventions in America during 1994-2007 found not only that the share prices and operating performance of the firms involved improved over the five years after the intervention, but also that the improvement was greatest towards the end of the five-year period. The firm’s activists targeted tended to be underperforming relative to their industry. These results hold true for the two sorts of activism that tend to be criticized most: actions designed to increase a firm’s leverage, such as taking on more debt or using cash to buy back shares, and actions that are especially hostile to a firm’s current management (The Economist, 2014). There is a very recent move by regulators to limit shareholder activism and relationship investing approaches in the US. U.S. corporate governance rules make it too easy for activist investors to get politically driven shareholder proposals onto public company ballots (Taylor, 2016).

2.2.2 Board Defense Mechanisms
According to Fulbright (2015), carefully crafted bylaws may provide a board with time and leverage in the face of an activist campaign. Advance notice requirements, for example, may require shareholders to notify the company in advance of a shareholder meeting of any proposals or director nominations. These provisions would help prevent against ambush proposals and give the company time to react to the proposal and, if appropriate, negotiate with the proposing shareholder. Other potential bylaw provisions that may provide time or leverage in the face of shareholder activism include: provisions eliminating any requirement for the annual shareholder meeting to be held on a fixed date; provisions allowing the board to accelerate the date of the annual meeting; provisions permitting the chairman to adjourn any meeting of shareholders irrespective of whether a quorum exists; provisions restricting who may call a special meeting or what actions may be considered at a special meeting; provisions prohibiting a board candidate who is nominated and paid by a shareholder from serving on the board; provisions specifying that the chairman has authority to control shareholder meetings; provisions requiring board candidates to disclose any and all financial arrangements with third parties; provisions prescribing qualifications for all nominees for
election as directors, including abidance of board policies regarding confidential information; provisions setting forth mandatory qualifications for any board nominees; requirements that any proposing shareholder be a record holder of the company’s shares; forum selection provisions, arbitration provisions, and fee shifting provisions; provisions providing the board with the exclusive right to fill board vacancies; and provisions providing that directors may only be removed for cause and defining cause. Certain bylaw provisions are viewed with disfavor by influential proxy advisory firms and corporate governance rating agencies. Careful thought should be given to potential shareholder and market reaction prior to amending any bylaws, and the bylaws should be carefully reviewed by inside and outside counsel to ensure consistency with applicable state law (Gregory, 2014).

Sometimes relationship investing has been criticized as being controversial and disruptive. For example, those who might oppose it have argued that it is driven by a dominant aim to merely create short term wealth for some shareholders to the broader disadvantage of the interests of all shareholders or the longer-term interests of the target company. In the context of board spills, it is often argued that a wholesale change to the composition of the board has an equivalent effect of changing control of the target company without requiring bidders to follow the take-over requirements otherwise applicable under domestic law when control of a company is to change and offering shareholders a premium for such control (Lovells, 2016). Conversely, relationship investing is also often seen as a legitimate, fair and appropriate exercise of rights by one or more shareholders to effect relevant change to a company. For example, influential shareholders may be motivated to alter the composition of a target board in the interests of improved corporate governance or to influence a change in strategic direction of the target company for the broader benefit of all shareholders and in the longer term interests of the target company (Lester & Cifelli, 2016).

2.2.3 Regulatory and Policy Challenges in a Global Context

Studies have found that some institutional shareholders adopt a passive approach to shareholder activism. The literature indicates that legal and regulatory barriers may hinder institutional shareholders from actively participating in shareholder activism (Bainbridge, 2006). For example, Bainbridge (2006) noted that the Securities and Exchange Commission rules on insider trading have made shareholders more cautious and also discouraged shareholder co-ordination and communication in the USA. The Netherlands faces similar
regulatory obstacles, where only directors (and shareholder with up to a 1 per cent stake in the company) are allowed to sponsor proposals (Cziraki et al., 2012). Research studies have also pointed out that some institutional shareholders prioritize the protection of their business relationships in the face of conflicting interest over activism. Institutional shareholders may be unwilling to engage in shareholder activism because of their pursuit of short-term profit. This is usually prevalent among private pension funds that wish to avoid potential damage to business reputation, governance cost and loss of competitive information advantage (Goranova & Ryan, 2014).

Filatotchev, Jackson, and Nakajima (2013) argue that a country’s legal system is a fundamental determinant of how its governance system evolves. Various countries across the world manifest a number of legal and institutional differences that may have an impact on the effectiveness of relationship investing as a governance factor. In UK for example, there are more favorable conditions for relationship investing because its legal system has fewer limitations on actions of shareholders (Filatotchev & Dotsenko, 2015). This is in contrast to the countries such as the USA where shareholders cannot call special meetings, unless the company’s corporate charter or bylaws allow otherwise. In the UK, shareholders with 10 % of voting rights may force the company to hold an Extraordinary General Meeting (EGM). Furthermore, corporate articles of association cannot deprive shareholders of this right. In the US, shareholders have to carry out a contested solicitation and bear all costs themselves if they want to put forward their board nominees. This process usually has low success rates and it is not very popular among investors. In contrast, the UK shareholders can replace the board with their own nominees if they managed to win more than half of eligible votes and each director received the majority of votes (Buchana, 2012).

According to Gregory (2015), given federal law and regulations, listing rules, and other related influences, the question that emerges is whether these are altering the balance that state law intentionally provides between the roles of shareholders and the board, and if so, whether that shift is beneficial or detrimental. State law places the management and direction of a corporation firmly in the hands of the board. This legal empowerment of the board, and the implicit rejection of governance by shareholder referendum, goes hand in hand with the limited liability afforded to shareholders.
2.2.4 Regulatory and Policy Challenges in a Kenyan Context

In Kenya, the Capital Markets Act Cap 485 (amended in 2014), is silent on the obligations of the boards of public listed companies in regard to relationship investing. Similarly, the Companies Act Number 17 of 2015 of Kenya is silent on the obligations of the boards of public listed companies in regard to relationship investing. However, the Capital Markets Authority published the “Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya” vide the Kenya Gazette Notice number 3362 of 2002. Under Section 3.1 on “Best Practices Relating to the Board of Directors”, Sub-section 3.1.1 “The Role and Responsibilities of the Board of Directors”, the guidelines stipulate that “…The board of directors should assume a primary responsibility of fostering the long-term business of the corporation consistent with their fiduciary responsibility to the shareholders. The board of directors should accord sufficient time to their functions and act on a fully informed basis while treating all shareholders fairly, in the discharge of their responsibilities”. Bullet (viii) of this sub-section adds that “…the board shall take into consideration the interests of the Company’s stakeholders in its decision-making process.” Nevertheless, the guidelines are not clear enough on how this ought to be achieved (Capital Markets Authority, 2002).

The legal environment affects relationship investing along three main dimensions: first, it may (may not) empower investors by granting them broad (narrow) governance rights and by making exercise thereof easy (difficult) and inexpensive (costly). Second, it may or may not favor profitable stake-building, by allowing investors to do so in a stealthy way or by imposing disclosure of their stake early on. Third, it may or may not grant investors bargaining leverage vis-à-vis insiders, mainly by making it more or less easy to orchestrate campaigns aimed at forcing change (Belcredi and Enriques, 2014).

2.3 Effect of Corporate Governance Practices on Relationship Investing

Corporate governance is a set of policies and mechanisms that affect how a firm is operated efficiently and profitably. This system of corporate governance ranges from practices and institutions, from accounting standards and laws concerning financial disclosure, to executive compensation and shareholdings, to size and composition/independence of corporate boards as well as patterns of shareholdings in the corporation (Oliveira, Curto, & Nunes, 2012). Corporate governance focuses on the issue of enhanced communication, accountability and transparency in the operations of firms with an overall objective of
welfare of all stakeholders including managers, shareholders, regulator, society and the economy as a whole (Afzar and Nazir, 2015).

Relationship investing has now become a broadly used investment strategy associated with the increasing willingness of investors to trigger corporate change and intervene in management’s decisions (Filatotchev and Dotsenko, 2015). Since 1986 good corporate reputation has been shown to provide legitimacy to a company and stabilize its stakeholder relationships. It helps companies attract customers, recruit and motivate talented employees, and induce favorable treatment by the media. In short, a good reputation establishes trust and credibility with a company’s various stakeholders (Hoffmann, Bronn and Fieseler, 2016).

2.3.1 Agency Problem
The researchers in corporate finance have long recognized that separation of ownership and control in firms has created the potential for the agency phenomenon which may be costly. The managers have substantial freedom to pursue their personal benefits at the expense of shareholders’ wealth due to limited incentive for shareholders to monitor the behavior and performance of their agents. The wealth maximization of shareholders will not motivate corporate decision making in the absence of an effective corporate governance mechanism (Afza and Nazir, 2012). During the last couple of decades, regulators, investors, policy makers and other capital market participants have been increasingly focusing on the need for firms to have an effective monitoring and accountability system of corporate governance in order to minimize this misalignment of interests between shareholders and managers, commonly known as the agency problem (Afza & Anwar, 2012).

2.3.2 Stakeholder Approach in Corporate Governance
A relationship-based governance system is one where relationships with stakeholders such as banks, group companies, and labor are seen as important and these relationships are manifested through their inclusion in decision-making. Often referred to as insider systems, key stakeholders are included in board representation or other decision-making bodies, such as works councils. Relationships are used as control mechanisms as well as for resource acquisition and sharing. These systems emphasize cooperation and consensus. Coordinated
market economies which can be classified as operating as a relationship-based system integrate a wider stakeholder focus into organizational purpose (Young, 2013). Compared to market-based systems commonly referred to as Anglo-American governance systems, relationship-based or insider governance systems integrate a wider stakeholder focus as part of the corporate purpose. Relationship-based governance systems have been historically predisposed to the stakeholder approach and incorporation of corporate responsibility into strategy and operations (Young, 2013).

The main players in corporate governance include the management, company secretaries, auditing groups, management team, and other interested parties in the auditing environment. The Board of Directors has a duty of setting up the company’s strategic aims, providing the necessary leadership and supervising the management of the business. It also reports to the shareholders on their stewardship and outlines functional areas of the Chief Executive Officer (CEO) and senior managers particularly the head of finance and the company secretary (Kilika and Mutua, 2013).

2.3.3 Shareholder Approach in Corporate Governance

From a shareholders’ perspective, the corporate governance framework is built on the assumption that shareholders engage with companies and hold the management to account for its performance (Rock, 2015). However, there is evidence that the majority of shareholders are passive and are often only focused on short-term profits. It therefore seems useful to consider whether more shareholders can be encouraged to take an interest in sustainable returns and longer term performance, and how to encourage them to be more active on corporate governance issues (Burr, 2012). Noting that shares of publicly held corporations are largely held by institutions, and that shareholding among institutions is concentrated, some have viewed institutional investors as having the potential to act as the responsible owners that corporate law seems to presume: shareholders that, by virtue of their holdings, will have the skills and incentives to keep an eye on managers and check departures from maximizing firm value, to prevent “short termism,” and to do whatever else one wants responsible owners to do (Rock, 2015).

According to Gregory (2015), governance of public corporations continues to move in a more shareholder-centric direction. This is evidenced by the increasing corporate influence
of shareholder engagement and activism, and shareholder proposals and votes. This trend is linked to the concentration of ownership in public and private pension funds and other institutional investors over the past 25 years, and has gained support from various federal legislative and regulatory initiatives. Most recently, it has been driven by the rise in hedge fund activism. It remains unclear whether, over the long term, greater shareholder influence will prove beneficial for shareholders, corporations and the economy. In the near term, however, there is reason to question whether shareholder influence is the solution that some advanced, or whether the current focus on shareholder value and investor protection is at the expense of other values that are central to the sustainability of healthy corporations.

2.3.4 Monitoring of Corporate Governance Practices

The EU’s 2011 Green Paper accurately expresses the conventional view that “the corporate governance framework is built on the assumption that shareholders engage with companies and hold the management to account for its performance” (EU Green Paper, 2011). The frustration, going back at least as far as Berle and Means (1932), is that shareholders in public corporations with dispersed ownership do not perform that function. Much corporate law scholarship and policy making has focused on how to remedy or adapt to this failing. “The move towards ensuring that the board of directors is dominated by independent directors can best be understood as one type of solution to the lack of shareholder engagement: because shareholders themselves do not monitor managers, we need a new player in the boardroom to play that role for the benefit of passive shareholders” (Rock, 2015). Too often, shareholders are only interested in the highest possible dividends. That is understandable but it fuels short-termism. Researchers have spoken for years about shareholder’s rights; but little has been debated about shareholders’ obligations. All these measures put together will make a difference and lead to better corporate governance in companies, to more responsibility and more accountability (EU Green Paper, 2011)

According to OECD (2014), the monitoring function should be the responsibility of all concerned parties, but it is a special concern of shareholders, who may be particularly vulnerable to the principal-agent problems associated with the separation of ownership from control in many large corporations. However, shareholders in some countries and jurisdictions have only limited legal rights and in others they have failed to exercise this responsibility. Although all investors can benefit from effective monitoring of managerial
actions, monitoring is an expensive proposition, and most minority shareholders, who would be expected to be the most independent of management, lack the necessary resources. To the extent that active monitoring ensures that corporate managers act in a disciplined way, it benefits not only the monitor, but other investors as well, including any rival institutions (Brav, Dasgupta, and Mathews, 2015).

There are a number of factors influencing institutional investors’ incentives to monitor corporate governance practices, especially amongst public companies (OECD, 2014). First, are the country-specific factors namely: the legal and regulatory system; and prevailing institutional arrangements. Second, are investor-specific factors namely: size (large holdings, interrelated with investment horizon and investment strategy may lead to more active governance activities); investment horizon (longer term investing favors more active role) and “Corporate culture” (portfolio managers generally do not show great enthusiasm for active use of governance rights). Thirdly, are the general factors. For instance, active monitoring is expensive and there are “free riders” (i.e. to the extent that active monitoring ensures that corporate managers act in a disciplined way, it benefits not only the monitor, but other investors as well, including any rival institutions) (OECD, 2014).

The credibility of any corporate governance framework rests on its enforceability since it determines its success or failure. In Kenya, according to Gakeri (2013), the CMA replicated the Combined Code of the United Kingdom which is based on a dispersed ownership structure without any serious attempt to domesticate the principles. No research was carried out to ascertain their appropriateness in Kenya or the need for modification. The “comply or explain” paradigm does not appear to have endeared the Guidelines to listed companies. Since most of the Guidelines are not based on any binding principles, their implementation has been unenthusiastic. As a result, listed companies have implemented some of the Guidelines out of necessity not choice. The effectiveness of guidelines, codes or principles is generally attributable to the underlying legal framework (Gakeri, 2013).

In The Modern Corporation and Private Property (1932), Berle and Means warned that with the separation of corporate ownership and control, the interests of shareholders and managers may diverge and that “no shareholder is in the position to place important pressure upon the management...” (p. 84). The substantial increase in institutional ownership over the last few
decades now positions institutional investors to have significant influence, particularly if they can work collectively and coordinate their efforts. Some institutional investors face additional costs of activism, and as a result, are more inclined to be passive. For example, investors that have business relationships with firms that extend beyond their ownership stakes may be reluctant to take active steps to address governance issues. This concern was developed in Aggarwal et al. (2011). Another alternative to engagements is to mandate change through regulation so that all firms adopt the same approach. Potential regulatory channels include national legislation, securities regulation, or stock exchange listing requirements (Doidge, Dyck, Mahmudi, and Virani, 2015).

2.4 Effect of Level of Investor Participation on Relationship Investing

2.4.1 Active versus Passive Investing: the Changing Role of the Investor

The need for relationship investing first emerged because large and complex organizations are subject to agency problems, as shareholders’ struggle to make sense of business decisions and future prospects (Berle and Means, 1932; Fama, 1980; Jensen and Meckling, 1976). In the past, most investors, particularly institutional investors, played a predominantly passive role when interacting with a company: overall, they pursued a diversified long- to mid-term, hands-off portfolio strategy. They maintained observer status regarding a company’s business development and reacted only to fundamental changes. When passive investors did communicate with the company, it was to seek information and an exchange of views regarding the company’s long-term strategy, fundamental value drivers and critical success factors, rather than to influence the company’s immediate plans or actions. Accordingly, passive investors would follow the Wall Street Rule and sell part or all of their holdings when the company’s strategy or performance was no longer in line with their expectations (Hirschman, 1971).

These traditional capital market relationships, however, were fundamentally shaken up when institutional investors began joining hedge funds in engaging companies on various aspects of their corporate governance rules and practices (Activist Insight, 2015). The author notes: ‘Issuers of all sizes are more vulnerable to investor activism and relationship management than ever before, particularly as they must confront increased skepticism by their
fundamental institutional investors and a shifting corporate governance paradigm that is changing the rules of engagement’ (p.6).

In the last 3 decades, individual and institutional shareholders found their voice. Today, they assert their power as a company’s owners in many ways – from selling their shares to private or public entities to communication with management and the board, from press campaigns to blogging, from openly talking to other shareholders to putting forward shareholder resolutions, and from calling shareholder meetings to seeking to replace individual directors or the entire board (Nadler, 2013). Although shareholder proxy proposals typically are not binding or may not receive enough votes to pass, they draw public attention to companies’ practices and often force them to reconsider their policies. As a result, a growing number of companies meet with their institutional shareholders during the planning stages of a proposal rather than wait until the implementation stage. And an increasing number of companies are submitting all-equity compensation plans for shareholder approval (Nadler, 2013).

Various studies have shown that there is a link between shareholder rights and corporate performance, in the sense that being able to exercise shareholder voting rights, or engage with companies via dialogue or other means such as focus lists, has a positive effect on corporate performance. Gompers, Ishii, and Metrick (2013) examined the ways in which shareholder rights vary across firms. They constructed a ‘Governance Index’ to proxy for the level of shareholder rights in approximately 1,500 large firms. An investment strategy that bought firms in the lowest decile of the index (strongest rights) and sold firms in the highest decile of the index (weakest rights) would have earned abnormal returns of 8.5 percent per year during the sample period. They found that firms with stronger shareholder rights had higher firm value, higher profits, higher sales growth, lower capital expenditures, and made fewer corporate acquisitions.

The statement, ‘Bigger is better’ seems very much true in case of institutional investors as the role played by them in corporate performance is a phenomenon accepted worldwide (Oliveira et al., 2012). An institutional investor is different from retail/individual investor in many aspects such as: size of shareholding, proficiency in monitoring as well as incentive to keep an eye on managers with low cost of monitoring. Therefore, institutional owner’s influence on firm performance is much significant as compared to retail/individual owner.
Two scenarios determine the influence asserted by financial institutions on firm performance. In the first scenario, a financial institution has its nominee on board, who may have a bird’s eye view on all activities of the firm, thus hindering managers from any exploitation of external shareholders’ rights. In the other scenario, a financial institution just holds stock and ‘stays behind the wall’, and does not interfere in any firm activity. The former is named as active institutional investor while the latter is known as passive institutional investor (Afza and Nazir, 2015).

There is another concern regarding the motivation for institutional investors to actively monitor the management. There are some institutional investors which are temporary and interested only in short-term performance of corporations. The focus of these institutional investors is short-term because their own performance is to be evaluated on the short-term profits they generate. So, there is no incentive for these investors to be present on the board of directors of firms where they have invested a bulk of money. Contrary to this, active investors with board representation have selected to exercise efficient monitoring and hence, their ownership stake is more likely to be associated with the value of the firm. So, it can be predicted that the extent of shareholdings of passive institutions may be unrelated to the corporate value and any relationship could be found may only be for shareholdings of active institutional investors (Shah et al., 2012).

Yet, there are many parallel and common issues that arise when examining the role of institutional investors in both relationship investing and corporate governance arenas. Two defining features of institutional investors have important implications for their potential to be effective source of influence or corporate control (Kerste et al, 2011). First, the fact that institutional investors often manage pools of assets on the order of billions of dollars implies that they tend to have sizable equity ownership stakes in individual companies and in the capital markets in general. As a result, they are potentially influential shareholders able to effect change at the companies in which they invest, and influential enough to command the attention of regulators or legislators to lobby for market-wide reforms (Cremers, Martijn and Romano, 2011). Second, institutional investors are financial fiduciaries who invest on the behalf of others and as a result, have a legal duty to invest in the best interests of their clients or beneficiaries. This traditionally means that relationship investing can only be justified if clients specifically authorize it, or if the enhanced investment return is greater than any
additional cost. While the early studies on corporate governance shareholder primacy generally failed to find measurable valuation effects on target firms or on investors’ portfolios, the later evidence summarized in Ferri (2011) suggests that institutional block investors have enjoyed much greater success recently.

Today’s shareholders are ramping up pressure on companies and their boards to demonstrate clear strategic vision and a roadmap for maximizing value. Influential hedge funds typically buy stakes in public companies and use these positions to advocate significant change to the strategic direction, operations, governance, or financial structure of the company (PricewaterhouseCoopers, 2016). While all investors with vested interests have their proprietary methods of analyzing target companies, many look for underperforming assets that may be creating a drag on overall stock performance. More recently, a number of investors have advocated the divestiture or break-up of one or more business lines as a way to unlock shareholder value and generate cash that can then be allocated to higher-growth areas of the business or returned to the shareholder. Management teams are often unprepared to deal with challenges from shareholder activists and have difficulty dedicating the time and resources needed to effectively evaluate, plan, and execute the strategic options they present (Benoit, 2015).

2.4.2 Proxy Advisory and Solicitation
Shareholder participation and voting plays a key role in corporate governance. It has become especially important because of the increase in institutional ownership, the rise in shareholder activism, the shift to majority voting for director elections, and the introduction of mandatory say-on-pay (Malenko and Shen, 2016). A significant development in recent years has been the growth of proxy advisory firms. Proxy advisors counsel investors on how to vote their shares on major corporate decisions, such as mergers and acquisitions, director elections, executive compensation, and corporate governance policies. As institutional shareholders, have become the dominant players in the stock market, they vote billions of shares each year on thousands of ballot items. Those diversified investors often lack proper incentives or necessary expertise to do research in order to vote in the best interests of clients, and many of them rely on the advice of proxy advisory firms. These are third-party advisors that provide independent proxy voting research and recommendations on each issue on a company's agenda (Li, 2016).
Shareholder participation in corporate governance takes many forms. Areas of focus for shareholders’ interventions include corporate governance matters, potential strategic transactions, returning capital to shareholders, and improving business operations (Fulbright, 2015). Relational investors frequently demand corporate governance reforms, including changes to personnel and structure. Private activism is attractive to investors (and management) because it is less hostile than public advocacy, builds sustainable relationships between management and shareholders, and creates consensuses. This activist approach also has the lowest probability to impair share value during the activist campaign (Brown and LaDuca, 2014).

Private solicitations are emerging as some of the new ways for shareholders to have a say in corporate votes. Private solicitations are an important part of the investors’ tool kit because they permit private discussions among major shareholders outside of the purview of the company (Fulbright, 2015). Without a doubt, this increases the influence of institutional shareholders and strengthens the leverage they have when negotiating corporate change with management. Small investors may also use private solicitations to “test the waters” with major shareholders before launching a formal proxy solicitation (Sharma, 2016). In certain circumstances, influential investors attempt to promote change through “vote no” or withhold the vote campaigns. Vote no campaigns are a by-product of the shareholder private communication rules. In these campaigns, activists encourage other shareholders to vote against a corporate proposal or refrain from voting for an incumbent director. Vote no campaigns are used because they are often more cost effective and less time consuming than shareholder proposals and proxy solicitations (Sharma, 2016).

2.5 Effect of Shareholder Composition on Relationship Investing

Agyei and Owusu (2014) indicated that the composition of investors and shareholders (owners) is generally made up of individuals, groups and institutions whose interests, goals, investment horizons and capabilities may vary considerably. As general shareholders, they have the right and capacity to influence company’s fundamental issues including election of directors, amendments in company’s organic documents, approval of extraordinary transactions, modifications in company’s internal status and appointment of auditors. Jensen and Meckling (1976) classify ownership structure and shareholder composition in terms of capital contributions, comprising inside investors (managers), and outside investors (debt
holder and equity holder). Abel and Okafor (2012) define ownership structure as the percentage of share held by managers (managerial ownership), institutions (institutional ownership), government (state ownership), foreign investors (foreign ownership), family (family ownership) among other aspects. Said (2013) points to the preference of managers to increase firm size through excessive investment for private benefit. Said (2013) suggests that the choice of the leverage itself raises an agency problem between shareholders and managers. This leads to the suggestion that free cash flow left in the business requires disciplinary systems that lead managers to use more leverage. The decision of funding depends on firm’s ownership structure since decisions are taken by those that run the affairs of the company. Said (2013) posited that given these arguments, the level of shareholders’ influence on funding mechanism (debt) is associated with the ownership structure.

2.5.1 The Dynamics of Shareholder Demographics

Shareholders are not a homogenous group of investors. They include a diverse mix of institutional and retail investors who differ in terms of investment horizon (long-term versus short-term), objectives (purely economic versus social objectives), level of activity (active versus passive), portfolio concentration, and size. Most corporations dedicate significant time and attention to managing their shareholder base (Beyer, Larcker, and Tayan, 2014). A recent survey by the National Investor Relations Institute (NIRI) and the Rock Center for Corporate Governance at Stanford University (2014) found that 91 percent of companies discussed shareholder composition at the senior-executive level; 75 percent discussed this at the board level; CEOs spent 4.2 days per quarter managing their shareholder base, and CFOs 6.4 days’ considerable figures given the managerial responsibilities of senior executives. Most companies (80 percent) believed that their stock would trade at a higher price if they could attract their “ideal” shareholder base. On average, companies estimate that their stock would rise 15 percent and share price volatility decrease 20 percent over a two to three-year period if they had the right shareholders (NIRI and RCCG, 2014).

The foundation of ‘shareholder democracy’ rests on seeking empowerment by shareholders in the governance of companies (In the US, since the 1970s, shareholders have used their power as stockowners to press companies for changes on a wide range of social, environmental and human rights issues). Provisions of company law in most jurisdictions support small-shareholder democracy; however, the process practically discourages the
same, as in companies large/block shareholders supersede the rights of small/dispersed shareholders in the election of directors (Sharma, 2010). Therefore, the shareholder democracy remains only in the books and for academic discourse. Small shareholders’ votes commonly do not win in the annual general meeting (AGM) amidst the vast power wielded by the controlling shareholders’ solicitation of proxy votes should be allowed prior to AGMs of listed companies. It becomes more difficult when the controlling shareholding is with a family (Kang, 2011).

It is generally accepted that ownership structure is an important component of corporate governance (Shleifer & Vishny, 1986). Some of the basic theories of corporate governance start with an idealized picture of a firm with widely diverse ownership, but in practice, the theoretical model of diffused ownership faces problems. When a company is owned by numerous small shareholders, it can be difficult for them to get information about the firm’s operations, meaning that a great deal of the real control rests with management; the principal-agent problem arises and company performance can suffer, to the detriment of the owners (the shareholders). This would seem to argue in favor of a more concentrated ownership system, and in fact, around the world we see that diffuse ownership is indeed the exception, not the rule (Wilson, 2013).

In most countries, the dominant organizational form is concentrated ownership, with control of most firms either in the hands of a family, a larger holding company, major institutional investors, or in some cases the state. This is true even in developed economies with robust capital markets and a high level of private ownership, where individual listed corporations are often part of a complex network of international or domestic holdings, which themselves in turn may or may not be listed. There are various reasons why this might be the case. First, in less developed economies, capital markets are thinner, there is less equity in the hands of the population, and we often see a more active state role in the economy, as well as a greater tradition of family ownership, which all lend themselves to concentrated ownership. In more developed economies, we have seen the natural growth of large institutional investors, including banks, hedge funds and other large financial players, and the pooling of pension funds that turns individual small owners into large investors. Thus, again we see a tendency toward concentrated ownership (Wilson, 2013).
The corporate governance structure of firms in most countries is characterized by the fact that most companies are managed and owned principally by founding family members, implying that there is little separation of ownership and control. Indeed, majority owners can retain control of their companies even though the companies are listed, which implies that ownership rights and management control are in the hands of a small circle of family members and trusted business associates. This situation is worsened by a relatively small, undeveloped, and illiquid capital market which provides no discipline and control of management through the market for corporate control (Anas, 2015). The highly concentrated and family-based ownership structure of companies leaves corporate decisions in the hands of the controlling family. Small and public investors have little or no power to protect themselves from appropriation by large shareholders as a result of weak legal protections (Anas, 2015).

2.5.2 The Principal – Agency Problem
Disclosure and the quality of corporate governance system are more often appreciated as closely related concepts - the higher the level of transparency, the better the quality corporate governance practices. As regards disclosure, if in a widely-held company (ownership dispersion) its role is to signal that the managers are acting in the best interests of the principals, in a highly-concentrated company (ownership concentration), it comes to thrash out the conflicts of interest between “insiders” (controlling shareholders and managers) and outside investors (Alexandrina, 2012). In case of a concentrated ownership, the situations become more complicated because since managers pursue their own interest, higher management shareholding would imply a larger sharing of the loss, and ultimately, a lower possibility that management would lower corporate value. Also, in this case, conflicts of interest are not between managers and shareholders, but between large and small shareholders (Shleifer and Vishny, 1997). When ownership control is high enough to ensure its position, management has the incentive to behave against the interests of other smaller shareholders because of its strong voting power to appoint someone it trusts to be CEO, directors and/or board chairman. Besides expropriating minority interests directly, these controlling shareholders can enrich themselves through connected party transactions in which profits are transferred to other companies they control (Chau and Gray, 2012).
Prevailing corporate governance literature has incontrovertibly identified the agency problems in controlled companies as those between the controlling shareholders (agent) and the minority shareholders (principal) or the "controller-minority" or "horizontal" agency problem (Lan and Varotill, 2015). While several corporate governance strategies have been preferred to address these agency problems in the broader setting, empirical literature debate has focused on two specific strategies that may be potentially deployed to address the agency problems in controlled companies. These are: (i) the participative strategy, wherein shareholders (particularly the minority) are enabled and encouraged to exercise greater participation in companies in which they have invested so as to strengthen shareholder democracy; and (ii) controlling strategy, wherein the focus is on controlling or regulating the actions of the controlling shareholders rather than empowering the minority shareholders (Gilson and Alan, 2013). The core argument here is that given the predominant ownership and control exercised by the controlling shareholders in controlled companies, the participative strategy is sure to be met with impediments. Any amount of additions to the powers of the minority shareholders in corporate democracy would not be meaningful if they are required to exercise it in the shadow of a controlling shareholder's dominance. Given the ineffectiveness of the participative strategy, the corporate governance efforts in controlled companies may instead be better spent on the controlling strategy. A system of greater monitoring of controlling shareholders, especially on matters where such shareholders may be interested, such as self-dealing transactions, would augur to the benefit of the minority shareholders (Lan and Varotill, 2015; Gilson and Alan, 2013).

Capital concentration stands as a maintenance of good governance, though some authors emphasize the persistence of a non-monotonous relationship between shareholding distribution and financial information quality. As for Shleifer and Vishny (1986) they state that the majority shareholders should play an active role in company governance. In the same line, Souha and Anis (2016) discovered that ownership concentration helps well in ensuring a more efficient company governance and control. With respect to Oded and Wang (2013) ownership concentration has been discovered to help further enhance frequent monitoring. They have put forward a model explaining that ownership concentration helps well enhance and motivate shareholder activism for the sake of promoting business value, and that a high concentration level is reflected by high expenditure in matters of supervision. In regard to managerial ownership, Bekiris (2013) stresses that when managerial ownership reaches a
high level, agency problem would turn out to be largely mitigated due to complete alignment between managers and shareholders. Consequently, higher the managerial ownership proves to be, the lower shareholder activism would be.

2.6 Chapter Summary
The chapter has provided a review of empirical literature on the key variables of the study which included regulatory environment; corporate governance practices; level of investor participation; and shareholder composition. The next chapter outlines the methodology that will be applied in executing the field study that gathered the data to show how the four variables enhance relationship investing in the Kenyan capital markets.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction
According to Kothari (2004), research methodology gives details regarding procedures used in conducting the study. It includes all techniques, methods and procedures adopted in the research. The issues described in this chapter includes the target population, the sampling techniques, the research design, a description of instruments or tools used to collect data, sample size and the techniques to be used in data analysis.

3.2 Research Design
According to Cooper and Schindler (2014), research design is the plan and structure formulated to obtain answers to the research questions. It includes the outline of what the researcher did from writing the hypothesis, to their operational inferences, to the final data analysis. The research adopted a descriptive research design. The descriptive design was applied to investigate the factors that influence relationship investing in the Kenyan capital markets. Descriptive research determines and reports the ways things are (Kothari, 2004). This approach was found appropriate because the study involved fact finding and enquiries to describe the state of the affairs (relationship investing) in Kenyan capital markets. The independent variables in the study comprised of regulatory and policy environment; corporate governance practices; level of investor participation; and shareholder composition. The dependent variable was relationship investing in the Kenyan capital markets.

3.3 Population and Sampling Design
3.3.1 Population
According to Cooper and Schindler (2014), the target population is the population to which a researcher wants to generalize the result of the study. The target population for this study was 141 respondents which was composed of players in the Kenyan capital markets who included: stockbrokers, investment banks, fund managers, investment advisors, custodians & authorized depositories, listed companies, securities exchanges, and central depositories. All these had their head offices in Nairobi. The managers or fund managers were the main respondents. These are summarized in Table 3.1 below
### Table 3.1: The Population Distribution

<table>
<thead>
<tr>
<th>Category</th>
<th>Stratum</th>
<th>Number of entities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Licensed Stockbrokers</td>
<td>Licensee</td>
<td>9</td>
</tr>
<tr>
<td>Licensed Investment Banks</td>
<td>Licensee</td>
<td>14</td>
</tr>
<tr>
<td>Licensed Fund Managers</td>
<td>Licensee</td>
<td>25</td>
</tr>
<tr>
<td>Licensed Investment Advisors</td>
<td>Licensee</td>
<td>13</td>
</tr>
<tr>
<td>Licensed Custodians &amp; Authorized Depositories</td>
<td>Licensee</td>
<td>14</td>
</tr>
<tr>
<td>NSE 20 Listed Companies</td>
<td>Listed company</td>
<td>20</td>
</tr>
<tr>
<td>Securities Exchange</td>
<td>Regulator</td>
<td>1</td>
</tr>
<tr>
<td>Central Depositories</td>
<td>Regulator</td>
<td>1</td>
</tr>
<tr>
<td>Capital Markets Authority</td>
<td>Regulator</td>
<td>1</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td><strong>141</strong></td>
</tr>
</tbody>
</table>

*Source: Capital Markets Authority (2016)*

#### 3.3.2 Sampling Design

##### 3.2.2.1 Sampling Frame

A sampling frame is the list or a set from which the respondents of a research study are picked (Cooper and Schindler, 2014). They describe the sampling frame as being closely related to the population as it is the list of elements from which the sample is actually drawn and that it is a complete and correct list of population members only. A sampling frame needs to be appropriate, i.e. free of any bias as well as relevant. The sampling frame of the study was made up 141 entities making up the Kenyan capital markets; mainly comprised of the Nairobi Securities Exchange (NSE) database of listed securities and the Capital Markets Authority (CMA) list of licensees and approved institutions.

##### 3.2.2.2 Sampling Technique

In the process of determining the sample size, the researcher used multi-stage sampling approach. In the first stage, stratified random sampling technique was used in selection of the entities or firms to be engaged in the study. To ensure representativeness, the population was sub-divided into three non-homogenous strata namely: CMA licensees; NSE listed companies; and capital market regulators. In the second stage, simple random sampling was used in determining the number of firms to be sampled from each stratum. A random sample
of 50% of the participating firms was drawn from each stratum. In the final stage, purposive sampling was used in selection of the study respondents from each selected firm. According to Kothari (2004), purposive sampling is used in selection of subjects that meet a pre-defined criterion. The respondents were therefore being the chief executive officers or lead transaction advisers / managers for each of the selected entity. These were considered because of their strategic position in their respective organizations and their ability to articulate various issues touching on the Kenyan capital markets, more so relationship investing.

3.2.2.3 Sample Size

From the sampling frame (Table 3.2), 70 firms were selected at random from each stratum to participate in the study. This represents 50% of the total population in the sector. However, for the regulators’ stratum, only one each was selected as each firm is an autonomous entity from its other two peers. Cooper and Schindler (2014) pointed out that samples of descriptive studies are considered adequate within the range of 10% and 50%. The overall sample size was therefore comprised of 73 respondents. Table 3.2 shows the sampling matrix.
### Table 3.2: The Sample Size Distribution

<table>
<thead>
<tr>
<th>Category</th>
<th>Stratum</th>
<th>Number of entities</th>
<th>Sample proportion</th>
<th>Sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Licensed Stockbrokers Licensee</td>
<td>Licensee</td>
<td>9</td>
<td>50%</td>
<td>5</td>
</tr>
<tr>
<td>Licensed Investment Banks Licensee</td>
<td>Licensee</td>
<td>14</td>
<td>50%</td>
<td>7</td>
</tr>
<tr>
<td>Licensed Fund Managers Licensee</td>
<td>Licensee</td>
<td>25</td>
<td>50%</td>
<td>13</td>
</tr>
<tr>
<td>Licensed Investment Advisors Licensee</td>
<td>Licensee</td>
<td>13</td>
<td>50%</td>
<td>7</td>
</tr>
<tr>
<td>Licensed Custodians &amp; Authorized Depositories</td>
<td>Licensee</td>
<td>14</td>
<td>50%</td>
<td>7</td>
</tr>
<tr>
<td>NSE 20 Listed Companies Listed company</td>
<td>Listed company</td>
<td>20</td>
<td>50%</td>
<td>10</td>
</tr>
<tr>
<td>Securities Exchange Regulator</td>
<td>Regulator</td>
<td>1</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Central Depositories Regulator</td>
<td>Regulator</td>
<td>1</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Capital Markets Authority Regulator</td>
<td>Regulator</td>
<td>1</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td><strong>141</strong></td>
<td></td>
<td><strong>73</strong></td>
</tr>
</tbody>
</table>

### 3.4 Data Collection Methods

The focus during the field survey was on gathering primary data. This is factual data collected for the first time to address the problem at hand. The questionnaire was the principal tool in collecting primary data. The questionnaire developed contained both structured, semi-structured and open-ended questions. A likert scale was used whereby statements were made and a respondent was required to indicate to what degree they agree or disagree with the statements. A scale whereby 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree and 5= Strongly Agree was used. According to Neuman (2013), semi-structured questions may elicit adequate qualitative and quantitative data.

The questionnaire consisted of two parts: Part A focused on the respondent’s demographics and Part B comprised of four sub-sections; Section 1, sought to capture information on the role of regulatory and policy environment in influencing relationship investing; Section 2, section sought to capture information on the effects of corporate governance practices; Section 3, was based on the level of investors’ participation and Section 4, sought to capture data on the role of shareholder composition in influencing relationship investing in Kenya. Questions in Part A required direct answers, while the questions in Part B relied on a likert
scale which presents a simple way of gauging specific opinions and also enables the measurement of broader attitudes and values (Johns, 2010).

3.5 Research Procedures

A Pilot study was conducted to ensure reliability, workability and validity of the questionnaire and the interview guide. It was conducted with selected informants drawn from non-listed firms in the banking and insurance sector. Specifically, five non-listed commercial banks and five non listed insurance companies were targeted for the pilot exercise. This process also assisted in illuminating any potential problems of the research instrument and provide a basis for design or structural changes. After the pilot test, the instruments were fine-tuned and redesigned on the basis of the feedback that the researcher received. The final version of the questionnaire and interview guide included in the appendix of this report was later administered to the respondents selected in the sample size excluding the respondents who participated earlier in the pilot test.

To ensure extensive responsiveness, effort was made to ensure as many of the sessions are done outside the official working hours when the respondents are available and willing to fill the self-administered questionnaires. To ensure high response rates, the researcher interpreted each of the sections of the questionnaires to the respondents to ensure that they fully understood the questions before answering. In addition, the researcher ensured that the respondents picked had the requisite experience and expertise to response to various underlying themes emanating from each of the independent variable. For executives who were not available at all, email forms designed in Google-Forms™ were used to collect the data from them. These forms were further encrypted with a single use electronic signature to ensure that one respondent does not respond to the form more than once.

The research targeted 73 respondents from the Nairobi Securities Exchange (NSE) database of listed securities and the Capital Markets Authority (CMA) list of licensees and approved institutions out of which 52 respondents representing 71.2% of total sample validly responded. The research data was then to be tested for reliability using the Alpha (Cronbach) technique and analysed using Statistical Package for Social Sciences (SPSS). The Analysis was presented using tables and graphs to give a clear picture of the research findings at a glance.
3.6 Data Analysis Methods

After the fieldwork, before analysis, all the questionnaires were adequately checked for completeness. The information was coded and entered into a spreadsheet and analyzed using SPSS (Statistical Package for Social Sciences). The data was checked to ensure that the output is free from outliers and the effect of missing responses is at minimum. Quantitative analysis involved generating descriptive statistics. The descriptive statistics included frequency tallies, their corresponding percentage scores, and Cronbach’s alphas. The data was presented by using tables. Qualitative analysis involved categorizing of data into common themes and presented using frequency distribution tables and charts.

3.7 Chapter Summary

This chapter has described the methods that will be used to find answers to the research questions outlined in Chapter one. Descriptive research design was used for this study. The sampling frame comprised of 141 organizations in the Kenyan capital markets from where 73 respondents were drawn. The organizations were stratified into CMA licensees; NSE listed firms; and regulator organizations. The questionnaire was the principal data collection instrument. Quantitative techniques of analysis were the most appropriate for the collected data. The next chapter present the findings from the field study. The findings were presented using tables and charts.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction
This chapter analyses, interprets and presents the study findings as per the aim of this study, which was to determine the factors that influence relationship investing in the Kenyan capital markets. The study also sought to determine the influence of regulatory and policy environment on relationship investing in the Kenyan capital markets, the effect of corporate governance practices on relationship investing in the Kenyan capital markets, how the level of investor participation influence relationship investing in the Kenyan capital markets and the effect of shareholder composition on relationship investing in the Kenyan capital markets.

4.2 Response Rate
The study had a sample size of 73 respondents, out of which 52 responses were obtained giving a response rate of 71.2%. The study did not achieve a 100% response rate as some of the questionnaires were not returned by the respondents and hence could not be used in the study.

Table 4.3: Response Rate

<table>
<thead>
<tr>
<th>Questionnaires</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Returned</td>
<td>52</td>
<td>71.2</td>
</tr>
<tr>
<td>Not Returned</td>
<td>21</td>
<td>28.8</td>
</tr>
<tr>
<td>Total</td>
<td>73</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.3 Reliability Analysis
Reliability of the research findings were evaluated through Cronbach’s Alpha which measures the internal consistency and establishes if items within a scale measures the same construct. The index alpha was computed using SPSS and measured the average of measurable items and its correlation. Cronbach’s Alpha was established for every variable which formed a scale as shown below in Table 4.2.
Table 4.4: Reliability Analysis

<table>
<thead>
<tr>
<th>Variable</th>
<th>Cronbach's Alpha</th>
<th>Number of Items</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory and Policy Environment</td>
<td>0.799</td>
<td>10</td>
</tr>
<tr>
<td>Corporate Governance Practices</td>
<td>0.701</td>
<td>12</td>
</tr>
<tr>
<td>Investor Participation</td>
<td>0.802</td>
<td>11</td>
</tr>
<tr>
<td>Shareholder Composition</td>
<td>0.838</td>
<td>10</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>0.785</strong></td>
<td></td>
</tr>
</tbody>
</table>

Table 4.2 illustrates that shareholder composition had the highest reliability (α= 0.838), followed by investor participation (α=0.802), regulatory and policy environment (α=0.799) and lastly corporate governance practices (α=0.701). This illustrates that all the four variables were reliable as their reliability values exceeded the prescribed threshold of 0.7 as contended by Field (2009). The results of the reliability test also revealed that all the four variables were reliable as the average index of 0.785 exceeded the adopted threshold of 0.7. This is an indication that regulatory and policy environment, corporate governance practices, investor participation and shareholder composition have relatively high internal consistency and measure the same construct.

4.4 General Information

4.4.1 Gender of the Respondents

The respondents were asked to indicate their gender. The results are illustrated in Table 4.3. From the findings, 73.1% of the respondents indicated that they were male while 26.9% indicated that they were female. Despite the large gender variance in the respondents, this does not represent the gender representation of the target population.

Table 4.5: Gender of the Respondents

<table>
<thead>
<tr>
<th>Gender</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>38</td>
<td>73.1</td>
</tr>
<tr>
<td>Female</td>
<td>14</td>
<td>26.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>
4.4.2 Position/Designation of the Organization

The respondents were asked to indicate position they held in their organization. From the findings, the respondents indicated that they held different positions in their organizations such as senior executives, investor relations officers, equity traders, executive assistants, investment officers, heads of research, investment analysts, investment dealers, investment managers, fund and portfolio managers, general managers, research analysts and associates as well as corporate finance analysts. This shows that there was diversity in representation of the various areas and sectors of the investment management space.

4.4.3 Category of the Organization

The respondents were asked to indicate the category of their organizations. The results are illustrated in Table 4.4. From the findings, 57.7% of the respondents indicated that their organizations fell in the CMA licensee category, 36.5% indicated NSE listed firm whereas 5.8% of the respondents indicated that their organizations fell in the regulatory category. This is an indicator that the study included respondents from all categories of organizations in the Kenya capital market with majority of organizations being CMA licensee.

<table>
<thead>
<tr>
<th>Category</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>CMA licensee</td>
<td>30</td>
<td>57.7</td>
</tr>
<tr>
<td>NSE listed firm</td>
<td>19</td>
<td>36.5</td>
</tr>
<tr>
<td>Regulatory (NSE, CMA, CDSC)</td>
<td>3</td>
<td>5.8</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.4.4 Experience in the Organization

The study sought to establish the respondents’ experience in their current organizations. From the findings presented in Table 4.5, 51.9% of the respondents indicated that they had experience of between 1-5 years with their organization. 25% indicated experience of between 6-10 years, 13.5% indicated more than 10 years’ experience while 9.6% indicated that they had experience of less than a year in their organization. This is an indication that majority of the employees working in organizations operating in the Kenyan capital markets have professional experience of at least more than an year in their organization and therefore would understand relationship investing and its applicability to their organizations and thus give credible information.
Table 4.7: Experience in the Organization

<table>
<thead>
<tr>
<th>Years</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 1 year</td>
<td>5</td>
<td>9.6</td>
</tr>
<tr>
<td>1-5 years</td>
<td>27</td>
<td>51.9</td>
</tr>
<tr>
<td>6-10 years</td>
<td>13</td>
<td>25.0</td>
</tr>
<tr>
<td>More than 10 years</td>
<td>7</td>
<td>13.5</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.4.5 Experience in the Capital Markets

The respondents were requested to indicate their experience in capital markets. From the findings presented in Table 4.6, 38.5% of the respondents indicated that they had an experience of between 6 and 9 years in the capital market. 32.7% indicated that they had an experience of 10 years and above, 25% indicated 2-5 years while 3.8% indicated that they had an experience of less than 2 years in the capital markets. This is an indication that majority of the investment professionals working in organizations operating in the Kenyan capital markets have experience of more than 6 years in the capital market and therefore would be able to understand and provide credible information on the subject matter.

Table 4.8: Experience in the Capital Markets

<table>
<thead>
<tr>
<th>Experience</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 2 years</td>
<td>2</td>
<td>3.8</td>
</tr>
<tr>
<td>2-5 years</td>
<td>13</td>
<td>25.0</td>
</tr>
<tr>
<td>6-9 years</td>
<td>20</td>
<td>38.5</td>
</tr>
<tr>
<td>10 years and above</td>
<td>17</td>
<td>32.7</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.4.6 Highest Level of Education

The respondents were requested to indicate their highest level of education. The findings are illustrated in Table 4.7. From the table, 48.1% of the respondents indicated their highest level of education as university post graduate, 40.4% indicated university graduate and 11.5% indicated post-secondary as their highest education. This is an indication that majority of the employees in the Kenya capital markets have university education.
Table 4.9: Highest Level of Education Attained

<table>
<thead>
<tr>
<th>Level</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Post-secondary</td>
<td>6</td>
<td>11.5</td>
</tr>
<tr>
<td>University graduate</td>
<td>21</td>
<td>40.4</td>
</tr>
<tr>
<td>University post graduate</td>
<td>25</td>
<td>48.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

4.4.7 Area of Specialization/Training/Profession

Further the respondents were requested to indicate their area of specialization/training/profession. From the findings, the respondents indicated their area of specialization as Investments, Economics, Finance, Equities, Fixed Income, Research and Analysis, Corporate Finance, Fund Management, Investor Relations, Portfolio Management and Public Relations. From these findings, it can be seen there was diversity in the specialization/training/profession of the respondents capturing most if not all of the various professional backgrounds that operate in the Kenyan Capital Markets.

4.5 Effect of Regulatory and Policy Environment on Relationship Investing

This section was designed to address the first research question concerning the effects the regulatory and policy environment have on relationship investing in the Kenyan capital markets. To do so, the respondents were requested to indicate their level of agreement with statements relating first to the regulatory and policy challenges in a global context then secondly the regulatory and policy challenges in a local Kenyan context.

The responses were rated on a five point Likert scale whereby 1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree and 5 = Strongly Agree.

4.5.1 Regulatory and Policy Challenges in a Global Context

Table 4.8 below illustrates the study findings. From these findings, the respondents agreed that the level of success of an investor often depends on their ability to outfox other investors within the legally allowable limits as indicated by a mean of 4.12, they also agreed the regulators were reluctant to engage the sector players to develop a clear policy to guide how shareholders could engage corporate boards in strategic decision making as indicated by a mean of 3.79, and that legal and regulatory barriers may hinder institutional shareholders from actively participating in shareholder activism as indicated by mean of 3.79. However,
the respondents disagreed that relationship investing has no legal basis in a liberalized / free trading environment as reflected by mean of 2.42.

Table 4.10: Regulatory and Policy Challenges in a Global Context

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) The level of success of an investor often depends on their ability to outfox other investors within the legally allowable limits</td>
<td>52</td>
<td>4.12</td>
<td>.732</td>
</tr>
<tr>
<td>b) Legal and regulatory barriers may hinder institutional shareholders from actively participating in shareholder activism</td>
<td>52</td>
<td>3.79</td>
<td>.936</td>
</tr>
<tr>
<td>c) The regulators have been reluctant to engage the sector players to develop a clear policy to guide how shareholders can engage corporate boards in strategic decision making</td>
<td>52</td>
<td>3.79</td>
<td>.800</td>
</tr>
<tr>
<td>d) Relationship investing has no legal basis in a liberalized / free trading environment</td>
<td>52</td>
<td>2.42</td>
<td>.936</td>
</tr>
</tbody>
</table>

4.5.2 Regulatory and Policy Challenges in a Kenyan Context

Table 4.9 below illustrates the study findings. From these findings, the respondents agreed that the statutes governing relationship investing Kenya were unclear to most of the retail investors as was indicated by a mean of 4.17. In addition, the study found out that respondents agreed that relationship investing is a concept which is foreign to the Kenyan capital markets scenario as indicated by a mean of 3.87. Further the respondents agreed that; the statutes governing relationship investing Kenya are unclear to most of the institutional investors as was indicated by a mean of 3.81. The respondents also agreed that the revised Company's Act 2015 of the Laws of Kenya failed to adequately address the role of shareholders in influencing board decisions as illustrated by a mean of 3.73. It was further found that the respondents agreed that the legal and regulatory framework on corporate governance and shareholder influence in Kenya, as in the rest of the Commonwealth states, seems to be in favor of restriction and limitation of shareholder influence as indicated by a mean of 3.65. The respondents however disagreed that the legal and regulatory framework in the Kenyan capital markets largely focuses on guaranteeing returns on investment for shareholders as indicated by mean of 2.27.
Table 4.11: Regulatory and Policy Challenges in a Kenyan Context

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) The statutes governing relationship investing Kenya are unclear to most of the retail investors</td>
<td>52</td>
<td>4.17</td>
<td>.617</td>
</tr>
<tr>
<td>b) Relationship investing is a concept which is foreign to the Kenyan capital markets scenario</td>
<td>52</td>
<td>3.87</td>
<td>.864</td>
</tr>
<tr>
<td>c) The statutes governing relationship investing Kenya are unclear to most of the institutional investors</td>
<td>52</td>
<td>3.81</td>
<td>.971</td>
</tr>
<tr>
<td>d) The revised Company's Act 2015 of the Laws of Kenya failed to adequately address the role of shareholders in influencing board decisions</td>
<td>52</td>
<td>3.73</td>
<td>.744</td>
</tr>
<tr>
<td>e) The legal and regulatory framework on corporate governance and shareholder influence in Kenya, as in the rest of the Commonwealth states, seems to be in favor of restriction and limitation of shareholder influence</td>
<td>52</td>
<td>3.65</td>
<td>.968</td>
</tr>
<tr>
<td>f) The legal and regulatory framework in the Kenyan capital markets largely focuses on guaranteeing returns on investment for shareholders</td>
<td>52</td>
<td>2.27</td>
<td>0.952</td>
</tr>
</tbody>
</table>

The study further sought to establish whether the respondents thought there were some issues that were not addressed in regards to legal and regulatory issues regarding relationship investing in the Kenyan capital markets. The findings as presented in Table 4.10 indicate that majority (88.5%) of the respondents indicated that there were unaddressed legal and regulatory issues regarding relationship investing in the Kenyan capital markets. However, 11.5% of the respondents indicated that there were no unaddressed legal and regulatory issues regarding relationship investing in the Kenyan capital markets. This is an indication that there are legal and regulatory issues regarding relationship investing in the Kenyan capital markets that have not been addressed. The unaddressed issues identified by the respondents included, governance rights to investors, provision for non-disclosure and lack of provision for investors bargaining leverage by making it more or less easy to orchestrate campaigns aimed at forcing change.
Table 4.12: Unaddressed Issues Regarding Regulatory and Policy Environment

<table>
<thead>
<tr>
<th>Opinion</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>46</td>
<td>88.5</td>
</tr>
<tr>
<td>No</td>
<td>6</td>
<td>11.5</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.6 Effect of Corporate Governance Practices on Relationship Investing

This section was designed to address the second research question concerning the effects of corporate governance practices on relationship investing in Kenyan capital markets. To do so, the respondents were requested to indicate their level of agreement with statements relating the agency problem, the stakeholder and shareholder approaches to corporate governance and finally the monitoring of corporate governance practices.

The responses were rated on a five point Likert scale whereby 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree and 5= Strongly Agree.

4.6.1 The Agency Problem

Table 4.11 below illustrates the findings of the study. From these findings it can be seen that the respondents agreed that the increase in shareholder activism brings into sharp focus the fiduciary role of the board viz-a-viz the shareholders as illustrated by a mean of 3.96. Further they agreed that boards should have the autonomy and competence to effectively lead their organizations with minimal engagement of other actors as indicated by mean of 3.79. The respondents agreed that the board of directors should be left to formulate policies, procedures and guidelines on how to engage with shareholders as indicated by mean of 3.65. However, the respondents disagreed that relationship investing interfered with transparency and accountability of the board to the shareholders as reflected by mean of 2.40.
Table 4.13: The Agency Problem

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) The increase in shareholder activism brings into sharp focus the fiduciary role of the board viz-a-viz the shareholders</td>
<td>52</td>
<td>3.96</td>
<td>.656</td>
</tr>
<tr>
<td>b) Boards should have the autonomy and competence to effectively lead their organizations; with minimal engagement of other actors</td>
<td>52</td>
<td>3.79</td>
<td>.800</td>
</tr>
<tr>
<td>c) The board of directors should be left to formulate policies, procedures and guidelines on how to engage with shareholders</td>
<td>52</td>
<td>3.65</td>
<td>.926</td>
</tr>
<tr>
<td>d) Relationship investing would interfere with transparency and accountability of the board to the shareholders</td>
<td>52</td>
<td>2.40</td>
<td>.799</td>
</tr>
</tbody>
</table>

4.6.2 Stakeholder Approach to Corporate Governance

Table 4.12 below illustrates the findings of the study. From these findings, it can be seen that the respondents strongly agreed that transparent and effective communication is important for building and maintaining good relationships with stakeholders as was indicated by a mean of 4.54. The respondents further strongly agreed that the board should consider not only the financial performance but also the impact of the Company’s operations on society and the environment as indicated by a mean of 4.52.

Table 4.14: Stakeholder Approach to Corporate Governance

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Transparent and effective communication is important for building and maintaining good relationships with stakeholders</td>
<td>52</td>
<td>4.54</td>
<td>.541</td>
</tr>
<tr>
<td>b) The Board should consider not only the financial performance but also the impact of the Company’s operations on society and the environment</td>
<td>52</td>
<td>4.52</td>
<td>.577</td>
</tr>
</tbody>
</table>
4.6.3 Shareholder Approach to Corporate Governance

Table 4.13 below illustrates the findings of the study. From these findings, it can be seen that the respondents agreed that the adoption of international standards in corporate governance best practices is essential for public companies in Kenya in order to maximize shareholders value through effective and efficient management of corporate resources as indicated by a mean of 4.48. The respondents further agreed that the essence of good corporate governance practices is to promote and protect shareholders' rights as was indicated by a mean of 4.44.

Table 4.15: Shareholder Approach to Corporate Governance

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) The adoption of international standards in corporate governance best</td>
<td>52</td>
<td>4.48</td>
<td>.577</td>
</tr>
<tr>
<td>practices is essential for public companies in Kenya in order to</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>maximize shareholders value through effective and efficient management of</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>corporate resources</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b) The essence of good corporate governance practices is to promote and</td>
<td>52</td>
<td>4.44</td>
<td>.539</td>
</tr>
<tr>
<td>protect shareholders' rights</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.6.4 Monitoring of Corporate Governance Practices

Table 4.14 below illustrates the findings of this study. From these findings, it can be seen that the respondents agreed that enforcement of corporate governance in Kenyan capital markets uses the “Explain or Comply” approach as illustrated by a mean of 3.96 and that mandatory voting by institutional investors would especially help address the challenges that relationship investing seeks to address in listed companies as indicated by mean of 4.10. It was further found that the respondents agreed that relationship investing was most ideal for listed companies which have no major shareholder as indicated by a mean of 3.87 and that relationship investing would be an ultimate solution to frequent board and internal wrangles amongst listed firms as shown by mean of 3.69.
The respondents were also asked whether they thought that there were still some issues that were not addressed regarding corporate governance practices as a factor of relationship investing in the Kenyan capital markets. The findings are shown in Table 4.15. From the findings, 78.8% of the respondents indicated that there were still some unaddressed issues regarding corporate governance practices and relationship investing in the Kenyan capital markets. However, 21.2% indicated that there were no unaddressed issues regarding corporate governance practices and relationship investing in the Kenyan capital markets. To support their claim some of the respondents noted that board responsibilities to shareholders were not clearly enforced and often took an ex-post outlook. They further noted that management discussion & analysis rarely adhered to recommended IASB guidelines resulting in limited use of information therein to would be investors - "boilerplate" declarations rather than company specific, decision useful information.

They also indicated that over the last 3 or so years, issues of corporate governance had increased. That they had seen bad governance and corporate leadership resulting in poor performance of companies. They therefore need stricter enforcement laws that helps deal with issues of this nature. The corporate governance rules do not address the plight of minority shareholders in regards to board decisions. They recommended that there should be more regulations in place to promote and ensure top-notch corporate governance as the capital market has been unable to self-regulate. The respondents indicated that transparency

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Enforcement of corporate governance in Kenyan capital markets uses the “Explain or Comply” approach</td>
<td>52</td>
<td>3.96</td>
<td>.593</td>
</tr>
<tr>
<td>b) Mandatory voting by institutional investors especially would help address the challenges that relationship investing seeks to address in listed companies</td>
<td>52</td>
<td>4.10</td>
<td>.748</td>
</tr>
<tr>
<td>c) Relationship investing is most ideal in listed companies with no major shareholder</td>
<td>52</td>
<td>3.87</td>
<td>.768</td>
</tr>
<tr>
<td>d) Relationship investing would be an ultimate solution to frequent board and internal wrangles amongst listed firms</td>
<td>52</td>
<td>3.69</td>
<td>1.112</td>
</tr>
</tbody>
</table>
in corporate governance was still lacking in the Kenyan capital markets. It was also felt that a number of organizations in the Kenyan capital markets had ineffective independent directors who failed to act in the interests of all shareholders but instead on those of a select few.

Table 4.17: Unaddressed Issues Regarding Corporate Governance Practices

<table>
<thead>
<tr>
<th>Opinion</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>41</td>
<td>78.8</td>
</tr>
<tr>
<td>No</td>
<td>11</td>
<td>21.2</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.7 Effect of Level of Investor Participation on Relationship Investing

This section was designed to address the third research question concerning the effect of level of investor participation on relationship investing in the Kenyan capital markets. To do so, the respondents were requested to indicate their level of agreement with statements first relating to active versus passive investing and the changing role of the investor then secondly on proxy advisory and solicitation.

The responses were rated on a five point Likert scale whereby 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree and 5= Strongly Agree.

4.7.1 Active versus Passive Investing; the Changing Role of the Investor

Table 4.16 below illustrates the findings of the study. From these findings, the respondents strongly agreed that active shareholder participation should be encouraged especially from institutional investors as indicated by mean of 4.54. The respondents agreed that it would be appropriate for pension funds through their investment managers to play a role in the corporate governance of the listed companies they invested in as indicated by a mean of 4.27. The respondents further agreed that shareholders’ participation in major decisions should be made mandatory for all listed companies as indicated by a mean of 4.17 and that institutional investors engage corporate boards only for realization of short-term performance of corporations as indicated by mean of 3.77. Finally the respondents agreed that the interest of shareholders to participate in governance issues is purely to ensure return of investment and sustained dividend payout as indicated by a mean of 3.65.
However, the respondents disagreed that institutional and block shareholders should be accorded preferential treatment than for the minority and foreign shareholder as reflected by mean of 1.79.

**Table 4.18: Active versus Passive Investing; the Changing Role of the Investor**

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Active shareholder participation should be encouraged especially from Institutional investors</td>
<td>52</td>
<td>4.54</td>
<td>.576</td>
</tr>
<tr>
<td>b) It would be appropriate for pension funds through their investment managers to play a role in the corporate governance of the listed companies they invested in</td>
<td>52</td>
<td>4.27</td>
<td>.888</td>
</tr>
<tr>
<td>c) Shareholders participation in major decisions should be made mandatory for all listed companies</td>
<td>52</td>
<td>4.17</td>
<td>.985</td>
</tr>
<tr>
<td>d) Institutional investors engage corporate boards only for realization of short-term performance of corporations</td>
<td>52</td>
<td>3.77</td>
<td>.854</td>
</tr>
<tr>
<td>e) The interest of shareholders to participate in governance issues is purely to ensure return of investment and sustained dividend payout</td>
<td>52</td>
<td>3.65</td>
<td>.814</td>
</tr>
<tr>
<td>f) Institutional and block shareholders should be accorded preferential treatment than for the minority and foreign shareholder</td>
<td>52</td>
<td>1.79</td>
<td>.776</td>
</tr>
</tbody>
</table>

4.7.2 Proxy Advisory and Solicitation

Table 4.17 below illustrates the findings of the study. From these findings, the respondents strongly agreed that the directors should provide sufficient time for shareholder’s questions on matters pertaining to the company's performance and seek to explain to the shareholders their concern as indicated by a mean of 4.62. Further, they agreed that the shareholders should be allowed to convene without the presence of the invested company board and management as indicated by a mean of 4.17 in each case. The respondents further agreed that shareholder proposals that do not make it to the board meetings should be made known to shareholders before or during a company general meeting as indicated by a mean of 4.13; Shareholder solicitation of proxy votes should be allowed for listed firms as indicated by a mean of 4.04 and finally that in Kenya, it has not been practical to have every shareholder
exercise their right to participate and vote at the general shareholders meeting including the election of directors as indicated by mean of 3.65.

**Table 4.19: Proxy Advisory and Solicitation**

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) The directors should provide sufficient time for shareholder’s questions</td>
<td>52</td>
<td>4.62</td>
<td>.491</td>
</tr>
<tr>
<td>on matters pertaining to the Company's performance and seek to explain to</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>the shareholders their concern</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b) The shareholders should be allowed to convene without the presence of</td>
<td>52</td>
<td>4.17</td>
<td>.785</td>
</tr>
<tr>
<td>the invested company board and management</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c) Shareholder proposals that do not make it to the board meetings should</td>
<td>52</td>
<td>4.13</td>
<td>.687</td>
</tr>
<tr>
<td>be made known to shareholders before or during a company general meeting</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d) Shareholder solicitation of proxy votes should be allowed for listed</td>
<td>52</td>
<td>4.04</td>
<td>.907</td>
</tr>
<tr>
<td>firms</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>e) In Kenya, it has not been practical to have every shareholder exercise</td>
<td>52</td>
<td>3.65</td>
<td>1.027</td>
</tr>
<tr>
<td>their right to participate and vote at the general shareholders meeting</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>including the election of directors</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The respondents were asked to indicate whether they thought that there were issues they felt were not addressed in regards to investor participation and relationship investing in the Kenyan capital markets. The findings are shown in Table 4.18. From the findings, 61.5% indicated that there were unaddressed issues regarding investor participation and relationship investing in the Kenyan capital markets. However, 38.5% indicated that there were no unaddressed issues regarding investor participation and relationship investing in the Kenyan capital markets. This is an indication that there are unaddressed issues regarding investor participation and relationship investing in the Kenyan capital markets.

In order to support this claim, the respondents indicated that minority shareholders required some minimum level of protection because they rarely had their say. They further indicated that the shareholders were not very active in the companies they invested in compared to in
other markets around the world. Further, they noted that some institutional investors were passive and did not even attend the annual general meetings of their portfolio companies. According to the respondents other unaddressed issues regarding investor participation and relationship investing in the Kenyan capital markets included shareholder solicitation of votes, low participation in the management of listed companies, lack of investor awareness in regards to shareholder rights within the companies they invest in and limited knowledge on the roles of shareholders in relationship investing in the Kenyan capital markets.

Table 4.20: Unaddressed Issues Regarding Investor Participation

<table>
<thead>
<tr>
<th>Opinion</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>32</td>
<td>61.5</td>
</tr>
<tr>
<td>No</td>
<td>20</td>
<td>38.5</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.8 Effect of Shareholder Composition on Relationship Investing

This section was designed to address the fourth research question concerning the effect of shareholder composition on relationship investing in the Kenyan capital markets. To do so, respondents were requested to indicate their level of agreement with statements relating to the dynamics of shareholder demographics and secondly the principal-agency problem.

The responses were rated on a five point Likert scale whereby 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree and 5= Strongly Agree.

4.8.1 The Dynamics of Shareholder Demographics

Table 4.19 below illustrates the findings of the study. From these findings, the respondents agreed that companies managed and owned principally by founding family members had little separation of ownership and control as indicated by a mean of 4.25. The respondents also agreed that managers who owned shares in the companies they worked for tend to become more committed to the organization since they had a stake in the residual income of the firm, and were likely to bear the cost of mismanagement as indicated by a mean of 4.17. The respondents further agreed that managers should be protected from unnecessary direct interference by the shareholders as a way of enhancing firm performance as indicated by a mean of 3.81. Companies with concentrated shareholding tend to be lacking in corporate governance practices as indicated by a mean of 3.77 and that the level of concentration in
shareholding tends to affect the performance of a company in the capital markets and that concentrated ownership and control systems lead to poor corporate performance to the disadvantage of the owners / shareholders as shown by mean of 3.73 in each case. They also agreed that firms listed at the NSE were still characterized by higher ownership concentration hence providing the controlling shareholders with the opportunity to use their power to undertake activities intended to obtain personal gains as shown by mean of 3.71

Table 4.21: The Dynamics of Shareholder Demographics

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Companies managed and owned principally by founding family members have little separation of ownership and control</td>
<td>52</td>
<td>4.25</td>
<td>.711</td>
</tr>
<tr>
<td>b) Managers who own shares in their company tend to become more committed to the organization since they have a stake in the residual income of the firm, and are likely to bear the cost of mismanagement</td>
<td>52</td>
<td>4.17</td>
<td>.785</td>
</tr>
<tr>
<td>c) Managers should be protected from unnecessary direct interference by the shareholders as a way of enhancing firm performance</td>
<td>52</td>
<td>3.81</td>
<td>1.121</td>
</tr>
<tr>
<td>d) Companies with concentrated shareholding tend to be lacking in corporate governance practices</td>
<td>52</td>
<td>3.77</td>
<td>.831</td>
</tr>
<tr>
<td>e) The level of concentration in shareholding tends to affect the performance of a company in the capital markets</td>
<td>52</td>
<td>3.73</td>
<td>.843</td>
</tr>
<tr>
<td>f) Concentrated ownership and control systems lead to poor corporate performance to the disadvantage of the owners / shareholders</td>
<td>52</td>
<td>3.73</td>
<td>.910</td>
</tr>
<tr>
<td>g) Firms listed at the Nairobi Securities Exchange are still characterized by higher ownership concentration hence providing the controlling shareholders with the opportunity to use their power to undertake activities intended to obtain personal gains to the</td>
<td>52</td>
<td>3.71</td>
<td>.997</td>
</tr>
</tbody>
</table>
4.8.2 The Principal – Agency Problem

From the findings, the respondents agreed that efforts should be directed at ensuring that firms do not just grow in age but rather grow faster in size and that ownership does not grow among few owners (higher ownership concentration) but rather spread out to many owners (diffused ownership) as indicated by a mean of 4.19. Further the respondents agreed that there was a significant relationship between ownership concentration and firm performance as indicated by mean of 3.67. In addition, the respondents agreed that when more than 30 per cent or more of shares are concentrated on a few hands, there is a tendency for the shareholders to be overzealous in their monitoring, controlling and ratification roles over managers as indicated by mean of 3.75.

Table 4.22: The Principal – Agency Problem

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Efforts should be directed at ensuring that firms do not just grow in age but rather grow faster in size and that ownership does not grow among few owners (higher ownership concentration) but rather spread out to many owners (diffused ownership)</td>
<td>52</td>
<td>4.19</td>
<td>.658</td>
</tr>
<tr>
<td>b) There is a significant relationship between ownership concentration and firm performance</td>
<td>52</td>
<td>3.67</td>
<td>1.004</td>
</tr>
<tr>
<td>c) When more than 30 per cent or more of shares are concentrated on a few hands, there is a tendency for the shareholders to be overzealous in their monitoring, controlling and ratification roles over managers</td>
<td>52</td>
<td>3.75</td>
<td>.682</td>
</tr>
</tbody>
</table>

The respondents were requested to indicate their opinion on whether there were issues they felt were not addressed in regards to shareholders’ composition and relationship investing in the Kenyan capital markets. From the results as shown by Table 4.21, majority of the respondents (71.2%) indicated that there were unaddressed issues regarding shareholders’ composition and relationship investing in the Kenyan capital markets. However, 28.8% of the respondents indicated that there were no unaddressed issues regarding shareholders’ composition and relationship investing in the Kenyan capital markets. This indicate that there are some unaddressed issues regarding shareholders’ composition and relationship investing in the Kenyan capital markets.
In order to support their claim, the respondents indicated that disclosures regarding management ownership and activity with regard to their company shares were less forthright with no announcement of whether there were compensation aspects related to shareholder ownership of the shares. Another shareholders’ composition issue indicated by the respondents was poor shareholding structure in the firms and institutions operating in the capital markets which they thought was crucial in the long-term performance of the firms operating in the sector.

The respondents further indicated that the impatience in the investors was an unaddressed issue. They indicated that it was important to have capital or investors who are in the company for the long term and are not affected by the short-term volatility in the performance of the company or even the share price of the company. This gave the management of the firms operating in the Kenyan capital market the confidence, flexibility and long term view needed to execute a good strategy. They further indicated that there was no clear measure in regards to shareholding structures especially with regards to nominal accounts and proxy shareholders. They recommended more emphasis on separation between owners and managers.

<table>
<thead>
<tr>
<th>Opinion</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>37</td>
<td>71.2</td>
</tr>
<tr>
<td>No</td>
<td>15</td>
<td>28.8</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.9 Chapter Summary

Chapter four has mainly described the research findings on the factors that influence relationship investing in the Kenyan capital markets. The study has established that the statutes governing relationship investing Kenya were unclear to most of the retail investors. The study further established that there are unaddressed issues concerning regulatory and policy environment and its influence on relationship investing in the Kenyan capital market. The study further established that the adoption of international standards in corporate governance best practices is essential for public companies in Kenya in order to maximize shareholder value. It was also established that issues of corporate governance in Kenyan
capital markets had not been fully addressed. Further it has been established that institutional investors engage corporate boards only for realization of short-term performance of corporations. There were some unaddressed issues concerning investor participation according to the findings. The study findings further revealed that the level of concentration in shareholding tends to affect the performance of a company in the capital markets and that concentrated ownership and control systems lead to poor corporate performance to the disadvantage of the owners / shareholders. The next chapter will be the discussion, conclusion and recommendations.
CHAPTER FIVE

5.0 DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
This chapter presents a summary of the findings, conclusions and recommendations for practice and further research on the problem. The main objective of the study was to determine the factors that influence relationship investing in the Kenyan capital markets.

5.2 Summary
Empirical evidence in regard to the factors influencing relationship investing in the Kenyan capital markets are not well researched or systematically documented. This study seeks to fill this gap by establishing the specific factors that influence relationship investing in the Kenyan capital markets. The study was guided by four variables of regulatory and policy environment, corporate governance practices, investor participation and shareholder composition.

This study employed a descriptive research design. The study targeted 141 entities that constitute the Kenyan capital markets (CMA licensees; NSE listed companies; and capital market regulators). The fund managers were the main respondents. The said target population was critical to this study because they gave first-hand information to the researcher. In the process of determining the sample size, the researcher will use multi-stage sampling approach. In the first stage, stratified random sampling technique will be used in selection of the entities or firms to be engaged in the study. To ensure representativeness, the population will be sub-divided into three non-homogenous strata namely: CMA licensees; NSE listed companies; and capital market regulators. In the second stage, simple random sampling will be used in determining the number of firms to be sampled from each stratum. A random sample of 50% of the participating firms will be drawn from each stratum. In the final stage, purposive sampling will be used in selection of the study respondents from each selected firm. A sample of 73 respondents where one respondent was selected from each sampled firm.
In order to establish the factors influencing relationship investing in the Kenyan capital markets; this study utilized a questionnaire to collect primary data. Data was analyzed both quantitatively and qualitatively. Quantitative data was analyzed by frequency tables and percentages. The analysis of the structured items was done by using the Statistical Package for Social Sciences (SPSS). Unstructured items were analyzed manually along major concepts and themes, and the results were presented using descriptive statistics.

On regulatory and policy environment, this study revealed that the regulatory framework in Kenya restricts shareholder influence with the laws failing to address the role of shareholders in business decisions. It was further revealed that were unaddressed legal and regulatory issues regarding relationship investing in the Kenyan capital markets. Legal and regulatory barriers may hinder institutional shareholders from actively participating in shareholder activism.

On corporate governance practices, study revealed that the respondents strongly agreed that effective communication is important in maintaining relationships with stakeholders and that the impact of the company’s operations on society and the environment should be considered by the board of management. The study further revealed that the adoption of international standards in corporate governance maximizes shareholders value while at the same time promoting and protection of shareholder rights. Mandatory voting by institutional investors if adopted would help tackle the challenges that relationship investing seeks to address in the capital markets. The “Explain or Comply” approach was recognized as being used in the enforcement of corporate governance in Kenyan capital markets. Relationship investing was found to be an ultimate solution to frequent board and internal shareholder wrangles amongst listed firms. However, the respondents disagreed that relationship investing interfered with transparency and accountability of the board to the shareholders.

On investor participation, the study revealed that the directors should provide sufficient time for shareholders to table questions on matters pertaining to the Company’s performance as well as seek to address shareholder concerns. In addition, they ought to encourage active investor participation especially from the institutional ones such as pension schemes and fund managers. The study further established that shareholder participation in major decisions should be made mandatory and that shareholders should be allowed to convene
meetings even with the absence of the board and management. Institutional investors engage corporate boards only for realization of short-term performance and returns from corporations instead of long term and should not be accorded preferential treatment from the minority and foreign shareholders. The study further revealed that there were unaddressed issues regarding investor participation and relationship investing in the Kenyan capital markets. Such issues included lack of say by minority shareholders, low shareholder/investor participation, shareholder solicitation of votes and failure to attend shareholder meetings.

On the shareholder composition, the study revealed that efforts should be directed at ensuring that firms grow in size with increased number of owners. The managers should be protected from unnecessary direct interference by the shareholders as a way of enhancing firm performance. The level of concentration in shareholding was found to have a direct bearing on the performance of a company in the capital markets with concentrated ownership and control systems leading to poor corporate performance. The study further established that there was a significant relationship between ownership concentration and firm performance in the Kenyan capital markets. Majority of the respondents indicated that there were unaddressed issues regarding shareholders’ composition and relationship investing. Such issues included poor shareholding structure, impatience in the investors, and lack of clear measure in regards to shareholding structures.

5.3 Discussions

5.3.1 Regulatory and Policy Environment

The findings revealed that the statutes governing relationship investing in Kenya were unclear to most of the retail investors. The respondents further agreed that the level of success of an investor often depends on their ability to outfox other investors within the legally allowable limits. The findings are in line with those of Gregory (2015) who noted that governance of public corporations continues to move in a more shareholder-centric direction evidenced by the increasing corporate influence of shareholder engagement and activism, and shareholder proposals and votes.

In addition, the study found out that respondents agreed that relationship investing is a concept which is foreign to the Kenyan capital markets scenario. This is not in line with the findings of Capital Markets Authority (2002) where the authority indicated that there are
provisions that relate to relationship investing in Kenya. The regulators were reluctant to engage the sector players to develop a clear policy to guide how shareholders could engage corporate boards in strategic decision making. The findings concur with Bainbridge (2006) who noted that the Securities and Exchange Commission rules on insider trading have made shareholders more cautious and also discouraged shareholder co-ordination and communication in the USA.

The study further indicated that legal and regulatory barriers may hinder institutional shareholders from actively participating in shareholder activism. This particular finding goes hand-in-hand with those of Bainbridge (2006) who noted that legal and regulatory barriers may hinder institutional shareholders from actively participating in shareholder activism.

In addition, the respondents agreed that the revised Company's Act 2015 of the Laws of Kenya failed to adequately address the role of shareholders in influencing board decisions. Further findings indicated that the statutes governing relationship investing Kenya are unclear to most of the institutional investors. The study findings support those of Capital Markets Authority (2002) who noted that the guidelines on relationship investing in Kenya are not clear enough.

It was further established that the respondents concurred that the legal and regulatory framework on corporate governance and shareholder influence in Kenya, as in the rest of the Commonwealth states, seems to be in favor of restriction and limitation of shareholder influence. This finding is also in line with that of Bainbridge (2006) who noted that the Securities and Exchange Commission rules on insider trading have made shareholders more cautious and also discouraged shareholder co-ordination and communication in the USA.

However, the study found that relationship investing has no legal basis in a liberalized / free trading environment, which differed with Belcredi and Enriques, (2014) who noted that the legal environment affects relationship investing by empowering investors in granting them governance rights and by making the exercise thereof easy and inexpensive. Lovells (2016) is in support of the findings by stating that relationship investing is a legitimate, fair and appropriate exercise of rights by one or more shareholders to effect relevant change to a company.
The study revealed that there were unaddressed legal and regulatory issues regarding relationship investing in the Kenyan capital markets. The above issues identified by the respondents included first, governance rights to investors, provision for non-disclosure and lack of provision for investors bargaining leverage by making it more or less easy to orchestrate campaigns aimed at forcing change. This is supported by CMA (2002) who noted that the law is silent on the obligations of the boards of public listed companies in regard to relationship investing.

5.3.2 Corporate Governance Practices

The study found that transparent and effective communication is important for building and maintaining good relationships with stakeholders. The findings are in line with those of Afzar and Nazir (2015) who indicated that corporate governance focuses on the issue of communication, accountability and transparency in the operations of firms with an overall objective of welfare of all stakeholders.

It was revealed that the essence of good corporate governance practices is to promote and protect shareholders' rights. Gompers, Ishii, and Metrick (2013) noted that there is a link between shareholder rights and corporate performance, in the sense that being able to exercise shareholder voting rights, or engage with companies via dialogue or other means such as focus lists, has a positive effect on corporate performance. Shareholder solicitation of proxy votes should be allowed prior to AGMs of listed companies. Sharma (2010) noted that small shareholders’ votes commonly do not win in the annual general meeting (AGM) amidst the vast power wielded by the controlling shareholders and so solicitation of proxy votes should be allowed prior to AGMs of listed companies.

The study indicated that the increase in shareholder activism brings into sharp focus the fiduciary role of the board viz-a-viz the shareholders. Bekiris (2013) stresses that when managerial ownership reaches a high level, agency problem would turn out to be largely mitigated due to complete alignment between managers and shareholders. The study further established that enforcement of corporate governance in Kenyan capital markets uses the “Explain or Comply” approach. This is in line with Gakeri (2013), who noted that the CMA replicated the Combined Code of the United Kingdom which is based on a dispersed
ownership structure. He further noted that the “comply or explain” paradigm used in Kenya does not appear to have endeared the guidelines to listed companies.

The findings indicated that relationship investing is most ideal in listed companies with no major large shareholder. This concurs with Hoffmann et al. (2016) who noted that relationship investing establishes trust and credibility with a company’s various stakeholders. Young (2013) noted that a relationship-based governance system is one where relationships with stakeholders such as banks, group companies, and labor are seen as important and these relationships are manifested through their inclusion in decision-making.

The study further revealed that relationship investing would be an ultimate solution to frequent board and internal wrangles amongst listed firms. This is in line with Filatotchev and Dotsenko (2015) who noted that relationship investing is a broadly used investment strategy associated with the increasing willingness of investors to trigger corporate change and intervene in management’s decisions. The board of directors should be left to formulate policies, procedures and guidelines on how to engage with shareholders. This is in agreement with those of Kilika and Mutua (2013) who noted that the board of directors has a duty of setting up the company’s strategic aims, providing the necessary leadership, and reporting to the shareholders on their stewardship.

The findings indicated that there were still some unaddressed issues regarding corporate governance practices and relationship investing. According to Gregory (2015) it remains unclear whether, over the long term, greater shareholder influence will prove beneficial for shareholders, corporations and the economy. To support their claim the respondents noted that board responsibilities to shareholders were not clearly enforced and took an ex-post outlook. They further noted that management discussion & analysis rarely adhere to recommended IASB guidelines resulting in limited use of information therein to would be investors - "boilerplate" declarations rather than company specific, decision useful information.

The findings indicate that there is bad governance and corporate leadership resulting in poor performance of companies. They therefore need stricter enforcement laws that helps deal with issues of this nature. The corporate governance rules do not address the plight of
minority shareholders in regards to board decisions. The investor was also largely seen as passive and CMA has in turn abrogated some of their rights with lack of prosecution of offenders. Transparency in corporate governance was found to be lacking in the Kenyan capital markets. A number of organizations in the Kenyan capital markets have also been indicated to have ineffective independent directors who acted in the interest of specific shareholders. This concurs with those of Gakeri (2013) who indicated that the credibility of any corporate governance framework rests on its enforceability since it determines its success or failure. As a result, listed companies in Kenya have implemented some of the Guidelines out of necessity and not by choice. The effectiveness of guidelines, codes or principles is generally attributable to the underlying legal framework.

5.3.3 Investor Participation

The findings revealed that directors should provide sufficient time for shareholder’s questions on matters pertaining to the company's performance and seek to explain to the shareholders their concern. This is supported by Oliveira et al. (2012) who noted that an institutional investor has the proficiency in monitoring as well as incentive to keep an eye on managers with low cost of monitoring.

It was established that active shareholder participation should be encouraged especially from Institutional investors. Shleifer and Vishny (1986) supports this by stating that the majority shareholders should play an active role in company governance. With respect to Oded and Wang (2013) ownership concentration has been discovered to help further enhance frequent monitoring.

The findings also show that it would be appropriate for pension funds through their investment managers to play a role in the corporate governance of the listed companies they invested. This is supported by Anas, (2015) who noted that small and public investors have little or no power to protect themselves from appropriation by large shareholders as a result of weak legal protections. This calls for pooling of pension funds that turns individual small owners into large investors (Wilson, 2013).

The results indicated that shareholders’ participation in major decisions should be made mandatory for all listed companies. This is in line with Malenko and Shen (2016) who noted
that shareholder participation plays a key role in corporate governance due to increased institutional ownership, shareholder activism and the introduction of mandatory say-on-pay.

Shareholder solicitation of proxy votes should be allowed for listed firms. This is supported by Sharma (2016) who noted that small investors may also use vote solicitations to “test the waters” with major shareholders before launching a formal proxy solicitation. Fulbright (2015) supports the findings as he indicated that solicitation of proxy votes is an important part of the investors’ tool kit because they permit private discussions among major shareholders outside of the purview of the company. He further indicated that this solicitation of proxy votes increases the influence of institutional shareholders and strengthens the leverage they have when negotiating corporate change with management.

Institutional investors have been found to engage corporate boards only for realization of short-term performance of corporations. Rock (2015) noted that the majority of shareholders are passive and are often only focused on short-term profits. The study further found that the level of concentration in shareholding tend to affect the performance of a company in the capital markets. Wilson (2013) noted that when a company is owned by numerous small shareholders the principal-agent problem arises and company performance can suffer, to the detriment of the owners (the shareholders).

It was also revealed that in Kenya, it has not been practical to have every shareholder exercise their right to participate and vote at the general shareholders meeting including the election of directors. According to OECD (2014) shareholders in some countries and jurisdictions have only limited legal rights and in others they have failed to exercise this responsibility.

The study established that the interest of shareholders to participate in governance issues is purely to ensure return of investment and sustained dividend pay-out. This concurs with Shah et al., 2012) who noted that some institutional investors are temporary and only interested in short-term performance of corporations as their own performance is evaluated on the short-term profits they generate.
The study further established that institutional and block shareholders should be accorded preferential treatment than for the minority and foreign shareholder. This is explained by Oliveira et al. (2012) who noted that institutional investors’ influence on firm performance is much significant as compared to that of a retail/individual owner. They are potentially influential shareholders able to effect change at the companies in which they invest, and influential enough to command the attention of regulators or legislators to lobby for market-wide reforms (Cremers et al, 2011).

There were unaddressed issues regarding investor participation and relationship investing in the Kenyan capital markets. Minority shareholders required some minimum level of protection because they rarely had their say. They further indicated that the shareholders were not very active in the companies they invested in compared to other markets around the world. Further they noted that some institutional investors did not even have representation during the annual general meetings of their portfolio companies. According to the respondents other unaddressed issues regarding investor participation and relationship investing in the Kenyan capital markets included shareholder solicitation of votes, low participation in the management of listed companies, lack of education in regards to investor rights within the companies they invest in and limited knowledge on the roles of shareholders in relationship investing in the Kenyan capital markets.

5.3.4 Shareholder Composition
The study established that companies managed and owned principally by founding family members had little separation of ownership and control. This is supported by Anas (2015) who noted that most companies are managed and owned principally by founding family members, implying that there is little separation of ownership and control. The efforts should be directed at ensuring that firms do not just grow in age but rather grow faster in size and that ownership does not grow among few owners (higher ownership concentration) but rather spread out to many owners (diffused ownership). In the same line, Souha and Anis (2016) discovered that ownership concentration helps well in ensuring a more efficient company governance and control. The findings differ with Wilson (2013) who favored a more concentrated ownership system.
The study further found that managers who owned shares in their company tend to become more committed to the organization since they had a stake in the residual income of the firm, and were likely to bear the cost of mismanagement. Alexandrina (2012) supported this by indicating that since managers pursue their own interest, higher management shareholding would imply a larger sharing of the loss, and ultimately, a lower possibility that management would lower corporate value.

Companies with concentrated shareholding tend to be lacking in corporate governance practices. Bekiris (2013) stresses that when managerial ownership reaches a high level, agency problem would turn out to be largely mitigated due to complete alignment between managers and shareholders. However, conflicts of interest exist not only between managers and shareholders, but also between large and small shareholders (Shleifer & Vishny, 1997). It was found that when more than 30 per cent or more of shares in a company are concentrated in a few hands, there is a tendency for the shareholders to be overzealous in their monitoring, controlling and ratification roles over management. With respect to Oded and Wang (2013) ownership concentration has been discovered to help further enhance frequent monitoring.

The findings indicated that the level of concentration in shareholding tends to affect the performance of a company in the capital markets. In the same line, Souha and Anis (2016) discovered that ownership concentration helps well in ensuring a more efficient company governance and control. It was further established that concentrated ownership and control systems lead to poor corporate performance to the disadvantage of the owners / shareholders. This differs with Gilson and Alan (2013) who noted that a system of greater monitoring of controlling shareholders, especially on matters where such shareholders may be interested, such as self-dealing transactions, would augur to the benefit of the minority shareholders.

There were unaddressed issues regarding shareholders’ composition and relationship investing in the Kenyan capital markets. Disclosures regarding management ownership and activity with regard to company shares were less forthright with no announcement of whether there were compensation aspects related to shareholder ownership of the shares. Another shareholders’ composition issue was poor shareholding structure in the firms and
institutions operating in the capital markets which was thought to be crucial in the long-term performance of the firms operating in the sector.

It was further indicated that the short-term nature of investors was an issue that would need to be addressed. It was indicated that it was important to have capital or investors who are in the company for the long term and are not affected by the short-term volatility in the performance of the company or even the share price of the company. This would give the management of the firms operating in the Kenyan capital market the confidence, flexibility and long term view needed to execute a good strategy. There was no clear measure in regards to shareholding structures especially with regards to nominal accounts and proxy shareholders. They recommended more emphasis on separation between owners and managers.

5.4 Conclusions

5.4.1 Regulatory and Policy Environment
With regards to the influence of regulatory and policy environment, the study revealed that the statutes governing relationship investing were unclear to most of the investors. The study also revealed that there are unaddressed issues concerning regulatory and policy environment in the capital markets in Kenya. The study hence concludes that the Kenyan capital market has been faced issues on regulation and policy which have affected the relationship investing in the markets. Thus, the study concludes that regulatory and policy environment is a key factor in relationship investing in Kenyan capital markets.

5.4.2 Corporate Governance Practices
The study revealed that relationship investing would be an ultimate solution to frequent board and internal wrangles amongst listed firms. The study therefore concludes that corporate governance influences relationship investing in listed firms. It was also revealed that the essence of good corporate governance practices is to promote and protect shareholders' rights. This leads to the conclusion that corporate governance practices affect relationship investing through promotion of shareholder rights. The findings indicated that there were still some unaddressed issues regarding corporate governance practices and relationship investing. The study therefore concludes that the Kenyan capital market faces
issues in corporate governance which has affected relationship marketing in Kenyan capital markets.

5.4.3 Investor Participation
The study established that active shareholder participation should be encouraged especially from Institutional investors. The results also indicated that shareholders’ participation in major decisions should be made mandatory for all listed companies. The study hence concludes that investor participation is key to relationship investing in Kenyan markets.

5.4.4 Shareholder Composition
The study established that companies managed and owned principally by founding family members had little separation of ownership and control. Companies with concentrated shareholding tend to be lacking in corporate governance practices. The findings indicated that the level of concentration in shareholding tends to affect the performance of a company in the capital markets. This shows that shareholder composition affects relationship investing in Kenyan capital markets.

5.5 Recommendations

5.5.1 Recommendations for Improvement
5.5.1.1 Regulatory and Policy Environment on Relationship Investing
The study recommends that the regulators in the Kenyan capital markets should ensure that the statutes governing relationship investing in Kenya are clear to most of the investors. The regulators should also engage the sector players to develop a clear policy to guide how shareholders could engage corporate boards in strategic decision making.

5.5.1.2 Corporate Governance Practices on Relationship Investing
The study recommends that the firms operating in the Kenyan capital markets adopt relevant government policies. Management discussion & analysis should adhere to recommended IASB guidelines resulting in increased use of information by investors. There is need for stricter enforcement laws that helps deal with issues of this nature. The study further recommends that there should be more regulations in place to promote and ensure top-notch corporate governance as the market has been unable to self-regulate.
5.5.1.3 Investor Participation and Relationship Investing
The study recommends that investors in the Kenyan capital markets need to be actively involved in the development of the markets. This would ensure that there is increased transparency and performance in their firms.

5.5.2.4 Shareholder Composition and Relationship Investing
The study recommends that firms operating in the Kenyan capital markets need to ensure that ownership does not grow amongst few owners (higher ownership concentration). This will ensure effective monitoring by shareholders. The management of the firms should also be encouraged to be invested in those firms by owning a significant number of shares. This will ensure effective management and reduced agency problem.

5.5.2 Recommendations for Further Studies
Since this study explored only four factors that influence relationship investing in Kenya, the study recommends that similar studies be done to explore other factors that could also influence relationship investing in Kenya.

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NIRI & RCCG (2014) “National Investor Relations Institute and the Rock Center for Corporate Governance, Study on How Investment Horizon and Expectations of Shareholder Base Impact Corporate Decision-Making” University of Stanford


OECD (2014) “Finding good corporate monitors” in Governance of and by Institutional Investors on Capital Market Reform in Asia; Tokyo, Japan


Young S., (2013) *Relationship-Based Systems*; La Trobe Business School, La Trobe University, Melbourne, VIC, Australia
APPENDICES

Appendix I: Questionnaire Cover Letter

Dear respondent,

I am a postgraduate student at United States International University pursuing Master’s Degree in Business Administration. As part of partial fulfillment, I am conducting a management project paper on: FACTORS INFLUENCING RELATIONSHIP INVESTING IN KENYA: A CASE OF THE CAPITAL MARKETS. For this reason, I would appreciate if you would kindly spare a few minutes of your time to fill in the blanks in the attached list of questions to the best of your knowledge as they apply to yourself, your organization, or the capital markets sector at large.

The information in this questionnaire will be treated with confidentiality and in no instance, will your name be mentioned in this research. In addition, the information will not be used for any other purpose other than for this research. Your assistance in facilitating the same will be highly appreciated.

Thank you in advance.
Yours Faithfully

__________________________
MAKOPA MWASARIA
MBA student
Appendix II: Questionnaire for Capital Markets Executives

The purpose of this interview is to assess the factors that influence relationship investing in the Kenyan capital markets. Kindly indicate with an X or tick (✓) your appropriate choice; or write a brief statement on the open spaces as shown:

PART A

General Information

1. Gender
   a. Male □
   b. Female □

2. Name of the organization________________________________________________________

3. What is your position / designation in the organization?
   ______________________________________________________

4. Category of the organization (select one)
   a. CMA Licensee □
   b. NSE Listed Firms □
   c. Regulatory (NSE, CMA & CDSC Only) □

5. Experience in the organization _____________ Years.
6. Experience in the capital markets ____________ Years.
7. Highest level of education attained (select one)
   a. Post-secondary □
   b. University Graduate □
   c. University Post Graduate □

8. What is your main area of specialization / training / profession?
   ______________________________________________________
### PART B

**Section 1: Information on Regulatory and Policy Environment**

9. Please indicate the level to which you agree (or disagree) with the following aspects regarding how the policy and regulatory environment affects relationship investing in Kenya? *(Rate in a scale of 1-5)*

<table>
<thead>
<tr>
<th></th>
<th>Strongly Disagree (1)</th>
<th>Fairly Disagree (2)</th>
<th>Neutral (3)</th>
<th>Fairly Agree (4)</th>
<th>Strongly Agree (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>a)</td>
<td>The level of success of an investor often depends on their ability to outfox other investors within the legally allowable limits.</td>
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<tr>
<td>b)</td>
<td>The statutes governing relationship investing in Kenya are unclear to most of the retail investors</td>
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<tr>
<td>c)</td>
<td>The statutes governing relationship investing in Kenya are unclear to most of the institutional investors</td>
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<tr>
<td>d)</td>
<td>The revised Company’s Act 2015 of the Laws of Kenya failed to adequately address the role of shareholders in influencing board decisions</td>
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<tr>
<td>e)</td>
<td>Legal and regulatory barriers may hinder institutional shareholders from actively participating in shareholder activism</td>
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<tr>
<td>f)</td>
<td>The legal and regulatory framework on corporate governance and shareholder influence in Kenya, as in the rest of the Commonwealth states, seems to be in favor of restriction and limitation of shareholder influence</td>
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<tr>
<td>g)</td>
<td>The legal and regulatory framework in the Kenyan capital markets largely focuses on guaranteeing returns on investment for shareholders</td>
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<tr>
<td>h)</td>
<td>The regulators have been reluctant to engage the sector players to develop a clear policy to guide how shareholders can engage corporate boards in strategic decision making</td>
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<tr>
<td>i)</td>
<td>Relationship investing is a concept which is foreign to the Kenyan capital markets scenario</td>
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</tr>
</tbody>
</table>
10. Do you think that there are still some unaddressed legal and regulatory issues regarding relationship investing in the Kenyan capital markets?
   
a. Yes
   b. No

Briefly explain your response ____________________________________________
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Section 2: Information on Corporate Governance Practices

11. Please indicate the level to which you agree (or disagree) with the following aspects regarding how corporate governance practices affect relationship investing in Kenya? (Rate in a scale of 1-5)

<table>
<thead>
<tr>
<th></th>
<th>Strongly Disagree (1)</th>
<th>Fairly Disagree (2)</th>
<th>Neutral (3)</th>
<th>Fairly Agree (4)</th>
<th>Strongly Agree (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>a)</td>
<td>Enforcement of corporate governance in Kenyan capital markets uses the “Explain or Comply” approach</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>b)</td>
<td>Mandatory voting by institutional investors especially would help address the challenges that relationship investing seeks to address in listed companies</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>c)</td>
<td>Relationship investing is most ideal in listed companies with no major shareholder</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>d)</td>
<td>Relationship investing would be an ultimate solution to frequent board and internal wrangles amongst listed firms</td>
<td></td>
<td></td>
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<tr>
<td>e)</td>
<td>The board of directors should be left to formulate policies, procedures and guidelines on how to engage with shareholders</td>
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<tr>
<td>f)</td>
<td>Relationship investing would interfere with transparency and</td>
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</tbody>
</table>
accountability of the board to the shareholders

g) The increase in shareholder activism brings into sharp focus the fiduciary role of the board viz-a-viz the shareholders

h) Transparent and effective communication is important for building and maintaining good relationships with stakeholders.

i) The Board should consider not only the financial performance but also the impact of the Company’s operations on society and the environment (adopt a stakeholder approach).

j) Boards should have the autonomy and competence to effectively lead their organizations; with minimal engagement of other actors

k) The adoption of international standards in corporate governance standards best practices is essential for public companies in Kenya in order to maximize shareholders value through effective and efficient management of corporate resources.

l) The essence of good corporate governance practices is to promote and protect shareholders’ rights.

12. Do you think that there are still some unaddressed issues regarding corporate governance practices and relationship investing in the Kenyan capital markets?

   a. Yes □
   b. No □

   Briefly explain your response _____________________________________________
   _____________________________________________
   _____________________________________________
   _____________________________________________
Section 3: Information on Level of Investor Participation

13. Please indicate the level to which you agree (or disagree) with the following aspects regarding how the level of investor participation affects relationship investing in Kenya?

(Rate in a scale of 1-5)

<table>
<thead>
<tr>
<th></th>
<th>Strongly Disagree (1)</th>
<th>Fairly Disagree (2)</th>
<th>Neutral (3)</th>
<th>Fairly Agree (4)</th>
<th>Strongly Agree (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>a)</td>
<td>Shareholders’ participation in major decisions should be made mandatory for all listed companies</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>b)</td>
<td>Active shareholder participation should be encouraged especially from Institutional investors</td>
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</tr>
<tr>
<td>c)</td>
<td>The shareholders should be allowed to convene without the presence of the invested company’s board and management</td>
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</tr>
<tr>
<td>d)</td>
<td>Shareholder proposals that do not make it to the board meetings should be made known to shareholders before or during a company general meeting</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>e)</td>
<td>Shareholder solicitation of proxy votes should be allowed for listed firms</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>f)</td>
<td>Institutional investors engage corporate boards only for realization of short-term performance of corporations.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>g)</td>
<td>The directors should provide sufficient time for shareholders questions on matters pertaining to the Company’s performance and seek to explain to the shareholders their concern.</td>
<td></td>
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</tr>
<tr>
<td>h)</td>
<td>Institutional and block shareholders should be accorded preferential treatment than for the minority and foreign shareholders.</td>
<td></td>
<td></td>
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<tr>
<td>i)</td>
<td>In Kenya, it has not been practical to have every shareholder exercise their right to participate and vote at the general shareholders meeting including the election of directors.</td>
<td></td>
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<tr>
<td>j)</td>
<td>The interest of shareholders to participate in governance issues is purely to ensure growth in return on</td>
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</tbody>
</table>
investment and sustained dividend payout

k) It would be appropriate for pension funds through their investment managers to play a role in the corporate governance of the listed companies they invested in

14. Do you think that there are still some unaddressed issues regarding shareholders’ participation and relationship investing in the Kenyan capital markets?
   a. Yes □
   b. No □

Briefly explain your response ______________________________________________
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Section 4: Information on Shareholder Composition

15. Please indicate the level to which you agree (or disagree) with the following aspects regarding how the level of shareholders’ composition or concentration affects relationship investing in Kenya? *(Rate in a scale of 1-5)*

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Strongly Disagree (1)</th>
<th>Fairly Disagree (2)</th>
<th>Neutral (3)</th>
<th>Fairly Agree (4)</th>
<th>Strongly Agree (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Companies with concentrated shareholding tend to be lacking in corporate governance practices</td>
<td></td>
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<tr>
<td>b) The level of concentration in shareholding tends to affect the performance of a company in the capital markets</td>
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</tr>
<tr>
<td>c) Companies managed and owned principally by for example, founding family members have little separation of ownership and control.</td>
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<tr>
<td>d) Concentrated ownership and control systems lead to poor corporate performance to the disadvantage of the owners / shareholders</td>
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<tr>
<td>e) A significant number of firms listed at the Nairobi Securities Exchange are still characterized by higher ownership concentration hence providing the controlling shareholders with the opportunity to</td>
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</tbody>
</table>
use their power to undertake activities intended to obtain personal gains to the detriment of minority shareholders

f) Efforts should be directed at ensuring that firms do not just grow in age but rather grow faster in size and that ownership does not grow among few owners (higher ownership concentration) but rather spread out to many owners (diffused ownership).

g) For organizations with concentrated shareholding, there should be a maximum number of board representatives they should have

h) When more than 30 per cent or more of shares are concentrated on a few hands (i.e. five shareholders or less), there is a tendency for the shareholders to be overzealous in their monitoring, controlling and ratification roles over managers.

i) Managers should be protected from unnecessary direct interference by the shareholders as a way of enhancing firm performance.

j) Managers who own shares in their company tend to become more committed to the organization since they have a stake in the residual income of the firm, and are likely to bear the cost of mismanagement

16. Do you think that there are still some unaddressed issues regarding shareholders’ composition (or concentration) and relationship investing in the Kenyan capital markets?
   a. Yes □
   b. No □

Briefly explain your response ___________________________________________________________

_________________________________________________________________________

THANK YOU FOR YOUR RESPONSES