EFFECTS OF CORPORATE SCANDALS ON FINANCIAL PERFORMANCE OF SELECTED FIRMS LISTED AT NAIROBI SECURITIES EXCHANGE

BY

CHRISTIAN MPIANA

UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

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EFFECTS OF CORPORATE SCANDALS ON FINANCIAL PERFORMANCE OF SELECTED FIRMS LISTED AT NAIROBI STOCK EXCHANGE

BY

CHRISTIAN MPIANA

A Research 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

SUMMER 2017
STUDENT’S 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: ______________________

Christian Mpiana (ID.No: 646277)

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

Signed: ___________________________  Date: ______________________

Dr. Amos Njuguna

Signed: ___________________________  Date: ______________________

Dean, Chandaria School of Business
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ABSTRACT

The purpose of the study was to investigate the effects of corporate scandals on the financial performance of the firm listed in the NSE in Kenya. Three research questions guided the study namely; what was effect of corporate scandals on the NSE listed firm’s share prices? Do corporate scandals have any effect on the NSE listed firm’s profitability? And what is impact of corporate scandals on the NSE listed firm’s liquidity?

The research methodology included the research design which includes a multiple case study of five selected and listed firms in NSE which were Uchumi Supermarkets, Eveready, Mumias Sugar, National Bank and Kenya Airways. The study has found that corporate scandal influence the firms share price negatively, however in some companies the scandals did not influence the firm’s share price.

Also, those corporate scandals affect the firm’s profitability and sales performance. Thus the study found that there was statistical significance between the corporate scandal and the firm’s profitability and sale performance on NSE listed firms in Kenya. The study found that there was statistical significance between the corporate scandal and the firm’s profitability and sale performance on NSE listed firms in Kenya. The findings indicated that corporate scandal has a greater influence to the sales performance. This is because once the company is reported to be involved on fraud customers and suppliers who are partner in businesses tend to withdraw. Hence reducing the sales and also the supply in the company respectively.

Finally, the study found that corporate scandals affect the firm’s liquidity negatively. Thus, there is statistical significant between corporate scandals and the NSE listed liquidity. Also the found that corporate scandals affect the firm’s liquidity negatively. Thus, there is statistical significant between corporate scandals and the NSE listed liquidity.
ACKNOWLEDGEMENT

I would like to take this opportunity to express my sincere appreciation and gratitude to the following people: my supervisor and friends without whose assistance, guidance and valuable support this study would not have been successful.
DEDICATION

This research project is dedicated to my mum for her entire support throughout my life.
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

The organization scandals of WorldCom and Enron which occurred in 2001 and 2002 contributed to a major crisis witnessed in corporate governance resulting to high levels of volatility in United States (US) Stock Markets (Graham, Litan and Sukhtankar, 2002). These firm scandals likely lost the US economy billions of dollars and thousands jobs were lost (Alan G. Hevesi, 2003).

With an estimated cost of $35 billion to the US economy alone in the year after these crises, foreign markets likely also suffered (Graham et al, 2002). While these figures indicate that corporate scandal negatively impacts the economy, there is surprisingly little empirical research examining the relationship between corporate scandal and a firm’s financial performance, particularly beyond the short term. Such scandals have not been confined to the USA, but rather occur everywhere - from Italy to Australia to Kenya – destroying investor confidence and upsetting markets.

For example, as a result of corporate scandals in the United States, the US congress passed a landmark reform known as the Sarbanes-Oxley Act of 2002 in order to strengthen the regulatory environment and prevent another Enron (Sorensen and Miller 2017). This involved much grappling with a key corporate governance problem (which shall be outlined in greater detail in chapter two under ‘Agency theory: “the need to protect shareholder and creditor rights against strong, self-interested management”’ (Sorensen and Miller 2017).

Chen (2016) noted that using data on shareholder-initiated class action lawsuits in the US, in investigating the corporate scandals of US-listed foreign firms. The shareholders of scandal firms suffer considerable loss in both the short term and the long term. The firms domiciled in countries with weak institutions are more likely to be embroiled in corporate scandals, but such a relation can be moderated by the presence of Big 4 auditors. Investors automatically adjust for undiscovered misconduct when valuing the stocks of non-scandal firms that is the spillover effect. Investors rely on the audit quality to form their expectations about the severity of undiscovered misconduct, and thus impose less negative spillovers on firms with Big four auditors, especially when the firms are from
countries with weak institutions. Taken together, my results suggest that listing on US exchanges does not fully compensate for weak local institutions; voluntarily bonding to a more stringent audit process has an incremental effect on protecting shareholder interests and enhances the confidence of investors in firms’ financial integrity.

Unlike the question of the specific impact of corporate scandal on financial performance, it is better established that there are strong links between good corporate governance and firms’ financial performance (Makki and Lodhi 2014, Wang et al. 2010, Shleifer and Vishny, 1997). Most of the studies have been done in developed economies, but in the context of developing economies such as Africa, Mohanty (2004) confirms the existence of a significant positive linkage between corporate governance practices and financial performance.

In United Kingdom, Robert (2015) considered the industrial exploitation of fishing quotas as a case of organized criminal entrepreneurship. Seldom is consideration given to the existence of informal and criminal entrepreneurship within the fishing industry. Consequentially, this case charts the involving Black Fish Scandal in the UK which saw the flouting of regulations and quotas on a commercial scale netting the protagonists £63 million through the illegal landing of undeclared fish. Entrepreneurship can be destructive in a Baumolian sense as well as being productive. The moral of the story is that the entrepreneurs involved in the scandal are primarily small businessmen and not organized criminals; and that lessons can be learned from this case on how knowledge of entrepreneurship can be used to ensure that entrepreneurs and businessmen are not tempted to stray into the commission of economic crime.

Yink, Jide and Emmanuel (2015) in Nigeria indicated that Recently, there has been growing concern about ethical and integrity issues in the accounting & auditing profession in public and private on questionable acts. As such, this era has been branded by series of corporate failures, ethical negligence, auditing and accounting scandals both in developed economies and developing economies. Damagum & Chima, (2014) posits that evidence in prior research shows that poor corporate governance also attributes to such failures, hence the need to keep vigil over corporate entities behaviors as well as need to control the behavior of managers and professional accountants through effective regulations. Broadcasted cases of the recent past, such as Enron, Satyam, WorldCom, Global Crossing, paramalat, Xerox, Tell one and some firms from Nigeria such as,
Cadbury and Afri-bank of which one of the big 4 auditing firm in Nigeria was indicted, these cases has drawn aggregate attention to the auditing profession.

In South Africa, Smith (2014) noted that scandals have to incorporate moral principles in their beliefs, values and behaviours. An ethical leader has the ability to influence the attitudes of employees and these employee attitudes towards the organisation could have a significant impact on their performance and dedication in executing their duties. The concept of ethical leadership is broad and may contain different types of values relevant to the construct domain including altruism, compassion, fairness, honesty and justice.

1.2 Statement of the Problem

Corporate governance practices, have, in recent times become a global policy concern, sparked in part by the impact of corporate scandal (Graham et al 2002). In Kenya, which was the focus area of this study, I have not, to the best of my ability, found any study analyzing the quantitative impact of corporate scandals on the financial performance of firms listed on the NSE. However, many corporate scandals have been profiled in the media and we hear anecdotally of the negative impact of such scandals on investor confidence and stock markets. In Kenya the media have reported corporate scandals as leading to the near collapse of listed companies such as Uchumi (once the largest supermarket in Kenya), National Bank, Mumia, Kenya Airways (KQ) and others. This study will attempt to fill a gap by collecting and analyzing data to determine the impact of corporate scandal on a firm’s financial performance.

For instance, Leng and Ding (2011) indicates that the corporate scandal within the organizations are determined by weak internal control, while the study differs and indicates corporate scandal affect the profitability of listed companies and is mainly caused by the management. In addition, Yang and Buckland (2010) in China focused on whether lack of involvement of external auditors influence the corporate scandal.

Kenya’s corporate governance regulations are currently captured in the Capital Markets Act (cap. 485A) of 2002 Gazette Notice no. 3362 which underpinned the importance of corporate governance (Markham 2006). Unethical or illegal actions by the firm’s governance – commonly referred to as corporate scandals – have continued to occur as firms face high pressure to out-perform their competitors. If this research can highlight that a corporate scandal tends to impact negatively on a firm’s financial performance,
than this may not only encourage the government to look at what reforms are required in the Capital Markets Act (2002), but also may help to deter firms from deviating from ethical practice in the first place. This study looked at how corporate scandals affect the financial performance of firms unlike previous study which looked at the effects of corporate governance on financial performance.

1.3 General Objective

The main objective of the study was to investigate the impact of corporate scandals on the financial performance of the NSE listed companies.

1.4 Specific Objectives

1.4.1 To determine the effect of corporate scandals on the NSE listed firm’s share prices in Kenya.

1.4.2 To establish the effect the corporate scandals have on the firm’s profitability on NSE listed firms in Kenya.

1.4.3 To determine the effects corporate scandal on the sales performance of NSE listed firms in Kenya.

1.4.4 To determine the effect of corporate scandals on the NSE listed firm’s liquidity.

1.5 Significance of the Study

1.5.1 Companies

The study was significant to the companies which are listed in NSE on how they can avoid engaging in corporate scandal since it affects the company overall performance. In addition, those companies that are not listed and intend to should avoid engagement in any fraudulent activity as it affect the initial public offer.

1.5.2 CMA

The CMA benefited from the study since it was able to identify the key effects that are caused by the corporate scandal. In addition, the study is important to CMA on the policies of preventing and deregistering companies that are engaged in fraudulent activities and are listed at NSE.
1.6 Scope of the study

The study selected five companies listed on the NSE that have faced publicly known corporate scandal in Kenya between 2007 and 2016, and investigate the financial performance of these firms before, during and after the corporate scandal. As well as these five firms, another five firms that have not faced scandals for the past 10 years will be randomly selected for the study, in order to account for any factors external to corporate scandal that may have impacted on financial performance.

Listed firms were analysed from 2007 to 2016 because we have seen a number of companies being mentioned in scandals during this time frame, for example: Uchumi supermarket was mentioned in scandal in the year of 2015; Mumia Sugar Company occurred in 2015; Kenya Airways made a loss of Sh26bn in the year 2015; the collapse of National bank was in 2015.

1.7 Definition of the Terms

This study defines specifically the following terms as used in the research;

1.7.1 Corporate scandal - involves alleged or actual unethical behaviour by people acting within or on behalf of a corporation (Beatty et al, 2013).

1.7.2 Fraudulent behaviour - that's deceptive, dishonest, corrupt or unethical. For a fraud to exist there needs to be an offender, a victim and an absence of control or safeguards (Beatty et al, 2013).

1.7.3 Managerial wrongdoings – refers to the acts or transactions which are undertaken by the management which are in contradictions with the normal business activities (Fama & Frenc, 2002).

1.7.4 Financial performance – refers to subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Akelola, 2012).
1.7.5 Shareholder’s value - implies that the ultimate measure of a company’s success is the extent to which it enriches shareholders (Adams & Mehran, 2005).

1.8 Chapter Summary

This chapter has set out the objectives of the research that this thesis will undertake. As corporate scandals in Kenya continue to make headlines, it is important to understand the impact of the scandal on the performance of the firm. If, through empirical data analysis, the impact of scandal on firm liquidity, share price, sales performance and profitability, can be quantified, this may provide incentives for private sector and government to work together to address gaps in corporate governance legislation. Following this introduction chapter is chapter two which is the literature review that discusses the theoretical literature review and empirical literature review as well as the overview of the two. Chapter three which is the methodology will present conceptual framework, model specification, variables to be used, research design as well as the ethical consideration. Chapter four will be the data analysis and discussion of the findings while chapter five will present the policy recommendation and the limitation of the study.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter examined the literature available relevant to the impact of corporate scandals on financial performance of firms listed on the Nairobi Stock Exchange (NSE). It first set out the major theories of corporate governance that played a vital role on determining the effect of corporate scandal on the financial performance of listed companies. In addition, summarising the literature related to corporate scandal on share prices; shareholder loyalty; and performance of sales and net profitability of the firms. The research questions are specifically tailored for firms quoted on the NSE more of the review is not connected to security exchange.

2.2 Effects of Corporate Scandals on Share Prices

Gatzert (2015) discovered that while the losses inflicted by scandal revelation upon investors are large, the direct economic costs of corporate financial misconduct may be just a minor component of its overall negative economic consequences. By undermining trust in financial markets, corporate scandals may decrease stock market participation, potentially increasing the cost of capital for all firms. Wang (2014) found that the cost of corporate financial misconduct is often measured using the losses accruing to the shareholders of fraudulent firms. Dyck, Morse, and Zingales (2013) estimate that on average corporate fraud costs investors 22% of enterprise value.

Moreover, firms decrease their stock holdings in fraudulent as well as on fraudulent firms. All households, not only the ones holding the stocks of fraudulent firms, decrease their equity holdings. For instance, the revelation of corporate scandal generally occurs at the beginning of economic downturns that may independently drive companies’ decision to reduce their equity holdings (Wang, Andrew, & Xiaoyun, 2010). Even companies in the same industry at a particular point in time can have different corporate scandal experiences and these have a negative impact on firms stock market participation (Goldman, Urs, & Irina, 2012; Karpoff, Allison, Scott, & Gerald, 2014).

Corporate scandal revelation causes deterioration in economic conditions as these changes affect all individuals in that economy independently from their past experiences.
Consistent with this finding, investors appear to sell also the stocks of out-of-the firms indicating that corporate scandal affects the shares of that particular company. Furthermore, the effect of corporate scandal on stock market participation appears to be unrelated to risk aversion, as it does not vary with investors’ risk tolerance and households do not increase their portfolio diversification or demand more insurance. In addition, in firms with high scandal revelation, there is a decrease in the proportion of individuals that report high confidence in financial markets, as captured by changes in confidence in big business and banks. Moreover, investors report an increase in confidence in media, which cover and often contribute to discover corporate financial misconduct (Dyck et al., 2010).

Scandal revelation increases familiarity biases as investors appear to sell the shares of firms to a lower extent to avoid risks (Kravet & Terry, 2010). This suggests that following scandal revelation investors trust less and want to have more information or to feel more familiar with their investments, even though they found no evidence that investors become more likely to delegate their equity portfolio selection to mutual fund managers or rebalance their portfolios towards more transparent stocks. The stock market participation of high status individuals, who in experiments (Karpoff, Scott, & Gerald, 2014). Also, it has been found to trust less because they have higher costs of betrayal (Dyck, et al, 2013), is more negatively affected by corporate scandal revelation. Taken together, with findings of Wang (2014) suggest that corporate scandal affects equity firms by undermining investors’ trust in the stock market. The negative shock to trust due to scandal could matter for stock market participation because it increases the subjective probability of being cheated and in this way investors’ expected cost of betrayal and desire to have information or to be familiar with the invested firms (Dyck, Adair, & Luigi, 2010).

It is important to note that extent of corporate scandal implies that the firms pattern on stock market participation will be affected negatively. Since presumably investors have some exposure to corporate scandals in other portfolio, that is to be interpreted as a lower bound of the negative effects of corporate scandal on the demand for equity (Agrawala & Cooperb, 2014).

Kurant (2014) findings on influence of corporate scandal and it consequences, where the study was an empirical found that scandal will always have a negative effect on the share
prices of the quoted company. This is because majority of the investors don’t like being associated with companies involved in fraud. Thus, the investors sell off their shares which increases the demand of the shares, since there are few investors who would like to trade with a company that is implicated in fraud. Broader literature trends towards suggesting a negative correlation between corporate scandal and a firm’s financial performance, and there is quite strong evidence that good corporate governance improve the financial performance of public firms. Wang et al. (2010) found a clear relationship between corporate governance and firm financial performance. This was supported by Yu et al. (2010) arguing that improved corporate governance is likely to increase the performance of firms, through more efficient management, better asset allocation, better labour practices. Makki and Lodhi (2014) also find significant association between corporate governance and financial performance. The main stream of the evidence was contradicted by Vintila and Duca (2014) who did not find any relationship between corporate governance and firm financial performance.

Armour et al. (2011) study included a sample from United Kingdom and matching this with US companies on corporate scandal even though British Financial Services Authority hold information of company that implicated with corporate scandals. They research found that shares prices of firms implicated in corporate scandals experience losses which are abnormal nine times than penalties paid. Moreover, companies implicated in corporate scandal face corporate image problem which include reputational losses involving misconduct or violation of contracts which have a negative effect on the share prices of the companies being traded in the security exchanges.

Beatty et al. (2013) study showed the effects of corporate scandals on peer companies’ investments. They focused on the biggest corporate scandals by documenting that capital expenditures of competitor firms were higher during scandal period more than preceding of three years associating with earnings overstatement. Also, competitors’ investments were noted to be higher in the same industries where investor sentiments were high and opportunity cost lower due to overstatement. Moreover, investments made in scandal time show low efficiency. The study showed that there was little significant difference on those effects by comparing low and high growth industries or rivals who are concentrated the same industries. Similarly, results obtained by Li (2012) found that rival firms have unexpectedly higher expenses on customer attacking and assets.
On the contrary the finding of Yu et al. (2010) indicates that corporate scandal contributes to spillover effect. When a company minimize corporate scandals the better for the firm since it reduced uncertainty and thus the share prices of the company are safeguarded from losses. The study of Kurant (2014) found that company maintain and attract new customers when it avoids being implicated in corporate scandals. Hence new customers help in increasing the share price of the company in the security market. Also, when sampling 75 firms which were quoted in the security market their study found that after the corporate scandal is known to the public who include the investors the share prices of these firms which implicated in the corporate scandal decreased in the security market. While, the share prices of the rival firms increased in value showing that the competitors companies were doing better in the stock market.

2.3 Effects of Corporate Scandals on Profitability

Kurant (2014) discovered that financing needs are also an important predictor of corporate scandal especially when a company is experiencing low profits. Companies with higher capital needs are more likely to resort to frauds. Armour, Mayer and Polo, (2012) found that desire to attract additional financing can be incentive to commit fraud. Managers manage earnings of the companies in order to increase capital at the lower cost, however when fraud is disclosed the cost of capital significantly increases. Kumar and Langberg (2009) and Wang (2011) presented complementary studies. They showed that easy access for external financing can create an incentive for fraud. Wang mentioned also factors such as extensive growth, profitability and leverage as factors influencing propensity for committing frauds.

Another proven fact is that legal sanctions cannot fully explain the losses of the firm accused of misconduct. It has been shown that other than the legal sanctions the loss in firm’s reputation plays a major role in the punishment of the company. Legal sanctions are simply the fines, fees or penalties that the company is obliged to pay. Reputation can be defined as “expectations of partners of the benefits of trading with it in the future” (Armour et al. (2011). This penalty imposed by the market can be explained by the fact that the firm might be non-reliable in the future. Such revisions of the expectations would affect the terms of trade in the future, its costs and operations. Those negative changes in input and output price would decrease the firm’s earnings and, as a consequence, its market value (Wang & Winton, 2012).
Beatty, Liao and Yu (2013) showed that reputation is related to firm’s reliance on the implicit contracts. The implication of this finding is that companies with large research and development expenditures and greater growth opportunities are more exposed to reputational losses than analogue companies operating on less implicit contracts and reputation.

The first meaningful research on the corporate fraud was conducted by (Berkman, Zou, & Geng, 2009). After analysing 132 cases of corporate fraud from US market they found that companies accused of committing a fraud face huge reputational losses, comparing to legal sanctions. Only 6.5 percent of the losses of companies can be attributed to court-imposed costs, penalties account for 1.4 percent; the rest, meaning over 90 percent, can be assigned to reputational losses. What is more, corporate fraud contributes to an average decrease in common stock values of 1.34 percent. The loss is even higher in case of fraud against government agencies, a 5.05 percent decrease, on average. They also claim that the actual losses for the companies are higher than the costs of crime and regulators should endeavour to reduce the court-imposed penalties.

Following research confirmed results of Bonini and Boraschi (2010) discovered that the highest penalties are imposed by the market, not regulators. “For each dollar of inflated value when a firm’s books are cooked, firm value decreases by that dollar when its misrepresentation is revealed; in addition firm value declines $0.36 more due to fines and class-action settlements and $2.71 due to lost reputation. For firms that survive the enforcement process as independent entities, the estimate of lost reputation is even greater at $3.83 per dollar of inflated value”.

Armour et al. (2011) used a more recent sample from UK that the authors claim are more explanatory comparing to the US examples because British Financial Services Authority does not disclose investigations of misconduct until they have been concluded and found against the company and that the penalty is set. They found that stock prices of companies that are found guilty experience abnormal losses of around nine times the penalties paid. However, reputational losses occurred just in related-party offenses, i.e. cases in which misconduct involved violation of implicit contracts; whilst in cases where victim was third party (not directly related) results were not statistically significant and losses were the consequence of the fees paid. Additionally, reputational losses are more intensive in the post-crisis period. The confirmation of the argument that reputational losses affect
companies, in which victim party is directly related, can be found in other papers as well (Murphy, Shrieve, & Tibbs).

On the other hand, some authors show that the losses can be attributed to the different factors. Karpoff et al. (2005) examined cases of violation of environmental laws and they got to the conclusion that the change in the returns is explained almost solely by the fine paid. (Goldman, Peyer, & Stefanescu, 2012), who analysed defence procurement frauds, found that influential contractors are penalized lighter than similar companies with less connections, experiencing not significant market share decrease.

Companies committing fraud faced increase in cost of capital due to changes in the terms of trade. Allegations of fraud can result in revision of existing contracts, including bank loans, a major source of financing for the companies. The study of bank loans allows understanding the real financial consequences of misreporting since the implications for the cost of debt can be assessed, both in a direct (interest rates) and indirect way (maturity, covenants etc.).

The literature focuses on the restatements, not corporate fraud in particular. Restatement of the financial statements means that bank has to re-evaluate the company because previous valuation was based on false financial information. It creates uncertainty about the reliability on the firm and deepens asymmetric information.

Graham et al. (2008) stressed that in the United States in the period between January 1997 and June 2002 about 10 percent of all listed companies restated their financial statements at least once, and the market value of restating company in this period increased from $500 million to $2 billion. They found the evidence that after restatement, loan spread increases on average by 42.5 percent, but if the restatement is fraud-based the spread increases by 68.9 percent. Other implication is non-direct consequences of restatement such as: “loans contracted after restatement announcements have significantly shorter maturity, higher likelihood of being secured and more covenant restrictions.” The availability of loans in general decreases; firms have to depend on the short-time financing, what implies that the company might have to give up some investment opportunities. This last finding is consistent with the Li (2012) theory that debt maturity is a function of risk ratings.
Similar studies however present varied results depending on the data used. Palmrose et al. (2004) found there is no significant change in spreads during the short period surrounding the announcement date. (Qiu & Slezak, 2012) found increase in bid-ask spreads only for restatements regarding revenue recognition problems and only for longer periods.

Nevertheless, combining these results with findings on the increasing cost of equity and decreasing market value lead to the conclusion that effect of fraud on cost of capital can be catastrophic for the company. Companies which have experience scandals are faced with legal sanctions which sometimes explain losses of the company involved corporate scandal. Legal sanctions are form of punishment to the company and shareholders tend to withdraw themselves from such companies. Legal sanctions contain fees, fines, or penalties that a firm has an obligation to pay which affects the profitability of the organization. In addition, if a company reputation is tainted by scandal partners to trust the company and hence this will influence the profit of the company and performance.

In Kenya, Akelola (2012) conducted a research on the commercial banks in Kenya and found that fraud is considered to be a major problem within the Kenyan banking industry, although the relative size of frauds conducted was relatively small and unsophisticated. Fraud detection and prevention methods used in the industry were standard and no different from global standards. The fraud triangle worked effectively to predict the patterns of fraud described by respondents. Also, a study done by Ogola, K'Aol and Linge (2016) found that in relation to the effect of top leadership’s tone at the top on occurrence of fraud, the study found significant correlations between top leadership’s tone at the top and amount of fraud loss and frequency of fraud and increases fraud loss recovery rates.

In respect to effect of prudential control systems set by CBK on occurrence of fraud, the study showed a correlation of prudential control systems set by CBK lowers the amount of fraud loss and enhances the fraud loss recovery rates. In relations to effect of alignment of top leadership’s compensation structure to occurrence of fraud, the grouped correlations show significance relationship with amount of fraud loss and increase in fraud loss recovery rate. In regards to effect of fraud response strategies on occurrence of fraud, the grouped correlational results of the showed that that robust fraud response strategies by the banks, lower amount of fraud loss. This was supported by Dhaway (2009) stating that African countries are not well equipped to adopt the type of corporate
governance found in developed countries. This is because difference in economic and political system of these economies, such as state ownership of companies, weak legal and judicial system and limited human capital (Gachoki & Rotich, 2013).

2.4 Effect of Corporate Scandals on Sales Performance

The hypothesis of fraud commitment due to high growth is also presented in (Agrawala & Cooperb, 2014). They claimed that companies experiencing high growth feel pressure to keep good results in the future and decide to use illegal practices. The median company involved in the financial scandal has 77 percent growth in sales over the two-year period before the scandal. (Armour, Mayer, & Polo, 2012) presented evidence on how financial distress influences fraud propensity. Companies with higher leverage ratios are more likely to manipulate their earnings. Accused companies have average five-year leverage ratio 23 percent higher than control firms. Additionally, 51 percent of those firms experience earning losses for more than two consecutive years for the fraud group but only about 16 percent of the firms for the control group do.

The majority of papers regarding corporate fraud are about the consequences of this misconduct for the accused firm. The consensus of those studies is one: the initial disclosure of corporate fraud causes negative (and significant) abnormal returns for accused companies (Armour, Mayer, & Polo, 2012)

In addition, of scandals on the fraud company itself. However, more recent studies (Goldman et al. (2012); Beatty et al. (2013) attempt to find the implications of restatement to the whole industries, but this phenomenon is not well explored in case of corporate frauds. Impact of disclosure of fraud of one company on its peers is called spill over effect or contagion effect.

There are two possible outcomes. The rival companies lose as a result of fraud within the industry because it is thought that the information provided by the companies is not reliable anymore, or the rival companies benefit from customers outflow from the accused company and reduced competition. Goldman et al. (2012) called those effects information spill over effect and industry competition effect, respectively. The total effect of fraud on rival firms depends on magnitude of those two effects.

Goldman et al. (2012) analysed the cases from Karpoff et al. (2008) dataset. They showed that on average the value of the firm directly connected to fraud decreases by 19.7 percent
and its rivals’ value drops by 0.54 percent on average in the three-day window surrounding the event. Among the rival companies, firms operating in less competitive industries experience higher cumulative abnormal returns (CAR) than others; if the rival company belongs to less competitive industry and has high sales, CAR is even higher. It means that prior clients of the company that committed fraud prefer to choose big company within the industry.

What is more, company that experienced stock price declines while accused firm announced high earnings prior to disclosure, benefits from the disclosure of fraud. CAR is also subject to information spill over effect. As CAR of the accused company is more negative, the lower the CAR of its peers (the exceptions are competitive industries where industry competition effect is stronger). For firms with higher uncertainty, market will take into account more recent (negative) information and CARs will be lower.

To conclude, Goldman et al. (2012) found that for “firms predicted to be most affected by the industry competition effect (rivals in the least competitive industries, rivals of large accused firms with very negative event date CARs, least opaque rivals, and most opaque accused firms), the average three-day CAR is 3.2 percent. For the subsample of rival firms predicted to be most affected by the information spill over effect (rivals in the most competitive industries, large accused firms with very negative CARs, most opaque rivals, and least opaque accused firms), the average three-day CAR is -1.5 percent.”

Grande and Lewis (2009) investigated the effect of shareholder-initiated class action lawsuits on the industry. They showed that “there is an average abnormal price decline of -0.34 percent over a 3 day announcement period for related firms (...). Over the 12-day event window [-10, +1] the average industry loss is $825.76 million”. Bonini and Boraschi (2010) showed consistent results. They found that competitors decrease their debt issuance during the fraud period. It could mean that investors (including banks) perceive the fraud as the risk for the whole industry and restrict the availability of financing sources. Additional findings concluded that stocks of peers experience negative returns around the announcement date.

It can be more severe due to capital structure changes imposed after disclosure of fraud. Though, the results are similar to Grande and Lewis (2009) (CAR equal to -0.21 percent, -0.56 percent and 0.75 percent for the [-1,0], [-5,+5] and [-10,+10] windows, respectively). Gleason et al. (2007) also found the effect of contagion and stressed that the
prices declines are higher when Peer Company has high earnings and high accruals and when peer and restating firms use the same external auditor.

Beatty et al. (2013) showed the impact of corporate fraud on peer firms’ investments. Focusing on the biggest financial scandals, they documented that capital expenditures of rival companies are higher during fraud period (before the disclosure) than in the preceding 3 years and are associated with earnings overstatement. Additionally, rivals’ investments are higher in the industries, in which investor sentiment is higher, cost of capital lower and managers’ private benefits higher. Moreover, investments made in fraud periods have low efficiency. There was no significant difference in those effects when comparing high and low growth industries or competitive and concentrated industries. Similar results were obtained by Li (2012), who found that competitors have unexpectedly high expenses on research and development, fixed assets and customer acquisition.

Yu et al. (2010) took a bit different perspective. They showed the importance of corporate governance in the spill over effect. The better quality of corporate governance of the peer companies, the smaller the uncertainty and, as a result, the weaker is the contagion effect after fraud disclosure. The core for better corporate governance is external governance, ownership structure and external auditors; less important is composition of the board. In case of frauds auditors play the major role.

Al-Matari, Al-Swidi, Faudziah and Al-Matari (2012) found that systematic risk decreases significantly with companies which are not implicated in corporate scandals as compared to compare who are mentioned in corporate scandal systematic risk increases thus reducing the sale performance of thee companies implicated in scandals. They findings suggested that market misestimate the firm’s beta before the corporate scandal was disclosed which was corrected through time. On the contrary, beta decreased in the firms engaged corporate scandals and changing management leads to a lower return volatility. Similarly, the beta increased in the firms with low betas pre-disclosure explained by the fact that companies achieved low high stability due to corporate scandal techniques and disclosing makes the firm potentially riskier in the future when those scandals activities are stopped. In addition, their sample of scandal cases was categorized into 3 groups considering the importance of beta change. There were 16 scenarios in which beta
decreased significantly, 26 scenarios in which beta increased significantly and 33 scenarios in which there was no change significant in beta.

Bonini and Boraschi (2010) study found that companies which implicated in corporate scandals they experience decrease in slae volume. On their findings, the results were consistent with the previous findings of the hypothesis that corporate scandals affect the sales performance of the companies after there are implicated in the scandals since customers and suppliers tend to shy away especially if they are risk averse and may not like to be associated with the company’s’ reputation. They research found that beta significantly changed meaning that corporate scandal was perceived to affect the reputation of the company which influence the sales performance of the companies implicated in fraudulent activities. When beta increase, the variability after the corporate fraud disclosure was expected to raise resulting to the firm being is more risky. Decreased beta can be explained through changes introduced in the firm and by doing so the returns are expected to stabilize in the future. The results contribute to the hypothesis that three types of beta change described above exist simultaneously in the market and the overall effect of fraud on the systematic risk depends on the individual features of the specific fraud case.

2.5 Effect of Corporate Scandals on Liquidity

The high degree of discretion associated with managements’ qualitative discussion of its operating performance in the 10-K creates opposing forces regarding how a firm might position its results. On one hand, fear of detection might lead fraudulent managers to disclose in a way that attempts to minimize detection. For example, a manager might under-disclose explanations of their fraudulent revenue or expense calculations. Alternatively, they may over-disclose complex transactions to increase the cost of detection. Such managers might also use excessively difficult to read text, or they may simply mimic the disclosures of their industry peers to appear “ordinary”. These considerations suggest that qualitative disclosures may be designed to strategically mislead financial statement readers.

While it may be the case that some firms strategically design qualitative disclosures, an alternative and nearly empirically indistinguishable explanation is that the same economic conditions that induce managers to commit fraud generate qualitative discussions that are
consistent with our main hypotheses. For example, a firm may experience a negative shock, such as a labour strike or a product liability claim that requires discussion in the MD&A, which differentiates it from its industry peers. Alternatively, a negative industry-wide shock could result in similar qualitative discussions among industry peers as they describe similar economic conditions. In both of these examples, common qualitative disclosures by fraudulent firms may be artefacts of either idiosyncratic or industry-wide conditions, and do not necessarily reflect proactive attempts to influence perceptions. Although we acknowledge and explore this possibility, it should be noted that these firms have already chosen to proactively and fraudulently disclose their quantitative performance. Hence, on the margin, the cost associated with attempting to disguise this fraud using manipulated verbal disclosure might be relatively low.

In a final test, we thus consider the specific strategic hypothesis that managers commit fraud to artificially improve their odds of issuing equity. Although other studies find evidence consistent with this motive, no existing studies report supportive evidence in verbal disclosures. Using an exogenous shock to equity market liquidity, which increases the motive to commit fraud for this reason, we find that treated firms produce disclosure that becomes more similar to fraudulent firms. In turn, we also find that the use of this common fraudulent disclosure is associated with higher rates of equity issuance. These results provide some suggestive evidence that at least some of our findings might be due to managers using verbal disclosure to further achieve the same goals that drive them to commit fraud in the first place (Graham, Li, & Qiu, 2008).

Many studies examine the links between accounting, stock returns and AAERs. Al-Matari, et al. (2012) examine the issues that motivate fraud and their consequences. Although we cannot summarize all literature in the area due to space constraints, we refer readers to Dechow, Ge and Schrand (2010) for a thorough review. Earlier work links standard accounting variables with fraudulent activity. Wang (2014) considers a Jones model, and examines whether firms that manipulate earnings can be separated from those that merely have more aggressive accruals. The study also considers a host of accounting ratios and constructs an index. Kurant (2014) find that a strong motive for earnings management is the desire to attract low cost financing. (Baker & Wurgler, 2006) finds that managers are more likely sell their own shares when earnings are overstated.
More recent studies extend these earlier works and provide more depth. Dechow, Ge, Larson and Sloan (2011) find that misstating firms hide diminishing performance, have higher relative prices, and have abnormal reductions in the number of employees. Wang (2013) addresses the partial-observability of fraud, and finds that R&D increases the likelihood of fraud while also reducing the likelihood of detection. Povel, Singh and Winton (2007) and Wang, Winton and Yu (2010) show theoretically and empirically that the incentive to commit fraud is more intense during industry booms.

Dyck, et al (2010) take a different approach and examine who is most likely to “blow the whistle”. The authors find that investors, the SEC, and auditors play only a small role, whereas employees and the media play a larger role. Kedia and Philippon (2009) find links to corporate hiring, executive option exercise, and firm productivity. Kedia and Rajgopal (2011) show that firm locations relative to SEC offices, and areas with past.

Cremer (2016) study indicates that companies which are implicated with scandal have bad reputation to the stakeholders which decreases the liquidity of the firm since no investor is willing to put their money in a company that is experiencing such fraudulent activities. Although their results their research found significance levels by which corporate scandals affects the liquidity of the company, this is because of cumulative abnormal returns registered by the firm after scandal disclose and investing in such a firm means it is very risky and thus unless an investor is a risk taker they cannot invest in the company which have been implicated with scandals.

Wang (2011) found that corporate scandals contribute to low liquidity of the firm meaning that the firm cannot meet its obligation when they fall due. The study determined the company experiencing financial needs can be a predictor of corporate scandal. Thus, Wang study concluded that a firm with higher capital requirements is due to fraudulent activities with the company environment. Also, the research found that urge to add finance was incentive to commit scandals thus meaning the company is experiencing problems with its liquidity. Company leaders manage return of the firms in order to experience capital growth at the lower cost, however when corporate scandal is disclosed the cost of capital increases significantly since the company want to bridge on liquidity. Further, the study presented when a firm requires external financing this can create an arena for scandal. Wang expound that factors like extensive growth, leverage and profitability are factors influencing propensity for scandals.
Akelola (2012) hypothesized on corporate scandal commitment is due to increased growth. They assumptions were that firm experiencing increased growth feel pressured to keep good results in the future and make to use fraudulent activities so that they can keep up with the increased growth. This is supported by the fact that firms involved in the corporate scandal have 77% increases in sales over the 2 year time before the corporate scandal. In addition, financial distress which affects the liquidity of the company had a great impact influences fraud propensity. Firms with increased leverage ratios are more likely to doctor their returns. Accused companies have average 5 year leverage ratio 23% higher than control Companies. In addition, 51% of those companies face returns losses for more than 2 consecutive years for the scandal group but only about 16% of the companies for the control group do. Thus, the research supported the hypothesis that external financing requirement influence propensity for corporate scandals.

Armour, Mayer and Polo (2012) obtained similar results on booms in the industry were even when investors are rational; companies’ incentives to commit scandal are highest in good times. Good periods are times with higher investment opportunities and when investors are rather optimistic. In good times investors do not have incentive to monitor firms with positive public information and that is why the propensity for crime tends to be higher. Corporate fraud peaks at the end of a boom because more companies decide to commit fraud in order to attract investors.

Additionally, Kedia and Rajgopal (2011) research found that propensity of American companies to restate their financial statements depending on SEC activity. This propensity reduced if companies are geographically located closer to the SEC offices, because SEC is more presumed to investigate firms from this group. Companies are less scandal-prone in the areas with greater past SEC enforcement activity.

Finally, regarding liquidity risk, Gachoki and Rotich (2013) research suggested that normal liquidity risk born by company can be reduced by using fraudulent activities, such as fraud. It can be perceived as a special kind of hedge. The goals of fraud are the same as for the legal activity that is the maximization of return, given the level of risk, or the minimization of risk, given the level of return. Reduction of systematic risk is done however at expense of increasing moral risk.
2.6 Chapter Summary

The literature on how the impact of corporate scandals affects financial performance of firms listed on the Nairobi Stock Exchange is very limited.

It should be noted that most of these studies have been conducted in developed countries where corporate governance and institutions are different and the result may not be generalized to a frontier market. My research, which will examine how corporate scandal impacts firm’s profitability, shareholder loyalty, and share prices, will contribute to our understanding of the link between corporate scandal and financial performance. It will also allow us to compare research findings from more developed markets to the findings from a frontier market such as Kenya. Because there is a gap in the literature whereby there is limited information on the link between corporate scandal and financial performance of NSE-listed firms, my research will contribute towards beginning to bridge that gap.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

The chapter gave the research techniques that were adopted. It covers the research design, the target population, data collection methods and data analysis that was used during the study. Further, research design was discussed, with justifications of the preferred research design. The population, sampling methodology and sample size were also discussed. Data collection instruments used in the research were also discussed clearly indicating the methods used. Research procedures explained the steps followed in conducting the study, including the research process, timing and schedules. Finally, the chapter summary provided a synopsis of the key discussions of the chapter.

3.2 Research Design

The design for this study was be multiple case studies. Gall et al (1996) defined case study research as “the in-depth study of instances of a phenomenon in its natural context and from the perspective of the participants involved in the phenomenon. In this study multiple case study design was used to analyze the impact of corporate scandals on financial performance of firms listed at Nairobi Stock Exchange. Each firm (and its associated scandal) represents a case study. Multiple case study approach was adopted since, the thesis aims to identify whether any trends exist regarding corporate scandals on profitability and sales performance, share prices and liquidity. Each firm in the study experienced a corporate scandal between the financial years 2012 to 2016. The sources were entirely of secondary data of annual financial reports of each firm mentioned in a corporate scandal. This method is the ideal model because allowed the researcher to analyze complex relationships between phenomena and context (Natalie Boyd, 2017). It also easy to explained to non-scientific audience.

3.3 Population and Sampling Design

3.3.1 Population

Mugenda (2008) noted that a population can be defined as the complete set of subject that can be studied: people objects, animals, plants, organizations from which a sample may be obtained. The population consisted of firms listed at the Nairobi Stock Exchange. The
target population consisted of five companies listed at the NSE mentioned in corporate scandals.

3.3.2 Sampling Design and Sample Size

Mugenda and Mugenda (2003) argues that sampling is that part of the statistical practice concerned with the selection of individual or observations intended to yield some knowledge about a population of concern. A sample is a small group of objects or individuals selected or drawn from a population in such a manner that its characteristics represent population characteristics (Orodho, 2009). The level of confidence that used is 95 percent which corresponds to t value of ±2.015. According to Denzin & Lincoln (2000), noted that business related studies advocate for 95 or 99 percent level of confidence.

Since the sample size is less than 30, the t-test was used to measure if there is a significant relation between corporate scandals and the profitability, share prices and liquidity of the firms mentioned in scandals. The sample size for the study was of five companies listed on the Nairobi Stock Exchange that have been stated on corporate scandals from 2012 to 2017 mainly because of poor corporate governance practices. Therefore this study analyzed how those scandals have impacted the financial performance of the firms.

Purposive sampling technics was adopted because the companies under-studied will be selected based on two common characteristics:

- The companies should have been mentioned on scandals from 2012 to 2017
- They must be a Kenyan firm listed at the NSE.

The objective was test the hypothesis that corporate scandals affect the financial health of the firm.

3.4 Data Collection Methods

The choice of data collection method or procedure requires consistency with the research objectives, purposes and strategy employed in study (Saunders, Lewis and Thornhill, 2003). Secondary data was used in collecting data. Financial reports of firms mentioned in corporate scandals will be analysed from 2007 till 2016. Financial reports of each firm was evaluated before, during and after the scandal has taken place.
3.5 Research Procedures

The procedure to be followed in undertaking this study included obtaining a research permit from the university authorizing the researcher to collect data. This permit was used to collect data using financial reports and the web sites of the selected firms to analyse the financial health of companies before and after the corporate scandals have taken place.

3.6 Data Analysis Methods

The data was edited to eliminate mistakes and ensure consistency. The data was cleaned and coded using Statistical Packages for Social Sciences (SPSS) software and classified into meaningful categories for analysis. This was assessing whether any associations between the variables exist. The data analysis included quantitative times series methods. For each case study of corporate scandal, the study examined annual financial reports from the 7 years immediately preceding the scandal, the year of the scandal, and the 2 years directly after the scandal. The study used t test which is a statistical measurement with a critical region that begins at t= +2.015 and -2.015. This is the critical T-test associated with 5% confidence level. If the obtained T-test falls in the critical region or “region of rejection,” then the null hypothesis was rejected.

3.7 Chapter Summary

This chapter has described the methodology that will used to undertake the study. The chapter has detailed the research design, the population and sampling design. Further, it has explained the data collection methods, research procedures and data analysis techniques to be used. Chapter four presents the results and findings.
CHAPTER FOUR

4.0 RESULT AND FINDINGS

4.1 Introduction

This chapter analyses the data gathered from the secondary sources. It also presents and discusses the findings of the study. Multiple case studies were used mainly annual financial reports for the past 10 years from 2007-20016 as secondary data to analyze the effect of corporate scandals on financial performances of firms listed on the NSE. The study examined five companies that is Uchumi, Kenya Airways, National Bank, Mumias and Eveready mentioned on corporate scandals by examining their share price; net profit and liquidity ratio or current ratio before and after the scandals have taken place. Also, the T-test of each variable has been calculated to give us a point of reference on if we should reject or accept the null hypothesis.

4.2 General Information

The general information consists of share price, net profit, current ratio and liquidity of the 5 listed companies as discussed below.

4.2.1 Financial Performance

The share price for the five companies were analyzed and indicated as follows;

4.2.1.1 Uchumi Supermarket

This section presents the findings from Uchumi from 2010 to 2016. The analysis includes the share price, net profit and current ratio or liquidity of the company. Uchumi: Once the largest supermarket in Kenya, Uchumi supermarket was mentioned in scandal in 2015 due to gross management, made a loss around Ksh 6,03bn on paper value (standard Digital, 2016). Financial report from 2010 to 2017 will be evaluated to draw a link between corporate scandal and the financial performance of the firm in its following financial years.
Table 4.1 Financial Performance of Uchumi Supermarket from 2010 to 2016.

<table>
<thead>
<tr>
<th>Year</th>
<th>Share Price</th>
<th>Net Profit</th>
<th>Liquidity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>18.68</td>
<td>865,099,000</td>
<td>0.922</td>
</tr>
<tr>
<td>2011</td>
<td>20.12</td>
<td>390,425,000</td>
<td>0.906</td>
</tr>
<tr>
<td>2012</td>
<td>19.55</td>
<td>334,667,000</td>
<td>0.723</td>
</tr>
<tr>
<td>2013</td>
<td>19.6</td>
<td>357,010,000</td>
<td>0.704</td>
</tr>
<tr>
<td>2014</td>
<td>10.45</td>
<td>384,288,000</td>
<td>0.671</td>
</tr>
<tr>
<td>2015</td>
<td>33.75</td>
<td>-3,421,360,000</td>
<td>0.343</td>
</tr>
<tr>
<td>2016</td>
<td>3.5</td>
<td>-2,836,732,000</td>
<td>0.258</td>
</tr>
</tbody>
</table>

Table 4.1 shows the overall effects of corporate scandal on Uchumi Supermarket by indicating the share prices, net profit and liquidity which are discussed below.

4.2.1.2 Kenya Airways

This section presents the findings from Kenya Airways from 2007 to 2016. The analysis includes the share price, net profit and current ratio or liquidity of the company. The overall shares prices, net profit and liquidity ratios are indicated on table 4.2

Table 4.2 Financial performance of Kenya Airways from 2007 to 2016.

<table>
<thead>
<tr>
<th>Year</th>
<th>Share Price</th>
<th>Net Profit</th>
<th>Liquidity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>15.89</td>
<td>4,098,000,000</td>
<td>1.30</td>
</tr>
<tr>
<td>2008</td>
<td>12.70</td>
<td>4,578,000,000</td>
<td>1.38</td>
</tr>
<tr>
<td>2009</td>
<td>15.54</td>
<td>4,083,000,000</td>
<td>0.90</td>
</tr>
<tr>
<td>2010</td>
<td>13.43</td>
<td>2,035,000,000</td>
<td>0.85</td>
</tr>
<tr>
<td>2011</td>
<td>14.67</td>
<td>3,538,000,000</td>
<td>1.06</td>
</tr>
<tr>
<td>2012</td>
<td>12.45</td>
<td>1,660,000,000</td>
<td>0.92</td>
</tr>
<tr>
<td>2013</td>
<td>12.60</td>
<td>-7,864,000,000</td>
<td>0.56</td>
</tr>
<tr>
<td>2014</td>
<td>8.55</td>
<td>-3,382,000,000</td>
<td>0.46</td>
</tr>
<tr>
<td>2015</td>
<td>4.85</td>
<td>-25,743,000,000</td>
<td>0.50</td>
</tr>
<tr>
<td>2016</td>
<td>5.90</td>
<td>-26,225,000,000</td>
<td>0.40</td>
</tr>
</tbody>
</table>
4.2.1.3 National Bank

This section presents the findings from National Bank from 2007 to 2016. The analysis includes the share price, net profit and current ratio or liquidity of the company. The overall shares prices, net profit and liquidity ratios are indicated on table 4.3

Table 4.3 Financial performance of National Bank of Kenya from 2007 to 2016

<table>
<thead>
<tr>
<th>Year</th>
<th>Share price</th>
<th>Net profit</th>
<th>Liquidity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>24.7</td>
<td>1,365,430,000</td>
<td>1.194</td>
</tr>
<tr>
<td>2008</td>
<td>22.5</td>
<td>1,240,610,000</td>
<td>1.170</td>
</tr>
<tr>
<td>2009</td>
<td>21.7</td>
<td>1,462,955,000</td>
<td>1.182</td>
</tr>
<tr>
<td>2010</td>
<td>24.8</td>
<td>2,021,919,000</td>
<td>1.198</td>
</tr>
<tr>
<td>2011</td>
<td>23.6</td>
<td>1,546,113,000</td>
<td>1.180</td>
</tr>
<tr>
<td>2012</td>
<td>19.35</td>
<td>729,752,000</td>
<td>1.184</td>
</tr>
<tr>
<td>2013</td>
<td>27.5</td>
<td>1,089,896,000</td>
<td>1.146</td>
</tr>
<tr>
<td>2014</td>
<td>24.75</td>
<td>800,698,000</td>
<td>1.109</td>
</tr>
<tr>
<td>2015</td>
<td>15.75</td>
<td>-1,183,293,000</td>
<td>1.091</td>
</tr>
<tr>
<td>2016</td>
<td>6.9</td>
<td>515,959,000</td>
<td>1.112</td>
</tr>
</tbody>
</table>

Table 4.3 shows the share price, net profit and liquidity ratio of National Bank which were used to analyze the data.

4.2.1.4 Mumias Company

This section presents the findings from Mumias Company from 2007 to 2016. The analysis includes the share price, net profit and current ratio or liquidity of the company. The overall shares prices, net profit and liquidity ratios are indicated on table 4.4
Table 4.4 Financial performance of Mumia Sugar Company from 2007 to 2016

<table>
<thead>
<tr>
<th>Year</th>
<th>Share Price</th>
<th>Net Profit</th>
<th>Liquidity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>10.4</td>
<td>1,393,611,000</td>
<td>2.279</td>
</tr>
<tr>
<td>2008</td>
<td>11.6</td>
<td>1,213,837,000</td>
<td>1.348</td>
</tr>
<tr>
<td>2009</td>
<td>9.7</td>
<td>1,609,972,000</td>
<td>1.356</td>
</tr>
<tr>
<td>2010</td>
<td>7.3</td>
<td>1,572,383,000</td>
<td>1.999</td>
</tr>
<tr>
<td>2011</td>
<td>5.44</td>
<td>1,933,225,000</td>
<td>2.199</td>
</tr>
<tr>
<td>2012</td>
<td>6</td>
<td>2,012,679,000</td>
<td>1.253</td>
</tr>
<tr>
<td>2013</td>
<td>3.3</td>
<td>-1,660,406,000</td>
<td>0.838</td>
</tr>
<tr>
<td>2014</td>
<td>1.9</td>
<td>-2,706,595,000</td>
<td>0.409</td>
</tr>
<tr>
<td>2015</td>
<td>1.65</td>
<td>-4,644,801,000</td>
<td>0.187</td>
</tr>
<tr>
<td>2016</td>
<td>1.3</td>
<td>-4,731,026,000</td>
<td>0.176</td>
</tr>
</tbody>
</table>

Table 4.4 shows the share price, net profit and liquidity ratio of Mumia Sugar Company which were used to analyze the data

4.2.1.5 Eveready Company

This section presents the findings from Eveready Company from 2007 to 2016. The analysis includes the share price, net profit and current ratio or liquidity of the company. The overall shares prices, net profit and liquidity ratios are indicated on table 4.5
Table 4.5 Financial performance of Eveready East Africa Company from 2007 to 2016

<table>
<thead>
<tr>
<th>Year</th>
<th>Share price</th>
<th>net profit</th>
<th>Liquidity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>5.5</td>
<td>126,408,000</td>
<td>1.6</td>
</tr>
<tr>
<td>2008</td>
<td>7.8</td>
<td>17,840,000</td>
<td>1.7</td>
</tr>
<tr>
<td>2009</td>
<td>3.8</td>
<td>28,271,000</td>
<td>1.5</td>
</tr>
<tr>
<td>2010</td>
<td>4.7</td>
<td>8,703,000</td>
<td>1.4</td>
</tr>
<tr>
<td>2011</td>
<td>3.6</td>
<td>-123,994,000</td>
<td>1.1</td>
</tr>
<tr>
<td>2012</td>
<td>1.6</td>
<td>70,084,000</td>
<td>1.3</td>
</tr>
<tr>
<td>2013</td>
<td>2.8</td>
<td>43,785,000</td>
<td>1.6</td>
</tr>
<tr>
<td>2014</td>
<td>3.65</td>
<td>-162,767,000</td>
<td>1.3</td>
</tr>
<tr>
<td>2015</td>
<td>2.7</td>
<td>-201,509,000</td>
<td>0.9</td>
</tr>
<tr>
<td>2016</td>
<td>2.35</td>
<td>-206,505,000</td>
<td>0.4</td>
</tr>
</tbody>
</table>

Table 4.5 shows the share price, net profit and liquidity ratio of Eveready Company which were used to analyze the data.

4.2.2 Share Price

4.2.2.1 Corporate scandal on Uchumi share price

The figure 4.1 indicates the influence of corporate scandal on the prices of shares for from 2010 to 2016.

![Figure 4.1 Impact of corporate scandal on Uchumi share price](image)

The figure 4.1 above indicates Uchumi’s share prices and its drastic drop after a sudden increase in price from 2015 to 2016 which accounts for 89.6% in the stock exchange.
Uchumi’s share price has drastically drop after been mentioned on scandal in 2015. The t-test will determine if the dropped in price has been due to corporate scandal or other reason which is not subject to this study.

### 4.2.2.2 Impact of corporate scandal on Kenya Airways’ share price

The study sought to determine the effect of corporate scandal on Kenya Airways share price. The results were analysed in the table 4.2.

![Figure 4.2 Impact of corporate scandal on Kenya Airways’ share price](image)

The figure 4.2 shows the trend of Kenya Airways share prices. The graph demonstrates that the price shares have been dropping specially in 2015 the year of scandal. It can deduced that in 2008 the shares declined by 20%. Also, it can deduced that the share prices declined from 2009 to 2016 by 2.2%, 15.5%, 7.7%, 21.6%, 20.7%, 46.2%, 49.4% and 60.7% respectively. The t-test will determine if this drop in price was due to the scandal or other factors.

### 4.2.2.3 Impact of corporate scandal on National Bank of Kenya’s share price

This section determined the impact of corporate scandal of National Bank of Kenya on the share price. The analyses were indicated on the figure 4.3.
The figure 4.3 above shows National Bank’s share price trend from 2007 till 2016. In 2007 the share price was Kes 25 and declined to Kes 21.7 in 2009. In addition, the shares increased by Kes 24.8 in 2010 and declines were recorded in the following two consecutive years that is 2011 and 2012. Further, the shares of National Bank rose to Kes 27.5 and thereafter declined for three consecutive years that is 2014 to 2016 by Kes 24.5, 15.75 and 6.9.

4.2.2.4 Impact of corporate scandal on Mumia’s share price
This section determined the impact of corporate scandal of Mumia Sugar Company on the share price. The data which was analyzed was obtained from the financial statements from 2007 to 2016. The analyses were indicated on the figure 4.4.
Figure 4.4 Impact of corporate scandal on Mumias share price

Figure 4.4 shows the trend of Mumia’s share price from 2007 till 2016. From 2013 to 2016 Mumia’s share price has been doing very poorly in the Kenya capital market. The company first registered the highest share price in 2008 of Kes 11.6. The company has been performing poorly for the last 8 consecutive years from 2009 to 2016.

4.2.2.5 Impact of corporate scandal on Eveready’s share price
This section determined the impact of corporate scandal of Eveready Company on the share price. The data which was analyzed was obtained from the financial statements from 2007 to 2016. The analyses were indicated on the figure 4.5.
Figure 4.5 Impact of corporate scandal on Eveready’s share price

Figure 4.5 shows Eveready’s share price trend from 2007 to 2016. It can be deduced that the company has been experiencing fluctuation since 2007. This can be noted when the shares prices of the company rose to Kes 7.8 in 2008 and declined in 2009 to Kes 3.8. In addition, the shares rose again to Kes 4.7 in 2010 and decline in 2011 and 2012 to Kes 3.6 and Kes 1.6 respectively.

4.2.3 Net Profit

4.2.3.1 Effect of Corporate Scandal on Uchumi’s Net Profit

This section examined the effects of the corporate scandal on the net profit of the supermarket from the year 2010 to 2016. The results were analysed and indicated on the figure 4.6.
From the figure 4.6 above, Uchumi had made profit worth Kes 865,099,000 in 2010. Also, the net profit declined by 54.9% from year 2010 to 2011 to Kes 390,425,000. In 2012, 2013 and 2014 using 2010 as a base index the net profit decreased by 61.3%, 58.7% and 55.6% respective. In 2015 the supermarket registered a massive loss of 296% and similarly, to year 2016 with a loss 228%. The t-test will determine if this loss was due to other reasons or due to poor governance practices which is the subject of this study.

4.2.3.2 Effect of corporate scandal on Kenya Airways’ net profit
The section examined the effects of corporate scandal on the Kenya Airways net profit from 2007 to 2016. The results were indicated in the figure 4.7.
From the figure 4.7 Kenya Airways made a huge loss in 2015 and 2016 after the scandal in 2015. It can deduce that from 2008 to 2011 the company net profit declined by -11.71%, 0.37%, 50.34% and 13.67% respectively. The rest of the years registered huge negative losses.

**4.2.3.3 Impact corporate scandal on National Bank of Kenya’s net profit**

The section determined the impact corporate scandal on National Bank of Kenya’s net profit focusing on the year 2007 to 2016 net profits of the bank in their financial statements. The results were analyzed and represented in the figure 4.8.
Figure 4.8 Impact of corporate scandal on National Bank of Kenya’s net profit

Figure 4.8 demonstrate National Bank’s net profit trend from 2007 to 2016. It can be deduced a massive loss in 2015 amounting to Kes -1,183,293,000 when the firm was mentioned on a scandal. However, the bank recorded an improvement in the following amounting to Kes 515,959,000.

4.2.3.4 Effect of corporate scandal on Mumia’s net profit

The section determined the impact corporate scandal on Mumia Sugar Company net profit focusing on the year 2007 to 2016 net profits of the bank in their financial statements. The results were analyzed and represented in the figure 4.9.
Figure 4.9 Effect of corporate scandal on Mumia’s net profit

Figure 4.9 shows the trend of Mumia’s net profit from the year 2007 till 2016. Mumia has been making losses from 2013 till now. The company had registered a tremendous net profit from 2007 to 2012. However, a decline of from 2013 to 2016 with the company experiencing losses.

4.2.3.5 Impact of corporate scandal on Eveready’s net profit

The section determined the impact corporate scandal on Eveready’s net profit focusing on the year 2007 to 2016 net profits of the company in their financial statements. The results were analyzed and represented in the figure 4.10.
Figure 4.10 Impact of corporate scandal on Eveready’s net profit

Figure 4.10 demonstrates Eveready’s net profit trend from 2007 to 2016. From 2014 to 2016 successive loss can be observed. It can be deduced that the net profit declined from 2007 to 2010. In addition, the company experience a loss in 2011 and 2013 onwards.

4.2.4. Liquidity Ratio

4.2.4.1 Impact of corporate scandal Uchimi’s liquidity ratio

The study also determined what are the impact of corporate scandals on the Uchumi’s supermarket on its liquidity or current ratio which were obtained from the financial statement for the year 2010 to 2016. The results were analysed and indicated in the figure 4.11.
Figure 4.11 Impact of corporate scandal Uchimi’s liquidity ratio

From the figure 4.11 Liquidity ratio determines the ability of a firm to pay its debts. In other word, a company should have enough current assets to be able to turn them into cash and pay its current liabilities without making loss. In this case from 2010 to 2016 Uchumi liquidity had been going down till 2016. The t-test will conclude if this is the result of poor governance practices or not.

4.2.4.2 Effect of corporate scandal on Kenya Airways’ liquidity ratio
The section examined the effects of corporate scandal on the Kenya Airways liquidity ratios from 2007 to 2016. The results were indicated in the figure 4.12.
The figure 4.12 shows Kenya Airways’ liquidity ratio trend. The liquidity ratio has been decreasing making drastically in the past few years. This can be deduced where since 2007 to 2016 the liquidity of the company declined by 69%. The T-test will be provided to determine if the decline in liquidity is due to poor to poor management governance practices resulting to scandals or other factors that are not subject to this study.

4.2.4.3 Impact of corporate scandal on National Bank of Kenya’s liquidity ratio
The section determined impact of corporate scandal on National Bank of Kenya’s liquidity ratio. The liquidity ratio for the National bank of Kenya was determined from 2007 to 2016. The results were analyzed and presented in the figure 4.13.
4.2.4.4 Impact of corporate scandal on Mumia’s liquidity ratio

The section determined impact of corporate scandal on Mumia’s liquidity ratio. The liquidity ratio for the Mumia Sugar Company was determined from 2007 to 2016. The results were analyzed and presented in the figure 4.14.

Figure 4.14 Impact of corporate scandal on Mumia’s liquidity ratio.
Figure 4.14 demonstrates the trend of the current ratio of Mumia Sugar Company from 2007 to 2016. The rate went below 1.0 from 2013 to 2016, which means that the company’s liabilities exceed that company’s assets.

4.2.4.5 Impact of corporate scandal on Eveready’s liquidity ratio
The section determined impact of corporate scandal on Eveready’s liquidity ratio. The liquidity ratio for the Eveready was determined from 2007 to 2016. The results were analyzed and presented in the figure 4.15.

![Figure 4.15 Impact of corporate scandal on Eveready’s liquidity ratio](image)

Figure 4.15 demonstrates Eveready’s current ratio trend from 2007 to 2016. In 2015 and 2016, Eveready’s current ratios were below 1 that means that they have more current liabilities than current assets.

4.3 Effect of Corporate Scandals on Share Price

4.3.1 Uchumi’s t-test on share price, net profit and liquidity
The t-test as a statistical measurement with a Critical Region that begins at t= +2.015 and -2.015. This is the critical T-test associated with 5% confidence level. If the obtained T-test falls in the Critical region or “region of rejection,” then the null hypothesis will be rejected. The results which were analysed from the year 2010 to 2016 were shown in the table 4.6.
Table 4.6 Uchumi’s t-test on share price, net profit and liquidity

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>T-test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Price</td>
<td>18.0</td>
<td>9.4</td>
<td>3.4</td>
</tr>
<tr>
<td>Net Profit</td>
<td>-560943285.7</td>
<td>1771915840.2</td>
<td>-0.8</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>0.6</td>
<td>0.3</td>
<td>2.0</td>
</tr>
<tr>
<td>n</td>
<td>7.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sqr of n</td>
<td>2.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Population</td>
<td>5.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 4.6 shows that the share price of Uchumi supermarket with a T score= 3.4 falls under the critical region. Therefore, the null hypothesis will be rejected. In other words, the test concludes that there is no enough evidence, based on the sample that corporate scandal affected the share price of the Uchumi supermarket.

On the other hand the net profit with t= -0.8 and liquidity ratio with t= 2.0 don’t fall under the critical region, therefore we can conclude that base on the sample there is enough evidence to support that the fall in net profit and liquidity is due to poor corporate scandal.

4.3.2 Kenya Airways’ t-test on share price, net profit and liquidity

The company’s effect of corporate scandal on the share price, net profit and liquidity was determined by t-test where Critical Region that begins at t= +2.015 and -2.015. This is the critical T-test associated with 5% confidence level. If the obtained T-test falls in the Critical region or “region of rejection,” then the null hypothesis will be rejected. The results which were analysed from the year 2007 to 2016 were shown in the table 4.7.
Table 4.7 Kenya Airways’ t-test on share price, net profit and liquidity

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>standard deviation</th>
<th>T-test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Price</td>
<td>11.658</td>
<td>3.90</td>
<td>5.1</td>
</tr>
<tr>
<td>Net Profit</td>
<td>-4.322,200,000</td>
<td>12068120591.97</td>
<td>-1.1</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>0.835</td>
<td>0.35</td>
<td>-35.9</td>
</tr>
</tbody>
</table>

n = 10
sqr of n = 3
population = 5

Table 4.7 indicates that Kenya Airways’ share price with a t-score = 5.1 and liquidity ratio with t = -35.9 both falling under the critical region or rejection region show that there is not enough evidence based on the sample to support that the drop in share price and current ratio is due to corporate scandals.

On the other hand it can conclude the net profit with a score of t = -1.1 falling outside the rejection region, we can say that the drop in net profit is due to corporate scandal or poor management practices.

4.3.3 National Bank’s t-test on share price, net profit and liquidity

The company’s effect of corporate scandal on the share price, net profit and liquidity was determined by t-test where Critical Region that begins at t = +2.015 and -2.015. This is the critical T-test associated with 5% confidence level. If the obtained T-test falls in the Critical region or “region of rejection,” then the null hypothesis will be rejected. The results which were analyzed from the year 2007 to 2016 were shown in the table 4.8.
<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>T-test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Price</td>
<td>21.155</td>
<td>5.98853071</td>
<td>8.093</td>
</tr>
<tr>
<td>Net Profit</td>
<td>959,003,900</td>
<td>872634021</td>
<td>3.297</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.157</td>
<td>0.039299939</td>
<td>-293.391</td>
</tr>
</tbody>
</table>

\[ n = 10 \]
\[ \text{sqr of n} = 3 \]
\[ \text{population} = 5 \]

From table 4.8 the test, there is no enough evidence to support that the fall in share price, net profit and liquidity ratio of National Bank are due to corporate scandal that the company faced in 2015. Thus, there could be other variables that influence the performance of the National bank other than the one indicated by the study. Thus the null hypothesis is rejected.

**4.3.4 Mumia’s t-test on share price, net profit and liquidity**

The company’s effect of corporate scandal on the share price, net profit and liquidity was determined by t-test where Critical Region that begins at \( t = +2.015 \) and -2.015. This is the critical T-test associated with 5% confidence level. If the obtained T-test falls in the Critical region or “region of rejection,” then the null hypothesis will be rejected. The results which were analysed from the year 2007 to 2016 were shown in the table 4.8.
Table 4.9 Mumia’s t-test on share price, net profit and liquidity ratio

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>standard deviation</th>
<th>T-test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Price</td>
<td>5.859</td>
<td>3.820</td>
<td>0.7</td>
</tr>
<tr>
<td>Net Profit</td>
<td>-400,712,100</td>
<td>2762886407.954</td>
<td>-0.4</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.204</td>
<td>0.794</td>
<td>-14.3</td>
</tr>
</tbody>
</table>

n = 10
sqr of n = 3
population = 5

From table 4.8 it can be conclude with confidence that there is enough evidence to support that the drop in share price and net profit of Mumia are due to corporate scandal that the company faced in 2014-2015. On the other hand, there is no enough evidence to support that the current ratio drop was due to corporate scandal.

4.3.5 Eveready’s t-test on share price, net profit and liquidity

The company’s effect of corporate scandal on the share price, net profit and liquidity was determined by t-test where Critical Region that begins at t=+2.015 and -2.015. This is the critical T-test associated with 5% confidence level. If the obtained T-test falls in the Critical region or “region of rejection,” then the null hypothesis will be rejected. The results which were analyzed from the year 2007 to 2016 were shown in the table 4.10.

Table 4.10 Eveready’s t-test on share price, net profit and liquidity ratio

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>standard deviation</th>
<th>T-test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Price</td>
<td>3.85</td>
<td>1.8</td>
<td>-1.9</td>
</tr>
<tr>
<td>Net Profit</td>
<td>-39,968,400</td>
<td>121629767.7</td>
<td>-1.0</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.279</td>
<td>0.4</td>
<td>-30.3</td>
</tr>
</tbody>
</table>

n = 10
sqr of n = 3
population = 5

According to the t-test in table 4.10, we can conclude that there is enough evidence to support that the drop in Eveready’s share price and Net profit were due to corporate scandal that the company faced from 2014-2015.

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On the other hand, there is no enough evidence according to the sample to support that the drop in current ratio is due to corporate scandal that the firm has faced in the year 2014-2015.

4.4 Chapter Summary

The chapter has looked at the findings which were collected from the annual financial reports of each company. The findings were presented inform of tables which included the graphs and T-test. Finally, this was able to give a clear picture of the responses.
CHAPTER FIVE

5.0 DISCUSSIONS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter finalizes the research study where by it gives the summary on impact of corporate scandal on the performance of listed companies. In addition, it focuses on the discussion, conclusion and recommendations on the corporate scandal of the listed companies.

5.2 Summary

The study analysed data which was obtained from the secondary sources that is from the financial statements of the five listed companies which have experienced corporate scandals. The companies which were understudy were Uchumi Supermarket, National Bank of Kenya, Mumia Sugar Company, Eveready Kenya and Kenya Airways.

First, on the effect of corporate scandal on the firms share price it can be summarized that Uchumi’s share prices and its drastic drop after a sudden increase in price from 2015 to 2016 which accounts for 89.6% in the stock exchange. Uchumi’s share price has drastically drop after been mentioned on scandal in 2015. In addition, the Kenya Airways share prices have been dropping specially in 2015 the year of scandal. It can deduced that in 2008 the shares declined by 20%. Also, National Bank’s share price trend from 2007 till 2016. In 2007 the share price was Kes 25 and declined to Kes 21.7 in 2009. In addition, the shares increased by Kes 24.8 in 2010 and a decline was recorded in the following two consecutive years that is 2011 and 2012. Further, from 2013 to 2016 Mumia’s share price has been doing very poorly in the Kenya capital market. The company first registered the highest share price in 2008 of Kes 11.6. The company has been performing poorly for the last 8 consecutive years from 2009 to 2016. Finally, Eveready share prices have been experiencing fluctuation since 2007. This can be noted when the shares prices of the company rose to Kes 7.8 in 2008 and declined in 2009 to Kes 3.8.

Secondly, on influence of corporate scandal on the listed firms profitability and sales performance it can be summarized that Uchumi registered a profit of Kes 865,099,000 in 2010 and the net profit declined by 54.9% from year 2010 to 2011 to Kes 390,425, 000.
In 2012, 2013 and 2014 using 2010 as a base index the net profit decreased by 61.3%, 58.7% and 55.6% respective. In 2015 the supermarket registered a massive loss of 296% and similarly, to year 2016 with a loss 228%. Also, Kenya Airways made a huge loss in 2015 and 2016 after the scandal in 2015 and from 2008 to 2011 the company net profit declined by -11.71%, 0.37%, 50.34% and 13.67% respectively. More significantly, National Bank’s net profit trend from 2007 to 2016 and a massive loss in 2015 accounting to Kes -1,183,293,000 when the firm was mentioned on a scandal. Moreover, Mumia’s net profit from the year 2007 till 2016 the company continued to record tremendous net losses from 2007 to 2012. On Eveready’s net profit trend from 2007 to 2016. From 2014 to 2016 successive loss can be observed. It can be deduced that the net profit declined from 2007 to 2010. In addition, the company experience a loss in 2011 and 2013 onwards. Finally, on the impact of corporate scandals on the NSE listed companies liquidity, it can be summarized that Uchumi liquidity had been going down till 2016. Kenya Airways’ liquidity ratio decreased drastically from 2007 to 2016 the liquidity of the company declined by 69%. National Bank liquidity declined from 2007 to 2016, and again it can be deduced that the company made a loss in 2015, the year of the scandal. Mumia sugar company liquidity ratio declined from 2007 to 2016. The rate went below 1.0 from 2013 to 2016, that means that the company’s liabilities exceed that company’s assets. Finally, Eveready’s current ratio declined from 2007 to 2016. In 2015 and 2016, Eveready’s current ratios were below 1 that means that they have more current liabilities than current assets.

5.3 Discussions

5.3.1 Effect of corporate scandals on the NSE listed firm’s share prices in Kenya

The study has found that share prices of the listed companies in NSE are affect by the scandal with the organization. This study concurs with Goldman et al. (2012) which was conducted US organization which were sued for shares fraud recorded a negative performance on the shares. In addition, the study has determined that whenever a quoted company is involved in corporate scandal due to market efficiency the share prices fall drastically. This agrees with Bernile et al. (2007) who studied 110 firms associated with scandals and found that shares prices declined ranging from 20% to 50. Moreover, the study has found that corporate scandal has major role in declining of the share prices which echoes a study by Jory et al. (2015) which linked organization scandals with the
decline in share price. Finally, a study by Iraya et al. (2015) indicated that positive corporate governance influence the firms’ performance which directly influences the prices of shares as the study has found.

Gatzert (2015) discovered that while the losses inflicted by scandal revelation upon investors are large, the direct economic costs of corporate financial misconduct may be just a minor component of its overall negative economic consequences. By undermining trust in financial markets, corporate scandals may decrease stock market participation, potentially increasing the cost of capital for all firms. Wang (2014) found that the cost of corporate financial misconduct is often measured using the losses accruing to the shareholders of fraudulent firms. Dyck, Morse, and Zingales (2013) estimate that on average corporate fraud costs investors 22% of enterprise value.

Moreover, firms decrease their stock holdings in fraudulent as well as on fraudulent firms. All households, not only the ones holding the stocks of fraudulent firms, decrease their equity holdings. For instance, the revelation of corporate scandal generally occurs at the beginning of economic downturns that may independently drive companies’ decision to reduce their equity holdings (Wang, Andrew, & Xiaoyun, 2010). Even companies in the same industry at a particular point in time can have different corporate scandal experiences and these has a negative impact on firms stock market participation (Goldman, Urs, & Irina, 2012; Karpoff, Allison, Scott, & Gerald, 2014).

The study has found that scandals within the organization decreases the values of securities. This concurs with the study of Kravet and Terry (2010) that indicated that when a scandal is revealed this increase familiarity biases as investors appeared to sell off their securities to lower price in order to avoid further risks. This shows that when scandals are revealed investors trust less and want to have more information or to feel more familiar with their investments, even though they found no evidence that shareholders likely delegated their security portfolio they had chosen to mutual fund managers or move their portfolios of securities towards transparent security option. The study has found that investors are aware of the effects of corporate scandal on the securities. This contrary to the study of Karpoff et al. (2014) which indicated that stock market participation contains high status individuals, who experiments. The study has also found that corporate scandal make the investors lose confidence with the organization. Also, this echos the study of Dyck et al. (2013) which found to trust less
because they have higher costs of betrayal is more negatively affected by corporate scandal revelation. Taken together, with findings of Wang (2014) suggest that corporate scandal affects capital of the firms where investors’ trust is with the company. The negative shock to trust due to scandal could matter for stock market participation because it increases the subjective probability of being cheated and in this way investors’ expected cost of betrayal and desire to have information or to be familiar with the invested firms (Dyck et al., 2010).

Finally, the study of (Agrawala & Cooperb, 2014) findings on the extent of corporate scandal on the firms pattern on stock market participation will be affected negatively. Since presumably investors have some exposure to corporate scandals in other portfolio, that is to be interpreted as a lower bound of the negative effects of corporate scandal on the demand for equity.

5.3.2 Effect the corporate scandals have on the firm’s profitability in NSE listed firms in Kenya.

Also, the study has found that corporate scandal affect negatively the net profit of an organization. This concurs, with study conducted by Aggarwal et al. (2009) that demonstrated that there is relationship positive corporate governance and net profit. Also another study by Kedia and Rajgopal (2011) determined that organization that are associated with unethical practices record poor sales which concurs with the study that determined that firms with no corporate scandals record high sales and hence a greater margin. In addition, a study by Shuili and Deborah (2016) discovered that firms who deceive customers on the quality and prices of the products and services once unveiled record low sales and net profit which concurs with the findings of the study that firm’s corporate scandal has greater influence on the net profit of the firm. The study has found that investors would encourage stiff penalties on the managers and staff who participate in scandals and fraud within the company. This concurs with the revelation of the findings of Bonini and Boraschi (2010) that penalties of the highest older should be compulsory by the market and not regulators. That is on each dollar of inflated value when a organization’s books are doctored, the companies value reduces by that dollar when there is misrepresentation in the financial statements, in addition firm value decreases by a value more due to tarnished name reputation. For firms that survive the
enforcement process as independent entities, the estimate of lost reputation is even greater percentage on dollar inflated value.

The study has found that profitability is directly influence by the organization scandal. This agrees with Armour et al. (2011) disclose of investigations on misconduct until they have been concluded and found against the company and that the penalty is set. They found that stock prices of companies that are found guilty experience abnormal losses of around nine times the penalties paid. However, reputational losses occurred just in related-party offenses, i.e. cases in which misconduct involved violation of implicit contracts; whilst in cases where victim was third party results were not statistically significant and losses were the consequence of the fees paid. Additionally, reputational losses are more intensive in the post-crisis period. The confirmation of the argument that reputational losses affect companies, in which victim party is directly related, can be found in other papers as well (Murphy, Shrieves, & Tibbs).

Karpoff et al. (2005) examined cases of violation of environmental laws and they got to the conclusion that the change in the returns is explained almost solely by the fine paid. (Goldman, Peyer, & Stefanescu, 2012), who analysed defence procurement frauds, found that influential contractors are penalized lighter than similar companies with less connections, experiencing not significant market share decrease. The above results agree with the study.

Companies committing fraud faced increase in cost of capital due to changes in the terms of trade. Allegations of fraud can result in revision of existing contracts, including bank loans, a major source of financing for the companies. The study of bank loans allows understanding the real financial consequences of misreporting since the implications for the cost of debt can be assessed, both in a direct and indirect way (maturity, covenants).

The literature focuses on the restatements, not corporate fraud in particular. Restatement of the financial statements means that bank has to re-evaluate the company because previous valuation was based on false financial information. It creates uncertainty about the reliability on the firm and deepens asymmetric information.

Graham et al. (2008) stressed that in the United States in the period between January 1997 and June 2002 about 10 percent of all listed companies restated their financial statements at least once, and the market value of restating company in this period increased from
$500 million to $2 billion. They found the evidence that after restatement, loan spread increases on average by 42.5 percent, but if the restatement is fraud-based the spread increases by 68.9 percent. Other implication is non-direct consequences of restatement such as: “loans contracted after restatement announcements have significantly shorter maturity, higher likelihood of being secured and more covenant restrictions.” The availability of loans in general decreases; firms have to depend on the short-time financing, what implies that the company might have to give up some investment opportunities. This last finding is consistent with the Li (2012) theory that debt maturity is a function of risk ratings.

Similar studies however present varied results depending on the data used. Palmrose et al. (2004) found there is no significant change in spreads during the short period surrounding the announcement date. (Qiu & Slezak, 2012) found increase in bid-ask spreads only for restatements regarding revenue recognition problems and only for longer periods.

Nevertheless, combining these results with findings on the increasing cost of equity and decreasing market value lead to the conclusion that effect of fraud on cost of capital can be catastrophic for the company.

5.3.3 Effect the corporate scandals have on the sale performance on NSE listed firms in Kenya.

Kurant (2014) discovered that financing needs are also an important predictor of corporate scandal especially when a company is experiencing low profits. Companies with higher capital needs are more likely to resort to frauds. Armour, Mayer and Polo, (2012) found that desire to attract additional financing can be incentive to commit fraud. Managers manage earnings of the companies in order to increase capital at the lower cost, however when fraud is disclosed the cost of capital significantly increases. Kumar and Langberg (2009) and Wang (2011) presented complementary studies. They showed that easy access for external financing can create an incentive for fraud. Wang mentioned also factors such as extensive growth, profitability and leverage as factors influencing propensity for committing frauds.

The study found that profit decline when scandals are mentioned. It has been shown that other than the legal sanctions the loss in firm’s reputation plays a major role in the punishment of the company. Legal sanctions are simply the fines, fees or penalties that
the company is obliged to pay. Reputation can be defined as “expectations of partners of the benefits of trading with it in the future” (Armour et al. (2011). This penalty imposed by the market can be explained by the fact that the firm might be non-reliable in the future. Such revisions of the expectations would affect the terms of trade in the future, its costs and operations. Those negative changes in input and output price would decrease the firm’s earnings and, as a consequence, its market value (Wang & Winton, 2012).

The rival companies lose as a result of fraud within the industry because it is thought that the information provided by the companies is not reliable anymore, or the rival companies benefit from customers outflow from the accused company and reduced competition. Goldman et al. (2012) called those effects information spill over effect and industry competition effect, respectively. The total effect of fraud on rival firms depends on magnitude of those two effects.

Goldman et al. (2012) analysed the cases from Karpoff et al. (2008) dataset. They showed that on average the value of the firm directly connected to fraud decreases by 19.7 percent and its rivals’ value drops by 0.54 percent on average in the three-day window surrounding the event. Among the rival companies, firms operating in less competitive industries experience higher cumulative abnormal returns (CAR) than others; if the rival company belongs to less competitive industry and has high sales, CAR is even higher. It means that prior clients of the company that committed fraud prefer to choose big company within the industry.

5.3.4 Effect of corporate scandals on the NSE listed firm’s liquidity.

Finally, study has found that firms that experience or are associated with corporate scandal have declining liquidity ratio. This concurs Nkem et al. (2015) study which found that corporate scandal affect the current ratio of organization and the firms implicated with scandals have low liquidity ratios. Further, the study has found that firm who are associated with scandals and fraud will always record low liquidity ration since the sales volume is affected and the shares prices. This agrees with the study of Adams and Mehran (2005) which found that firm that are linked to fraud, unethical practices they register low liquidity ratio. Finally, a study conducted by Mwangi (2013) found that firms that are associated with corporate scandal are not able to meet the creditors’ obligations due to reduced net profit as the study has discovered.
In a final test, we thus consider the specific strategic hypothesis that managers commit fraud to artificially improves their odds of issuing equity. Although other studies find evidence consistent with this motive, no existing studies report supportive evidence in verbal disclosures. Using an exogenous shock to equity market liquidity, which increases the motive to commit fraud for this reason, we find that treated firms produce disclosure that becomes more similar to fraudulent firms. In turn, we also find that the use of this common fraudulent disclosure is associated with higher rates of equity issuance. These results provide some suggestive evidence that at least some of our findings might be due to managers using verbal disclosure to further achieve the same goals that drive them to commit fraud in the first place (Graham, Li, & Qiu, 2008).

Many studies examine the links between accounting, stock returns and AAERs. Al-Matari, et al. (2012) examine the issues that motivate fraud and their consequences. Although we cannot summarize all literature in the area due to space constraints, we refer readers to Dechow, Ge and Schrand (2010) for a thorough review. Earlier work links standard accounting variables with fraudulent activity. Wang (2014) considers a Jones model, and examines whether firms that manipulate earnings can be separated from those that merely have more aggressive accruals. The study also considers a host of accounting ratios and constructs an index. Kurant (2014) find that a strong motive for earnings management is the desire to attract low cost financing. (Baker & Wurgler, 2006) finds that managers are more likely sell their own shares when earnings are overstated.

More recent studies extend these earlier works and provide more depth. Dechow, Ge, Larson and Sloan (2011) find that misstating firms hide diminishing performance, have higher relative prices, and have abnormal reductions in the number of employees. Wang (2013) addresses the partial-observability of fraud, and finds that R&D increases the likelihood of fraud while also reducing the likelihood of detection. Povel, Singh and Winton (2007) and Wang, Winton and Yu (2010) show theoretically and empirically that the incentive to commit fraud is more intense during industry booms.
5.4 Conclusions

5.4.1 To investigate the effect of corporate scandals on the NSE listed firm’s share prices in Kenya

The study concludes that corporate scandals influence the firms share price negatively, however some of the list companies under study recorded that there was no significance between corporate scandal and firm’s share price.

5.4.2 To estimates the effect the corporate scandals have on the firm’s profitability on NSE listed firms in Kenya.

The study concludes that corporate scandal affect the firm’s profitability. Thus the study found that there was statistical significance between the corporate scandal and the firm’s profitability and sale performance on NSE listed firms in Kenya.

5.3.3 To estimates the effect the corporate scandals have on the firm’s sale performance on NSE listed firms in Kenya.

The study also concludes that corporate scandal has a greater influence to the sales performance. This is because once the company is reported to be involved on fraud customers and suppliers who are partner in businesses tend to withdraw. Hence reducing the sales and also the supply in the company respectively.

5.3.4 To find out the impact of corporate scandals on the NSE listed firm’s liquidity.

Finally, the study concludes that corporate scandals affect the firm’s liquidity negatively. Thus, there is statistical significant between corporate scandals and the NSE listed liquidity.

5.5 Recommendations
The recommendations are based on the findings;

5.5.1 Suggestion for Improvement

5.5.1.1 Firms Share Price

The study recommends that on share prices that the firm should always cultivate a reputable name if the firm is to experience growth and hence increase the shareholders
wealth. This is because when the shareholders or investors realize there is scandal in the company they tend to sell of their shares

5.5.1.2 Profitability
Also, the study also recommends that firms should avoid at all costs fraud, scandals and ethical activities that may jeopardize their relationships among the suppliers, creditors and customers who all play an important role in the sales volume of an organization.

5.5.1.3 Sales Performance
The study also suggest that the management being agents of the shareholders should avoid conflict of interest where there propagate scandals that may affect the sale performance of the company.

Finally, the study also recommends that company should fire immediately any staff that is implicated in the corporate scandal so that they can maintain the name of the company in order to boost the liquidity of the firms.

5.5.2 Suggestions for Further Research
The study was conducted in the listed companies only, future study should focus on other companies which are not listed in NSE and determine the effect of corporate scandal on the financial performance
REFERENCES


# APPENDICES: FINANCIAL STATEMENTS

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