Do Markets React to Corporate Governance Reforms? Evidence from a Developing Economy

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Abstract

Purpose

The purpose of this study is to investigate market reaction to corporate governance reform pronouncements on board diversity in Kenyan listed firms.

Design/methodology/approach

An event study was performed using 240 days pre-event period and an event period that consisted of 25 days pre and 25 days post the March 2016 board diversity reforms announcement in Kenya. The difference in differences (DiD) method was also used for cause–effect analysis for two years before and three years after the March 2016 board diversity reforms announcement. The outcome variable was firm value, whereas the treatment and control groups were Kenyan listed firms and deposit-taking credit unions, respectively.

Findings

The event study method found cumulative abnormal returns after the date of the board diversity reforms announcement to be positive and significant. The DiD methods found a positive and significant market reaction to the March 2016 board diversity reforms announcement in Kenya.

Research limitations/implications

This study was limited by the secondary data that was collected and analyzed from financial statements and stock price data from the Nairobi Securities Exchange (NSE). Financial statements have the disadvantage of being affected by the judgment and estimates of their preparers or accountants.

Practical implications

Emerging markets like the NSE are vulnerable to market manipulation by insiders. Efficient stock markets are known to attract more investors who are interested in a trustworthy stock price determination mechanism. The Capital Market Authority should thus continue implementing corporate governance reforms aimed at improving the efficiency of the NSE and the trustworthiness of stock prices therein. The continued reforms thus imply better value for money for the NSE investors.

Originality/value

This study makes an important contribution to literature by combining an event study and DiD analysis to assess market reaction to board diversity reform announcements in emerging markets of sub-Saharan Africa which is a concept that has not been researched before. Past studies have

used event studies to investigate the efficiency status of stock markets in sub-Saharan Africa, whereas the current study used an additional method of DiD and hence contributed to literature.

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