

**RELATIONSHIP BETWEEN OWNERSHIP STRUCTURE AND FINANCIAL  
PERFORMANCE OF COMPANIES LISTED AT THE NAIROBI SECURITIES  
EXCHANGE IN KENYA**

**BY**

**RUTH GICHOHI**

**REG.NO 13/01445**

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**DECLARATION**

**STUDENT’S DECLARATION**

I declare that this dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made, and author duly acknowledged.

Student Name: Ruth Gichohi.

Reg. No. 13/01445

Sign: .....

Date: .....

**SUPERVISOR’S DECLARATION**

I do hereby confirm that I have examined the master’s dissertation of Ruth Gichohi and have certified that all revisions that the dissertation panel and examiners recommended have been adequately addressed.

Sign: .....

Date: .....

Dr. Michael Njogo.

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## **DEDICATION**

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## **ABBREVIATIONS AND ACRONYMS**

<b>EPS</b>	Earnings per Share
<b>NPM</b>	Net Profit Margin
<b>NSE</b>	Nairobi Securities Exchange
<b>ROA</b>	Return on Asset
<b>ROE</b>	Return on Equity

## OPERATIONAL DEFINATION OF KEY TERMS

**Ownership structure:** Ownership structure tries to define who the shareholders are and who among them belongs to the controlling groups (Zhang, 2009)

**Ownership Concentration:** Refers to the share of the largest owner and is influenced by absolute risk and monitoring costs (Gursoy&Aydogan, 2002)

**Ownership Identity:** The actual owner in the listed company (Thomsen & Pedersen, 2000).

**Government owned firm:** Firm in which government has controlling shareholding (Nuru&Rashidah, 2004)

**Return on Assets (ROA):** is as a percentage the amount of net income returned of total assets. **Return on Equity (ROE):** is understood as the amount of net income returned as a percentage of shareholder's equity

## ABSTRACT

Distinct groups of stockholders have growing influence on performance of companies listed on East Africa's stock markets. Recent policies on foreign ownership and the Growth of institutional investment at the NSE have made it critical to dig into the effects that these distinct stockholder groups have on profitability if any on listed companies. This paper seeks to establish the relationship between ownership structure and financial performance of listed firms at Nairobi Securities Exchange. The four dominant ownership groups focus on are local (EA Investors & institutional), foreign and managerial investors to determine their effect on the financial performance of companies listed at the Nairobi Securities Exchange in Kenya. The study adopted descriptive research design and the target population was all the 65 listed companies in the Nairobi securities exchange in Kenya. A sampling was used to focus on actively traded counters to ensure reliability, completeness and integrity of secondary data collected from Nairobi Securities Exchange for a period of six years (2012-2017). STATA software was used to conduct regression and correlation analysis using panel data. The analysis was to test effect of each stockholder group on ROA. The Pearson correlation analysis test for multicollinearity was applied to the dependent variable (ROA) against the independent variables to find the correlation. The researcher also used the Levin-Lin Chu (LLC) test for Unit Roots to test for stationarity between the dependent and independent variables. The White test was applied to check for Heteroscedacity and finally the Woodridge test was done for serial correlation. The study findings showed that the correlation analysis between ROA and firm performance indicated that government ownership is negatively related with the firm's return on assets with significance of (p-value=0,06) whereas domestic ownership of firms is negatively correlated with firm's return on assets (p-value=0.33) . Foreign ownership was established to be positively correlated with firm's return on asset (p-value=0.00) and management ownership is positively correlated with ROA (p-value=0.88). Regression analysis shows that relationship between government ownership and financial performance of companies is negative. Relationship between local ownership, foreign ownership and managerial shareholding is positive. Conclusion based on these findings are that higher government's ownership deteriorates financial performance. Local ownership has a positive relationship with financial performance and therefore the higher the local investors' ownership improves performance. Thirdly, foreign ownership has a positive effect on a firm's financial performance i.e. firms with higher foreign ownership have higher ROA in line with prior expectations that improved firm performance is measured with more foreign stake. Lastly, Local ownership concentration, as measured by the shareholding by local investors on listed firms, has a positive relationship with financial performance. This study recommends that directors of companies should target more local and foreign stockholding and reduced Government and management shareholding to achieve optimal performance. The study had limitation due to scanty and inconsistent data, particularly with suspended and illiquid companies. More studies into the negative effect of Government ownership is needed. Further studies on how government ownership influences the strategic direction and operational management of listed companies would also help to identify the problem.

**Key Words:** ROA, NSE, Stockholders, NSE, Investors.

## CHAPTER ONE: INTRODUCTION

### 1.1 Background of the Study

Globalization as well as the emergence of open markets has led to an increase in the intensity of competition from other states around the globe. Gomez (2005) associates the increase in scholarly interest of ownership structure role in influencing organization performance to the change in corporate governance structures witnessed in the past two decades. In corporate finance and among other stakeholders, the relationship of firm performance and ownership structure is of interest to investors, bringing lots of attention (Jiang and Wong, 2004).

Business organizations are started with the aim of maximizing profits; entirely dependent on the decision-making mechanisms in place. The company's decisions influence its investment and plans to either go for debt or equity financing. Under debt financing, organizations get funds or money and reserves from exterior sources, and pay back with interest (Raji, 2012). The stock markets are broadly considered as central to the functioning of a modern capitalism economy. There has been immense paradigm shift in the corporate governance field as most firms incorporate the ownership structures principles into their actions.

Berk and DeMarzo (2007) opine that corporate governance framework aims at improving accountability and transparency, thus enhancing firm's effectiveness. Currently, there lacks a specific system for ensuring the wellbeing and creation of wealth for all stakeholders in a company as well as the alignment of managers' interests, the board of directors and all concerned parties thereof. The financial performance of an organization mostly depends upon the strategic decisions carefully designed and taken by their owners. Several studies (Amarjeet, 2016; Benjamin & Dirk, 2015; Maina&Ishmail, 2014), indicate that the structure of ownership is characterized by division of equity, in addition to the identity of equity owners and its system within corporate governance which has influenced firm's performance for many years.

Jiang and He (2015) argue that a typical feature of ownership structure in modern corporate governance in any company is the separation of ownership and management. To better the development of firms, business owners take the companies operating rights to professional managers to manage and only retain the power of the residual value of the

company to obtain rights. The disagreement between shareholders and management will lead to manager's selfish behavior of short-term profit harming the interest of owners and destroying the contractual relationship.

Therefore, in addition to incentive pay, the shareholdings of managers is a good way to help the management and the shareholders become more united to promote their interests. Hence the managers will pay attention to the development of long-term interests of the company thus contributing to achievement of the contract objectives (Matengo, 2008). Therefore, shareholding of managers will make them pay more attention and emphasis on long term development of the firm.

Lioui& Sharma and Qui (2012) argue that firms' ownership is meant to increase firm value and suggest that firms' capital structure decisions as well as ownership reflect the efforts to solve agency issues among the different stakeholders to avoid arising conflicts of between the majority shareholder and minority investors interests. According to Hassan and Butt (2009), the relationship between an organization's firm performance and ownership structure is dependent on corporate governance. Srivastava (2011) noted that since the initiation of economic reforms, various laws and government policies relating to the corporation have changed resulting in several changes in ownership structures, stakeholder expectations, and the corporate environment. The changes are aimed to ensure efficient, entrepreneurial and effective management that can in the long-term ensure the firm's success.

Ndemo (2009) observed that to improve state firm's performance through ownership structure, the Government of Kenya has undertaken a deliberate policy of divestiture, that is aimed at state ownership minimization, infusing modern management styles into the public sector by encouraging the participation of the private sector in the conducting of state corporations that will ultimately improve their financial performance. According to Norman (2010), it is not only the government companies which are changing ownership structure the trend has resulted to private firms converting to public firms to be able to raise more capital while loss-making government-owned firms lead to privatization to offload the financial burden from the government. Mule *et al.* (2013) also noted that the NSE was demutualized in attempt to diversify ownership structure, increase competitiveness, and allow it to raise capital from the public. This study seeks to therefore, grasp how ownership

structure influences the financial performance of corporations found in the Kenyan Nairobi Securities Exchange.

### **1.1.1 Ownership Structure**

In a firm both decision making segment and ownership structure relates. The two broadly used of the term 'ownership structure' are; ownership concentration and owner identity. Zhuang (2009) argued that ownership structure is a very key factor to shape the corporate governance systems of a country. The two significant features of corporate ownership as recognized by Zhuang are concentration and composition. He observed that the extent of ownership concentration in a company establishes the way in which power is allocated amongst the managers and the shareholders. In addition, there tends to be weakening in the shareholding controls due to a drop in the monitoring of shareholders' interests once ownership has been dispersed.

According to (Zhuang, 2009) the question that is raised then is, if all small shareholders act in such a way, then there would be no monitoring in the managerial efforts. He furthermore argued that when a company's ownership is concentrated, huge shareholders will have a high role in monitoring the managers. Conversely, Zhuang said that the major crisis with ownership concentration is on how to protect minority shareholders from exploitation by major shareholders who may act unilaterally with no consideration towards them whatsoever. He also pointed out that ownership composition tried to differentiate between who the shareholders are and who among them belongs to the decision-making group.

The importance of ownership structure is evident in the fact that corporate governance and the ownership structure of companies is currently characterized by change processes as the economies of the world become more and more globally integrated. Ownership structures are also of major importance in corporate governance because they affect the incentives of managers, and thereby the efficiency of firms. As the world continues to grow and experience economic changes, the importance of ownership is evidenced by the developing need for corporate governance practices.

Benson (2015) noted that the volatility of the corporate ownership portfolios in the multinational enterprise has renewed keen interest on the matters of the ownership. This could be used to explain the difference between the developed and developing nations ownership structure. In developed countries, ownership has been isolated while on the other hand developing nations ownership structure features a weak legal system that safeguarding the investors' interests and ownership structure is concentrated (Ehikioya, 2009). Going by the argument by Fazlzadeh, Hendi and Mahboubi (2011) ownership structure is one way of providing policy makers with the intuitions that enable a system of corporate governance to function.

According to Holderness (2009), higher firm value is brought about by a reduction in the conflict of interests due to ownership and control balancing. He further stated that it can get confusing as one examines the interrelationship of ownership, firm value and control. For instance, managers who own shares in a company work more efficiently by putting the interests of line managers and shareholders first. In contrast to when manager's interests and those of shareholders are not wholly inclined, high stake in the firm can provide managers with great opportunities to chase their individual objectives without the fear of punishment. Thus, the consequences of managerial ownership on the firm's value depend on the trade-off between entrenchment and alignment effect (Denis & McConnell, 2002).

In addition, the deviation in voting rights and capital rights permit investors to gaining control with slight equity participation through such methods as dual-class equity, pyramids, etc. Thus, discrepancy must be taken into considerations when scrutinizing the implications of ownership structure on firm performance. Ownership simply measures the extent of concentration of the rights to voting. The rights to vote for the majority shareholders and the total of voting rights of the second to third largest shareholders measure it. Moreover, the variance ratio of the main shareholder demonstrates ownership concentration from a different angle. Owner identity is dependent on the kind of biggest shareholder.

### **1.1.2 Financial Performance**

Financial performance evaluates how well a firm can use assets from its primary mode of business and generate revenues. Financial performance also is a general measure of a firm's common financial health over time and can be used to contrast alike companies or compare



industries or sectors in aggregate (Fauzi, 2007). According to Brealey, Myers and Marcus (2009) they indicated that the performance of an organization can be determined according to its profitability, solvency, liquidity, financial efficiency and repayment capacity. Profitability is the measure of the profit acquired by a firm through utilization of its productive assets. Liquidity analyses the ability that a firm must meet its obligations when or as they fall due where else solvency is a firm's ability to meet all its financial obligations if all of its assets are sold. A firm's organizational performance therefore, can be measured using the net income or net operating income, its assets performance or even its cash flows.

The measurement of financial performance of an organization is looked at from a firm's financial ratios which using the accounting figures are arrived at from obtained financial statements. These statements include activity ratios, liquidity ratios, debt ratios and profitability ratios. Measurement of non-financial performance on the other hand, is more subjective. According to Haber & Reichel, (2005) it mainly looks at employee satisfaction, customer service, perceived growth in market share, sales growth and perceived change in cash flow.

Other literature that can be used to analyze the profitability of companies from various economies may include indicators like net operating profitability. Other scholars have utilized different methods to quantify the firm's financial performance such as include Return on Equity (ROE) and also Return on Asset (ROA) (Peters & Bagshaw, 2014; Oforiet al. 2014), Return on asset (ROA). Accounting terms such as ROA, ROE and shareholder's wealth measures like stock price and EPS were used by Mujahid and Abdullah (2014). Net Profit Margin (NPM) and Return on Asset (ROA) were used by Flammer (2013). Therefore, this study will quantify the company's financial performance by examining their profitability that is Return on Assets and Return on Equity. Return on Assets (*ROA*) is as a percentage the amount of net income returned of total assets. Return on Equity (ROE) is understood as the amount of net income returned as a percentage of shareholder's equity.

### **1.1.3 Ownership Structure and Firm Performance**

Mokaya with Jagongo (2015) conducted a research on the firms listed at Nairobi securities exchange to put up the ownership structure for financial performance. This research used two methods; the descriptive and cross-sectional survey method. The target population consisted

of all the 63 companies, members of the Nairobi Securities Exchange. The research relied on secondary data which was gathered from the annual financial statements. To determine the score for ownership structure, content analysis was utilized. Regression analysis tested the relationship between ownership structure and financial performance of firms listed in the NSE. The study established a strong positive correlation coefficient between financial performances of companies listed in NSE and ownership structure.

Furthermore, the research also revealed that Ownership structure influenced the firm's decision-making segment. The power distributed between its shareholders and managers is influenced by the level of ownership concentration. The strong positive correlation between the financial performance of companies listed in NSE and Ownership concentration was found in the study. The control variables of the study were age of the firm and size of the firm, the financial performance proxy in their study was only ROA whereas the current study will have ROA, ROE as financial performance proxies. The current study will also not have any control variables rather will focus on the direct relationship between ownership structure and financial performance. The current study will also focus on 61 firms as compared to 63 firms which Mokaya and Jagongo which implies that some of the firms have exited the market which could be attributed to by poor performance and poor corporate governance practices. In furtherance, the business operating environment is changing rapidly and hence the need to carry out this study to establish if the existing findings are true.

Lioui and Shaema (2012) argued that firms' ownership is organized to maximize firm value; further, firms' ownership and capital structure decisions mirror tries to quell problems in the agency between various stakeholders to avoid possibility conflicts of interest between a majority shareholder and minority investors. According to Hassan and Butt (2009), the connection between ownership structure and firm performance is laid on the issue of corporate governance. Uzel (2015) argues that the notion that the main objective of businesses is to make profits and organizational performance is key. Iravo, Ongori, and Munene (2013) raised concern that has influenced a study of ownership structure and financial performance of organizations. Why do some organizations succeed while others fail?

Miring'u and Muoria (2011) noted that firms that have good governance perform well better and that it is of much essence to firms. It also further propels an argument that any corporate entity's governance structure affects the firm's ability to react to external constituent that have some effect on its performance. Countries like Ghana and South Africa in the African continent, the concept step by step is warming itself up to the top of policy agenda. The notion of corporate governance has brought about a lot of heat in broader field of corporate finance as it is believed to have contributed to the poor performance of the corporate sector in Africa to the Asian crisis.

Scholars Cespedes, Gonzalez and Molina (2010) evaluated the determinants of ownership-structure and firms' performance of Latin American firms. They also observed that, higher ownership-concentration improve firm's performance. With the results, they concluded root factor that affect firm's ownership and control allocation is ownership structure, thereby impacting the performance of a firm. According to Clarkson, Overell and Chapple (2011) various foreign specialists found out that ownership and capital structure have notable changes on the performance of a firm and that the change of ownership structure on financial performance mainly considers ownership concentration, type and capital market value of listed firms.

Bahraini listed on sample of 42 companies for 5 years from 2007-2011 (Khamis, et al, 2015) in a study on the relationship between ownership structure and corporate performance. The analysis according to the study shows that institutional ownership brings about a negative relationship on the company's performance if measured by Tobin's Q. However, this was not the case on managerial ownership since it has a positive effect on performance. Nafula (2012) studied firms listed in the Nairobi stock exchange and in the relationship between their ownership structures and corporate governance found there is a less important effect between the ownership structure and corporate structure.

Nafula concluded that regulatory bodies played a greater effect on the observance of corporate governance principles by these institutions and that they had an impact on firm's performance. However, Mbaabu (2013) in his study about relationship between corporate governance, ownership structure and financial performance of insurance companies in Kenya observed that there was positive relationship between corporate governance and dispersed

ownership on the financial performance of the insurance firms. The study focused on the insurance firms while the current study will focus on all the firms listed at the Nairobi Securities Exchange.

#### **1.1.4 Nairobi Securities Exchange**

The NSE is Kenya's main stock exchange. It was constituted in 1954 as an overseas stock exchange where at the time Kenya was still a British colony with permission of the stock exchange in London (NSE, 2014). However, in July 2011 the Nairobi Stock Exchange Limited changed its name to Nairobi Securities Exchange Limited. This change mirrors the strategic plan of the NSE to evolve into a service securities exchange that fully supports trading, clearing and settlement of equities, derivatives, debt and other associated instruments.

There have been rapid changes in the NSE to facilitate smooth functioning of the market. Among some of the key changes include the introduction of the Central Depository and Settlement Corporation (CDSC) which increased the market efficiency. Buying and selling shares became easier as investors open electronic accounts similar to their bank accounts to buy shares and bonds. Demutualization, deregulation and automation of the market activities removed control of the market from the hands of few brokers who could send signals among themselves to influence the activities of the market and ensured that the market was demand/supply driven (Kihumba, 2003).

The NSE had 65 listed companies as at 2016 and is considered one of the largest stock markets in Africa representing different sectors namely the Agricultural, Finance and Investment, Commercial and Services, and Industrial and Allied sectors. It is, through the NSE, that many Kenyan entities can raise capital and expand their business activities. Since 1990, Kenyan companies have raised around \$1 billion through initial public offerings. The expansion of these companies is really boosting the Kenyan economy. The study therefore considers the NSE to be a good representative population to study because companies listed herein consists of many sectors of the Kenyan economy as well as the diversity in ownership structures.

## 1.2 Statement of the Problem

Extensive research using theoretical and empirical literature has been made on the influence of ownership structures on firm execution. This might be because of the fact that this is the decision making segment of a firm, which makes ownership powers influential in firm decisions. From the reviewed studies, the findings are contradictory and thus inconclusive. Some of the studies conducted such as Zeitun (2009); (Esther *et al.*, 2016); (Ongore, K'Obonyo and Ogutu, 2011); (Alulamusi, 2013), found a negative relationship between ownership structure and performance while others found positive relationship (K'Obonyo, 2011; Kiruri, 2013; Mokaya and Jagongo, 2015; Cespedes, Gonzalez and Molina, 2010; Khamis et al., 2015).

Further, there has also been a policy shift across the East African regional markets towards opening up of the regional capital markets to foreign investors. This is evident in recent approval on the Dares Salaam Securities Exchange by Tanzania's Capital Market Securities Authority of 100% foreign ownership and the current push by Kenya's Capital Market Authority to allow more than the current 75% foreign ownership cap on listed firms. The recent spate of cross listings and proposals by East Africa Securities Regulatory Authority for market integration imply a positive shift in line with global trends towards free market policies.

It is worth noting that majority of listed blue chip companies were a result of privatization of Government owned businesses and over the past ten years, have witnessed the same privatized companies now held by majority foreign and local/institutional investors. Thus one cannot gauge market performance today without considering foreign and local institutional investor sentiment to get accurate reports. Most majority government held companies listed at the NSE like Kenya airways, Mumias Sugar, Portland cement and National Bank are perennial non-performers with huge loss making margins while those that have shifted from GOK to foreign majority stakes like Safaricom & Kenya Commercial Bank have thrived. Equity Bank and Coop Bank have remained successful both under majority local and now majority foreign ownership.

Noticeable, there has been a stagnation in new listings through privatizations, private listings and listings by introduction at the NSE. There have been no new major listings since COOP

Bank and the FAHARI I-REIT. Recently we have had a series of de-listings largely to private ownership through acquisition e.g. Unilever & Rea Vipingo, more recently we have had acquisition bids for UNGA Ltd and currently KenolKobil where acquiring firms have stated intention to delist. These have led to the number of listed firms shrinking from 67 to 65. There is therefore a need to reexamine the relationship between ownership and profitability to find out whether it informs these recent trends of directors' preference towards delisting and/or reduction of government control of companies listed on the Nairobi Securities Exchange.

### **1.3 Research Objectives**

#### **1.3.1 General objective**

To establish the relationship between ownership structure and financial performance of companies listed at Nairobi Securities Exchange in Kenya.

#### **1.3.2 Specific objectives**

- i. To determine the relationship between government ownership and financial performance of companies listed at the Nairobi Securities Exchange in Kenya
- ii. To examine the relationship between local ownership and financial performance of companies listed at the Nairobi Securities Exchange in Kenya
- iii. To establish the relationship between foreign ownership structure and financial performance of companies listed at the Nairobi Securities Exchange in Kenya
- iv. To assess the relationship between managerial shareholding and financial performance of companies listed at the Nairobi Securities Exchange in Kenya

### **1.4 Research Hypothesis**

The research was guided by the following research hypothesis;

H<sub>01</sub>: There is no significant relationship between government ownership and financial performance of companies listed at the Nairobi Securities Exchange in Kenya.

H<sub>02</sub>: There is no significant relationship between local ownership and financial performance of companies listed at the Nairobi Securities Exchange in Kenya.

H<sub>03</sub>: There is no significant relationship between foreign ownership structure and financial performance of companies listed at the Nairobi Securities Exchange in Kenya.

H<sub>04</sub>: There is no significant relationship between managerial shareholding and financial performance of companies listed at the Nairobi Securities Exchange in Kenya.

### **1.5 Significance of the Study**

The results of this study can inform policy decisions by various players including the government, institutions management, investors and other researchers and scholars. This study is of use to the government of Kenya and policy makers as they seek to create a conducive environment and design policies to strengthen and build confidence across all categories of investors to build an economy that is inclusive. One of the key drivers of growth in a developing economy is inclusion of both large and small scale investors in mobilizing the scarce resources. This study can be valuable to both the existing and potential investors in these listed firms to make the best decisions by enlightening them with knowledge of how ownership structure of an institution can influence performance of their investment.

The research can be of benefit to institution managers of these firms in establishing the right capital mix and adjusting it accordingly to ensure they optimize the firm's returns and enhance growth and increase the competitive advantage. The study findings can help company's management and shareholders in evaluating the importance of contribution by different categories of investors on their financial performance in terms of reducing agency costs and bolstering the relationship between the principals and the agents. Firm's management would benefit from the study as well since they would acquire information that directly relates to their decision-making paradigm and be able to carry out their day-to-day operations. The findings of this study also added new information to the existing body of literature on ownership structure that can be referenced to in future, therefore benefitting scholars and researchers.

### **1.6 Scope of the Study**

This study sought to establish the outcome of ownership structure on financial performance of listed firms at NSE in Kenya. Specifically, the study looked at whether government ownership, local ownership, foreign ownership and managerial shareholding affect performance of listed firms at NSE in Kenya. The study was conducted in all (65) listed firms

at NSE. The study was conducted in year 2017-2018. Secondary acquired data for the research was collected for a period of six years (2012-2017).



## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

The literature that majors on the area of ownership structure and financial performance of firms is what is explored in this chapter. It commences by reviewing the theories that relate to ownership structures of companies, and then majors on the empirical studies that look at the link between ownership structure and financial performance.

### **2.2 Theoretical Review**

The study was focused on different theories such as the agency, stakeholder and stewardship theory.

#### **2.2.1 Agency Theory**

The agency theory was proposed by Coase (1960), Jensen and Meckling (1976) and Fama and Jensen (1983). The theory defines the connection between principals. These principals include agents which are firm's senior management and shareholders. The principal assign tasks to an agent. The agency problem consists of a conflict of interest between a company's management and the company's stockholders which the theory tries to deal with first. Secondly the principal and agent settle for unlike risk tolerances.

In a firm, there are mainly two main agency relationships that are usually in conflict. These include the relationship between the company's management and stockholders and the relationship between the stockholders and the debt holders. These agency conflicts have consequences on business ethics and corporate governance. Agency costs due to such relationships are encountered so as to maintain an effective agency relationship. A common example of agency costs is the incentive fees paid to agents so as to encourage behaviors similar to those with the principal's goals. (Bowie & Edward, 1992).

Debt financing can be employed as a method of reducing agency difficulties as it helps with the issues that are usually associated with free cash-flow and asymmetric information problems more so in cases of private debts. Secondly, the divisions between ownership and control also lead to the emergence of conflicts of interest between the shareholders and the managers.

Alignment of the interest between them can however be made through managerial ownership, thereby reducing the total agency costs. The firm's optimal point can be achieved when the managers acquire all the company's shares as a linear relationship exists between the agency costs and managerial ownership. (Jensen & Meckling, 1976). Thirdly, Ownership concentration is also an option that shareholders should take in reducing agency costs as they can proactively take active roles in supervision. However, this depends on the amount of their equity at stake. The higher an investor stakes, the more likely they are to watch and take caution when it comes to their investment (Gilson & Lang, 1990).

Agrawal and Knoeber (1996) explain that agents such as company managers are less inclined to go into behaviors that are solely profit maximizing and whose shareholders are not keen on watching their dealings. This therefore implies that owner-controlled firms are higher performers than manager-controlled firms. Thus, it is assumed that high level ownership of a commercial bank provides better monitoring therefore leading to better execution of tasks. This theory was applicable to this study because the study focused on relationship between shareholders and their professional agents existing in different ownership structure and how they affect the financial performance of listed companies at the Nairobi securities Exchange.

### **2.2.2 Stakeholder Theory**

This theory recommends that a firm be managed in the best interests of all its stakeholder challenges the primacy assumption of shareholder interests (Freeman, 1994). The theory assumes that values are essential and explicitly a part of carrying out a business and more so managers need to enunciate the shared sense of value they create hence bring the key stakeholders together. It is most likely to that if stakeholders get what they want, they will certainly seek for more from the firm (Freeman, 1984; Freeman & McVea, 2001).

Ulrich *et al.* (2008) argues that stakeholders can be key in corporate achievement and for that reason; corporate leaders have to be mindful of the claims of stakeholders when making decisions and conduct business responsibly towards the interests of all stakeholders. The stakeholder theory debates that managers should be able to make a conclusion so as to consider the interests of all stakeholders in a firm including not up to financial claimants, but also customers, communities, governmental officials, employees, customers and communities (Manville & Ober, 2003; White, 2009).

Stakeholder theorists imply that organizations' managers should be of service to a network of relationships. Entailed to this network are the business partners, suppliers, employees, customers and the community. Abdullah & Valentine, (2009) argue that this group of networks more than what is stated in agency theory of owner manager- employee relationship is more important. Stakeholder theorists suggest that a firm being an organization with stakeholders has the purpose of creating wealth for its stakeholders. The theory posits that the boards of directors for corporations should be constituted in such a manner that all the stakeholders are taken care of.

In many countries therefore, especially in Europe and Asia, the most common are the stakeholder models of governance, as they emphasize the boards role is representation of the employee and community interests not forgetting those of owners, (Yoshimor, 2005). Freeman (1994) concludes that a firm can only maximize market value if it does not ignore the long-term interests of its stakeholders. This theory was therefore relevant in this study so as to help us analyse and understand how different ownership structures adopt a proactive approach to bring together all stakeholders worries into their own decision-making processes and to put down the needed governance structures to maximize firm's financial performance in the long- term.

### **2.2.3 Stewardship Theory**

To counter to agency theory, Davis et al. (1997) developed the Stewardship theory of management. Both theories, that is, management and the agency theory have key interest on the philosophies of leadership adopted by the owners of an organization. The stewardship theory was birthed by the seminal work of Donaldson and Davis (1989, 1991) which was developed then as a model. On behalf of the organization and principals, senior executives acted as stewards' for their best interests.

The stewardship theory according to the model of man is based upon the assumption that between collectivist options and self- servicing options the manager will make decisions in the best interest of the organization. Doing the right thing for the organization to this type of person is what motivates them because they believe that at the end when the organization flourish they will also benefit. From a strong organization which benefits both the steward

and the principal, the steward manager maximizes the performance of the organization working under the premise (Mallin, 2010).

From psychology and sociology, we also find stewardships roots as was illustrated by Davis, Schoorman, and Donaldson (1997), thus: "...as a steward protects and maximizes shareholder's wealth through firm performance, because by so doing, the steward's utility functions are maximized" (Abdullah & Valentine, 2009). The stewardship perspective suggests that when organizational success is attained stewards are satisfied and motivated. Stewardship theory recognizes that empowerment of the steward brings maximum autonomy built on high level trust.

Emphasis to act more autonomously to maximize on the shareholders' returns is put on the position of employees or executives. It is believed in this sense, that the performance of the firm can directly affect the perceptions of that individual's performance. To have greater role as stewards in the organization and reduce agency costs, the role of the CEO and the chairman as suggested under Stewardship theory should be unified.

The stewardship theory suggests that managers will be self-driven to act in the best interest of the shareholders and therefore, when appropriately empowered would give better returns to the shareholders without any need for monitoring or further incentives. To this end therefore, the theory posits that more inside directors would yield better returns to the shareholders. While the theory has acquired a lot of credence considering the recent research findings, it fails, however, to provide solutions to the increasing corporate scandals across the world, which seems to suggest a need for increased management monitoring.

## **2.3 Empirical Review**

### **2.3.1 Government Ownership and Financial Performance**

Alipour (2013) defines government ownership as the percentage or degree of ownership by the government. From the agency theory perspective as argued by Jensen and Meckling (1976), the modern corporation is featured by the separation of ownership and control. This in effect leads to self-interested actions especially by those who are in control. Lack of capital market monitoring would cause State ownership to be judged inefficiently since according to the Agency theory managers would be inclined to pursue their own interest at the expense of

those of the enterprise (Kiruri, 2013). Similarly, as claimed by Najid and Abdul-Rahman (2011) state-owned firms lack enough entrepreneurial drive leading them to be politically inclined rather than being commercially motivated which in turn leads to a poor financial performance. It is therefore clear from the agency theory perspective that government ownership deteriorates firm's performance in the long-run.

On matters concerning government ownership and corporate performance effect, empirical evidence presents mixed outcome as the prior studies conducted have reported on the relationships between the two variables both positive and negative results. In Kenya, for example, a sample of 43 was taken by Kiruri (2013) and simple linear regression analysis investigated on a bank's profitability in Kenya, the effects of ownership structure. It was discovered in the study that ownership concentration and state ownership had both negative as well as positive effects on bank profitability. Based on a sample of 134 firms in Kuwait listed on the Kuwait Stock Exchange in the year 2010, Alfaraih et al (2012) unveiled a negative relationship between government ownership and Kuwait Stock Exchange firm performance using the regression analysis results, thereby inclining a worse market performance when there exists' government ownership. Both a market-based (Tobin's Q) and an accounting-based (ROA) measures are used to measure firm performance.

A study in Malaysia of 87 non-financial listed companies using data from the year 2001 by Ghazali (2010) on the annual reports in the composite index found that two ownership variables, namely as a substantial shareholder, the government and foreign ownership were statistically significant and with corporate performance positively associated with market based performance as measured by Tobin's Q. Mrad&Hallara (2012) evaluated on the post privatization period in France, the relationship between performance, the residual Government ownership and value creation. In the study, it was revealed that very high levels of government ownership and value creation within the privatized company are associated with an increase on performance, while the vice versa on government ownership is associated with a decline in performance and value creation.

In a research by Zeitun (2009) of 167 Jordanian companies during 1989-2006 on the impact of ownership structure on company performance and failure in panel estimation, it was found that there is a significant negative relationship between firms accounting

performance and government ownership. Mishariet *al.* (2012) found a positive relationship between institutional investors and firm performance when he explored some firms listed in Kuwait on the effects of ownership structure on the ROA and Tobin's Q while a negative one exists in the government. Esther et. al. (2016) proposes that private investors will play a really active role in decision making and control if there would be a restructuring of government companies that would lead to a reduction of government ownership. The proposal is made on the condition that some ownership of privatized firms is not transferred from the government thus increasing shareholders' confidence, safeguarding their investments and proper monitoring of management.

An investigation into a sample of 95 listed firms in Russia done by Poyry and Maury (2010) revealed significantly higher debt levels in organizations with high state ownership. The implication of these results is that high state-owned entities have an upper hand when it comes to access of resources via the debt market, due to the preferential treatment received from banks owned by the government. State-owned firms for instance, can obtain debt finance at a significantly lower cost than other private firms. This will make them more inclined to utilize more debt than other corporations. On the other hand, Huang, Lin and Huang (2011) examined Chinese listed organizations from 2002 and 2005 and concluded that state ownership is beneficial to the debt ratio. They argued that the possibility of a takeover by managers could cause a surge in agency costs in corporations with high state ownership. Consequently, issuing more debt would curb agency costs of equity.

Ongore, K'obonyo and Ogutu (2011) examined forty-two Kenyan corporations on their ownership basis. The elements were: government; foreign; institution; diverse and the manager. The findings of the analysis revealed a positive relation between inside ownership, foreign ownership, institutions ownership, diverse ownership and firm performance. This was unfortunately not so for the relationship between government ownership and firm performance; which was negative. The above findings were supported by Alulomusi (2013) who concurred that there exists a negative relationship between government ownership and financial performance. He blames it on low asset quality and management efficiency which was due to blasé credit management, inefficient operations and low returns.

Mwathi (2009) took an in-depth look at the relationship between the ownership structure of commercial banks and their financial performance, she categorized the banks as private, government, foreign and domestic. She used regression analysis to narrow down the banks to the ones where the top ten shareholders possessed more than 50% of the shareholding from 2004 to 2008 in Kenya. The use of ROA indicated that; bank ownership had a fairly positive influence on performance; private and state-owned banks had a negative relationship with performance, foreign and domestic banks had a positive relationship with performance. The research hypothesized that government owned banks performed worse than foreign or domestic commercial banks and there is a negative correlation between state ownership and financial performance.

### **2.3.2 Local Ownership and Financial Performance**

Local ownership is a structure whereby the ownership constitutes locals. It can be viewed based on diverse ownership and institution ownership. Diverse ownership refers to corporations owned by more than one individual. Margaritis and Psillaki (2010) sampled manufacturing firms in France and analyzed the correlation between capital, ownership structure and performance of the firms. They discovered a better performance for firms with a concentrated structure than with a diverse structure. This was because of greater agency costs in diverse ownership and sound controls in concentrated ownership thus improving financial efficiency and lowering agency costs.

Czarnitzki (2015) observed that the performance in the stock market remained unaffected by the dispersed ownership. However, the same could not be said of the overall performance indicators. Kiruri (2013) studies the effects of ownership structure on the profitability of Kenyan banks. He found that local and foreign ownership benefited the banks' profitability while institutional ownership and state ownership had adverse effects on the banks' profitability. He concluded that lower profitability resulted from higher ownership concentration and government ownership, and higher profitability resulted from foreign and local ownership.

Cornett et al (2007) analyzed the relationship between institutional ownership structure and company profitability. They did it in a research titled, "The Impact of Institutional Ownership on Corporate Operating Performance". They used the ratio of cash-

flow to sales to measure performance. The research revealed a high positive correlation between the number of institutional shareholders and the ratio of cash flow to sales. Bruton and Filatotchen et al (2010) sampled firms in the U.K and France. They analyzed the effects of a firm's governance and ownership structure on the IPO performance. They concluded that ownership with a higher concentration improves a firm's IPO and overall financial performance.

Dana (2015) conducted an investigation to find out whether institutional ownership had an effect on performance for Jordan. She measured performance using Return on Assets (ROA) and Return on Equity (ROE) with six explanatory variables. She used data regression to study a sample which constituted 82 non-financial firms listed at Amman Stock Exchange (ASE) in Jordan from 2005 to 2013. The analysis depends on the OLS models pooled, Fixed Effects and Random Effects. Eventually, the Breusch and Pagan Lagrangian Multiplier (LM) and Hausman test proved that the Fixed Effects model was the most suitable for the data and was thus selected.

The findings revealed weak evidence of any correlation between institutional ownership and performance. This was because of the fact that there are advantages and disadvantages of institutional ownership and they have an influence on the level of risk in investment decisions by managers and in return, they affect the overall firm performance. The Nigeria government was advised to design programs and give incentives to boost industrial capacity utilization in the country. Nominal exchange rates determined by the market should prevail in the economy. The government should regulate its foreign reserve policy by setting a threshold, any amount in excess of the threshold should be ploughed back to the economy through investments instead of supporting excessive importation.

Yongjia and Xiaoqing (2017) conducted a study titled "Does Institutional Ownership Influence Firm Performance?" They sampled Chinese firms during the period 2004 to 2014 and investigated the effects of institutional ownership on performance using simultaneous equations model with a generalized method of moment's estimator. They found that institutional ownership positively affected firm performance and they strengthened the accounting for deregulation, contemporaneous market conditions and different stock market boards. Some institutional investors however, do not improve performance because they do



not actively monitor. For instance, the investigation revealed that large, foreign, pressure insensitive institutional shareholders have greater positive effects on performance than small, domestic and pressure sensitive shareholders. Further findings reveal that institutional investors increase shareholder's value by reducing management ownership and attracting more analysis. These findings are subject to a series to sensitivity analysis. These studies show a positive relationship exists between local ownership and financial performance.

### **2.3.3 Foreign Ownership and Financial Performance**

Managers are appointed by foreigners to improve performance. There is a widely accepted hypothesis that foreign-owned firms perform better in financial and production measures than their domestic peers. Azzam and Siddiqui (2013) however claim that several authors have proved the above hypothesis to be false; therefore, opinion on this matter is divided. Clarkson, Orell and Chapple (2011) claim that various foreign scholars have proved that ownership and capital structure have significant effects on firm performance and that ownership type and concentration, and capital market value of listed firms are mainly considered in the effect of ownership structure on financial performance.

A study conducted by Djankov and Simeon (2008) revealed a positive correlation between foreign ownership and provision of general and specific knowledge to the local company. Ochieng and Ahmed (2014) examined the performance of Kenya Airways before and after privatization. It had been expected that performance would improve after privatization since it brought about foreign investors. Financial performance of the firm however, did not meet this expectation and there were doubts as to whether Kenya Airways reaped the benefits associated with private ownership.

Bwire (2012) conducted a study in order to establish whether there were profitability differences between listed foreign and local banks. He did it by analyzing the determinants of their profitability. The sample constituted three foreign listed banks and six local listed banks. The data was examined using correlation analysis, descriptive analysis and regression analysis. The data revealed no significant differences in performance between the foreign and local banks. The study also found that none of the variables had significantly affected ROA and ROE. The regression analysis revealed that bank profitability was not influenced by

foreign ownership. The study therefore concludes that foreign banks do not perform better than local banks.

Li, Yue and Zhao (2009) conducted research in non-publicly traded Chinese corporations and found that foreign ownership i.e. the fraction of ownership by foreign investors, is negatively correlated to all measures of leverage, which include total debt, long-term debt and short-term debt divided by total assets. The outcome was caused by the following factors; Companies with high foreign ownership, due to their reputation, have a better access to sources of capital than local firms and Foreign-owned firms in China attract a lower corporation tax than local firms, therefore utilizing less debt.

Huang, Lin and Huang (2011) made the same conclusion when they investigated Chinese firms from 2002 to 2005. However, they explained that foreign owners who are mainly institutional investors possess significant experience in monitoring managers. They have a better ability to obtain and interpret information on firm performance (Al-Najjar& Taylor 2008). Consequently, foreign ownership helps to either control the managers' problem of over investment or reduce the agency cost between managers and shareholders.

Mang'unyi (2011) found that there is a high correlation between ownership structure and financial performance. This was after he analyzed the effects of ownership structure over management and performance of a sample of Kenyan banks. He argues that banks with a foreign investor perform better than banks with a domestic investor. Uddin and Suzuki (2011) obtained similar results in their study which aimed at banks in Bangladesh operating between 2001 and 2008. Alimehmeti and Paletta (2012) analyzed the relationship between shareholder concentration and value of the firm in their research conducted from 2006 to 2009. They surmised that there was a positive correlation between ownership concentration and firm value. The correlation however, was not evident in the crisis period of 2008.

Mahai (2012) investigated the relationship between foreign ownership and firm performance for the companies listed in the Bucharest Stock Exchange. The sample constituted 63 companies which excluded all credit and financial companies. Mahia used return on asset and return on equity to assess the financial performance of the company. He also used linear regression analysis and measured foreign ownership by the percentage of

shareholding held by foreigners. The study showed no significant difference in performance between foreign-owned entities and domestic-owned entities.

Chege (2013) examined the relationship between ownership structures and financial performance among Kenyan commercial banks listed in the NSE. He found that banks with more foreign shares owned reported higher profits than those with local share ownership. The unit changes in foreign shares significantly explained the higher profitability. However, he also found a negative correlation between local ownership and profitability. Chege's findings were similar to Alulamusi's (2013) since he also concluded that there was a positive correlation between foreign ownership and the various parameters of financial performance. He attributed the results to high monitoring capabilities of foreign owners. The cited studies reveal an overall positive relationship between foreign ownership and financial performance.

#### **2.3.4 Managerial Shareholding and Financial Performance**

Managerial ownership is the percentage of shares owned by the CEO and board members (Bayrakdaroglu et al. 2012). It is also defined as the percentage of outstanding shares held by executive directors (Cheng et. al, 2012). From Agency theory outlook, one of the ways to curb agency problems between managers and shareholders is through managerial ownership. It curbs agency problems by encouraging manager-owners to aim for managerial gain, incentivizing them to increase firm value instead of shirking their responsibilities (Jensen &Meckling, 1976).

Agency theorists claim that matching shareholders' and management interests, which can be done through increasing management stock holdings, will significantly improve firm performance. Bryan et al. (2000): Perry&Zenner, (2000) claim that managers will be more likely to act in line with the shareholders' interests if they were to own substantial amount of equity in the firm. Alternatively, they will carry on pursuing their personal interests such as job security, salary increment, power and status (Himmelberg et al. 1999, Zahra et al. 2000).

There is evidence of the relationship between management ownership and performance; however, the evidence is mixed. Khan et al. (2014) made observations on a sample of 1154 firms in Australia from 2000 to 2006 regarding the relationship between managerial ownership and the firm's earnings. The researchers observed a negative

correlation between insider ownership and performance. Chiang (2005) also discovered a negative relationship. A study conducted in Finnish, Lappalainen and Niskanen (2012) evaluated the effects of ownership structure and board composition on financial performance. The study was conducted on sample of small to medium-sized entities in Finland. The conclusion was that firms with high managerial ownership reported increased profits but with lower growth rates.

Ezazi et al. (2011) analyzed the correlation between ownership structures on share price volatility of listed firms in Tehran Stock Exchange. The result of the study indicate that the share prices of companies whose greatest shareholders possess more shares are more volatile than the prices of companies that the more percentage of their shares is held by individual shareholders. It is vital to point out that the measure of ownership of five greater shareholders and institutional shareholders and board members might not reveal a useful solution for investors interested in the volatility of the share prices.

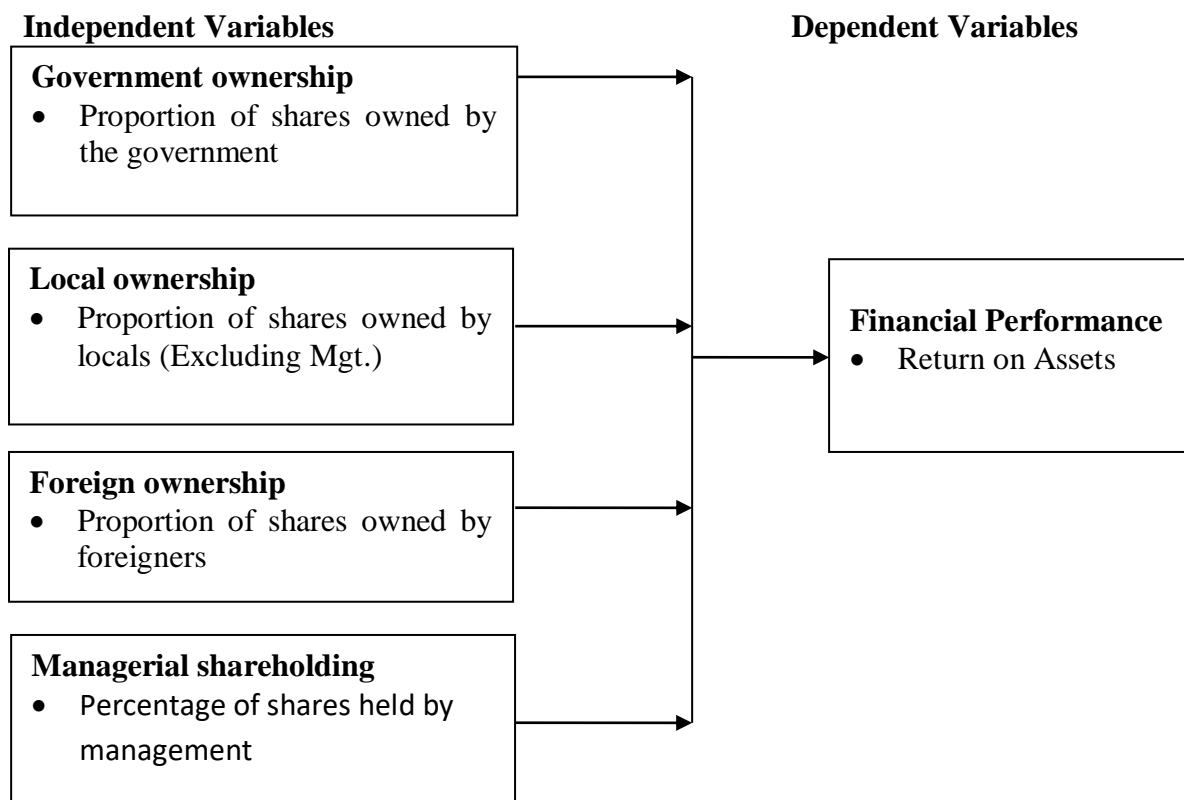
Dadson (2012) researched on the concentrated share ownership and financial performance of listed companies in Ghana. He used data on listed firms at the Ghana Stock Exchange between 1999 and 2008. The study used panel data regression analysis. Financial performance was measured using Tobin's Q and ROA. The research showed that share ownership is highly concentrated among the Ghanaians and that institutional and insider ownership leads to better performance. He recommended increased concentrated ownership structure and promotion of investments by managers and institutions in order to ensure proper monitoring, to reduce agency cost and improve overall performance.

Ruan, Tian and Ma (2011) used a cubic function to evaluate the relation between managerial ownership and leverage in 197 listed firms in China from 2002 to 2007. Managerial ownership was measured by the percentage of equity owned by managers. They observed a non-linear N-shape relation between managerial ownership and leverage. There is a negative relationship between insider ownership and debt ratio when this ownership is lower (18%) and higher (46%). Debt ratio is positively correlated with managerial ownership within a range of 18% to 46%. They posit that at an increase of managerial ownership may reduce the managers-shareholders conflict. Therefore, the use of less debt can maximize the shareholders' wealth and increase the firm's value by avoiding financial distress.

However, when insider ownership increases beyond a certain level, managers may increase the cash flow in order to obtain more cash and achieve their own interests or prevent share dilution so as to safeguard their control of the firm. As revealed by the cited studies, there is a positive relationship between managerial shareholding and financial performance since the interests of managers and shareholders are completely aligned when managerial ownership reaches a high level, thus the firm will use less debt to reduce bankruptcy risks.

## 2.4 Conceptual Framework

This is a research tool aimed at developing awareness and understanding of a particular situation under observation and communicates the situation. It has potential validity as a tool to assist a researcher to comprehend and communicate subsequent findings. According to Smyth (2004), the framework forms a section of the agenda for negotiation to be tested, reviewed, scrutinized and reformed as a result of the investigation and it expounds on the possible links between the variables.



**Figure 2.1: Conceptual Framework**

## 2.5 Operationalization of Study Variables

This section defines how variables in the study will be operationalized. All study variables are adapted from other studies and modified to suit the current study. A summary of the different variables are presented in Table 2.1.

**Table 2.1: Operationalization and Measurement of Study Variables**

Type of variable	Variables	Measurement	Scale	Data collection method
Dependent	Financial Performance	<ul style="list-style-type: none"> <li>Return on Assets</li> </ul>	Ratio Scale	Secondary data for a period of 6 years
Independent	Government ownership	<ul style="list-style-type: none"> <li>Proportion of shares owned by the government</li> </ul>	Ratio	Secondary data for a period of 6 years
Independent	Local ownership	<ul style="list-style-type: none"> <li>Proportion of shares owned by locals (Excluding Mgt.)</li> </ul>	Ratio	Secondary data for a period of 6 years
Independent	Foreign ownership	<ul style="list-style-type: none"> <li>Proportion of shares owned by foreigners</li> </ul>	Ratio	Secondary data for a period of 6 years
Independent	Managerial shareholding	<ul style="list-style-type: none"> <li>Percentage of shares held by management</li> </ul>	Ratio	Secondary data for a period of 6 years

## **2.6 Summary of Literature Review**

Many researchers have examined the correlation between ownership structure and the firm's financial performance. The findings were mixed, for instance: Nahila et al. (2016); Benjamin and Czarnitzki (2015); Ersoy (2015); Pervan et al. (2012); Mishari et al. (2012) and Namusonge (2011) found that the ownership had a negative correlation with the firm's performance. On the other hand, studies by Sirtaj Kaur (2016), Daskalakis et al. (2014), Ochieng and Ahmed (2014), Mokaya and Jagongo (2015) Zahoor (2014) Ofori et al. (2014); Mei, (2013) found that government ownership positively influences performance. With regard to the relationship between institutional ownership and financial performance; Mishari et al. (2012); Uwuigbe and Olusanmi (2012) reported a positive relationship, while Wei et al. (2005); Alipour and Amjadi (2011) reported a negative relationship. Wei et al. (2005) claims that foreign investors have a positive influence on performance but Omran et al. (2008) found that the foreign investors did not affect the performance significantly. Ongore et al. (2011) found that dispersed shareholders improved firm performance, a stance that Mei (2003) disagreed as he found out that dispersed shareholders had a negative effect on performance. Some researchers examined the impact of a single aspect of ownership whereas others analyze the influence that several mechanisms have on performance. None of the researchers looks at the effects of ownership structure on the financial performance on the stock market. The studies done on this subject are conflicting with no clear direction of the effects. Mang'unyi's (2011) and Ongore's (2011) studies on this topic are accessible. Mang'unyi sheds light on governance practices related to the ownership structure in Kenya's banking sector. Ongore claims that the concept of ownership can be defined along ownership concentration and ownership mix. Ownership concentration is the proportion of shares to the number of shareholders owning the shares. Ownership mix is concerned with the identity and type of persons holding the shares. Henceforth, this study investigated how ownership structure affects financial performance of companies listed at the Nairobi Securities Exchange. It seals a large gap since none of the researchers analyzed the effects of ownership structure on the financial performance of firms in the Nairobi Securities Exchange.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

This chapter takes a look at the research design, the population, as well as some of the techniques used while sampling in the study. Also, it looked at instruments, methods and procedures of data collection. Finally, it looked at data analysis and presentation methods.

### **3.2 Research Design**

The study used a design that was more of descriptive about the research. The design was preferred because the study aimed at establishing the relationship between ownership structure and financial performance of companies under the Nairobi Securities Exchange listing. (Cooper & Schindler, 2008) they describe the survey design as a method of gathering data through administering questionnaires or even interviewing selected individuals. It is mostly or rather preferably used when sampling information about peoples' social issues such as; attitudes, opinions or habits. Sekaran and Bougie (2011) note that compared to other methods, descriptive study has various advantages such as; aiding in the understanding of the characteristics of a given group in a certain situation as well as assisting in the systematic thinking about different aspects in a certain situation.

### **3.3 Target Population**

A population can be defined as an entire group of people, objects or events that share common objectives that are visible. Therefore, the target population is described as the events, objects or people to which a scholar wants to generalize the results of the study (Borg & Gall, 2007). The researchers therefore draw their samples from a population that is easily accessible, and which represents a sizeable population. The study targets a population of all actively traded of the 65 listed companies under the Nairobi securities exchange in Kenya, and was conducted using a census survey owing to the number of the companies listed being manageable. Therefore, the study targets the whole population of the study.

A list that is inclusive of every member of the subject from which a sample is to be acquired is known as a sample frame (Kothari, 2004). (Mark et al., 2009) states that any random sample of a population other than one that is really small is impossible to achieve without some form of a sample form. According to one Kothari (2004) a sampling frame is one that



contains of a list of items from which the test subject is to be taken. Having the main aim of carrying out this research, the sampling frame for the target subject was the 61 listed companies at NSE in Kenya as indicated on Appendix III.

### 3.4 Data Collection

The study relied on secondary data in meeting its obligation. Therefore, secondary data collection techniques were employed. Secondary data on financial performance as well as shareholding data presented in the yearly reports from the targeted institutions and data on financial performance was collected from the NSE within the study period 2012-2017. This data was analyzed to facilitate meeting the study objective.

### 3.5 Model Specification

Utilization of an empirical model was efficient to sample the statistical importance of the relationship involving the study quantities namely government ownership, local ownership, foreign ownership and managerial shareholding, financial performance. A multivariate panel data regression model was used as follows to link the independent variables to the dependent variable;

$$Y_{it} = \beta_0i + \beta_1iX_{1t} + \beta_2iX_{2t} + \beta_3iX_{3t} + \beta_4iX_{4t} + \epsilon_{it}$$

Where;

$Y_{it}$  = Financial Performance of firm  $i$  at time  $t$

$X_{1t}$  = Government Ownership at time  $t$

$X_{2t}$  = Local Ownership at time  $t$

$X_{3t}$  = Foreign Ownership at time  $t$

$X_{4t}$  = Managerial Shareholding at time  $t$

$\beta_0i$  = the constant term of firm  $i$

$\beta_{ii} = 1 \dots 4$  measure of the sensitivity of the dependent variable ( $Y$ ) to unit change in the predictor variables  $X_{1t}$ ,  $X_{2t}$ ,  $X_{3t}$  and  $X_{4t}$ .

$\epsilon_{it}$  = the error term that captures the unexplained variations in the model.

### **3.6 Diagnostic Tests**

Whereas correlation and regression analysis were the main tools of analysis in this study, use of general regression analysis makes a number of assumptions surrounding the quality and distribution of the data, key among them including those of independence of observations, homoscedasticity of random errors and normality of the data (Yan & Gang Su, 2009). As such, before any data was subjected to linear regression analysis, a number of statistical tests were necessary to confirm that such data was suited for the analysis. These tests include that of normality, the test for homoscedasticity or absence of Heteroscedasticity, unit root tests and the Hausman test.

Correlation and regression analysis are parametric tests that require that variables be normally distributed (Osborne & Elaine, 2002) since not normally distributed variables (high kurtosis or skewed) can tamper with relationships and significance tests. Though visual inspection of histograms or frequency distributions can give an indication of variable distribution, this was augmented inferentially using skewness-kurtosis test/Jarque-Bera test for normality. West et al. (1996) proposed a departure from normality as an absolute skew value  $> 2$  and an absolute kurtosis value  $> 7$ . However, for this study the recommendation of Myoung (2008) as a rule of thumb asserted that a variable reasoning close to normal skewness and kurtosis are between  $-1.0$  and  $+ 1.0$  was adopted.

For any data to be subjected to regression analysis it should be homoscedastic and the variance or errors should not vary with the values of the explanatory variables. According to Osborne & Elaine, (2002) homoscedasticity is when the discrepancy of errors is the same across all platforms of the independent variable and when this variance is different at various values of the independent variable, heteroscedasticity arises. Heteroscedasticity is assumed when all random errors have the same constant variance and this is true if the observations of the error term are assumed to be drawn from identical distributions (Yan and Gang Su, 2009). Heteroscedasticity interferes not only with the significance tests in a study but also weakens the analysis thus distorting the results of the analysis. What was used to test heteroscedasticity was the White's test since it does not presume any particular type or source of heteroscedasticity (Yan & Gang Su, 2009). The variables are said to be heterogonous if

they are statistically significant ( $<0.05$ ). To test for constant variance of stochastic disturbances using the White's test, the squared residuals from the regression model are regressed onto the regressors, the cross products of the regressors, and the squared regressors. The whites test was augmented with the graphical method which involves (Osborne & Elaine, 2002; Yan & Gang Su, 2009) which involves examination of a plot of the standardized by regression. Residual errors in homoscedastic data are randomly scattered around the horizontal line corresponding to zero, providing an even distribution.

The data was tested for stationarity using the Levin-Lin-Chu (2002) test. It works exclusively for strongly balanced panel data (Espinoza & Prasad, 2010). Stationarity or otherwise can strongly influence its behavior and property. Stationarity can be either weak form or covariance stationarity. If more than one variable is trending over a period of time in a case of stationarity there could be high  $R^2$  of one in the regression even if the two are totally independent. If the variables in the model are not stationary, then there would be proof of invalidity of standard assumptions for asymptotic analysis. In simple terms, the usual t-rules will not follow a t-distribution so it will not be possible to undertake hypothesis test about the regression patterns. If stationarity exists, the data will have to be de-trended before regression is carried out to get more accurate results. The variables are said to be stationary if the p value is greater than 0.05 and therefore the null hypothesis is accepted.

### **3.7 Data Analysis**

Once the sample has been identified or picked, the data is processed so as to make meaningful information out of it. Sounders, Lewis and Thornhill, (2009) call process data analysis. Burns and Grove (2003) define analysis as a mechanism for the reduction as well as the organization of data to bring forth findings that do not require the researcher's interpretation. De Vos (2002) further defines analysis of data both as a creative and challenging process characterized by a close relationship between the researcher, general data and the participants. This is more efficient because first hand data convey little meaning to most people.

Descriptive statistics is the analysis that illustrates, describes and summarizes data in a meaningful way so that for instance, patterns would be revealed from the data. However, descriptive statistics does not set any boundaries on making conclusions that go overboard on

the information analyzed, nor reach any conclusions whatsoever concerning any hypothesis made. They simply describe the sampled information. Descriptive analysis therefore included the use of trends, frequencies and percentages. Regression analysis was used to establish the association between independent and dependent variables. Mugenda and Mugenda (2003), state that this method is used so as to evaluate the intensity of the association between two or more variables, and that the outcome of the analyzed data will be presented by the use tables and graphs.

## CHAPTER FOUR: RESULTS AND DISCUSSION

### 4.1 Introduction

This chapter presents the analysis of the secondary data collected from NSE Listed firms for the period 2012 to 2017. The results in this chapter proceeds in two distinct ways; first, we present the descriptive analysis such as means of variables. Secondly, inferential analysis; correlation analysis and the conventional panel data analysis are presented.

### 4.2 Descriptive Statistics

Table 4.1 shows the descriptive statistics of the variables used in the study. In case of return on assets, its mean value (0.08) shows that majority of firms had a ROA of 8% between 2012 and 2017 with a minimum and maximum value of 0.23 and 0.67 respectively and a standard deviation of 0.30, an indication of ROA across firms being moderated dispersed around the mean. The results findings are supported by Mukulu, Nteete and Namusonge (2012) who argued that performance measurement is important for organizations as a means of continuous improvement and also as a means of determining whether or not organizations are achieving their objectives.

For ownership concentration, the results show that local ownership constitutes 56% with the local ownership ranging between 0% and 100% with a standard deviation of 0.31 implying that the local ownership variations from the mean is moderately dispersed, closely followed by foreign ownership with a mean of 30% and also ranging between 0% and 95% with a standard deviation of 0.29 an indication of low variation of the values of foreign ownership from the mean.

Government ownership average 8% and ranged between 0% and 74% with a standard deviation of 0.18 while management ownership structure averaged 2% with its range between 0% and 66% with a standard deviation of 0.08 indicating less dispersion from its mean values. The ownership structure reveals that the dominant owners of majority of the firms are local/domestic shareholders and followed by foreign shareholders with limited ownership position by the government and management.

**Table 4.1: Descriptive statistics**

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	312	0.08	0.30	0.23	0.67
Government ownership	312	0.08	0.18	0.00	0.74
Local ownership	312	0.56	0.31	0.00	1.00
Foreign ownership	312	0.30	0.29	0.00	0.95
Management ownership	312	0.02	0.08	0.00	0.66

The results as presented in Table 4.2 shows that the Pearson Correlation coefficients. From the results in the correlation matrix below we infer that government ownership is negatively ( $r = -0.1049$ ) and significantly ( $p - value = 0.06$ ) correlated with firm's return on assets at 10% level of significance. This thus implies that the higher the stake of a firm that the government owns the less will be the firm's performance as measured by its return on assets. This is in line with the proposition that state-claimed firms in most cases lacks adequate entrepreneurial drive and have a tendency to be politically as opposed to monetarily propelled and corroborates the fact that it is likely to deter firms for operating efficiently and thus affecting its performance negatively. This finding is also in line with the findings of Capobianco and Christiansen (2011); Gunasekarage et al. (2007); Firth et al. (2008); Kiruri (2013) and Alfaraih et al (2012) who established that state ownership has an adverse effect on firm performance. This could be due to the misalignment of state ownership goals with those of the shareholders and by the virtue that state ownership suffers from agency costs arising due to poor corporate governance.

Domestically-claimed ownership of firms is established to be negatively ( $r = -0.0549$ ) and insignificantly ( $p - value = 0.33$ ) correlated with firm's return on assets. This implies that as the share of a firm's domestic ownership increases its performances is more likely experience decline. The finding of this study on the effect of local ownership on firm performance resonates the findings of Margaritis and Psillaki (2010); Kiruri (2013) and

Yongjia and Xiaoqing (2017) who found that more domestic concentrated ownership of firms ensures sound controls which as a result which enhances financing effectiveness and lower agency costs prompting great financial execution and consequently higher firm's financial performance

Foreign ownership on the other hand is established to be positively ( $r = 0.1595$ ) and significantly ( $p - \text{value} = 0.00$ ) correlated with firm's return on assets at 5% level of significance whereas management ownership of firms is established to be positively ( $r = 0.0089$ ) but insignificantly ( $p - \text{value} = 0.88$ ) correlated with firm's return on asset. This finding is consistent with the findings of Djankov and Simeon (2008) and Li, Yue and Zhao (2009) who also found that a higher share of foreign ownership has a positive connection with firm performance. This is attributed to the fact that could be because foreign investors helped in improving management systems and provided access to huge resources than other forms of ownership structures. Equally, foreign owned firms benefit from sophisticated technology spillovers and a more diversified financing channel.

On foreign ownership and firm performance the correlation analysis reveals that more foreign ownership of a firm is associated with increased firm performance which could be due to the fact that foreign investors help improve management systems and provide access to massive resources than other forms of ownership structures. As for management ownership the results imply that an increase in management ownership is also associated with increased firm performance and this could be due to the fact that manager's interests is more likely to be well aligned with those of the shareholder's interests. Turning to the nexus between the different types of ownership structures we establish that they are all negatively correlated which conforms to the fact that as the ownership share increases then as a matter of fact the other ownership pie must reduce accordingly.

**Table 4.2: Pearson correlation analysis test for multicollinearity**

	ROA	Government ownership	Local ownership	Foreign ownership	Management ownership
ROA	1				
Government ownership	-0.1049 (0.06)	1			
Local ownership	-0.0549 (0.33)	-0.3055 (0.00)	1		
Foreign ownership	0.1595 (0.00)	-0.2281 (0.00)	-0.6267 (0.00)	1	
Management ownership	0.0089 (0.88)	-0.0793 (0.16)	-0.0989 (0.08)	-0.0882 (0.12)	1

### 4.3 Diagnostic Tests

#### 4.3.1 Stationarity Tests

Within a panel data framework, the test for non-stationary of a series is imperative as a regression based on non-stationary series yields spurious results. To avoid the problem of spurious regression results we tested for the presence of a unit-root using the Levin-Lin Chu (LLC) test. The results presented in Table 4.3 shows that all the variables are stationary at levels (that is, non-presence of unit roots) at 5% level of significance. As such the variables can be used in the form they are to conduct further analysis.

**Table 4.3: Levin-Lin Chu (LLC) test for unit roots**

Variable	t-statistic	p-value	Decision
ROA	-13.101	0.00	Stationary
Government ownership	-10.8261	0.00	Stationary
Local ownership	-37.4085	0.00	Stationary
Foreign ownership	-21.8964	0.00	Stationary
Management ownership	-23.1132	0.00	Stationary



### 4.3.2 Testing for heteroskedasticity

In testing the spherical disturbances assumption that the regression's residuals have a constant variance (i.e. considered homoscedastic) we adopted the White's test of independence whose null hypothesis states that the spherical disturbances are homoscedastic or tests the null of poolability (Gujarati, 2003; Wooldridge, 2003). The Breusch-Pagan LM test with a  $\chi^2(10) = 2.2e + 05$  is statistically significant (p-value = 0.00) and thus we conclude that the spherical disturbance assumption is violated and thus we conclude that the residuals are heteroscedastic. To ensure homoscedasticity of the residuals we use the robust standard errors in estimation and hence addressing the bias of non-sphericity of the disturbance term.

**Table 4.5: White's test of heteroskedasticity**

$\chi^2 - test$	<b>p - -value</b>
$\chi^2(52) = 2.2e + 05$	0.0000

### 4.3.3 Testing for autocorrelation

Serial autocorrelation is a common problem experienced in panel data analysis and has to be accounted for in order to achieve the correct model specification. According to Wooldridge (2002), failure to identify and account for serial correlation in the idiosyncratic error term in a panel model would result into biased standard errors and inefficient parameter estimates. In the spirit of panel data analysis, this study used the Wooldridge test for serial correlation to test for the presence of autocorrelation in the linear panel data which is an F-test under the null hypothesis of no first-order autocorrelation.

The F-test statistic i.e.  $F(1,51) = 21.513$  is found to be statistically significant (p-value = 0.00) and thus we cannot reject the existence of first-order autocorrelation. To address this problem together with the non-sphericity of the disturbance we use the cross-sectional time series feasible generalized least squares (FGLS) regression to correct for the existence of first-order autocorrelation and sphericity of the disturbance.

**Table 4.6: Wooldridge test for serial correlation**

<b>F – test</b>	<b>p – -value</b>
F(1,51) = 21.513	0.000

**4.4. Model Fitting****Table 4.7 Regression Analysis**

<b>Dependent variable: ROA</b>	<b>Coef.</b>	<b>Std. Err.</b>	<b>z</b>	<b>P&gt;z</b>	<b>[95% Conf. Interval</b>	
Constant	-1.14	8.58	-0.13	0.89	-17.95	15.67
Government ownership	-0.08	0.12	-0.66	0.51	-0.32	0.16
Local ownership	0.04	0.02	2.23	0.03	-0.13	0.22
Foreign ownership	0.19	0.10	1.95	0.05	0.00	0.38
Management ownership	0.09	0.22	0.42	0.67	-0.34	0.53
<i>Wald</i> $\chi^2(52)$		10.10				
Prob> F		0.0388				
Log-likelihood		-1501.4				

$$Y = -1.14 - 0.08X_1 + 0.04X_2 + 0.19X_3 + 0.09X_4 + \varepsilon$$

Where;

$X_1$  =Government ownership;

$X_2$  =Local ownership;

$X_3$  = Foreign ownership;

$X_4$  =Management ownership

In summary, the regression equation (1) suggests that the expected performance of firms when different firm ownership structures are all equal to zero is -1.14. From the results an increase in government ownership by one percent reduces firm performance (ROA) by 0.08% while a one percent increase in local ownership increases firm performance (ROA) by 0.04%. Similarly, a one percent increase in foreign ownership share increases firm performance (ROA) by 0.19% while a 1% increase in management ownership increases firm performance (ROA) by 0.09%. The results affirm that the highest increase in a firm's return on assets is expected when the share of foreign ownership increases followed by management ownership and finally when the share of local ownership increases. This implies that in considering the optimal firm structure firms should strive to ensure a balance between them so as to achieve optimal performance.

#### **4.4.1. $H_{01}$ : There is no significant relationship between government ownership and financial performance of companies listed at the NSE.**

The regression results in Table 4.7 below reveal that the relationship between government ownership and financial performance of companies listed is negative ( $\beta = -0.08$ , p-value = 0.51) though insignificant at 5% level of significance. This therefore invariably means that as a firm's government ownership increases, its financial performance deteriorates. The results are consistent with that of many other research studies in both emerging and frontier markets. The results are in agreement with the findings of Kiruri (2013) who established that a higher stake of government ownership of banks in Kenya has a negative effect on a firm's performance. It also resonates with the findings of Alfaraih et al (2012) in Kuwait who also established the existence of a negative relationship between government ownership and the performance of firms listed at the Kuwait Stock Exchange.

This finding is supported by the fact that government unlike other institutional investors do not have as their main objective to make profits. Instead, the government's goal is to reduce unemployment, increase tax collection and therefore it trying to play a dual role of being regulator of the economy and being owners of firms results in conflicting positions as the two roles often conflicts. More importantly government owned firms are political enterprises often characterized by bureaucracy and no clear incentives of improve on firm performance.

#### **4.4.2. H<sub>02</sub>: Relationship local ownership and financial performance of companies listed at the NSE.**

From Table 4.7, we observe that local ownership, as measured by the shareholding by local investors on listed firms, has a significant positive relationship with financial performance ( $\beta=0.04$ , p-value = 0.03). This therefore implies that the higher the local investors ownership of listed firms the higher will be the performance of the firms.

This finding is in line with those of Margaritis and Psillaki (2010) who found that more domestic concentrated ownership of firms ensures sound controls which as a result which enhances financing effectiveness and lower agency costs prompting great financial execution and consequently higher firm's financial performance. It is also in agreement with the findings of Kiruri (2013) who documented the existence of positive association between local ownership and firm performance in Kenya's banking industry.

#### **4.4.3. H<sub>03</sub>: To establish the correlation between foreign ownership and financial performance of companies listed at the NSE**

We also establish from Table 4.7 that foreign ownership has a statistically significant positive effect on a firm's financial performance ( $\beta = 0.19$ , p-value = 0.05) with the coefficient being higher in magnitude compared to those of other ownership structures. This therefore implies that firms with higher foreign ownership have higher return on assets which is in line with priori expectations that foreign ownership is associated with improved firm performance.

This finding is consistent with the findings of Djankov and Simeon (2008) and Li, Yue and Zhao (2009) who also found that a higher share of foreign ownership has a positive connection with firm performance. The finding from this study can be interpreted and in support of the fact that a higher share of foreign ownership in a firm is associated with sophisticated technology spillovers which gives the firms an upper hand in being efficient. Similarly, firms with high foreign possession have more diversified financing channels to get to capital than others as a result of their reputation and connections

#### **4.4.4. Ho<sub>4</sub>: Relationship between financial performance and the managerial shareholding of companies listed at the NSE**

We also note from Table 4.7 that managerial shareholding has a positive effect on firm performance ( $\beta = 0.09$ , p-value = 0.67) though insignificant. This is in accordance with the theoretical underpinning of the agency theory that views management ownership as being noteworthy in guiding a firm's governance thus manager's goals often are in accordance with those of other shareholders. From an empirical stand point the findings are in agreement with the findings of Niskanen & Lappalainen (2012) in Finland who showed that management ownership influences positively both the development and the profitability of firms. Firms with high administrative possession levels show higher profitability ratios but have lower growth rates.

## **CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

### **5.1 Introduction**

The chapter presents a summary of the findings on the relationship between financial performance and ownership structure of firms listed at the Nairobi Securities Exchange Kenya (NSE). Section 5.2 of this chapter presents conclusion while 5.3 gives recommendations.

### **5.2. Summary**

This study investigates the relationship between financial performance and ownership structure of firms listed at the Nairobi Securities Exchange Kenya. Four research questions are answered: (1) what is the effect of government ownership on financial performance? (2) What is the effect of local ownership on financial performance? (3) What is the effect of foreign ownership structure on financial performance? Lastly, (4) what is the effect of managerial shareholding on financial performance?

#### **5.2.1 Government ownership and financial performance**

The descriptive statistics showed that the average government ownership of firms stood at 8% and ranged between 0% and 74% with a standard deviation of 0.18. The results also reveal that government ownership is negatively ( $r = -0.1049$ ) and significantly ( $p - value = 0.06$ ) correlated with firm's return on assets at 10% level of significance. This thus implies that the higher the stake of a firm that the government owns the less will be the firm's performance as measured by its return on assets. Regression results reveal that there is an insignificant negative relationship between government ownership and financial performance of companies listed.

#### **5.2.2 Local ownership and financial performance**

From the result we establish that local ownership constitutes 56% and ranges from between 0% and 100%. Similarly, domestically-claimed ownership of firms is established to be negatively ( $r = -0.0549$ ) and insignificantly ( $p - value = 0.33$ ) correlated with firm's return on assets. This implies that as the share of a firm's domestic ownership increases its performances is more likely experience decline. The regression results in addition reveals that

local ownership has a significant positive relationship with financial performance. This therefore implies that the higher the local investors' ownership of listed firms the higher will be the performance of the firms.

### **5.2.3 Foreign ownership and financial performance**

The descriptive analysis revealed that of the firms consider 30% were foreign owned with the ownership ranging between 0% and 95% with a standard deviation of 0.29 an indication of low variation of the values of foreign ownership from the mean. From the correlation analysis we establish that more foreign ownership of a firm is associated with increased firm performance which could be since foreign investors helped in improving management systems and provided admission to enormous resources than other forms of ownership structures. Regression results reveals that foreign ownership concentration has a positive and significant effect on return on assets which is consistent with the view that foreign owned firms are more profitable which is due to technology spillovers which makes them more efficient.

### **5.2.4 Managerial Holding and financial performance**

The descriptive statistics of management ownership structure averaged 2% with its range between 0% and 66% with a standard deviation of 0.08 indicating less dispersion from its mean values while the correlation analysis on the other hand revealed that an increase in management ownership is also associated with increased firm performance and this could be due to the fact that manager's interests is more likely to be well aligned with those of the shareholder's interests.

The regression results that managerial shareholding has a positive effect on firm performance although the relationship is insignificant. Lastly, we establish that nexus between government ownership and financial performance is negative though insignificant at 5% level of significance which is in tandem with the finding by Niskanen&Lappalainen (2012) who showed that management ownership influences positively both the development and the profitability of firms. This is attributable to the fact that there is better alignment between manager's interests with those of the shareholders hence partly mitigating the agency problems due to separation of powers about firm ownership and management.

### **5.3. Conclusions of the study**

The first conclusion on objective one drawn from the study findings is that relationship between government ownership and financial performance of listed firms is negative though insignificant. This therefore invariably means that as a firm's government ownership increases its financial performance could deteriorate more probably due to poor governance associated with government run corporations. Secondly, we conclude that local ownership has a positive relationship with financial performance and therefore the higher the local investors' ownership of listed firms the higher will be the performance of the firms. Thirdly, we conclude that foreign ownership has a statistically significant positive effect on a firm's financial performance implying that firms with higher foreign ownership have higher return on assets which is in line with priori expectations that foreign ownership is associated with improved firm performance. Lastly, we conclude that local ownership concentration, as measured by the shareholding by local investors on listed firms, has a positive relationship with financial performance and therefore the higher the local investors' ownership of listed firms the higher will be the performance of the firms.

### **5.4. Recommendations for policy**

This study recommends that corporations should engage more with strategic investors that comprises local investors both individuals and institutional, and foreign for enhanced firm's performance.

The Government should promote corporate governance in corporations where it has a majority ownership for effective firm performance.

Government should cede controlling stake in the privatization of state owned companies and focus on the policy forming and taxation element to create a business friendly environment and cushions listed companies from unnecessary meddling in strategic and operational management.

Management should enhance corporate governance, reduce agency costs and be risk takers to promote effective firm performance.



## **5.5 Limitation of the study**

The study encountered some limitations which are documented hereunder. The study only targeted companies listed in the Nairobi Securities Exchange. This implies that the findings cannot be generalized and may not apply to categories of other organizations like academic institutions, NGOs, SMEs and faith-based organizations. This is because firms in different industries have unique ownership structures that may influence their overall performance.

The study had limitations due to scanty and inconsistent data, particularly with suspended and illiquid companies since these would result in inaccurate results and null observations. Complete data set available was therefore for 52 of the listed 65 companies at the NSE. However the sampled data is representative across all sectors on the market and therefore constitutes adequate data to conduct a conclusive analysis. With a +-5% statistical error margin.

## **5.6 Areas for Further Research**

The study recommends a replica study to be done to non-listed firms to find out whether the combined use of different ownership structures would have an effect on firm performance. Similarly, future studies should apply different research instruments like questionnaires, interview guide, and focus group discussions to involve respondents in discussions in order to generate detailed information which would help in improving firms' performance in Kenya through adoption of appropriate ownership structures.

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