Effect of Ownership Structures on Financial Performance of Listed Firms in Nairobi Securities Exchange in Kenya

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ABSTRACT

The purpose of this study is to determine the effects of ownership structure on firm's financial performance and will be guided by the following specific objectives: to determine the effects of state ownership on firm's financial performance; establish the effects of local ownership on firm's financial performance. Thirdly the study will endeavour to investigate whether foreign ownership affects firm's financial performance. Finally the study will determined whether ownership structure and managerial shareholding affects firm's financial performance. The study will adopt Co relational and cross-sectional research designs. The study will use both statistics (quantitative) and themes (qualitative) to develop strong evidence in support of the study

variables. The target populations of the study will be the 61 companies listed in Nairobi Securities' Exchange.

Key words – local ownership, Foreign Ownership, Government Ownership, managerial shareholding

1.0 INTRODUCTION

In the age of globalization and open market, companies all over the world are now exposed to more intense competition from other nations around the world. Gomez (2005) pointed out that from the global perspective the past two decades have witnessed significant transformations in corporate governance structures, leading to increased scholarly interest in the role of board of directors in driving corporate performance. According to Jiang and Wong (2004) for the last two decades the relationship of ownership structure and firm performance has become an area of interest among investors and has developed considerable attention in the broader field of corporate finance and among other stakeholders.

Lioui and and Shaema (2012) argued that firms' ownership is organized in order to maximize firm value and suggested that firms' ownership and capital structure decisions reflect attempts to mitigate agency problems between various stakeholders to avoid potential conflicts of interest between a controlling shareholder and minority investors. Uzel (2015) argued that the concept of organizational performance is core to businesses because the major objective of businesses is to make profits. Iravo, Ongori and Munene (2013) raised concern as to why some organizations succeed while others fail and this has influenced a study on ownership structure and financial performance of organizational.

Mukulu, Nteete and Namusonge (2012) noted 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. Gonzalez and Molina (2010) observed that, higher ownership-concentration improve firm's performance and concluded that Ownership structure is the basic factor that affect firms' ownership and control allocation, and it has a strong impact on firm performance.

1.1Statement of the problem

Ownership structures have great effects on corporate governance adopted by a firm and according Miring'u and Muoria (2011) the governance structure of any corporate entity affects the firm's ability to respond to external factors that have some bearing on its performance**,** survival and growth. Performance of the firms is becoming highly exposed to scrutiny by potential investors due to the risks involved including adverse publicity brought about by collapsing of some firms.

Namusonge, Kabare & Mutua, (2012) Kenya has been experiencing turbulent times with regard to its organizational practices in the last two decades. This has resulted in generally low profits across the economy. Weir and Laing (2002) argues that good ownership structure advocates for good governance mechanisms that boosts a firm's capacity to attract investors, ensures effective monitoring mechanisms of the board and the decision-making process are in place to protect and promote shareholders' interests and improve the overall firm's performance.

Most Kenyan studies, Mbaabu (2013), Chege (2013), Nafula(2012), Miring'u and Muoria (2011), Mang'unyi (2011) and Wanjiku (2011), Ongore and K'Obonyo (2011) and Wanyama (2012) on ownership structure and firm performance have been contradictory in theory and findings moreover the area has also been dominated by studies conducted in developed countries. However, there is an increasing awareness that theories originating from developed countries such as the USA and the UK may have limited applicability to emerging markets. According to Franks and Mayer (2001) systematic and conclusive evidence on the financial performance effects of various ownership structures remains sparse, notably in emerging markets and developing economies. Emerging markets have different characteristics such as different political, economic and institutional conditions, which limit the application of developed markets' empirical models.

It is on the background of the above mixed reports and the fact that the Kenya economy is undergoing transition from emerging to developed market opening opportunities for small investors that the study will sought to examine how ownership structure affects the firm's financial performance and spill over effects to economy at large and shed new light into corporate finance literature on the type of ownership structure which would demonstrate highest returns.

2.0 Research Objectives

2.1 General objective

The general objective of this study is to establish the effects of ownership structures on the financial performance of public companies listed in Nairobi security Exchange in Kenya.

2.2 Specific objectives

The study will pursue the following specific objectives;

1) To evaluate the effect of government ownership on financial performance of firms listed in the Nairobi Securities Exchange in Kenya
2) To analyse the effect of local ownership on financial performance of firms listed in the Nairobi Securities Exchange in Kenya
3) To establish the effect of foreign ownership structure on financial performance of firms listed in the Nairobi Securities Exchange in Kenya
4) To determine the effect of ownership structure and managerial shareholding on financial performance of firms listed in the Nairobi Securities Exchange in Kenya

3.0 THEORETICAL FRAMEWORK

3.1 Agency Theory

The Agency theory rests on the assumption that the role of organizations is to maximize the wealth of the shareholders (Blair, 1995). Further the Agency theory explains a fundamental problem for absent or distant owners who employ professional executives to act on their behalf. The agency theory is then adopted for this study because according to Eisenhardt (1989) agency theory is concerned with analysing and resolving problems that occur in the relationship between shareholders and their professional agents. Further it tries to understand how to best organize relationships between the principal(owners) and the agents(Professionals) and determines the work, which the agent should undertakes and the measures the owners should put in place to maximize their returns (Eisenhardt, 1989).

3.2 Stakeholder Theory

Stakeholders' theory challenges the primacy assumption of shareholder interests and advocates that a company should be managed in the interests of all its stakeholder (Freeman, 1994).The theory is based on the assumption that values are necessarily and explicitly a part of doing business and that managers need to articulate the shared sense of value they create to bring its key stakeholders together. When stakeholders get what they want from a firm, they return to the firm for more (Freeman, 1984; Freaman & McVea, (2001). Stakeholders' theory is therefore adopted in this study to help us analyse and understand how different ownership structures adopts a proactive approach to integrate all stakeholders' concerns into their decision-making processes and to lay the necessary governance structures to maximize firms financial performance in the long- term.

3.4 Stewardship Theory

Donaldson and Davis (1991) advanced this theory as an alternative to the agency theory. They argued from the view of managerial motivation by stating that management far from being an opportunistic shirker essentially wants to do a good job, to be a good steward of the corporate assets. The basic idea behind the stewardship theory is that it states humans to be in greater needs than the neo classical view in the sense of them to be opportunistic, untrustworthy and focused on personal gains. Stewardship theory was adopted in this study to enable analyse how different ownership structures have put in place, facilitating and empowering structures rather than monitoring and controls, that are proposed by the agency theory which interferes with the motivation of the steward instead of ensuring that both the principal and the steward interests are aligned to enhance effectiveness of agent in pursuit of improved firms financial performance in the long-term.

4.0 EMPRICAL REVIEW OWNERSHIP STRUCTURES

4.1 Government ownership and Firm Performance

Ongore, K'Obonyo and Ogutu (2011) analysed ownership identity of forty-two firms in Kenya based on five elements: government; foreign; institution; diverse; and manager (insider). The study found a significant positive relationship between insider ownership, foreign ownership, institutions ownership, diverse ownership and firm performance. However there was a significant negative relationship between government ownership and firm performance. His findings were consistent with Alulamusi (2013) who observed that Government ownership had a negative relationship with financial performance and attributed this to asset quality and low management efficiency due to laxity in prudent credit management practices and inefficiency of operations and poor returns.

4.2 Foreign ownership and firm performance

Djankov and Simeon (2008) in their study had found a positive relationship between foreign ownership and the provision of generic and specific knowledge to the local company. Aydin, Sayim and Yalama, (2007) argued that on an average foreign owned firms have performed better than the domestically owned firms because foreign owners are more likely to have the ability to monitor managers and give them performance based incentives. Foreign ownership goes beyond financial contribution and extends to provision of managerial expertise, technical collaboration and transfer of new technology and globally tested management practices to the firm, which helps them to increase the efficiency and effectiveness of the operational processes leading to improved performance (Pallathitta ,2005).

4.3 Local ownership and firm's performance.

Local ownership refers to the companies owned by locals and can be viewed in terms of diverse ownership and institution ownership. Diverse ownership refers to companies owned by local individuals with no single controlling shareholder. Margaritis and Psillaki (2010) using a sample of French manufacturing firms investigated the relationship between capital structure, ownership structure and firm performance and their empirical results showed that listed firms with more dispersed ownership face greater agency costs which lowers their financial performance while listed firms with more concentrated ownership have sound controls which improves financing efficiency and lower agency costs leading to good financial performance.

4.4 Management shareholding

According to Bozec et al. (2002) the agency theory assumes that managers seek to maximize their own advantage rather than that of the owners of the firm or the firm itself. However, Cuervo and Villalonga, (2000) argues that managers are disciplined by a number of external control mechanisms, such as the market forces and also by internal control mechanisms, such as compensation and rewards incentives which prevents the managers from seeking their own advantages. Further, Gloria (2007) explains in her study findings is that in Kenya, managers work better in an environment where they are afforded an opportunity to own shares of the firm and allowed freehand to exercise their professional judgment without undue influence from shareholders.

4.6 MEASUREMENT OF FINANCIAL PERFORMANCE

This study will focus on those measures that are strategically important for the success of the company. Therefore, the study will measure the financial performance of the companies by looking at profitability (Return on Assets, and Return on Equity). Return on Assets *(ROA)* refers to the amount of net income returned as a percentage of total assets. Matolcsy and Wright (2011) measured firm performance by using return on assets. It was decomposed as follows: Return on Assets= EBIT / Average total Assets – in book value.

5.0 RESEARCH METHODOLOGY

5.1 Research Design

This study will adopt correlation research design. According to Albright et al. (2011) a correlation research is a procedure in which subjects' score on two or more variables are simply measured, without manipulation of any variable, to determine whether there is a relationship. The study will undertake cross-sectional study in which data will be gathered just once and as such, a causal study will be undertaken in a non-contrived setting with no researcher interference. A cross sectional study will be used to determine the interrelationship between the variables under consideration among the different firms in the study to permit the researcher to make statistical inference on the broader population and generalize the findings to real life situations and thereby increase the external validity of the study.

5.2 Target population

The population of interest in this study will be all the firms that have been listed at the NSE between 2010 and 2014 and had compiled their financial reports for the relevant period of study.

According Nairobi Stock Exchange (NSE) Handbook on profiles and performance of listed companies (2010-2014) there were 61firms listed at the NSE.

5.3 Sampling frame

Sampling Frame

The sampling frame for this study consist of all the registered firms in the Nairobi securities Exchange as at December, 2014 as they appear in the NSE listing manual(2014) The major reason for choosing firms listed in Nairobi Securities Exchange is due to accessibility to the required data by the fact that it's a legal requirement of the companies Act Cap 482 for listed companies to publish their audited financial statements which will provide data required by this study.

5.5 Sample and Sampling Technique

The study will adopt stratified random sampling to stratify the firms into Government owned, Foreign owned and Local owned. The following formula used by Saunder et. al., (2009) will also be adopted to arrive at the study sample.

$$P\% \times \mathrm{q}\% \times \frac{(z)^2}{e\%}$$

$$50\% \times 50\% \times \frac{n(1.96)^2}{5\%}$$

$$\mathrm{n} = 385$$

$$n^1 = \frac{\mathrm{n}}{1+\frac{n}{p}}$$

$$n^1 = \frac{385}{1+\frac{385}{44}}$$

$$n^1 = 39$$

Using the above formula a study sample of 39 companies was derived.

For each company four respondents will be considered and therefore total number of the sampled respondent will be 156.

5.6 Data Collection methods

The study will use questionnaires to obtain qualitative data for analysis which will further be validated from analysis results from secondary data quantitative analysis acquired through analysis of the companies' published annual accounts and quarterly market reports.

5.7 Data Collection Procedure

Primary data will be collected through the administration of questionnaires to four respondents in each firm. Two research assistants will be engaged to mainly make follow-up of the administered questionnaires. The entry point to the firms will mainly be through public relation officer and research departments for those firms which had research department. Secondary data will be obtained from the company's annual reports submitted to the Nairobi Securities exchange.

5.8 Pilot Test Study

The study will carry out a pilot test to test the validity and reliability of the questionnaires in gathering the data required for purposes of the study. Dawson (2002) states that pilot testing assists researchers to see if the questionnaire will obtain the required results. This being a study which involves qualitative and quantitative data, a pilot study is necessary.

5.9 Data Processing and Analysis

Data will be analysed through statistical procedures which covers a broad range of descriptive analysis, from simple procedures that are used regularly like computing an average to complex and sophisticated methods. Besides using frequencies and descriptive analysis, the study will use multiple linear regression analysis to test the statistical significance of the various independent variables.

5.10 Qualitative Data Analysis

Qualitative data collected through questionnaires will first be edited and response rate calculated. The data will then be categorized into different themes according to research variables and descriptive statistics such as mean, standard deviation and frequency distribution which according to Kothari (2012) measures the point about which items have a tendency to cluster and also describes the characteristics of the data collected will be computed.

5.11 Quantitative Analysis

Quantitative data will be analyzed using inferential statistics. Pearson correlation test will be conducted to test level of significance between all independent variables and dependent variables. Variance Inflation Factor (VIF) will be conducted to test for Multicollinearity among predictor's variables. Multiple regressions model will be used to determine the type of the relationship that exists between the dependent and dependent variables.

$$\boldsymbol{Y = \beta_0 + \beta_1\, Gvt\ Own + \beta_2\, Fgn\ Own + \beta_3\, Lcal\ Own + \beta_4\, Mgt\ shrding + \varepsilon}$$

Where;

$\boldsymbol{Y}$ Represents Financial Performance variables which are Return on Assets and Return on Equity for firms listed in NSE.

$\boldsymbol{\beta_0}$ –Represents constant or intercept which is the value of dependent variable when all the independent variables are zero

$\boldsymbol{\beta_1 - \beta_4}$ Represents Regression Coefficient for each independent variable

$\boldsymbol{\beta_1\ Gvt\ Own}$ **-**Represents Government Ownership Structure

$\boldsymbol{\beta_2 Fgn\ Own}$ **-** Represent Foreign Ownership Structure

$\boldsymbol{\beta_3\ Lcal\ Own}$ **-** Represents Local ownership Structure

$\boldsymbol{\beta_4\ Mgt\ shrding}$**-** Represent Management shareholding

$\boldsymbol{\varepsilon}$ **-** Represents the error term which accounts for other possible factors that could influence $\boldsymbol{Y}$ that are not captured in the model.

6.0 CONCLUSION

The study reviewed the theories related to the study which included the Agency theory, Resource Dependence, Stewardship theory and Stakeholder theory which analyses the relationship between ownership (shareholders/principals), management (agents) and the conflict between principal and agents and how such conflict affects performance of the firm. It also covered the different types of ownership structures and their effect on financial performance of listed firms in Nairobi securities exchange. The conceptualized ownership structures of listed firms are: Government ownership, Local ownership, Foreign ownership and a moderating variable of management shareholding. The linkage among the variables is determined and a conceptual framework is hypothesized and relevant gaps explained.

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