

**RELATIONSHIP BETWEEN COMMERCIAL BANKS' FINANCIAL
PERFORMANCE AND THEIR OWNERSHIP STRUCTURE**

ZIPPORAH NJOKI MWATHI

D61/P/8834/05

UNIVERSITY OF NAIROBI

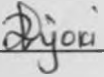
SEPTEMBER 2009

**UNIVERSITY OF NAIROBI
LOWER KABETE LIBRARY**

**A research project submitted in partial fulfillment of the award of
Master of Business Administration (MBA), School of Business,
University of Nairobi.**

DECLARATION

This project is my original work and has not been presented for any other university award.



Zipporah Njoki Mwathi

20/11/2009

Date

D61/P/8834/05

This project has been written under my supervision and submitted for examination with my approval as university supervisor.



Mr. Moses Anyangu

21.11.09

Date

ACKNOWLEDGEMENT

I take this opportunity to thank my lecturers at University of Nairobi for their dedication during our coursework.

To my supervisor, Mr. Moses Anyangu for his time and encouragement.

To my MBA colleagues especially Jane Wairua, Priscilla, Ondieki, Leonard, Juma, Wafula and Nancy Gathungu.

To my family, thank you for believing in me and all the support you gave me.

To my employer, KRA, for all the support given to me during my MBA coursework.

DEDICATION

To the Almighty God, thank you Lord for the numerous blessings. You are my strength Lord and you never let me down.

I dedicate this project to my dear parents, Michael and Mercy Mwathi and my dear sister Josephine Mwathi. Thanks for believing in me. God bless you.

TABLE OF CONTENTS

Page

Declaration.....	ii
Acknowledgement.....	iii
Dedication.....	iv
List of tables	vii
Abstract.....	viii

CHAPTER ONE

1.0 INTRODUCTION.....	1
1.1 Background of the Study.....	1
1.2 Statement of the Problem.....	7
1.3 Objectives of the Study.....	8
1.4 Importance of the Study.....	9

CHAPTER TWO

2.0 LITERATURE REVIEW.....	10
2.1. Ownership structure	
2.1.1. Government versus private ownership	10
2.1.2. Foreign versus local ownership.....	12
2.1.3. Closely held versus dispersed ownership.....	15
2.1.4. Block ownership of banks	16
2.2 Other factors affecting bank performance.....	17
2.3 Performance	18
2.4 Measures of bank performance	19
2.4.1 Profitability analysis	19
2.4.2 Capital adequacy ratios	20
2.4.3 Long term solvency	20
2.4.4 Earnings and profit performance emphasis	21
2.5 Relationship between ownership structure and firm performance	21

CHAPTER THREE

3.0 RESEARCH METHODOLOGY..... 25

3.1 Introduction..... 25

3.2 Research Design..... 25

3.3 Population 25

3.4 Study sample and sampling procedure..... 25

3.5 Data Collection 26

3.6 Data Analysis 27

CHAPTER FOUR

4.0 DATA ANALYSIS AND FINDINGS

4.1 Introduction 29

4.2 Factor analysis 29

4.3 Regression analysis 31

CHAPTER FIVE

5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS 38

5.1 Introduction 38

5.2 Summary of findings 38

5.3 Conclusions of the study 39

5.4 Recommendations 40

5.5 Areas for further research 40

References..... 41

Appendices..... 47

Appendix I: Survey Data 47

LIST OF TABLES

Table 1:	Communalities.....	29
Table 2:	Total Variance Explained	30
Table 3:	Rotated Component Matrix	31
Table 4:	Descriptive Statistics	32
Table 5:	Correlations	33
Table 6:	Variables Entered/Removed.....	35
Table 7:	Model Summary	35
Table 8:	ANOVA.....	36
Table 9:	Coefficients.....	37

ABSTRACT

The study examines the relationship between commercial banks financial performance and their ownership structure. We distinguish between private banks, government banks, foreign banks, domestic banks, widely held and closely held banks where the top 10 shareholders hold more than 50% of the shares. The empirical work analyses data on banks operating between 2004 and 2008 in Kenya. We use regression analysis to determine the relationship between the two independent variables (performance and ownership structure).

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Although by regional standards, Kenya's financial system is relatively well developed and diversified, major structural impediments prevent it from reaching its full potential. Country comparisons have shown the importance of a well developed financial sector for long term economic growth and poverty alleviation. Experience from other developing economies has shown the detrimental effect of government ownership and the positive influence that foreign bank ownership can have on the development of a market based financial system (Beck, T. and Fuchs, M., 2004).

The banking sector in Kenya is oligopolistic, with at most four foreign and / or government participating banks controlling at least 50% of the banking sector assets. These banks are Barclays Bank, Standard Chartered Bank, Kenya Commercial Bank and National Bank of Kenya. CBK Annual Report (2007)

The performance of the banking sector has greatly improved over the last seven years. This is evidenced by the large growths in profitability. According to CBK reports, the banking sector at December 2007 had pre tax profits of Kshs 35.5 billion compared to Kshs 27.3 billion at December 2006 reflecting a 30% growth in profits. CBK Annual Report (2007)

Among other things, banks can play a crucial role in jump-starting financial development by providing credit to institutions that would otherwise not be able to raise funds on their own. This process may be hindered if the owners of banks do not pursue social and economically optimal objectives (e.g. government owned banks may pursue political objectives). (Kithinji, A and Waweru, N., 2007)

While governments have an important role in creating an enabling environment for efficient financial markets, experience in both developed and developing countries have shown a negative impact of government ownership on financial development. Formerly seen as a necessary tool to foster financial and economic development, government owned banks have fallen short of delivering on their promises and have prevented especially developing economies from building market based financial systems. Countries with a higher share of government owned banks have experienced lower GDP per capita growth, less effective capital allocation, lower and more concentrated access to Credit and higher interest rate spread (Lopez-de-Silanes and Shleifer, 2002; Barth, Caprio and Levine, 2004).

Cross country comparisons have shown the benefits of foreign bank ownership in developing countries like Kenya, while providing little evidence for adverse consequences on access and cost of financial services (Claessens and Jansen, 2000, Clarke et al., 2003). In addition to investment in the capitalization of financial institutions, foreign banks usually bring better know how and technical capacity, which then spills over to the rest of the banks. They impose competitive pressure on domestic banks, increasing efficiency of financial intermediation. They provide more stability to the financial system, being able to draw liquidity resources of their parent banks. Finally, there is even evidence that access to credit is higher in countries with a larger share of foreign owned banks. These results suggest that even in those cases where foreign banks have focused narrowly on the top end of the market rather than providing financial services to small scale borrowers, they can force domestic banks to refocus on the small borrower segments.

In the Kenyan banking sector, those banks with government participation have been performing dismally while foreign banks have outperformed domestic banks. Most of the banks that have collapsed have been either locally owned or with government majority. Several reasons have been advanced to explain this occurrence in other developing

countries but little study has been done in Kenya to test whether there is any significant relationship between ownership structures of banks and their performance.

The role of large domestic block holders has not been addressed in most studies of bank ownership (Claessens, Demirguc-Kunt and Huizinga, 2001; Micco, Panizza and Yanez, 2004). Large domestic block holders, after all, may significantly affect bank performance, but there is no documented evidence of this. Though most authors emphasize the beneficial effects of foreign banks entry in developing economies, there is still very little evidence on the impact of foreign owned banks on the profitability in the banking industry in Kenya.

In this study analysis of several profitability differences of various aspects of ownership structures will be tested. These are:

- (i) Between foreign owned and domestic banks.
- (ii) Between Government owned and private banks
- (iii) Between closely held and dispersedly owned banks.

One of the objectives of financial liberalization is to inject greater competition into banking markets to enhance efficiency. This requires new entrants from the private sector. But new investment by foreign banks in Kenya over the last decade has been very limited. Consequently, the local private sector is the only potential source of new investment in banking, and an increase in the market share of the local banks provides the only realistic option for reducing oligopoly in the banking market. These potential benefits will not be realized unless local banks are prudently and honestly managed. The foreign banks have clearly outperformed the local banks while government participation in banks has been associated with mismanagement resulting to poor performance.

The emergence of banks owned by the local private sector began in the mid 1970s. Financial markets in Kenya have been dominated by foreign and government owned commercial banks. The expansion of the local banks was temporarily retarded in Kenya by a series of bank failures in the mid 1980s, but rapid growth resumed later in the decade.

Table 1 provides data on the number of local banks in operation at various dates between 1980 and the mid 1990s and the estimated market share of the sector in the mid 1990s.

Year	Number of local banks
1980	0
1985	4
1991	7
1994	17 (25%)

Sources: Kariuki (1993, p.307) and CBK Annual reports

Notes: the figures in parentheses give the deposit market share of the local banks

The foreign banks have generally been very conservative in their lending policies, concentrating on the multinational corporations (MNCs) and other large corporate customers. Extending access to credit to local businesses was one of the motives for the establishment of government banks and development finance institutions (Harvey, 1993). But these were often inefficiently managed and directed a large share of their lending to parastatals; therefore had only a limited impact on the credit needs of local businesses. In addition, the oligopolistic features of banking markets meant that the retail services provided by the foreign and government banks were usually of poor quality, expensive

and limited in range. Consequently, the local banks were able to gain a foothold in financial markets by targeting customers neglected by the established banks, such as small businesses, and by offering better services.

To a much greater extent than the established foreign banks, the local banks have been vulnerable to adverse incentive and selection problems. This is partly because they have operated in segments of the credit markets where these problems have been at their most acute (i.e. at the bottom end of the market, which contains the least creditworthy borrowers, often with limited, if any, collateral), and partly because of the deficiencies in the institutional mechanisms for constraining adverse selection and moral hazard (banks are under capitalized and lack adequate expertise, supervisory systems are weak, etc.) Moreover, some features of the local banks, notably close links with politicians, have exacerbated problems of moral hazard. The public sector banks have faced a different set of problems, mainly involving political interference in the allocation of credit and the pursuit of non commercial objectives (Harvey, 1993).

Financial distress has afflicted numerous local banks, many of which have been closed down by the regulatory authorities or have been restructured under their supervision. Two local banks were closed between 1984 and 1989. A further five local banks were taken over in 1993/94, and two more local banks in 1996. In 1993/94 around 11 per cent (11%) of the total assets of banks were held by the failed local banks. A statement in the Kenyan parliament in October 1995 revealed that the Central Bank of Kenya (CBK) lost a total of Kshs 10.2 billion (equivalent to 3.8 per cent of 1993 GDP) from frauds involving the “political banks” (Economist Intelligence Unit, 1995, p.13).

Most of the local banks in Kenya have been performing dismally compared to foreign banks. One of the major causes of local bank failure such as the Continental Bank, Trade Bank and Pan African Bank is extensive insider lending, often to politicians. According to (Kithinji, A. and Waweru, N., 2007), several factors contributed to this.

First, politicians are involved as directors and shareholders of some of the local banks. Political connections are used to obtain public sector deposits: many of the failed banks relied heavily on wholesale deposits from a small number of parastatals. Because of political pressure, the parastatals which made these deposits are unlikely to have made a purely commercial judgement as to the safety of their deposits. Moreover, the availability of parastatal deposits reduced the need to mobilize funds from the public. Hence these banks faced little pressure from depositors to establish a reputation for safety.

Second, most of the failing banks are undercapitalized, in part because the minimum capital requirement in force when they had been set up was very low. Owners have little of their funds at risk should their bank fail, which created a large asymmetry in the potential risks and rewards of insider lending.

A third factor contributing to bank's poor performance was the excessive concentration of ownership. In many of the failed banks, the majority of shares were held by one man or one family, while managers lacked sufficient independence from interference by owners in operational decisions. A more diversified ownership structure and a more independent management might have produced better performance.

Table 2: The proportion of foreign owned banks to total number of banks (in %)

Nature of Ownership	2007
Foreign Owned	25
With government participation	11
Locally owned	64
Total	100

Note: Foreign – owned banks are defined as those with foreign ownership exceeding a 50% share as at end of year.

Source: Central Bank of Kenya monthly reports

1.2 Statement of the problem

Having witnessed the varying performance of banks in Kenya, it's worth noting that out of the ten most profitable banks in Kenya (using the 2007 financial results) four of these are foreign banks that control over 30% of the entire banking sector's profits. The remaining six banks have the participation of a large block holder whether local, government or foreign. Most of the locally owned banks perform dismally. Also government owned banks with the exception of National Bank which has received substantial capital injection from the government have performed dismally.

Government involvement in commercial banks has been associated with poor management due to involvement of politicians. Most of these banks then suffer from large volumes of non performing loans. A good example is Kenya Commercial Bank (KCB) and National Bank of Kenya (NBK). When the government had a majority ownership of KCB, the company was been badly run due to huge volumes of non performing loans. However when the government gave up a large chunk of its shares to the public, the bank has slowly improved its performance and is now among the top three most profitable banks in Kenya.

Thuku (2002) conducted a study to establish whether there was a relationship between a bank's ownership structure and its performance. The study showed that there was no significant relationship between a bank's ownership structure and the financial performance. The period of study for his research was 1996 and 2000. In this period the Kenyan banking sector was going through very difficult times and actually saw the occurrence of a banking crisis. The economic conditions affecting the banking sector

were so severe that at present 13 banks (27% of the population) out of the research's population of 48 have since ceased operations.

The banks were charging high base lending rates to borrowers due to the competition for funds with the government characterized by high treasury bill rates. The average base lending rates for year 1999 and 2000 was 25.2% and 19.6% respectively. The study did not cover insider ownership and block ownership. There is a lot of evidence that there was a lot of mismanagement in the financial sector which influenced the sector's overall performance. Thus we can conclude that the results of the study could have been influenced by other factors outside the scope of the study.

Since year 2000, the Kenyan banking sector has gone through major changes which have helped improve the banks' performance. There have been major amendments to the Banking Act that have altogether changed the playing ground increasing competition among market participants. Banks are now allowed to participate in other areas such as mortgage provision and investment advice.

Thuku (2002) used Return on capital Employed (ROCE) as a measure of financial performance. In this study the performance measure to be used will be Return on Investment (ROI): $EBIT / \text{average long term liabilities} + \text{equity}$. Unlike ROCE, ROI evaluates the earnings performance of the firm without regard to the way the investment is financed. ROI measures the earnings on investment and indicates how well the firm utilizes its asset base.

1.3 Objective of the study

The objective of this study is to investigate the relationship between bank ownership structure and bank financial performance in Kenya.

1.4 Importance of the study

The Kenyan banking sector has undergone important changes in the last two decades that shifted the business environment of banking firms to a more competitive one. Liberalization that started in the 1990s, made Kenyan banks less protected by expanding the market for corporate control. Amendments to the Banking Act has led to increased competition on the product market and expanded the banking opportunity set by broadening the range of activities banks can engage in. All these developments unified the market for corporate control and the market for financial services, and led banks to operate under the same “threats” nation wide. Consequently, governance mechanisms such as ownership structure are expected to play a more active role in aligning managers’ interests with those of shareholders.

The results of this study can be used to:

- a) Help formulate regulatory reforms to enhance better performance of banks. Such reforms can include the limiting of ownership of banks to various levels for certain types of shareholders.
- b) Determine the optimal ownership structure of a bank so as to maximize performance.
- c) Make effective decisions by the government on whether to privatize banks or not.

CHAPTER TWO

LITERATURE REVIEW

There exists a substantial body of literature focusing on the relationship between ownership structure and bank performance.

2.1 Ownership Structure

2.1.1 Government ownership versus private ownership

State ownership in banks has been prevalent in transition and developing countries. The argument for state ownership is that governments are able to channel funds to sectors and projects with low financial but high social returns since private capital is distrustful in doing so. The arguments against state ownership in banks are mainly built on poor performance. State ownership theoretically means all citizens are co-owners who in practice have no power and therefore no incentive to influence and monitor the management of state banks. This free-rider problem leaves government the only effective representative agent (Huibers, 2005).

Most of the literature on government ownership of banks documents the poor performance (i.e. lower profitability, poor asset quality) of state owned banks vis a vis their private counterparts (Berger, Bonime, Goldberg and White, 2004; Berger, Clarke, Cull, Klapper and Udell, 2005; Micco, et al., 2004). In addition, government ownership of banks has been associated with slower future economic growth and financial development (Barth, et al., 2004; Galindo and Micco, 2004; La Porta, et al., 2002a).

According to Barth, et al., government ownership of banks is more prevalent in poorer countries and in countries with more interventionist and less efficient governments and less secure property rights (La Porta, et al., 2002a). The bulk of evidence supports the political view of government ownership of banks, which argues that government control

of financial institutions politicizes resource allocation for the sake of advancing certain political agendas (e.g. obtaining votes, bribing office holders), and by pursuing such objectives, economic efficiency is hampered (Kornai, 1979; Shleifer and Vishny, 1994). Consistent with the political view, several papers document that government ownership of banks inhibits financial development and economic growth (Barth, et al., 2004; Galindo and Micco, 2004; La Porta, et al., 2002a).

Cornett, Guo, Khaksari, and Tehranian (2003) examine the differences in performance in 16 Far East countries between 1989 and 1998. They also find that state owned banks are significantly less profitable, have lower capital ratios, greater credit risk, lower liquidity, and lower management efficiency.

Another well documented findings is the poor performance of state owned banks relative to their domestic or foreign owned counterparts (Berger, Clarke, Cull, Klapper and Udell, 2005; Mian, 2006b; Micco, et al., 2004). Berger et al. (2005) uses data from Argentina in the 1990s to analyze static, selection, and dynamic effects of domestic, foreign, and state ownership on bank performance. They find that state owned banks have poor long term performance and that those banks undergoing privatization have poor performance beforehand, and dramatically improve their performance after privatization. Mian (2006b) studies 1,600 banks in 100 emerging markets and documents that government banks perform poorly and only survive due to government support.

Micco et al. (2004) examine the relationship between bank ownership and bank performance for banks in 119 countries. They find that in developing countries, state owned banks have lower profitability, higher costs, higher employment ratios, and poorer asset quality than their domestic counterparts. With the exception of state owned banks having higher costs than their domestic counterparts, they do not find evidence of significant differences between state and domestic private banks' performance in industrial countries.

Micco et al. (2006) study covering the period 1995-2002, to reassess the relationship between bank ownership and bank performance, providing separate estimations for the developing and industrial countries. Specifically, the authors focus on the question whether the differential in performance between public and private banks is driven by political considerations. Their findings suggest that state owned banks located in the developing countries tend to have lower profitability and higher costs than their private counterparts, and that the opposite is true for foreign owned banks. They did not find a strong correlation between ownership and performance for banks located in industrial economies.

The bulk of evidence on state ownership of banks suggests that it is associated with poor bank performance and negative economic outcomes. There is little evidence supporting the more optimistic development view (Gerschenkron, 1962) of government ownership of financial institutions, which argues that governments can play a major role in the financial and economic development of countries in which economic institutions are not sufficiently developed. With this in mind the vast reductions in Kenyan government ownership of banks over the last ten years has been associated with economic growth and financial development.

2.1.2 Foreign ownership versus local ownership

Local banks have since the mid – 80s gained a significant share of banking markets in Kenya. The Kenyan banking market had previously been dominated by foreign and government owned banks. The local banks could provide important benefits to the Kenyan economy and facilitate the objectives of financial liberalization by stimulating improvements in services to customers and expanding access to credit, especially to domestic small and medium scale businesses. But the attainment of these benefits has been jeopardized because the local banks have been vulnerable to financial distress.

Studies on foreign ownership of banks have generally documented a positive impact of foreign ownership on bank performance, particularly in developing countries (Bonin, Hasan and Wachtel, 2005; Claessens, et al., 2001; Micco, et al., 2004). Foreign bank presence also appears to improve the competitiveness of domestic banks (Claessens, Demirguc-Kunt and Huizinga, 2001; Micco, Panizza and Yanez, 2004).

In terms of individual bank performance, Claessens et al. (2001) document that foreign banks are more profitable than their domestic counterparts in developing countries, but the opposite is true in developed markets. Demirguc-Kunt and Huizinga (1999) studied banks in 80 countries over the 1988-1995 period and found that foreign banks have higher margins and profits than domestic banks in developing countries but the opposite is true for industrial countries. Micco et al. (2004) also document that foreign banks have higher profitability, lower costs, and lower employment ratios than their domestic counterparts in developing countries, although they exhibit higher non performing loans than their counterparts.

Bonin et al. (2005) examine bank performance in six Eastern European transition economies and find that foreign banks are more efficient in terms of cost and profit than domestic banks. They also find support for the importance of privatizing banks by selling them to strategic foreign investors. Banks privatized in such manner are more cost and profit efficient than state owned banks. Majnoni, Shankar, and Varhegyi (2003) study the dynamics of foreign bank ownership in Hungary between 1994 and 2000 and find that foreign banks, while pursuing lending policies, achieve greater profitability than their domestic counterparts.

De Young and Nolle (1996) made a significant contribution with their research where they investigated relative profit efficiency of foreign owned U.S. banks and U.S. owned banks between 1985 and 1990. Their results suggest that foreign owned U.S. banks were significantly less profit efficient than U.S. owned banks during the investigated period. Since in that period foreign banks expanded rapidly in the U.S. market, the results were

consistent with the hypothesis that foreign banks sacrificed profitability in exchange for increased market share.

Several studies document the impact of foreign bank entry on domestic banks. Micco et al. (2004) find that foreign bank presence is associated with increased competitiveness of the domestic banks (lower margins and lower overhead costs). Claessens, et al. (2001) show that foreign bank entry diminishes the profitability of domestic banks and reduces their non interest income and overall expenses. When other factors are controlled for, higher profits reflect a lack of competition, while overhead costs, a lack of efficiency. They argue that their findings are consistent with foreign banks improving the efficiency of domestic banks.

Unite and Sullivan (2003) studies how foreign bank entry and foreign ownership of banks affects the banks in Philippines. They show that foreign bank entry and penetration reduces interest spreads and operating expenses of domestic banks, making them more efficient. Barajas, Salazar, and Steiner (2000) show that foreign entry appears to improve the efficiency of Colombian domestic banks by reducing non financial costs, although the increased competition may have resulted in increased risk and deterioration in domestic banks' loan quality.

Foreign banks are better than domestic banks at monitoring "hard" information (e.g. accounting information, collateral value), but have a disadvantage in monitoring "soft" information (e.g. entrepreneurial ability). This leads foreign banks to lend to safer and more transparent customers to avoid lending to opaque firms (Berger, Klapper and Udell, 2001; Mian, 2006a).

Overall, the evidence shows than in developing countries like Kenya, foreign banks are more efficient than their domestic counterparts, while the opposite is true for developed countries.

2.1.3 Closely held ownership versus dispersed ownership

Very few studies try to account for differences in banks' ownership structure (closely-held and widely held) and thus fail to explore the role played by these different kinds of structures.

Adenikinju and Ayorinde (2003), defines ownership concentration as the proportion of shares held by the top ten (10) shareholders. Shleifer and Vishny (1997) argue that concentrated ownership, which has both interests in profit maximization and adequate control rights over the assets of the firms, can control a firm's management effectively. The concentrated ownership, however, is not without limitations. A fundamental problem of having concentrated ownership is the difficulty of protecting interests of minority shareholders that somehow may not coincide with those of the majority owners.

It is argued that deficiencies in corporate governance structures are mitigated by higher concentrations of ownership. For example, La Porta *et al.* (1996, 1997 and 1998) argue that ownership concentration and institutional differences are a response to differing degrees of legal protection of minority shareholders across countries. Roe (2003), Pagano and Lombardo (1999) and Pagano and Volpin (2001) argue that political determinants primarily explain differences in ownership concentration.

The impact of ownership concentration on firm performance is two fold. On the one hand, concentrated ownership can provide for better control of management, as size of ownership stake and the incentive to monitor are positively correlated. In turn this should improve firm performance and equally benefit minority shareholders. On the other hand, it can come with costs for minority shareholders as the controlling owners might try to expropriate from them. This is one of a number of private control benefits enjoyed by large block holders at the expense of firm value (Jensen and Meckling, 1976; Grossman and Hart, 1988).

The existing literature is split concerning the effect of ownership on performance. Bebchuk and Roe (1999) and Roe (2003) argue that what, at face value, appear to be inefficient ownership structures (whether dispersed or concentrated), are in fact efficient in the context of their institutional environment.

2.1.4 Block ownership of commercial banks

The presence of shareholders holding a high proportion of the firm's capital constitutes one of the ways to mitigate the effects of the separation of ownership and control on a firm's value. The manager of a firm in which each shareholder holds only a small fraction of the firm's capital can engage in value reducing activities (Berle and Means, 1932). Indeed a shareholder with little stake in a firm has weak incentives to engage in monitoring of managers since he or she supports all the costs of monitoring while getting only a small fraction of the benefits (the typical free rider problem). In contrast, an ownership structure in which one or more shareholders own a block of stock has the potential for refuting the managers from engaging in moral hazard behavior. The presence of block holders may present a threat to the company's management because they can easily dismiss errant managers. A block holder may also nominate a person to represent him or her on the board of directors, in order to ensure that management is acting in the interests of shareholders. Consequently, firms with block holder ownership are expected to have less agency problems, and the need for alternative control mechanisms is reduced.

Stockholders with large ownership stakes may have an incentive to closely monitor a firm's performance, which can help alleviate the principal – agent problems that exist between managers and shareholders (Jensen and meckling, 1976). Several studies of non financial firms have shown positive correlations between firm value and cash flow ownership of large shareholders (Claessens, djankov, fan and Lang, 2002; la Porta, Lopez-de-Silanes, Shleifer and Vishny, 2002b). There is one such study in the banking

literature: Caprio, Laeven and Levine (2003) document that larger cash flow rights by controlling owners boost bank valuations.

On the other hand, there are potential costs associated with the presence of large shareholders (Shleifer and Vishny, 1997). Large shareholders may pursue their own interests, ignoring interests of other stakeholders. This is consistent with the idea that through their ownership of banks, large domestic blockholders may direct fundings to particular industries in which they (or their friends) have a vested interest. Such actions prove to be detrimental to the profitability of the bank.

Thomson et al. (2003) pointed out that block holders might destroy firm value. Large blockholders will be more likely to influence managerial behavior although as Scheifer and Vishny (1986) noted this does not require shareholding voting rights. Block holders will exercise more effective corporate governance. It also lowers the direct agency conflict with the management reducing the scope of managerial opportunity.

Further research suggests that large block outside ownership may also be an effective counter-balance to managerial opportunism. Companies may have large, undiversified shareholders that play a critical leadership and monitoring role. They have both incentives and the means to restrain the self serving behavior of managers (Maug, 1998; McConnell and Servaes, 1990; Zeckhauser and Pound, 1990). In addition, they make value enhancing implicit contracts with employees and other stakeholders (Shleifer and Summers, 1988).

2.2 Other factors affecting bank performance

The role of ownership structure (Morck et al., 1988, and McConnell and Servaes, 1990) in monitoring management and so improving firm performance has been largely investigated in empirical corporate governance literature.

The subject of financial performance and research into its measurement is well advanced within finance and management fields. It can be argued that there are three principal

factors to improve financial performance for financial institutions; the institution size, its asset management, and the operational efficiency. To date, there have been little published studies to explore the impact of these factors on commercial banks' financial performance.

(Chien Ho, and Song Zhu, 2004) showed in their study that most previous studies concerning bank performance evaluation focus merely on operational efficiency and operational effectiveness which might directly influence the survival of a bank.

Existing empirical research shows that foreign owned banks play a stabilizing role in emerging economies' banking systems. Anecdotal evidence suggests that this stabilizing role can be attributed to transnational banks' access to more diversified sources of liquidity.

However research has shown that profitability of both domestic and foreign banks is affected not only by bank's specific characteristics but also by financial market structure and macroeconomic conditions.

2.3 Performance

There are different views on what performance is. It can be regarded simply as the record of outcomes achieved on an individual basis; it is a record of a person's accomplishments (Drucker, 1977). The Oxford English Dictionary defined performance as 'the accomplishment, execution, carrying out and working out of anything ordered or undertaken'. This refers to outcomes as well as results being achieved. The Oxford Paperback Dictionary (Hawkins, 1988) defines performance in two ways: the process or manner of performing and also a notable action or achievement.

In the world of work, these definitions of performance may be taken to mean either the way in which business is conducted or a successful outcome. Managers must be concerned with each interpretation because both processes and outcomes affect bank success. Individuals are constantly assessing performance and outcomes in daily life

using personal sets of scales based on aspirations and previous performance. This means that performance is often judged against subjective criteria that vary from person to person. In one sense, the supply of goods and services is a performance too, with employees as actors and the “show” rated by the “audience” of customers (Katzenbach and Smith 1993).

A more comprehensive view of performance is thus achieved if it is defined as embracing both behaviour and outcomes. This is well put by Brumbrach (1988:389) “Performance means both behaviour and results. Behaviours emanate from the performance and transform performance from abstraction to action. Not just the instruments for results, behaviours are also outcomes in their own right- the product of mental and physical effort applied to tasks and can be judged apart from results.”

This definition leads to the conclusion that when managing the performance of teams and individuals, both inputs (behaviour) and output (results) need to be considered. This is the so-called ‘mixed model’ (Hartle 1995) of performance management, which covers competence or capability and achievements as well as objective setting review.

2.4 Measures of bank performance

Performance is the ability to generate and sustain income, stability and growth. It is a measure of relative investment and can be relative to one of the following factors: Assets, capital adequacy, liquidity, liabilities, number of employees and other size measures. According to Pandy, Brealey and Myers, the following are the most common measures of financial performance:

2.4.1 Profitability analysis

This is the most common measure of financial performance. The measures are used to assess how well management is investing the firms’ total capital and raising funds. Profits serve as a cushion against adverse conditions such as losses on loans, or losses caused by unexpected changes in interest rates. Consequently, creditors and regulators concerned

about failure also look to profits to protect their interests although the measures ignore firm's risk.

Profits depend on three primary structural aspects of financial institutions: Financial leverage, Net interest margin and non portfolio income sources. Return on Equity (ROE) and Return on Assets (ROA) are the most commonly applied profitability ratios used to assess financial performance. In this study we will use Return on Investment (ROI) as the measure of a commercial bank's financial performance.

2.4.2 Capital adequacy ratios

They relate to the firm's overall use of financial leverage. Generally firms with high financial leverage will experience more volatile earnings behavior. It indicates the extent to which a bank's capital base covers the risks inherent in its operations. Important capital adequacy ratios include:

- (i) Shareholders equity to total assets
- (ii) Shareholders equity to total loans
- (iii) Shareholders equity to total customer deposits (gearing ratio)

2.4.3 Long term solvency

Solvency refers to the ability of a bank to survive over a long period of time. It is the same concept as liquidity except that it is for long term rather than short term. Ratios to assess long term solvency are measures of a bank's riskiness. There is no absolute ratio that has been put forward theoretically as the best measure of a good level of solvency. Total liabilities to Total assets and Shareholders funds to Total Assets are some of the ratios that measure solvency.

2.4.4 Earnings and profit performance emphasis

The banking sector management have shifted their focus to profitability because of the recent developments in the sector which include: the need for additional capital implying that profits should be boosted as a main source of funds, increased need for provisioning for bad and doubtful debts, need for funds for expansion and modernization/technological advance to serve customers better and attain competitive advantage. This requires efficiency and intensive capital investment, high volatility of interest rates and exchange rates and intensive competition following liberalization of the sector are the factors considered. Weston and Copeland concluded that profitability ratios are the most critical factors in a firm's ability to avoid failure.

2.5 Relationship between Ownership Structure and Firm Performance

The relation between ownership structure and firm performance has been an important research topic during the last three decades, and produced ongoing debate in the literature of corporate finance. Theoretical and empirical research on the relationship between ownership structure and firm performance was originally motivated by the separation of ownership and control identified by Berle and Means (1932). Berle and Means (1932) suggested that an inverse correlation could be observed between the diffuseness (concentration) of shareholdings, and firm performance, in which ownership structure affects firm performance. Central to this analysis is the agency theory that explains the conflict of interest between inside owners and outside shareholders (Jensen and Meckling, 1976; Fama and Jensen, 1983).

Jensen and Meckling (1976) argue that the relative amount of ownership held by insiders (management) and outsiders (investors with no direct role in the management of the firm) provide managers with the incentives to pursue activities to serve their own benefits. According to their hypothesis, both a firm's value and its performance increase with the level of insider ownership. The agency conflict between the owner-manager and outside shareholders is manifest from the manager's tendency to appropriate perquisites out of the

firm's resources for his own consumption. This view was challenged by Demsetz (1983), who argues that the ownership structure of a corporation should be thought of as an endogenous outcome of decisions that reflect the influence of shareholders. According to Demsetz (1983), there should be no systematic relation between variations in ownership structure and variations in firm performance.

Demsetz and Lehn (1985) provide evidence of the endogeneity of a firm's ownership structure. They use a measure of the profit rate on a fraction of shares owned by the five largest shareholding interests, in which ownership structure is treated as an endogenous variable. They found no evidence of any relation between the profit rate and the ownership concentration. Shleifer and Vishny (1986) confirm the findings of Berle and Means (1932). They show the importance of the role played by large shareholders, and how the price of the firm's shares increases as the proportion of shares held by the large shareholders rises. They argue theoretically for a positive relationship between ownership concentration and firm value.

Following these studies, there have been other studies examining the effects of ownership concentration on performance. Hill and Snell (1988) show that ownership structure affects firm performance as measured by profitability through strategic structure. Later, Hill and Snell (1989) confirm this positive relation for US firms by taking productivity as a measure of performance. On the contrary, McConnell and Servaes (1990) do not find evidence supporting any direct effect of large shareholders on firm value. Nevertheless, the empirical evidence in Agrawal and Mandelker (1990) supports the hypothesis proposed by Shleifer and Vishny (1986) that the existence of large owners or a high concentration ownership leads to better management and also better performance, especially when ownership is concentrated in institutional investors rather than individual investors. Therefore, institutional ownership could increase a firm's performance and decrease the probability of default.

Leech and Leahy (1991) analyse the implications of the separation of ownership from control for a UK firm value. They describe ownership structure using several measures of concentration and control types. Therefore, ownership structure is expected to affect a firm's performance through the effects of ownership concentration. They found that there is a negative and significant relationship between ownership concentration and firm value and profitability. Another study of the British case, by Mudambi and Niclosia (1998), confirms this negative relationship between ownership concentration and performance.

Wu and Cui (2002) study the effect of ownership structure on a firm's health. They found that there is a positive relation between ownership concentration and accounting profits, indicated by return on assets (ROA) and return on equity (ROE), but the relation is negative with respect to the market value measured by the share price-earning ratio (P/E) and market price to book value ratio (M/B). Also, the contribution of government (state) and institution ownership is significantly positive to company profit, while negative to the market value.

Corporate governance mechanisms vary around the world and can produce different ownership effects on firms' performance. Shleifer and Vishny (1997) defined at least three kinds of mechanisms in the world economies. In the USA and the UK, firms substantially rely on the legal protection of investors, and the ownership structure is dispersed. In Europe and Japan, there is less reliance on elaborate legal protections, and more reliance on large investors and banks. In the rest of the world, ownership is typically heavily concentrated in families, in which the legal protection is weaker than the other types of ownership.

Because of the differences between US corporate governance and other systems such as the German and Japanese, different relations between ownership and firm value could be expected. For example, in Japan, where firm ownership is highly concentrated, a positive and significant effect of ownership concentration on firm performance is produced. Despite this argument, Prowse (1992) examines the structure of corporate ownership in a

sample of Japanese firms in the mid-1980s. His empirical work indicated that there is no relationship between ownership concentration and profitability. Opposing evidence is shown in Kaplan and Minton (1994) and Morck *et al.* (2000), whose results confirm the relation between ownership concentration and performance.

Chen and Cheung (2000) found a negative relationship between concentrated ownership and firm value for a sample of 412 publicly listed firms in the Hong Kong stock exchange through 1995-1998. Xu and Wang (1997) investigated whether ownership structure has significant effects on the performance of publicly listed companies in China. They find that ownership structures, both the mix and concentration of ownership have a significant effect on the performance of stock companies. There is a significant and positive relationship between ownership concentration and firm's profitability. Also the effect of ownership concentration is stronger for companies dominated by shareholders than for those dominated by the state. Firms' profitability is negatively correlated with the fraction of state owned shares. They also find that labor productivity declines as the proportion of state ownership increases. The coefficient for the fraction of the state owned shares are negative and significant, indicating that state ownership does not help to improve firms' performance.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the study design and explains the research procedures to be followed. It includes the study population and the sampling design, description of the research tools, data collection and data analysis procedures.

3.2 Research Design

The study was time-series research design in that it to observe a sequence of event (ownership structure and performance) collected at regular intervals over a period of time and a single population group of defined size is studied over a period during which measurements of factors and variables of interest are studied too. Time series analysis can be useful to see how a given economic variable (ownership structure) changes over time or how it changes compared to other variables (banks' performance) over the same time period. The study covered a five (5) year period between 2004 and 2008.

3.3 Population

A population is any group of individuals or institutions which have one or more characteristics in common that are of interest to the researcher. The population of interest to the study was all the commercial banks in Kenya. In Kenya, there were 44 banks operating as at the end of year 2008.

3.4 Study Sample and Sampling Procedure

The researcher applied convenience in the selection of banks used in this study because of the availability of data. Scott and Usher (1999) explain that convenience sampling comprises choosing an unrepresentative sample by selecting the sample because it's

expedient for the researcher to achieve the studies objectives and does not follow a prescribed logical sequence.

The study used 43 out of the 44 commercial banks in Kenya that had been in existence in the study period (2004-2008), licensed and registered under the Banking Act. This study will exclude several banks due to the following reasons:

- a) Some of the banks have been bought out by larger banks during the study period. These include Akiba Bank, First American Bank and Middle East Bank.
- b) Some banks started operations within the study period.
- c) Some banks have been put under statutory management and thus did not operate throughout the study period.
- d) Some banks are not purely commercial as they are formed to pursue specific development goals such as African Development Bank (ADB) and East African Development Bank (EADB).

3.5 Data Collection

Secondary data will be used in this study obtained from various sources such as companies' published final accounts and CBK annual reports. The data that will be collected includes:

- 1) Financial performance measures from banks annual reports.
- 2) Top ten shareholders of the commercial banks.

The data that will be obtained from the financial statements which enabled the study compute ROA (Return on Assets) was the measure of financial performance. The data required will be as follows:

- a) Earnings Before Interest and Taxes (EBIT)

b) Total Assets

The data showing the different ownership structures of banks will be obtained in the notes to the financial statements which includes information on the major shareholders of banks. Data on ownership structures will also be obtained from documents held at the Registrar of Companies on registration of companies. This will also be obtained from various reports done and maintained by the Central Bank and Kenya Institute of Bankers.

3.6 Data analysis

To analyse the survey data basic statistical tools such as means and percentages will be used. Data on the banks performances (profitability) will be analysed and presented using percentages. Various ownership measures will be determined and expressed in percentages. These two variables will then be cross tabulated.

Regression tests will then be done to determine whether there is any relationship between these two variables (ownership structure and bank performance). The t – statistic test will be used to determine the probability (likelihood) that the two categorical data variables are associated. To assess the strength of relationship between the two variables, Pearson’s Product Moment Correlation Coefficient (PMCC) will be used. These tests will be run using a software package “SPSS”. The model used was:

$$\text{PERF} = a + b (\text{PRIVATE}) + c (\text{FOREIGN}) + d (\text{DOMESTIC}) + e (\text{GOVT}) + f (\text{DISP}) + g (\text{STOCK}) + h (\text{LOG_ASSET}) + i$$

Where:

PERF measured performance of the firm and was measured as return on assets (ROA)

PRIVATE measured whether the bank was private held or public. A value of 1 was given if private otherwise 0.

- FOREIGN** measured whether the bank was foreign or not. a value of 1 was given if the bank was foreign otherwise 0.
- DOMESTIC** this measured whether the bank was domestic or not. A value of 1 was given if the bank was domestic otherwise 0.
- GOVT** this measured whether the bank was owned by the government or not. a value of 1 was given if the bank was owned by the government otherwise 0.
- DISP** this measured whether the bank was widely held or closely held. A value of 1 was given for banks that were widely held otherwise 0.
- STOCK** this was a control variable for the banks listed on the stock exchange. A value of 1 was given if the bank was listed otherwise 0.
- LOG_ASSET** this was a control variable for bank size. It was measured as the natural logarithm of assets.

CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

4.1 Introduction

This chapter presents the results of the study and there interpretation thereof.

4.2 Factor Analysis

A factor analysis was performed to test whether all the variables in the model could be used in the regression analysis from the strength of their effect on the dependent variable. The communalities presented in Table 1 show that the extraction values were large so all the variables could be used in the model. This is because the values were greater than 0.5.

Table 1: Communalities

	Initial	Extraction
PRIVATE	1.000	.832
FOREIGN	1.000	.983
DOMESTIC	1.000	.973
GOVERNMENT	1.000	.887
DISPERSION	1.000	.965
STOCK	1.000	.645
LOG_ASSET	1.000	.864

Extraction Method: Principal Component Analysis.

The eigenvalues shown in Table 2 indicate that three components explained up to 86.404% of the variance in the model.

Table 2: Total Variance Explained

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	2.363	39.381	39.381	2.363	39.381	39.381	2.336	38.925	38.925
2	1.744	29.060	68.441	1.744	29.060	68.441	1.715	28.591	67.516
3	1.078	17.963	86.404	1.078	17.963	86.404	1.133	18.888	86.404
4	.592	9.864	96.268						
5	.424	7.214	97.477						
6	.197	3.275	99.544						
7	.027	.456	100.000						

Extraction Method: Principal Component Analysis.

The results of the rotated component matrix shown in Table 3 show that there were generally three factors that influence performance of commercial banks in Kenya. These could be grouped into government, private and stock (component 1), foreign and domestic (component 2) and log_asset or size of the firm (component 3).

Table 3: Rotated Component Matrix

	Component		
	1	2	3
GOVERNMENT	.919		
PRIVATE	-.908		
STOCK	.637		
FOREIGN		.936	
DOMESTIC		-.904	
DISPERSION		.901	
LOG_ASSET			.920

4.3 Regression analysis

A regression analysis was run in order to show the relationship between ownership and performance of commercial banks in Kenya. The descriptive statistics presented in Table 4 show the mean of each of the variables in the model as well as their standard deviations. The number of firms surveyed, N, is also presented.

Table 4: Descriptive Statistics

	Mean	Std. Deviation	Minimum	Maximum
PRIVATE	.7907	.41163	.00	1.00
FOREIGN	.3023	.46470	.00	1.00
DOMESTIC	.5349	.50468	.00	1.00
GOVERNMENT	.1395	.35060	.00	1.00
DISPERSION	.1452	.21453	.00	1.00
STOCK	.2326	.42746	.00	1.00
LOG_ASSET	3.9132	.53023	2.75	5.11

Table 5 shows results of the correlation matrix. As shown, there was no serial auto-correlation between the independent variables in the model.

Table 5: Correlations

		ROA	PRIVATE	FOREIGN	DOMESTIC	GOVT	DISP	STOCK	LOG_ASSET
Pearson Correlation	ROA	1.000	-.261	-.073	-.095	.220	.457	.252	.127
	PRIVATE	-.261	1.000	.339	.323	-.783	.036	-.393	-.087
	FOREIGN	-.073	.339	1.000	-.706	-.265	.145	-.003	-.162
	DOMESTIC	-.095	.323	-.706	1.000	-.432	.485	-.259	.007
	GOVERNMENT	.220	-.783	-.265	-.432	1.000	.224	.414	.228
	DISPERSION	.457	.036	.145	.485	.224	1.000	.147	.125
	STOCK	.252	-.393	-.003	-.259	.414	.147	1.000	-.148
	LOG_ASSET	.127	-.087	-.162	.007	.228	.125	-.148	1.000
Sig. (1-tailed)	ROA	.	.045	.321	.273	.079	.078	.051	.208
	PRIVATE	.045	.	.013	.017	.000	.421	.005	.289
	FOREIGN	.321	.013	.	.000	.043	.011	.493	.150
	DOMESTIC	.273	.017	.000	.	.002	.235	.047	.483
	GOVERNMENT	.079	.000	.043	.002	.	.362	.003	.071

	DISPERSION	.078	.421	.011	.235	.362	.	.458	.124
	STOCK	.051	.005	.493	.047	.003	.024	.	.172
	LOG_ASSET	.208	.289	.150	.483	.071	.125	.172	.

Results in Table 6 show the number of variables that were entered in the model for analysis by the SPSS. As shown, all the requested variables were entered. These were log_asset, domestic, stock, private, government, and foreign. The dependent variable was ROA. The ROA measured bank performance. The Log_Asset measured size of the bank while STOCK measured whether the bank was listed on the stock exchange market or not. The remaining variables indicated the type of ownership.

Table 6: Variables Entered/Removed

Variables Entered	Variables Removed	Method
LOG_ASSET, DOMESTIC, STOCK, DISPERSION, PRIVATE, GOVERNMENT, FOREIGN	.	Enter

The results of the regression analysis, as presented in Table 7 show that generally, there was a positive correlation between ownership structure and performance of commercial banks in Kenya. The Pearson product moment of correlation, R, was 0.343 while R square was 0.118. The R square implies that ownership structure accounted for up to 11.8% of the variance in bank performance as measured by ROA.

Table 7: Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.343	.118	-.030	.03826

The analysis of variance (ANOVA) shown in Table 8 indicate that the regression did not account for much of the variance in performance as much of the variance was as a result of other factors other than those in the model. This is because the p-value of F statistic was 0.557.

Table 8: ANOVA

	Sum of Squares	df	Mean Square	F	Sig.
Regression	.007	6	.001	.799	.577
Residual	.053	24	.001		
Total	.060	30			

Results in Table 9 show the coefficients of each of the variables in the model and their significance in influencing performance as measured by ROA. As shown, PRIVATE and GOVERNMENT had negative correlations with ROA (-.023 and -.005 respectively). The rest of the variables (FOREIGN, DOMESTIC and DISPERSION) had a positive influence on ROA.

These results imply that there is a negative relationship between private commercial banks and those that have government ownership with performance as measured by ROA. The results also imply that there is a positive correlation between performance as measured by ROA and foreign commercial banks, domestic commercial banks and dispersion of ownership. However, a look at the p-values indicates that these relationships were not significant at 5% significance except for ownership dispersion.

Table 9: Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	p-value
	B	Std. Error	Beta		
(Constant)	.081	.059		1.372	.179
PRIVATE	-.023	.029	-.255	-.799	.430
FOREIGN	.007	.050	.084	.136	.893
DOMESTIC	.006	.048	.080	.126	.901
GOVERNMENT	-.005	.043	-.050	-.125	.901
DISP	.023	.017	.124	2.451	.003
STOCK	.019	.016	.218	1.190	.242
LOG_ASSET	.011	.012	.162	.953	.347

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of study findings, conclusions made from the study and the recommendations thereof. The chapter also presents areas for further research.

5.2 Summary of findings

The results of the factor analysis to test whether all the variables in the model could be used in the regression analysis from the strength of their effect on the dependent variable showed that the extraction values were large enough (greater than 0.5) hence all the variables could be used in the model. The eigenvalues showed that three components explained up to 86.404% of the variance in the model. From the rotated component matrix, the study found that these three factors that influenced performance of commercial banks in Kenya could be grouped into government, private and stock (component 1), foreign, dispersion and domestic (component 2) and log_asset or size of the firm (component 3).

The study found that from the results of the correlation matrix, there was no serial auto-correlation between the independent variables in the model. The SPSS accepted all the variables that were entered for analysis. These variables were log_asset, domestic, stock, private, government, dispersion and foreign. The results of the regression analysis showed that generally, there was a positive correlation between ownership structure and performance of commercial banks in Kenya. The Pearson product moment of correlation, R, was 0.343 while R square was 0.118 which implied that ownership structure accounted for up to 11.8% of the variance in bank performance as measured by ROA.

The analysis of variance (ANOVA) showed that the regression did not account for much of the variance in performance as much of the variance was as a result of other factors other than those in the model. This is because the p-value of F statistic was 0.557. The coefficients of each of the variables in the model showed that PRIVATE and GOVERNMENT had negative correlations with ROA (-.023 and -.005 respectively). The rest of the variables (FOREIGN, DOMESTIC and DISPERSION) had a positive influence on ROA. These results imply that there is a negative relationship between private commercial banks and those that have government ownership with performance as measured by ROA. The results also imply that there is a positive correlation between performance as measured by ROA and foreign commercial banks, domestic commercial banks and those that were widely held. However, the p-values indicated that these relationships were not significant at 5% significance.

5.3 Conclusions of the study

The study sought to investigate the relationship between bank ownership structure and bank financial performance in Kenya. From the analysis, it was noted that generally, the bank ownership structure had a moderate positive influence on its overall performance as measured by return on assets.

Individually, the study found that the commercial banks owned by the government as well as those that were wholly private had a negative correlation with performance. Further, it was noted that foreign owned banks, domestic commercial banks and widely held banks had a positive correlation with performance metric. These results lead to the conclusion that government owned banks do not perform better than the foreign or domestic commercial banks. The results also lead to the conclusion that widely held banks perform better than closely held ones.

5.4 Recommendations

The study recommends that it may be fruitful for the Government to consider the option of selling of the commercial banks it has high stakes in to the public. This is because these commercial banks do not seem to perform better than those in the public domain. Further, the banks listed on the stock exchange market seem to have better results than those not listed. For this reason, it may be economical for the government to exercise this option.

5.5 Areas for further research

There is need to replicate this study to other industries or the stock exchange market. Industry factors may have an influence on the ownership structure and hence performance thus there is need to explore on this further.

REFERENCES

- , 2002a, Government ownership of banks, *Journal of Finance* 57, 265-301.
- , 2006b, Foreign, private Domestic, and Government banks: New Evidence from Emerging markets, *Journal of Banking & Finance*.
- _ (1995), *Monthly Economic Review* (Nairobi: Central Bank of Kenya), November.
- Adenikinju, O and Ayorinde, F. (2003), "An analysis of Ownership in Nigerian quoted companies and its correlation with corporate performance." *African Journal of Economic Policy*.
- Agrawal, A., Mandelker, G. (1990), "Large shareholders and the monitoring of managers: the case of antitakeover charter amendments", *Journal of Financial Quantitative Analysis*, Vol. 25 No.2, pp.143-61.
- Barajas, Adolfo, Robert Steiner, and Natalia Salazar, 2000, The impact of liberalization and foreign investment in Colombia's financial sector, *Journal of Development Economics* 63, 157-196.
- Beck, T., and Fuchs, M., 2004, Structural issues in the Kenyan Financial System: Improving Competition and Access, *World Bank policy research working paper* 3363.
- Berger, Allen N., George R.G. Clarke, Robert Cull, Leora Klapper, and Gregory F. Udell, 2005, Corporate governance and bank performance: A joint analysis of the static, selection, and dynamic effects of domestic, foreign, and state – ownership, World Bank, Working Paper.

Berger, Allen N., Leora Klapper, and Gregory F. Udell, 2001, The ability of banks to lend to informationally opaque small businesses, *Journal of Banking & Finance* 25, 2127 – 2167.

Berle, A., Means, G. (1932), *The Modern Corporation and Private Property*, Harcourt, Brace & World, New York, NY, .

Berle, Adolf, and Gardiner means, 1932. *The Modern Corporation and Private Property* (Mac-Millan, New York)

Bonin, John P., Iftekhar Hasan, and Paul Wachtel, 2005, Bank performance, efficiency and ownership in transition countries, *Journal of Banking & Finance* 29, 31-53

Brealey, A.R. Myers, C.S., *Principles of Corporate Finance*, McGraw Hill, New York, 1996.

CBK (various issues), *Annual Report and Accounts* (Nairobi: Central Bank of Kenya).

Cho, M.H. (1998), "Ownership structure, investment, and the corporate value: an empirical analysis", *Journal of Financial Economics*, Vol. 47 pp.103-21.

Claessens, Stijn, Asli Demirguc-kunt, and Harry Huizinga, 2001, How does foreign banking entry affect domestic banking markets?, *Journal of Banking and Finance* 25, 891 – 911.

Demirguc – kunt, Asli, and Harry Huizinga, 1999, Determinants of commercial bank interest margins and profitability: some international evidence, *The World Bank Economic Review* 13, 379-408.

Demsetz, H. (1983), "The structure of corporate ownership and the theory of the firm", *Journal of Law and Economics*, Vol. 26 No.2, pp.375-90.

- Demsetz, H., Lehn, K. (1985), "The structure of corporate ownership: causes and consequences", *Journal of Political Economy*, Vol. 93 No.6, pp.1155-77.
- Drucker, P. (1977), *People and Performance*, Heinemann, London, .
- ECONOMIST INTELLIGENCE UNIT (1995), *Country Report Kenya*, fourth quarter (Nairobi).
- Fama, E.F., Jensen, M.C. (1983), "Separation of ownership and control", *Journal of Law and Economics*, Vol. 26 No.June, pp.301-25.
- Galindo, Arturo, and Alejandro Micco, 2004. Do state – owned banks promote growth? Cross-country evidence from manufacturing industries, *Economic Letters* 84, 371-376.
- HARVEY, Charles (1993), "The role of commercial banking in recovery from economic disaster in Ghana, Tanzania, Uganda and Zambia", *IDS Discussion Paper*, No. DP.325 (Brighton: Institute of Development Studies, University of Sussex).
- Hawkins, J.M. (1988), *The Oxford Paperback Dictionary*, Oxford University Press, Oxford, .
- Hermalin, B., Weisbach, M. (1991), "The effects of broad composition and direct incentives on firm performance", *Financial Management*, Vol. 20 No.4, pp.101-12.
- Hill, C., Snell, S. (1988), "External control, corporate strategy, and firm performance in research-intensive industries", *Strategic Management Journal*, Vol. 9 pp.577-90.
- Hill, C., Snell, S. (1989), "Effects of ownership structure and control on corporate productivity", *Academy of Management Journal*, Vol. 32 No.1. pp.25-46.
- Himmelberg, C., Hubbard, R.G., Palia, D. (1999), "Understanding the determinants of managerial ownership and the link between ownership and performance", *Journal of Financial Economics*, Vol. 53 pp.353-84.

Holderness, C., Kroszner, R., Sheehan, D.P. (1999), "Were the good old days that good? Evolution of managerial stock ownership and corporate governance since the Great Depression", *Journal of Finance*, Vol. 54 No.2, pp.435-69.

Holderness, C., Sheehan, D. (1988), "The pole of majority shareholders in publicly held corporations: an exploratory analysis", *Journal of Financial Economics*, Vol. 20 pp.317-46.

Huibers, F. E., 2005. Initial public offerings, in: Caprio, G., Fiechter J. L. Litan, R., Pomerleano, M.(Eds), *The Future of State-Owned Financial Institutions*. Brookings Institution Press, Washington, D. C. pp. 315-344.

Jensen, M., Meckling, W. (1976), "Theory of the firm: managerial behavior, agency costs and ownership structure", *Journal of Financial Economics*, Vol. 3 No.4, pp.305-60.

Jensen, Michael C., and William H. Meckling, 1976, Theory of the Firm: Managerial Behavior, Agency costs and ownership Structure, *Journal of Financial Economics* 3, 305-360.

Kaplan, S., Minton, B. (1994). "Appointments of outsiders to Japanese boards. Determinants and implications for managers", *Journal of Financial Economics*, Vol. 23 pp.225-58.

Katzenbach, J.R., Smith, D.K. (1993), *The Wisdom of Teams: Creating the High-Performance Organization*, Harvard Business School Press, Boston, MA, .

Kithinji, A. and Waweru, N. M. (2007), Merger Restructuring and financial performance of commercial Banks in Kenya. *Economic, Management and Financial Markets Journal*, 2(4), 9 – 39.

Kornai, Janos, 1979, Resource-constrained versus demand-constrained systems.

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny, 2002b, Investor protection and Corporate Valuation, *Journal of Finance* 57,1147-1170.

Leech, D., Leahy, J. (1991), "Ownership structure, control type classifications and the performance of large British companies", *The Economic Journal*, Vol. 101 No.409, pp.1418-37.

Loderer, C., Martin, K. (1997), "Executive stock ownership and performance: tracking faint traces", *Journal of Financial Economics*, Vol. 45 No.2, pp.223-55.

Manjoni, Giovanni, Rashmi Shankar, and Eva Varhegyi, 2003, the dynamics of foreign bank ownership: Evidence from Hungary. World Bank, Policy Research Working Paper.

McConnell, J., Servaes, H. (1990), "Additional evidence on equity ownership and corporate value", *Journal of Financial Economics*, Vol. 27 No.2, pp.595-612.

Micco, Alejandro, Ugo Panizza, and Monica Yanez, 2004, bank ownership and performance, Inter-American Development Bank, Working Paper.

Morck, R., Shleifer, A., Vishny, R.W. (1989), "Management ownership and market valuation: an empirical analysis", *Journal of Financial Economics*, Vol. 20 pp.293-315.

Mudambi, R., Niclosia, C. (1998), "Ownership structure and firm performance: evidence from the UK financial services industry", *Applied Financial Economics*, Vol. 8 No.2, pp.175-80.

Prowse, S. (1992), "The structure of corporate ownership in Japan", *The Journal of Finance*, Vol. 47 No.3, pp.1121-41.

Shleifer, A., Vishny, R. (1986), "Large shareholders and corporate control", *Journal of Political Economy*, Vol. 94 No.3, pp.461-88.

Shleifer, Andrei, and Robert W. Vishny, 1997, A Survey of Corporate Governance. *Journal of Finance* 52, 737-783.

Tabaoda, Alvaro (2007), "The impact of changes in bank ownership structure on the allocation of capital".

Thomsen, S., Pedersen, T., and Kvist, H., (2003), "The effect of block ownership on firm value in market and control based governance systems." Copenhagen Business School.

Thuku David, 2002, 'Ownership structure and bank financial performance in Kenya'. Unpublished MBA project, University of Nairobi.

Unite, Angelo A., and Michael J. Sullivan, 2003, The effect of foreign entry and ownership structure on the Philippine domestic banking market, *Journal of Banking and Finance* 27, 2323-2345

Wu, S., Cui, H. (2002), "Consequences of the concentrated ownership structure in Mainland China – evidence of Year 2000", working paper, City University of Hong Kong, Hong Kong, .

Xu, X., Wang, Y. (1997), "Ownership structure, corporate governance, and corporate performance: the case of Chinese stock companies", working paper, The World Bank, Washington, DC, .

APPENDICES

Appendix I: Survey Data

Bank name	ROA	Private	Foreign	Domestic	Govt	Disp	Stock	log_asset
ABC	0.124	0	0	0	0	1	0	3.736
BANK OF AFRICA	0.079	1	0	1	0	1	0	3.842
BANK OF BARODA	0.098	1	1	0	0	1	0	4.078
BANK OF INDIA	0.099	1	1	0	0	1	0	3.935
BARCLAYS BANK	0.143	1	1	0	0	1	0	5.111
CFC-STANBIC	0.089	1	1	0	0	0	1	4.421
CHASE BANK	0.112	0	0	0	1	0	1	3.625
CITIBANK	0.090	1	0	1	0	1	0	4.564
CITY FINANCE BANK	0.108	1	1	0	0	1	0	2.753
COMMERCIAL BANK OF AFRICA	0.090	1	0	1	0	1	0	4.543
CONSOLIDATED BANK	0.156	0	0	1	0	1	0	3.545
CO-OPERATIVE BANK	0.129	0	0	0	1	1	0	4.777
CREDIT BANK	0.118	0	0	1	0	0	1	3.477
DEVELOPMENT BANK	0.108	1	0	1	0	1	0	3.556
DIAMOND TRUST BANK	0.186	0	0	0	1	1	0	4.381
DUBAI BANK	0.173	1	1	0	0	0	1	3.105
ECOBANK	0.097	1	0	1	0	1	0	3.903
EQUATORIAL BANK	0.103	1	1	0	0	1	0	3.591
EQUITY	0.160	1	0	1	0	0	0	4.362
FAMILY BANK	0.169	1	0	1	0	1	1	3.975
FIDELITY BANK	0.127	1	0	1	0	1	0	3.384
FINA BANK	0.109	1	0	1	0	1	0	4.015
FIRST COMMUNITY BANK	0.007	1	0	1	0	1	0	3.502
GIRO BANK	0.097	1	1	0	0	1	0	3.920
GUARDIAN BANK	0.112	1	0	1	0	1	0	3.689
GULF AFRICAN BANK	0.025	1	0	1	0	1	0	3.473

HABIB AG ZURICH	0.082	1	1	0	0	1	0	3.732
HABIB BANK	0.085	1	1	0	0	0	0	3.540
HOUSING FINANCE BANK	0.120	1	1	0	0	1	0	4.031
I&M BANK	0.109	0	0	0	1	1	1	4.362
IMPERIAL BANK	0.204	1	0	1	0	0	0	3.966
KENYA COMMERCIAL BANK	0.130	1	0	1	0	1	0	5.013
K-REP BANK	0.178	0	0	0	1	0	1	3.698
MIDDLE EAST BANK	0.102	1	1	0	0	1	0	3.550
NATIONAL BANK OF KENYA	0.151	1	0	1	0	1	0	4.561
NIC BANK	0.107	0	0	0	1	0	1	4.416
ORIENTAL BANK	0.119	1	0	1	0	0	1	3.220
PARAMOUNT UNIVERSAL BANK	0.112	1	0	1	0	1	0	3.287
PRIME BANK	0.096	1	0	1	0	1	0	4.014
SOUTHERN CREDIT BANK	0.135	1	0	1	0	1	0	3.660
STANDARD CHARTERED BANK	0.115	1	0	1	0	0	0	4.911
TRANS-NATIONAL BANK	0.162	1	1	0	0	1	1	3.427
VICTORIA COMMERCIAL BANK	0.095	1	0	1	0	0	0	3.616

APPENDICES

Appendix I: Institutions in Terms of Shareholding

a) Foreign owned institutions

i) Foreign owned not locally incorporated

1. Bank of Africa (K) Ltd.
2. Bank of India
3. Citibank N.A. Kenya
4. Habib Bank A.G. Zurich
5. Habib Bank Ltd.

ii) Foreign owned but locally incorporated institutions (Partly owned by locals)

1. Bank of Baroda (K) Ltd.
2. Barclays Bank of Kenya Ltd.
3. Diamond Trust Bank Kenya Ltd.
4. K-Rep Bank Ltd.
5. Standard Chartered Bank (K) Ltd.
6. Ecobank Ltd
7. Gulf Africa Bank (K) Ltd
8. First Community Bank

b) Institutions with Government participation

1. Consolidated Bank of Kenya Ltd.
2. Development Bank of Kenya Ltd.
3. Housing Finance Ltd.
4. Kenya Commercial Bank Ltd.
5. National Bank of Kenya Ltd.
6. Savings & Loan Kenya Ltd.
7. CFC Stanbic Bank Ltd

c) Institutions locally owned

1. African Banking Corporation Ltd.
2. City Finance Bank Ltd.
3. Commercial Bank of Africa Ltd.
4. Co-operative Bank of Kenya Ltd.
5. Credit Bank Ltd.
6. Charterhouse Bank Ltd.
7. Chase Bank (K) Ltd.
8. Dubai Bank Kenya Ltd
9. Equatorial Commercial Bank Ltd.
10. Equity Bank Ltd.

11. Family Bank Ltd.
12. Fidelity Commercial Bank Ltd.
13. Fina Bank Ltd.
14. Giro Commercial Bank Ltd.
15. Guardian Bank Ltd.
16. Imperial Bank Ltd.
17. Investment & Mortgages Bank Ltd.
18. Middle East Bank (K) Ltd.
19. NIC Bank Ltd.
20. Oriental Commercial Bank Ltd.
21. Paramount Universal Bank Ltd.
22. Prime Bank Ltd.
23. Southern Credit Banking Corporation Ltd.
24. Trans-National Bank Ltd.
25. Victoria Commercial Bank Ltd.

Bank name	ROA	PRIVATE	FOREIGN	DOMESTIC	GOVERNMENT	STOCK	Av_logasset
ABC	0.124	0	0	0	0	0	3.736
BANK OF AFRICA	0.079	1	0	1	0	0	3.842
BANK OF BARODA	0.098	1	1	0	0	0	4.078
BANK OF INDIA	0.099	1	1	0	0	0	3.935
BARCLAYS BANK	0.143	1	1	0	0	0	5.111
CFC-STANBIC	0.089	1	1	0	0	1	4.421
CHASE BANK	0.112	0	0	0	1	1	3.625
CITIBANK	0.090	1	0	1	0	0	4.564
CITY FINANCE BANK	0.108	1	1	0	0	0	2.753
COMMERCIAL BANK OF AFRIC	0.090	1	0	1	0	0	4.543
CONSOLIDATED BANK	0.156	0	0	1	0	0	3.545
CO-OPERATIVE BANK	0.129	0	0	0	1	0	4.777
CREDIT BANK	0.118	0	0	1	0	1	3.477
DEVELOPMENT BANK	0.108	1	0	1	0	0	3.556
DIAMOND TRUST BANK	0.186	0	0	0	1	0	4.381
DUBAI BANK	0.173	1	1	0	0	1	3.105
ECOBANK	0.097	1	0	1	0	0	3.903
EQUATORIAL BANK	0.103	1	1	0	0	0	3.591
EQUITY	0.160	1	0	1	0	0	4.362
FAMILY BANK	0.169	1	0	1	0	1	3.975
FIDELITY BANK	0.127	1	0	1	0	0	3.384
FINA BANK	0.109	1	0	1	0	0	4.015
FIRST COMMUNITY BANK	0.007	1	0	1	0	0	3.502
GIRO BANK	0.097	1	1	0	0	0	3.920
GUARDIAN BANK	0.112	1	0	1	0	0	3.689
GULF AFRICAN BANK	0.025	1	0	1	0	0	3.473
HABIB AG ZURICH	0.082	1	1	0	0	0	3.732
HABIB BANK	0.085	1	1	0	0	0	3.540
HOUSING FINANCE BANK	0.120	1	1	0	0	0	4.031
I&M BANK	0.109	0	0	0	1	1	4.362
IMPERIAL BANK	0.204	1	0	1	0	0	3.966
KENYA COMMERCIAL BANK	0.130	1	0	1	0	0	5.013
K-REP BANK	0.178	0	0	0	1	1	3.698
MIDDLE EAST BANK	0.102	1	1	0	0	0	3.550
NATIONAL BANK OF KENYA	0.151	1	0	1	0	0	4.561
NIC BANK	0.107	0	0	0	1	1	4.416
ORIENTAL BANK	0.119	1	0	1	0	1	3.220
PARAMOUNT UNIVERSAL BAN	0.112	1	0	1	0	0	3.287
PRIME BANK	0.096	1	0	1	0	0	4.014
SOUTHERN CREDIT BANK	0.135	1	0	1	0	0	3.660
STANDARD CHARTERED BANK	0.115	1	0	1	0	0	4.911
TRANS-NATIONAL BANK	0.162	1	1	0	0	1	3.427
VICTORIA COMMERCIAL BANK	0.095	1	0	1	0	0	3.616

