

**THE RELATIONSHIP BETWEEN OWNERSHIP STRUCTURE AND FINANCIAL
PERFORMANCE OF FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE**

RAEL .J. ROTTICH

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DECLARATION

I declare that this is my original work and has not been presented for a degree in any other university or institution for higher learning for academic purposes.

RAEL .J. ROTTICH

D61/ 67893 / 2011

Signature Date

This project has been submitted with my approval as the University Supervisor.

MR. HERICK ONDIGO

Lecturer,
Department of Finance and Accounting
School of Business
University of Nairobi

Signature Date

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DEDICATION

The research is dedicated first to my dear parents, who were a great source of inspiration to my education and without their foresight, sacrifice and support I would not have gone this far. Secondly, to my beloved children Sharon, Sheldon and Stephanie for their encouragement and being a constant source of inspiration. God bless you all.

ABSTRACT

The ownership structure of a firm defines the combination of residual claims and decision control that has consequences on firm behavior. These consequences of ownership structure are conditioned by the legal and institutional setting of the country in which the firm operates. Modern firms have a variety of ownership patterns, and exploring ownership type recognizes that large-block shareholders are not homogenous and that certain types of owners have a disproportionately large impact on corporate governance. Some very large firms are dominated by large-block shareholders who have a seat on the board of directors, some by shareholders who sustain their ownership blocks over time, and some by families owning large blocks of shares. On the basis of the above studies, there has been no study that the researcher is aware of that has looked at the relationship between ownership structure and financial performance of all firms listed at the NSE especially with the number of listed firms having changed significantly over the last 4 years. This gap, led to the research question what is the relationship between ownership structure and financial performance of firms listed at the NSE. Ownership structure was operationalized in terms of ownership concentration (percentage of shares owned by the top five shareholders) and ownership identity (actual identity of shareholders). Measures of performance were Return on Assets, Return on Equity and Dividend Yield. Forty two (out of sixty one) listed companies were studied using both primary and secondary data. Reliability of data was tested using Cronbach's Alpha, while Tolerance and Variance-Inflation Factor were used to test multicollinearity. Using Pearson's Product Moment Correlation and Logistic Regression, the study found that Ownership structure and Government Ownership have significant negative relationships with firm performance. On the other hand, Institutional Ownership, Foreign Ownership and Individual Ownership were found to have significant positive relationships with firm performance. The main contribution of this paper is therefore, two fold. First, it dispels the long-held position that concentrated ownership supports firm performance. Second, it identifies types of ownership identities that are good for firm performance, and those that hamper it.

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LIST OF ABBREVIATIONS

AIMS	--	Alternative investment Market Segment
CDSC	--	Central Depository Settlement Corporation
CDS	--	Central Depository System
CEO	--	Chief Executive Officer
D/E	--	Debt to Equity Ratio
EBIT	--	Earnings Before Interest and Tax
FISMS	--	Fixed Interest Securities Market Segment
MIMS	--	Main Investment Market Segment
NSE	--	Nairobi Securities Exchange
PBT	--	Profit Before Tax
R&D	--	Research and Development
R&D	--	Research and Development
ROD	--	Return on Firms Assets
ROE	--	Return on Equity
ROI	--	Return on Investment
ROS	--	Return on sales
S&P	--	Standard and Poor

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The ownership structure of a firm defines the combination of residual claims and decision control that has consequences on firm behavior. These consequences of ownership structure are conditioned by the legal and institutional setting of the country in which the firm operates (La Porta, Lopez-de-Silanes, Shleifer, & Vishny (2002)). They further point that firms in common law countries are characterized by a dispersed ownership structure so that the manager shareholder relationship is the main source of conflicts.

This expropriation may take a variety of forms, such as diversion of corporate opportunities from a firm by its controlling shareholders, transfer pricing favoring the controlling shareholder at non-market prices, loan guarantees using the firm's assets as collateral, and so on. If stakeholders perceive that ownership structure affects expropriation, they will take into account the ownership characteristics of a firm to generate their expectations about the firm's possibilities of satisfying their interests.

An organization ownership matters for firm performance because the ownership of an organization allocates property rights, or control of assets, to various stakeholders involved in the firm. Neubaum, & Huse (2000) posit that property rights present opportunities for actors to realize their interests and affect firm performance since, for example, family ownership of large blocks of shares may force firms to remain in less profitable geographical locations or managers may use their control of operational decisions to divert firms into unprofitable endeavors that may benefit managers' careers but decrease the return to shareholders.

Demsetz & Villalonga (2001) further observe that the ownership of large companies is so dispersed that no single owner holds more than a tiny fraction of the listed shares in each one of them. As a result of this, it follows that, no single shareholder has the ability or the incentive to exercise control over the company, which in turn leads to companies being inefficiently run. The lack of ability of owners refers to the fact that, when ownership is widely dispersed, a single owner cannot individually have much influence on the way the company is being run. Modern firms have a variety of ownership patterns, and exploring ownership type recognizes that large-block shareholders are not homogenous and that certain types of owners have a disproportionately large impact on corporate governance. Some very large firms are dominated by large-block shareholders who have a seat on the board of directors, some by shareholders who sustain their ownership blocks over time, and some by families owning large blocks of shares.

Agency theory posits that large block-holders have both the incentive and influence to ensure that a firm's management operates in the interest of shareholders Bethel & Liebeskind (2003). Block-holders will generally have invested substantially in the firm and this substantial wealth they have invested leads them to actively monitor firm management and performance. However, Perrini et al. (2008) noted that the interests' of institutional shareholders and other owners will have to be in tandem.

1.1.1 Ownership Structure

A firm's ownership structure is an essential component of corporate governance as it directly influences the profitability of the company Daily & Thompson (2004). The ownership structure of a company tells us how better that company is doing and consists of four groups namely institutional investors, small private shareholders, large private shareholder and corporate

shareholders Dalton et al.(2003). Institutional shareholders are the organizations that have a large amount of funds to invest and put them in the company shares. The main institutional investors are pension funds, insurance companies and collective investment institutions such as trust funds and open ended investment companies. Secondly, the small private shareholders are the individuals that hold shares in small trenches. They have very little communication from the company. The votes of the small shareholders are unlikely to affect the outcome of the shareholders, the voting of the general meeting of the company vary the block votes of the institutional shareholders and large private shareholders carry much more weight. Thirdly, large proportions of the company shares are held by the private shareholders Dalton et al. (2003).

Modern firms have a variety of ownership patterns, and exploring ownership type recognizes that large-block shareholders are not homogenous and that certain types of owners have a disproportionately large impact on corporate governance. Some very large firms are dominated by large-block shareholders who have a seat on the board of directors, some by shareholders who sustain their ownership blocks over time, and some by families owning large blocks of shares Kang (2008).

1.1.2 Financial Performance

Organizational performance can be measured by financial aims attainment or non-financial parameters. Ho (2008) pointed that performance can be evaluated by efficiency and effectiveness of aim attainment. Furthermore, Venkatraman et al. (1986) cited that performance can be assessed by financial performance namely, return on investment (ROA), return on equity (ROE), growth of sales, profitability, organization effectiveness, and business performance. Similarly, Delaney et al. (2006) assert that organization performance can be evaluated by quality service

and products, satisfying customers, market performance, service innovations, and employee that organization performance can be appraised by the following “dimensions of performance: return of investment, margin on sales, capacity utilization, customer satisfaction and product quality”. In the same way, Green et al. (2007) identified that return on investment, sales and market growth, and profitability as important factors that can be measured by organization performance. According to these researchers, there are many factors in this study that can be measured by performance such as market shares, financial performance, efficiency and effectiveness of an organization performance, and human resource management.

There is general agreement that organizational profitability is a function of internal and external factors. Koch (1995) observed that the performance differences between firms are an indicator of differences in management philosophy as well as differences in the market served. Profitability is a function of internal factors that are principally influenced by a firm’s management decisions and policy objectives such as the level of liquidity, provisioning policy, capital adequacy, expense management and bank size, and the external factors related to industrial structural factors such as ownership, market concentration and stock market development and other macroeconomic factors (Athanasoglou *et al.*2006).

1.1.3 Effect of Ownership Structure on Financial Performance

Efficient monitoring hypothesis (EMH) postulates that, greater institutional ownership provides large corporate shareholders with opportunity and power to decrease the costs of monitoring the management. Grossman and Hart (1986) stated that large corporate shareholders tend to play an active role in the decision-making process, for they find their interests in efficient monitoring of the management. Moreover, Shleifer & Vishny (1997) mentioned that institutional ownership is

considered as one of the foundations of good corporate governance. They showed that institutional ownership has a positive effect on the productivity of companies an increase in the ownership of large shareholders leads to increased market value of the companies. Kapopoulos and Lazaretou (2007) came to the conclusion that companies with greater institutional ownership have greater profitability and that productivity decreases with ownership dispersion. Thomsen and Pedersen (2000), after controlling for the type of industry, capital structure, and nationality of companies, concluded that concentration of family ownership is positively related to the performance of the companies.

Other researchers have also argued that institutional ownership decreases monitoring costs and leads to improved performance and productivity, suggesting that there is a positive relationship between institutional ownership and corporate performance Perrini et al.(2008). The separation of ownership and control gives rise to information asymmetries that managers may use to exploit outside individual shareholders Berle & Means (1932). To minimize such sub-optimal managerial actions, researchers have identified a number of pure market forces like product market competition, the market for corporate control, and labour market pressure Fama (1980). However, despite these market controls, there remains residual demand for additional governance measures, such as well-designed managerial compensation schemes.

According to Tian (2001), privately-owned enterprises have better performance than state-owned enterprises. He came to the conclusion that ownership structure has a great effect on the companies' accounting measures of performance, including return on assets (ROA). They also reported that state ownership has a significant negative relationship with return on equity and

that companies can increase their profitability by reducing state ownership. Wei (2007) came to the conclusion that when state ownership is low, the relationship between state ownership and performance is not negative, while more than 50 percent state ownership leads to reduced performance.

1.1.4 Nairobi Securities Exchange

The origin of Nairobi Securities Exchange (NSE) can be traced back to 1954, when it was constituted as a voluntary association of stockbrokers registered under the Societies Act. The NSE was established to meet a number of objectives among them: to provide an alternative method of raising capital to small, medium sized and young companies that find it difficult to meet the more stringent listing requirements of the Main Investment Segment Market (MIMS), facilitate the liquidity of companies with a large shareholder base through ‘introduction’, that is, listing of existing shares for marketability and not for raising capital and also offer investment opportunities to institutional investors and individuals who want to diversify their portfolios and to have access to sectors of the economy that are experiencing growth.

Several milestones can be highlighted through the process of growth of the Nairobi securities exchange. In 1991 NSE was registered under the Companies Act and also adopted a 20-share index and changed the computational method of the index to a geometric mean. In 2000, Kenya, Uganda and Tanzania signed the Joint Stock Exchange Taskforce report on cross border listing and as a consequence several Kenyan firms have cross listed in the larger East African market. Examples of such Kenyan firms include East Africa Breweries, Cooperative Bank and Equity bank. In 2001, NSE was categorized into three market segments namely, the Main Investment Market Segment (MIMS), Alternative Investment Market Segment (AIMS) and Fixed Income

Securities Market Segment (FISMS). The first rights issue under the AIMS was implemented in February 2001. In 2002, an agreement was reached for the establishment of the Central Depository and Settlement Corporation (CDSC). The CDSC is the legal entity that owns the automated clearing, settlement, depository and registry system (CDS). All these changes in the management and operation of the NSE have been geared towards adapting the institution to meeting the changing demands of the financial market.

1.2 Research Problem

The present day business entities have different kinds of shareholders. The presence of different individuals in the ownership structure of companies will therefore lead to conflict of interest and the question that will arise is whether difference in the ownership structure influences corporate performance Lins (2003). Question abound on whether there is going to be difference in the financial performance if the owners of companies consist of different groups such as the state, institutional owners, family owners, individuals, and other corporate Gedajlovic & Shapiro (2008).

In addition which combinations of ownership are more effective in improving corporate performance? The answers to such questions will expectedly prepare the grounds for improving the performance of companies, and decision makers and investors will pay attention to the ownership structure of companies in order to bring optimal performance to economic units. The importance of ownership of a firm is a complex phenomenon of corporate governance and no one worth his/her salt can deny the importance of ownership structure of the corporate world. Ownership identity basically measures the power of the shareholder and objective of the owner's identity to dominate the corporate system Grosfeld & Hashi(2007).

Firms listed at the Nairobi Securities Exchange represent a mix of firms operating in Kenya from different sectors. The combination of the ownership structure of the shareholding will also differ and being the firms whose securities performance will influence the economic outlook of Kenya, it becomes imperative that all factors that are thought to influence their performance need to be given due consideration. Ownership structure as one of the corporate governance tenets will also give an indication to the level of compliance to the capital market authority guidelines on corporate governance. There is need to study how ownership structure of these firms will impact, if any, their organizational performance. It is the demand of the time that determines the level of ownership structure and how much it is related with performance.

The magnitude of the privatization and controlling shareholders associated with the majority and the rights of the shareholders. Further, the results of such a research can be examined to understand which ownership theory is effective for Kenya. Moreover, the privatization of some previously governed owned companies listed in NSE calls for a closer evaluation of the performance of these companies, and for the process of privatization in Kenya to continue, a research is necessary to examine the effect of ownership structure (as one of the mechanisms of corporate governance) on the performance of Kenyan firms.

Several studies have been undertaken locally on the relationship between ownership and firm performance. Matheu (2009) researched on the Effect of Ownership on the performance of non-banking institutions in the NSE and her findings support the proposition that institutional ownership may provide a negative effect on investment and that dispersed ownership structures in the Kenyan non-financial firms are more efficient compared to concentrated ownership.

Wanjiku (2010) investigated effect of block holder ownership on dividends policies; an empirical analysis of firms listed on NSE and found evidence to support the clientele dividend policy in which block holders were found to prefer capital gains than dividends and therefore such firms tended to pay low level of dividends. Nafula (2012) looked at the relationship between corporate governance and ownership structures of firms listed at the Nairobi stock exchange in which it was found a less significant effect between the ownership structure and corporate structure but found that regulatory bodies had a greater effect on the observance of corporate governance tenets by these institutions.

Mbaabu (2013) researched on the relationship between corporate governance, ownership structure and financial performance of insurance companies in Kenya. His findings were that there were positive relationship between corporate governance and dispersed ownership on the financial performance of the insurance firms. On the basis of the above studies, there has been no study that the researcher is aware of that has looked at the relationship between ownership structure and financial performance of all firms listed at the NSE especially with the number of listed firms having changed significantly over the last 4 years. This gap, leads to the following research question what is the relationship between ownership structure and financial performance of firms listed at the NSE?

1.3 Objective of the Study

To establish the relationship between ownership structure and financial performance of firms listed at the NSE

1.4 Value of the Study

The understanding of the effect that ownership structure and corporate governance has on the firms performance is of help to policy makers – governments and other stakeholders – to design targeted policies and programs that will actively stimulate the growth and sustainability of the firms in the country, as well as helping those policy makers to support, encourage, and promote the establishment of these firms. Regulatory bodies such as, Capital Markets Authority, Central Bank of Kenya and the Kenya Revenue Authority can use the study findings to improve on the framework for regulation.

The study findings were of benefit to management and staff of the firms who can gain insight into how their organizations can restructure their ownership structure for effective realization of the organizations objective. This study offers an understanding on the importance of a diversified ownership structure and its effect on the firm's performance. This is because in the current changing business environment, firms need to adapt to the changing needs of the current business set up and requirement of various suppliers and providers of services. As a result, these firms will derive great benefit from the research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews literature relating to a firm's ownership structure and its influence on financial performance. The literature review has been organized in the following sections. First section covers the theoretical framework underlying the study, determinants and variables of financial performance. The second section covers the empirical reviews and summary of the chapter is covering where the gaps of the study was addressed.

2.2 Theoretical Review

The major objective of a business entity is to generate adequate returns to its shareholders and in the process maximize the shareholder wealth. Consequently, the management of all firms will need to establish and manage all variable that will influence the firm's profitability. However, there are a number of dimensions in which the firms can manage their ownership structure as one of the factors that influence the level of profitability. In plain words, there are competing ownership structure theories. These competing theories include: Agency Theory, market failure theory, and shareholder theory.

2.2.1 Agency Theory

The agency cost theory as advanced by Jensen & Meckling (1976) states that there exist agency cost incurred by a firm as a result of the owners delegating the management of the organization to managers. Appropriate ownership will help in the minimizing the costs arising from conflicts between the parties involved. They argue that agency costs play an important role in financing decisions due to the conflict that may exist between shareholders and debt holders

The agency theory extends the analysis of the firm to include separation of ownership and control, and managerial motivation. In the field of corporate management, agency issues have been shown to influence managerial attitudes toward risk taking and hedging Smith & Stulz (1985). This theory explains a possible mismatch of interest between shareholders, management and debt holders due to asymmetries in earning distribution, which can result in the firm taking too much risk or not engaging in positive net present value projects. Consequently, some of the mechanisms that the agency theory implies that can have important influence on firm value is hedging Fite & Pflleiderer (1995). Agency theory provides strong support for hedging as a response to mismatch between managerial incentives and shareholder interests.

Agency theorists suggest that the separation of ownership and control is often the best available organizational design, as it will lead to the benefits of increased access to capital and the professional management resulting will outweigh the costs associated with delegating control of business decisions to managers Fama & Jensen (1983). However, in the absence of strong corporate governance systems, public corporations may suffer in performance when self-interested managers pursue their own interests rather than the interests of shareholders Jensen (1989). Managers with no ownership interest in the firm have opportunities for pursuing their own interests in prestige, luxurious accommodations and modes of transportation, and high salaries because they have been delegated rights through their contracts to control cash flows and information in their firms.

Conflicting interests in the agency relationship between managers and shareholders motivate the use of derivatives. Most senior managers have a highly undiversified financial position because they derive substantial (monetary and non-monetary) income from their employment by the firm. According to Stulz (1990), risk aversion cause managers to deviate from acting purely in the best

interest of shareholders by expending resources to hedge diversifiable risk. The time horizon of managers and shareholders may also differ because management compensation is tied to short-term accounting measures. These conflicts of interest can be mitigated by corporate risk management if compensation schemes appropriately link managers' pay to the stock price of the firm. This suggests that the use of stock option plans in a corporation can be a determinant of corporate hedging. Executive stock options can effectively reduce a manager's risk aversion and thus lower the propensity for using derivatives to decrease idiosyncratic risk.

Modern public corporations often are faced with considerable agency costs since it is expensive to gather information and assess managerial actions, and particular shareholders only gain a fraction of any pecuniary benefits produced, proportional to the percentage of total equity they own Shleifer & Vishny (1989). This creates collective action problems. Gains are available to all shareholders regardless of whether they have incurred the costs of monitoring, a problem that contributes to the separation of ownership and control Berle & Means (1932). Because the costs of participating in corporate governance typically exceed the benefits, and because of the problem of free riding, dispersed shareholders are generally unlikely to participate in corporate governance.

2.2.3 Market Failure Theory

The market failure theory posited by Leff (1976) shows that group-affiliated firms can avoid market inefficiencies. Succeeding studies continuously proved that group-affiliated firms perform better than non-group-affiliated ones in emerging markets Castaneda (2007). Moreover, Leff's (1976) theory was extended to the internal capital market hypothesis to explain how group-affiliated firms often have advantages in the early stages of capital market development. The internal capital market hypothesis posits that group-affiliated firms can use internal capital

markets to obtain the needed funds when experiencing information asymmetries and external financing constraints Perotti & Gelfer (2001). In an efficient market, such a market simultaneously achieves exchange efficiency, production efficiency, and product-mix efficiency. Under such a conditions there is no need for government action beyond establishment of the framework—law and order, a monetary system, and international peace. In the public domain, this depiction is similar to Adam Smith’s “invisible hand” and thus provides the technical argument for laissez-faire economic policy.

In contrast to Fama and Miller, theorists such as Stiglitz set out to offer an alternative to the efficient-market hypothesis. Stiglitz (1980) built his career on demonstrating the fragility of the neoclassical model of market efficiency, given slight deviations from its restrictive assumptions. Stiglitz stresses imperfections in the information that actors possess and deviations from perfectly competitive market conditions. They argue that given asymmetric information and a monopolistically competitive environment, market perversities rather than market perfection are likely to result. If government interventions distort information and provide perverse incentives, and in this situation economic actors make mistakes, the market is not leading them astray; the government interventions have discouraged the market’s participants from weeding out error.

Claessens et al. (2006) observe that today’s inefficiency represents tomorrow’s profit for a firm who recognizes and grasps the opportunity. The market economy’s strength is its dynamic adjustment to constantly changing circumstances. Entrepreneurs react to the existing array of prices to realize gains from trade through arbitrage, and the lure of pure profits spurs

entrepreneurs to realize the gains from innovation through the introduction of new products or the discovery of better ways to produce or deliver existing products.

2.2.3 Shareholder Theory

Shareholder theory has advanced by Leff (1976) defines the primary duty of a firm's managers as the maximization of shareholder wealth. The theory enjoys widespread support in the academic finance community and is a fundamental building block of corporate financial theory. The shareholder value maximization hypothesis predicts that a firm will engage in risk management policies if, and only if, they enhance the firm's value and thus its shareholders' value. This goal is credit with the advantages that it considers all direct stakeholders of the firm, it is a long term objective and considers all the cash flows and also that it considers uncertainty of returns since discounting rate can be adjusted according to the riskiness of the project Manoes et al.(2007).

However, the shareholder model has been criticized for encouraging short-term managerial thinking and condoning unethical behavior. Smith (2003) notes that critics believe shareholder theory is geared toward short-term profit maximization at the expense of the long run objectives. Further, he asserts that shareholder theory involves using the prima facie rights claims of one group shareholders—to excuse violating the rights of others. However, Jensen (2004) argue out that such critics are misguided because wealth maximization is inherently a long term goal—the firm must maximize the value of all future cash flows—and does not condone the exploitation of other stakeholders. The criticisms are understandable because many proponents of shareholder theory, in a stylized version of the model, exhort managers to maximize the firm's current stock price.

2.3 Determinants of Financial Performance

A firm's performance is influenced by several parameters. These factors include a firm's ownership structure, Capital Adequacy, Asset Quality, Management Efficiency, Liquidity Management and Sensitivity. A more dynamic financial analysis tool for measuring financial performance of listed firms is the CAMELS model. The model looks at performance from the angle of Capital Adequacy, Asset Quality, Management Efficiency, Liquidity Management and Sensitivity.

2.3.1 Ownership Structure

A firm's ownership structure has been found to influence its value. Ownership structure (insider) according to Brailsford et al. (2002), - using the ownership of directors and managers (insiders) – showed a relationship between ownership structure and corporate value. Insider ownership is measured by the number of shares owned by the directors and managers/total number of shares outstanding. The capital structure variables used in previous studies include total liabilities/total book value of equity, total liabilities/total market value of equity, and total liabilities/total book value of assets. Brailsford et al. (2002) used the book value of debt as a proxy for the market value of debt because of the problems in estimating the market values of unlisted debt securities. Bowman (1980) also argued that although the market value of debt is a more accurate measure of leverage, using the book value of debt is not expected to distort the leverage ratios. The present study employed the definition of Brailsford et al. (2002), total liabilities/total market value of equity, as a measure of the firm debt-equity ratio (D/E)

2.3.2 Capital Adequacy.

Listed firms capital is very essential to help the firms withstand any internal or external crisis. Dang (2011) expresses that the Capital adequacy ratio helps analyze the internal strength of firms to withstand such crisis (Ongore & Kusa, 2013).

2.3.3 Asset Quality

Another critical aspect of listed firms is the asset quality. The assets owned are major components therefore; their quality has a major impact on their performance. (Bathala, Moon & Rao, 1994).

2.3.4 Management efficiency

Management efficiency was analyzed using the ratio of operating expenses to total assets since management quality determines the level of operating expenses (Athanasoglou et al., 2005). Listed firms also need to be able to meet their obligations.

2.3.5 Liquidity Management and Sensitivity

Liquidity is the ability of an institution to transform its assets into cash or its equivalent in a timely manner at a reasonable price to meet its commitments as they fall due. Liquidity management is very important for every organization that means to pay current obligations on business, the payment obligations include operating and financial expenses that are short term but maturing long term debt. Liquidity ratios are used for liquidity management in every organization in the form of current ratio, quick ratio and Acid test ratio that greatly effect on profitability of organization. Su, D., (2010), &Wang. (2002)

2.4 Empirical Review

Several previous studies have found that insiders at the management level have the decision-making power to determine the capital structure of the firm. Jensen and Meckling (1979) argue

that the ownership structure of the firm is part of the firm's production function, together with the technology and productive resources. This implies that different ownership structures may result in different production possibility sets and, therefore, the implicit assumption made by the classical theory might not apply.

Kim and Sorensen (1986) observed that the agency cost of debt is reduced as insider ownership increases. This is because creditors believe that negotiation with managers can reduce agency costs.

Pound (1988) and McConnell & Servaes (1990) present evidence of the monitoring effects of collective institutional ownership. On the one hand, Pound finds that firms with high levels of institutional ownership are less likely to be targeted. Performance was measured in terms of return on sales (ROS) and return on investment (ROI), two commonly used indicators of profitability that have been used in this stream of literature.

An indicator of operational efficiency measured as a ratio of cost of goods sold (direct materials, direct labor, and manufacturing overheads) to sales was used to complement the profitability parameters.

Jensen et al. (1992) argued that a negative relationship exists between debt ratio and insider ownership. One reason is that insiders with major stakes are less diversified and have more incentives to reduce their financial risks. The other reason arises from higher insider ownership possibly resulting in higher agency costs of debt.

Black (1992) praises the potential benefits of the political approach, but he is doubtful that institutions can effectively assist monitoring through facilitation, between dissidents and management, unless restrictions on institutional ownership are relaxed. He suggests that if individual institutions could easily own 5 to 10% stakes, then collectively they could influence corporate policy and elect a minority of board members without becoming too powerful. In the absence of such regulatory reform, Black argues that dispersed institutions have the incentive to remain passive or to support management so as to preserve valuable business relationships with the firm. There is, however, some evidence to suggest that collective institutional ownership provides facilitation between dissidents and managers.

Bethel and Liebeskind (1993) studied the Effects of Ownership Structure on Corporate Restructuring. The results of the study show that institutional ownership in sample firms was a determinant of growth and increases in investment, not downsizing. This evidence is also consistent with the argument that shareholders' power increased during the 1980s, allowing them to prevent managers from investing in over expansion and over diversification more effectively than before.

Griffith (1999) studied the CEO ownership and firm value. The results of his finding was that the Tobin's q rises when the CEO owns between 0 and 15% of the firm, then declines as CEO ownership increases to 50%, and rises again thereafter. The decline in Tobin's Q supports the entrenchment hypothesis, that once the manager effectively obtains control of the firm, he or she was come self-indulgent.

.Chang and Hong (2000) sampled group-affiliated firms in Korea and found that, although the performance of group-affiliated firms is not apparent, internal trade may be used to raise profitability. The performance of these group-affiliated firms can also be manipulated by party transactions or accounting measures. Thus, traditional performance measurement indicators such as return on assets (ROA) and return on equity (ROE) are easily affected by management influence on internal sales to boost the net profit.

Ramaswamy (2001) studied the organizational ownership, competitive intensity, and firm performance for the Indian Manufacturing Sector. The results show that state-owned enterprises do not perform as well as their private sector counterparts, and that the magnitude of the privately state owned performance differential increases with increasing competitive intensity

Short et al. (2002) revealed that increasing insider ownership aligns the interests of insiders and creditors. Low agency costs of debt increase debt financing, which show a significant positive relationship between insider ownership and debt financing.

Anderson and Reeb (2003) studied the Founding-Family Ownership and Firm Performance for S&P 500. The results of the study are that CEOs in family firms earn nearly 10.0 percent less of their total pay in equity-based forms compared to CEOs in non-family firms.

Lins (2003) studied the equity ownership and firm value in emerging markets for 1433 firms from 18 emerging markets. The model he used was Tobin's Q on the percentage of control rights held by management. The model provides no evidence that higher management control rights are linked to lower firm values.

Rostislav (2003) studied, “The Effects of Institutional ownership on Investment and Performance for Russia”. Their evidence supports the proposition that institutional ownership may provide a negative effect on investment. They also found that dispersed ownership structures are more efficient compared to concentrated ownership in Russia.

On the contrary, Claessens et al. (2006) found gains from group affiliation for East Asian firms; however, these gains do not automatically occur because costs may also arise due to agency problems. Financially constrained companies such as small entities, fast-growing firms, and those with high R&D expenses can benefit more from group affiliation.

Manos et al. (2007) demonstrated that intra-group loans are also an important means of transferring funds among Indian group-affiliated firms. Group affiliates are not significantly affected by the availability of non-debt tax shields and the illiquidity of their stocks.

Conversely, the determinants of their capital structure decisions are affected by certain group-level factors such as the profitability of other group members and the size of the group.

Zulfiqar et al. (2009) have examined the relationship between the board composition and earning management for Pakistani listed companies. They analyzed set of listed companies have been investigated the relationship for the year of 2003-2007. Board composition has measured the board independence and intuitional ownership whereas the earning management has evaluated the discretionary accruals modified the cross sectional Jones model (1995) has been used to

determine the earning management. Their results show that except for institutional ownership no other variables have any impact on earnings management being only significant value and results. They concluded that the institutional ownership has a negative relationship with discretionary accruals. Board independence does not have any relationship with discretionary accruals. Their control variables size of the firm and return on equity also do not impact on earning management.

Kiruri (2013) conducted a study which sought to investigate the effects of ownership structure on banks profitability in Kenya. The study found that institutional ownership and state ownership had negative and significant effects on the banks profitability while foreign ownership and domestic ownership had positive and significant effects on the banks profitability. The study conclude that higher ownership concentration and state ownership lead to lower profitability in commercial banks while higher foreign and domestic ownership lead to higher profitability in commercial banks.

Chege (2013) examined the relationship between ownership structures and financial among commercial banks listed in the NSE in Kenya. The study found out that there is a positive relationship between profitability and log foreign shares, log local retail, log debt to equity and log share capital as indicated by beta coefficients. Log local corporate, have a negative relationship. Log foreign shares were found to be significant in explaining results that a unit changes in log foreign shares were found to be significant in explaining profitability. Results indicate that a unit change in log foreign shares, log local retail, log debt to equity and log share capital led to a positive change in profitability while the inverse is the case with log local corporate.

Alulamusi(2013) undertook a study on the relationship between ownership structure and financial performance of commercial banks in Kenya and established that there is a relationship between foreign ownership and the different parameters of financial performance .This finding, consistent with earlier findings showed the high monitoring capabilities of foreign owners and efficiency. Government ownership had a negative relationship with asset quality, earnings quality and management efficiency indicating laxity in prudent credit management practices and also inefficiency of operations and poor returns. Institutional ownership on the other hand showed a positive relationship with most of the parameters with an exception of some commercial banks. This brought out the negative relationship of block holders with very high shareholding to financial performance

2.5 Summary of Literature Review

The results of the literature review between institutional ownership and performance are mixed and this can be due to a number of reasons. One interpretation is that previous studies on the separation of ownership and control have not used adequate control parameters and consequently do not sufficiently account for the complex social context in which ownership occurs. Further, it is possible that surviving firms enjoy the level of institutional ownership that is most efficient for their industrial and institutional environment. Consequently, ownership organization is considered endogenous and not an independent influence on performance. A third interpretation of the mixed empirical evidence found regarding the effects of institutional ownership on firm performance is that examining formal ownership rights does not adequately capture important social dimensions of ownership. In addition most of the studies have centered in developing countries and the ownership structure that exist in such economies differs from one existing in

emerging economies such as Kenya, This study will therefore seek to bridge this gap and by focusing in a developing country.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter sets to explain the research design, the population of interest, the basis of sample selection, the type of secondary data used, the sources of data, the techniques of analysis used and the data analysis.

3.2 Research Design

This study employed correlation research design. According to Albright et al. (2011) a correlation research is a procedure in which subjects' score on two variables are simply measured, without manipulation of any variable, to determine whether there is a relationship. The study also used cross-sectional study in which data was gathered just once over the period 2009 to 2013 and as such, a causal study was undertaken in a non-contrived setting with no researcher interference.

A cross sectional study was used to determine the interrelationship between the variables under consideration among the different firms in the study and this will 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.

3.3 Population of the Study

The population of interest in this study was all the firms that have been listed at the NSE between 2009 and 2013. Currently, there are 61 firms listed at the NSE (Appendix I). The reason as to why this group is chosen is due to the availability and the reliability of the financial statements in

that they are subject to the mandatory audit by internationally recognized audit firms as well as regulators. Since the number of the respondents is limited, then the study was a census survey.

3.4 Data Collection

Data was collected from annual reports submitted to the NSE and Capital Markets Authority. From the financial statements, the researcher collected information on the number of shares owned by the management as well as directors, level of debt, dividend payout ratio, profitability ratios and book value of assets.

In addition, in order to obtain a representative sample from the population, a number of filters were applied. Observations of firms with anomalies such as negative values in their total assets, current assets, fixed assets, capital, depreciation or the interest paid was eliminated. In addition, only firms that had continuously operated over the period 2009 to 2013 were considered in the study.

3.5 Data Analysis

Multiple regression analysis was applied to the data to examine the effect of the various aspects of ownership structure on the performance of the listed firms by close examining the CAMEL attributes. Profitability = $f(\text{CAMEL}, \alpha) + f(\text{Institutional Ownership, Foreign Ownership, Government Ownership, Individual Ownership})$

3.5.1 Analytical Model

The model will specifically take the form;

$$\text{ROA} = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon$$

Where :

CAMEL is financial performance. It is measured by: C - Capital Adequacy ratio A – Asset Quality, M- Management Efficiency E - Earnings Quality L - Liquidity

Y= Financial Performance=f (Ownership Identity) CAMEL= f (Institutional Ownership, Foreign Ownership, Government Ownership, Individual Ownership)

X₁=C -Capital Adequacy ratio

X₂=A - Asset Quality

X₃= M- Management Efficiency

X₄= E - Earnings Quality

X₅= L - Liquidity

The data in this study were analyzed using Pearson's Product Moment Correlation and Logistic Regression. The results were presented in two categories: 1) institutional ownership and firm performance, and ownership identity and firm performance.

3.5.2 Test of Significance

Reliability analysis was used to assess internal consistency (degree of homogeneity among the items). Cronbach's Alpha coefficients were computed for 18 items under board effectiveness and managerial discretion, and the overall assessment was 0.87. According to Nunnally (1978), a data collection instrument with a good internal consistency should have Cronbach's Alpha coefficients that are higher than 0.7. The items were therefore, found to be highly homogeneous.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter covers data presentation and analysis. The main objective of the study was to determine the relationship between ownership structure and performance of listed firms at NSE in Kenya. In order to simplify the discussions, the researcher provided tables and figures that summarize the collective reactions and views of the data.

4.2 Response Rate

A census approach was used, and thus the sampling frame consisted of all listed firms in Kenya. Using the Nairobi Stock Exchange Handbooks (2009-2013), 61 firms were on the roll, out of which six had not compiled their financial reports for the relevant period of study. Another six failed to take part in the study. The final sample therefore, consisted of forty-two firms, representing about 78 percent response rate. The sample comprised two firms from the Agricultural sector (9.5%), seven from Commercial Services (16.7%), ten from Finance and Investment (23.8%), fourteen from Industrial and Allied (33.3%), and seven from Alternative Investment Market (16.7%).

4.3 Descriptive statistics

Table 4.1: Descriptive Statistics Results

Variable	Govt	Foreign	Institutional	Individual
Mean	2.96E+11	8.26E+11	50.164	16.1781
Median	6.95E+10	8.22E+11	48.7728	14.395
Minimum	3.51E+09	2.54E+11	46.9983	9
Maximum	1.74E+12	1.61E+12	54.9903	31.11
Std. Dev.	4.29E+11	3.55E+11	3.19624	6.0548
C.V.	1.44794	0.430114	0.063716	0.374259
Skewness	1.87928	0.436739	0.385404	0.951922
Ex. Kurtosis	2.90735	-0.63687	-1.57615	0.048466
5% Perc.	3.87E+09	3.21E+11	47.0014	9
95% Perc.	1.47E+12	1.53E+12	54.8794	29.509

Source: Research Findings

4.4 Correlation Analysis

The data in this study were analyzed using Pearson's Product Moment Correlation and Logistic Regression. The results were presented in two categories: 1) institutional ownership and firm performance, and 2) ownership identity and firm performance

Table 4.1: Correlation of different ownership identities based on financial performance

Ownership Identity	C	A	M	E	L
Govt	-0.77	0.236	0.909	-0.150	0.70
Foreign	0.105	-0.386	0.173	-0.064	0.215
Institutional	0.225	-0.196	-0.327	0.424	0.105
Individual	-0.271	0.030	0.105	-0.2300.	-0.0469

Sources: Research Findings

4.4.1 Capital Adequacy

Government ownership had a correlation of -0.77 showing a negative relationship with capital adequacy. The test significance was 0.747. Foreign ownership on the other hand had a correlation of 0.105 and a test of significance of 0.659. Institutional owners were highly correlated to capital adequacy compared to foreign owners with a correlation of 0.225 and a significance of 0.340. Individual owners had a correlation of -2.71 showing a negative correlation with a significance of 0.248. 36

4.4.2 Asset Quality

Findings showed a positive correlation between government ownership and asset quality. It had a correlation of 0.236. Foreign, Institutional ownership had negative correlations of -0.386 and -0.196 respectively indicating that they have lower ratios of asset quality indicating better asset quality. Individual ownership on the other hand had a correlation of 0.030.

4.4.3 Management Efficiency

Findings showed a negative correlation between the different ownership identities and management efficiency. Government ownership and individual ownership had a correlation of 0.909 and 0.105 respectively. This indicates high cost income ratios hence lower efficiency. Foreign and Institutional ownership had 0.173 and -0.327 respectively. Institutional owned banks were the most efficient.

4.4.4 Earnings Quality

With a correlation of 0.424 at a significance of 0.62, Institutional ownership had the best returns of their investors. The government, foreign and individual owned banks had correlations of -0.150, -0.064 and -0.230 respectively.

4.4.5 Liquidity

Findings indicated positive correlation between government, foreign and institutional ownership and liquidity. Government had a lesser correlation of 0.070 with a significance of 0.771. Foreign Ownership had the highest correlation of 0.215 with a significance of 37 0.363. Institutional ownership followed with a correlation of 0.105 and a significance of 0.661.

4.5 Regression Analysis

The regression results showed a positive relationship of all ownership identities with capital adequacy. Institutional investors were the most capital adequate displaying a β of 0.548 with a significance of 0.550. Foreign owned listed firms and Government owned listed firms had β of 0.471 and 0.313 respectively with significance of 0.626 and 0.737 respectively. Individual owned listed firms were the lowest with β of 0.078 and a significance of 0.921. 38 .

Table 4.2 Regression Results for the effects of Predictor Variables on Firm Performance

	Parameter Estimates (β)	Parameter Estimates (β)	Parameter Estimates (β)	Parameter Estimates (β)	Parameter Estimates (β)
	C	A	M	E	L
GOVERNMENT	0.313	0.881	0.575	-0.020	0.130
FOREIGN	0.471	0.460	0.641	0.065	0.249
INSTITUTIONAL	0.548	0.825	0.252	0.417	0.187
INDIVIDUAL	0.078	0.608	0.520	-0.129	-0.317

Source: Research Findings

A Low ratio of asset quality is a good indicator of financial performance. Regression findings indicate government as one with poor asset quality as shown by a β of 0.881 followed by institutional owned listed firms that had a β of 0.825. Foreign ownership had the best asset

quality with a β of 0.460 at a significance of 0.617. Individual owned banks had a β of 0.608. Efficiency in operations of listed firms is shown by a low cost-income ratio. Institutional owned listed firms had a β of 0.252 emerging the most efficient with a significance of 0.781. Foreign owned listed firms were less efficient with a β of 0.641 followed by Government owned listed firms and Individual owned banks with β of 0.575 and 0.520 respectively.

The government and individual owned listed firms showed a negative relationship with Earnings Quality. Their β were -0.020 and -0.129 respectively with significance of 0.982 and 0.863 respectively showing that the banks had low returns to their investors. Foreign and Institutional owned listed firms had β of 0.065 and 0.417 at significance of 0.944 and 0.633 respectively showing institutional owned banks as one with the highest returns on their investment. The findings of the regression results for the relationship between the ownership identities and liquidity indicate a β of 0.130, 0.249, 0.187 and -0.317 for the government, foreign, institutional and individual ownership structures respectively. These findings show a positive relationship between government, foreign and institutional ownership with liquidity. However, individual owned listed firms have a negative relationship with liquidity.

4.5.1 Linear Regression

The dependent variables: Return on Assets ($\beta = -0.761$, $p < 0.05$), Return on Equity ($\beta = -0.645$, $p < 0.05$) and Dividend Yield ($\beta = -0.888$, $p < 0.05$) all recorded significant negative correlations with institutional ownership.

Table 4.3: Linear Regression Results for the effects of Predictor Variables on Firm Performance

Indicator Variable	ROA	ROE	DY
Predictor Variable	Parameter Estimates (β)	Parameter Estimates (β)	Parameter Estimates (β)
Institutional ownership			
Institutional ownership	-0.761	-0.645	-0.888
Ownership Identity			
Foreign ownership	1.598*	1.218*	1.592*
Institution ownership	1.012*	.775	.826
Government ownership	-0.798	-0.616	-0.483
Diverse ownership	.946*	.789*	.723
Board Effectiveness			
Board effectiveness	-.557*	-.237*	-.111
Manager Ownership			
Manager/insider ownership	1.003	.792	.241

*p<0.05 **Sources: Research Findings**

The results of the Linear Regression presented in table 1 indicate that overall, institutional ownership was negatively and significantly related to all the three indicators of firm performance. This was evident from the beta coefficients and levels of significance of the relationships. The dependent variables: Return on Assets ($\beta = -0.761$, $p < 0.05$), Return on Equity ($\beta = -0.645$, $p < 0.05$) and Dividend Yield ($\beta = -0.888$, $p < 0.05$) all recorded significant negative correlations with institutional ownership.

4.5.2: Logistic regression

The results of the Logistic Regression tests in Table 4.2 indicate that there is a negative and significant correlation between institutional ownership and Return on Assets ($\beta = -0.360$, $p < 0.05$) and Return on Equity ($\beta = -0.085$, $p < 0.05$). The results for Dividend Yield ($\beta = -0.102$, $p < 0.05$) were also negative but not significant.

Table 4.4: Logistic Regression Results for the effects of Predictor Variables on Firm Performance (Above Market Average)

Indicator Variable	Column 1 ROA Above Market Average	Column 2 ROE Above Market Average	Column 3 DY Above Market Average
Predictor Variable	Parameter Estimates (β)	Parameter Estimates (β)	Parameter Estimates (β)
Institutional ownership	-.360*	-.085	-.102*
Foreign ownership	6.436*	3.810	6.579
Institution ownership	4.888	2.595	3.120
Government ownership	-15.794	-17.778	-17.021
Diverse ownership	6.041*	5.038	3.718
Board effectiveness	-.033	-.042	-.035
Manager/ insider ownership	5.013	4.049	5.162

Sources: Research Findings * $p < 0.05$

The Linear Regression results: ROA ($r=0.026$, $p < 0.05$), ROE ($r=0.038$, $p < 0.05$) and DY ($r=0.041$, $p < 0.05$). Logistic Regression results: ROA ($\beta=5.013$, $p < 0.05$), ROE ($\beta= 4.409$, $p < 0.05$) and DY ($\beta = 5.162$, $p < 0.05$). The relationship was positive and significant, and hypothesis H_{2a} was accepted. The Linear Regression results: ROA ($r=-.017$, $p < 0.05$), ROE ($r=-.058$, $p < 0.05$); DY ($r=-.077$, $p < 0.05$). Logistic Regression results: ROA ($\beta=-15.794$, $p < 0.05$), ROE ($\beta=-17.778$, $p < 0.05$) and DY ($\beta=-17.021$, $p < 0.05$). The relationship was negative and significant, leading to acceptance of the hypothesis H_{2b}. The research findings are in line with regard government (state) ownership, there is much more unanimity in the academic circles. State ownership has been regarded as inefficient and bureaucratic.

De Alessi (1980, 1982) defines state-owned enterprises as “political” firms with general public as a collective owner. A specific characteristic of these firms is that individual citizens have no direct claim on their residual income and are not able to transfer their ownership rights.

Ownership rights are exercised by some level in the bureaucracy, which does not have clear incentives to improve firm performance. Vickers and Yarrow (1988) consider the lack of incentives as the major argument against state ownership. Other explanations include the price policy (Shapiro and Willig, 1990), political intervention and human capital problems (Shleifer and Vishny, 1994). The Linear Regression results: ROA ($r=-.016$, $p<0.05$), ROE ($r=-.014$, $p<0.05$); DY ($r=-.029$, $p<0.05$). Logistic Regression results: ROA ($\beta=4.888$, $p<0.05$), ROE ($\beta=2.595$, $p<0.05$) and DY ($\beta=3.120$, $p<0.05$). The results were positive and significant. This study is in line with (Jensen and Meckling, 1976) who posted that the control of the firm reverts to underhand dealings aimed at augmenting their income. This insider dealing might compromise company performance. Manager/insider ownership, on the other hand, has attracted a lot of attention and interest for a wide variety of reasons.

Much of the interest has focused on the potential for better economic performance, particularly through enhanced motivation and commitment from employees who have a direct stake in the residual income of the firm. Strong majorities of the public believe that manager-owners work harder and pay meticulous attention to the quality of their work than non-owners, and are more likely than outside shareholders to influence firm performance. There have also been social arguments for manager/insider ownership of firms, based on its potential to broaden the distribution of wealth, decrease labor-management conflict, and enhance social cohesion and equality by distributing the fruits of economic success more widely and equitably. The Linear Regression results: ROA ($r=0.012$, $p<0.05$); ROE ($r=0.023$, $p<0.05$); DY ($r=0.061$, $p<0.05$). Regression results: ROA ($\beta=6.041$, $p<0.05$), and ROE ($\beta=5.038$, $p<0.05$); DY ($\beta=3.718$, $p<0.05$). This findings were in line with research of Aydin, Sayim and Yalama, 2007) who concluded that, on average, multi-national enterprises have performed better than the

domestically owned firms. It is therefore, not surprising that the last two decades have witnessed increased levels of Foreign Direct Investments in the developing economies.

Moreover, the findings established that two main reasons have been put forward to explain the phenomenon of high performance associated with foreign ownership of firms. The first reason is that foreign owners are more likely to have the ability to monitor managers, and give them performance-based incentives, leading the managers to manage more seriously, and avoid behaviors and activities that undermine the wealth creation motivations of the firm owners. The second reason is the transfer of new technology and globally-tested management practices to the firm, which help to enhance efficiency by reducing operating expenses and generating savings for the firm.

The Linear Regression results: ROA ($r=0.044$, $p<0.05$), ROE ($r=.037$, $p<0.05$); DY ($r=.041$, $p<0.05$). Logistic Regression results: ROA ($\beta=6.436$, $p<0.05$), ROE ($\beta=3.810$, $p<0.05$); DY ($\beta=6.579$, $p<0.05$). The relationship between ownership structure and firm performance was conceptualized based on pertinent literature on corporate governance. Ownership Structure was conceptualized as comprising institutional ownership and ownership identity. Institutional ownership (shareholding above 30%) was determined using Herfindahl Index, or the equity stake of several largest investors, typically the top five shareholders (Demsetz and Lehn, 1985). Four ownership categories were identified, namely: foreign; institutional; government; and diverse. Each of these ownership identities has different risk-taking orientations, which in effect impact investment decisions and firm performance differently.

4.6 Interpretation of the Findings

The relationship between ownership structure and firm performance was conceptualized based on pertinent literature on corporate governance. Ownership Structure was conceptualized as comprising institutional ownership and ownership identity. Institutional ownership (shareholding above 30%) was determined using Herfindahl Index, or the equity stake of several largest investors, typically the top five shareholders. Four ownership categories were identified, namely: foreign; institutional; government; and diverse. Each of these ownership identities has different risk-taking orientations, which in effect impact investment decisions and firm performance differently.

The findings of this study therefore, appeared to contradict the position held by proponents of institutional ownership (Moldoveanu & Martin, 2001; Kuznetsov & Murvyev, 2001; Jensen & Murphy, 1990; Fama & Jensen, 1983; Jensen & Meckling, 1976; Berle & Mean, 1932) who argue that institutional ownership affords the shareholders the motivation and ability to monitor and control management decisions. This, they posit, ensures that managers make decisions that support the wealth creation motivation of the shareholders. Managerial ownership is seen as the most controversial where its overall effect depends on the relative strengths of the incentive alignment and entrenchment effects (Cho, *et al*, 1998). Diffusely owned firms have been shown in previous studies to be poor performers in part due to the fact that diverse/diffuse shareholders lack the wherewithal and motivation to monitor, control and ratify management decisions. The apologists of strict monitoring and control however, fail to clearly appreciate the fact that ultimately, the shareholders rely on the managers' creativity and innovation to deliver the desired superior corporate performance, and inordinate interference of shareholders in the management processes will certainly undermine corporate outcomes. The latter position is supported by

Bergloef and Von Thadden (1999) who posit that concentrated ownership curtails the managers' creativity to a great extent, and therefore force managers to adhere to only those strategies that are favored by shareholders, even if they genuinely doubt the efficacy of those strategies.

The results of this study appeared to vindicate the latter position, which essentially means that institutional ownership tends to place inordinate monitoring and ratification powers on shareholders, many of whom may not necessarily understand the business well, thereby undermining firm performance. The conclusion that may be drawn from the study findings is that in Kenya, institutional ownership is inimical to manager creativity and innovation, and curtails firm performance.

There is near convergence that Government ownership of firms leads to bureaucracy and inefficiency that negatively impacts firm performance (Nickel, 1997). Many researchers (De Alessi, 1980, 1982; Vickers and Yarrow, 1988; Shapiro and Willig, 1990; Shleifer and Vishny, 1997) have argued that state-owned enterprises are political firms with citizens as the shareholders, but these citizens have no direct claim to the residual income of those firms. The citizens thus cede their ownership rights to the bureaucracy which does not have clear incentives to improve performance of the corporations. Others (Nickel *et al*, 1997) have attributed the prevalent poor performance of Government owned firms to the tendency of those firms not to strictly adhere to government statutory requirements and regulations. Political manipulation and poor human resource policies are other factors that have been blamed for the general poor performance of state-owned enterprises (Shapiro *et al*, 1990).

Since the early 1990's, the Kenyan Government has pursued a deliberate policy of divestiture, aimed at reducing state ownership of corporations with a view to attracting private sector

participation in management of the fledgling state corporations. It was envisaged that this policy would infuse modern management styles into the public sector that would ultimately improve performance of these companies. The fact that Government ownership of firms was found to still impact firm performance negatively is perhaps an indication that the divestiture program in Kenya is yet to reach a critical level where its value can begin to reflect on corporate performance. Pertinent literature regarding the relationship between ownership by corporations and firm performance emphasizes that investors differ in the degree to which they are prepared to take risks (Shleifer & Vishny, 1997; Welch, 2000; Xu & Wang, 1997). Firm owners make investment choices that are influenced by their interests and preferences.

When a firm acquires shares in another firm, the shareholders of the first firm extend their investment preferences, interests and risk taking behavior to that new firm. The interesting thing about firm ownership by other firms in Kenya is that the holding firms are typically large corporations with the ability to reorganize their branch/affiliate operations to bail out non-performing affiliates. Most of these holding firms have also reported good performance during the period of study. The good performance of the firms they own is therefore, consistent with the documented practice by firms to extend their investment preferences and risk-taking behavior to the firms they acquire. Regarding the impact of diverse ownership on firm performance, the findings of this study appear to contradict those of previous researchers (Fama and Jensen, 1983; Jensen and Meckling 1976; Berle and Mean, 1932) who have argued that agency problems are more severe in diffusely held firms due to lack of capacity to collectively monitor the activities of managers, a situation that gives managers unlimited leeway to run the affairs of the corporation in their own self-interest. This argument, however fails to appreciate that shareholder-managers will almost invariably demonstrate more commitment to the firm than will

their counterparts who are not shareholders since the latter have no stake in the residual income of the firm.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The chapter provides the summary of the findings from chapter four, and it also gives the conclusions and recommendations of the study based on the objectives of the study. The objectives of this study were to establish relationship between ownership structure and financial performance of firms listed at the NSE

5.2 Summary

There is a significant negative relationship between institutional ownership and firm performance. The monitoring and control school of thought argues that the free-rider problems associated with diffuse ownership do not arise with concentrated ownership, since the majority shareholder captures most of the benefits associated with this monitoring. This found out that the reverse is actually true in the Kenyan context. The implication is that when more than 30 per cent or more of shares are concentrated on a few hands (i.e. five shareholders or less), there is a tendency for the shareholders to be overzealous in their monitoring, controlling and ratification roles over managers.

This stifles managers' creativity and innovation, and ultimately affects firm performance adversely. It is even worse when the shareholders lack specific and general knowledge about the business of the firm. There is a positive relationship between insider ownership and firm performance. It has been argued that when managers own shares in their company, they become more committed to the organization since they have a stake in the residual income of the firm, and are likely to bear the cost of mismanagement.

There is a significant negative relationship between government ownership and firm performance. Government ownership has been roundly criticized for contributing to generally poor performance of firms, due to excessive bureaucracy, tribalism, nepotism, poor human resource policies, political expediency in appointments and lack of respect for laws and regulations of the country.

There is a positive relationship between ownership by corporations and firm performance. Previous studies have found ambiguity in the relationship between ownership by corporations and firm performance, due mainly to the differences in investment preferences and shareholders' goals. So the good performance is attributable to the investment choices and orientation of the parent companies, and not necessarily the ability of managers. The results are a pointer that companies that are performing poorly need to carefully chose strategic partners to prop up their poor performance.

There is a positive relationship between diverse ownership and firm performance. The global trend toward diffuse ownership has confounded many researchers, since it undermines the popular belief that managers are inherently self-seeking and can easily wreck the organization if left without close monitoring. The findings have brought a new dimension that emphasizes managerial discretion for creativity and innovation, and less monitoring by shareholders. Thus, diffuse ownership of firms provides a good environment for excellent policies to be developed and implemented by managers. The managers are therefore best informed regarding alternative uses for the investors' funds.

As a result, the managers end up with substantial residual control rights and discretion to allocate funds as they choose. The downside of this argument is that it presumes that managers are honest, and always prepared to work in the objective interest of the shareholders, a position that is often not true. The fact that managers have most of the control rights can lead to problems of management entrenchment and rent seeking behavior by managers. This study has shown that managers work best when they have sufficient latitude for innovation and creativity, that is, less monitoring by principals.

The positive and significant relationship between foreign ownership and firm performance appears to have gained universal acceptance across the globe due to a number of factors. First, foreign owned companies have access to management systems whose efficacy has been tested in many contexts. The massive resource base and bail-out plans for fledgling affiliates are other factors that enhance performance of foreign owned firms. However, the ability of these companies to re-organize their global operations to be able to assign more costs to harsh tax regimes and profits to tax havens in a bid to reduce their overall tax liability, is the most damning feature of foreign ownership.

5.3 Conclusion

Prior research has found significant links between ownership structure and firm performance. Studies comparing institutional ownership and firm performance have often found a higher rate of return in companies with concentrated ownership. Other studies have also shown that it is not only the amount of equity held by shareholders that matter when studying firm performance but also the identity of the shareholder. Although some researchers have tended to favor concentrated ownership over diverse ownership, the reality is that the agency costs incurred in

monitoring managers (especially if they are not shareholders) are huge, and may undermine firm performance. Thus, it is a lot cheaper for managers to be able to make independent decisions that support shareholder objectives than have shareholders to impose imprudent ideas on them. The import of the study findings is that in Kenya, managers work better in an environment where they are afforded an opportunity to own shares of the firm, then allowed freehand to exercise their professional judgment without undue influence from shareholders. This arrangement works best in a diffusely held firm. It can also be argued that the high performing blue chip companies have high likelihood to attract more individual investors to buy their shares, thereby diversifying shareholdings.

The most definitive results were on the relationship between foreign ownership and firm performance. The significant positive relationships have indicated the long-held belief that on average, foreign owned companies perform better than their counterparts with dominant local ownership. Thomsen and Pedersen (1997) posit that preferences regarding company strategies will often involve a trade-off between the pursuit of shareholder values, orientation and other goals. Successful companies with an international presence tend to be large, with well-established management systems that are replicated (with minimal customization) in all their branches and affiliates abroad.

5.4 Recommendations for Policy and Practice.

The study recommends that the typical agency problems that are very likely to arise in situations where professional managers control the assets of a corporation in which they are not shareholders are adverse selection (miscalculations) and moral hazard (failures of managerial integrity). It has been argued that these problems often arise because managers lack the requisite motivation to ensure prudence since they do not have a stake in the residual income of the firm

managerial ownership is the most controversial and ambivalent form of firm ownership, and has mixed effects on performance. Whereas ownership by managers may be seen as a system of aligning the interests of managers with those of the shareholders in a way that enhances corporate performance, this form of ownership can also lead to entrenchment of managers, which is costly when they chose to pursue their self-interests. It has been argued that the overall impact of managerial ownership on firm performance depends on how well the entrenchment effects and incentive alignment are balanced

Moreover, the massive resource base and bail-out plans for fledgling affiliates are other factors that enhance performance of foreign owned firms. However, the ability of these companies to re-organize their global operations to be able to assign more costs to harsh tax regimes and profits to tax havens in a bid to reduce their overall tax liability, is the most damning feature of foreign ownership.

5.5 Limitations of the Study

The researcher encountered various limitations that were likely to hinder access to information sought by the study. The findings of this study agreed to a significant extent with the argument that managerial ownership enhances corporate performance. In Kenya, manager ownership of firms has been actualized through executive share options. On the other hand, managers who are not shareholders are more likely to engage in insider dealings as a way of enhancing their personal wealth and prestige. The researcher encountered problems of time as the research was being undertaken in a short period with limited time for doing a wider research. However, the researcher countered the limitation by carrying out the research across the listed firms that were selected which enabled generalization of the study findings.

5.6 Areas for Further Research

Evidence from the study reveals that there is significant positive relation between foreign ownership and firm's performance. Further studies can be carried out to establish the extent to which governance issues have an impact on financial performance of firm listed at the NSE using a sector wide approach and all the companies listed in their totality. It would be of interest if the study period was prolonged for a longer period say 9 years and studies carried out after every three year's interval to assess if the findings hold. The study recommends that further studies can be done on the effect of ownership structure and financial performances of firms listed at the Nairobi Securities Exchange and increase the parameters of measurement.

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APPENDICES

APPENDIX 1: COMPANIES LISTED AT THE NAIROBI SECURITIES EXCHANGE AS AT 31ST DECEMBER 2013.

1. Eaagads Ltd
2. Kapchorua Tea Co. Ltd
3. Kakuzi
4. Limuru Tea Co. Ltd
5. Rea Vipingo Plantations Ltd
6. Sasini Ltd
7. Williamson Tea Kenya Ltd
8. Express Ltd
9. Kenya Airways Ltd
10. Nation Media Group
11. Standard Group Ltd
12. TPS Eastern Africa (Serena) Ltd
13. Scangroup Ltd
14. Uchumi Supermarket Ltd
15. Hutchings Biemer Ltd
16. Longhorn Kenya Ltd
17. Safaricom Ltd
18. Car and General (K) Ltd
19. CMC Holdings Ltd
20. Sameer Africa Ltd
21. Marshalls (E.A.) Ltd
22. Barclays Bank Ltd
23. CFC Stanbic Holdings Ltd
24. I&M Holdings Ltd
25. Diamond Trust Bank Kenya Ltd
26. Housing Finance Co Ltd
27. Kenya Commercial Bank Ltd
28. National Bank of Kenya Ltd
29. NIC Bank Ltd
30. Standard Chartered Bank Ltd
31. Equity Bank Ltd
32. The Co-operative Bank of Kenya Ltd
33. Jubilee Holdings Ltd
34. Pan Africa Insurance Holdings Ltd
35. Kenya Re-Insurance Corporation Ltd
36. Liberty Kenya Holdings Ltd
37. British-American Investments Company (Kenya) Ltd
38. CIC Insurance Group Ltd
39. Olympia Capital Holdings ltd
40. Centum Investment Co Ltd
41. Trans-Century Ltd
42. B.O.C Kenya Ltd

43. British American Tobacco Kenya Ltd
44. Carbacid Investments Ltd
45. East African Breweries Ltd
46. Mumias Sugar Co. Ltd
47. Unga Group Ltd
48. Eveready East Africa Ltd
49. Kenya Orchards Ltd
50. A.Baumann CO Ltd
51. Athi River Mining
52. Bamburi Cement Ltd
53. Crown Berger Ltd
54. E.A.Cables Ltd
55. E.A.portland Cement Ltd
56. KenolKobil Ltd
57. Total Kenya Ltd
58. Kenya Power Lighting Co Ltd
59. Umeme Ltd
60. Home Africa
61. Kengen

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