THE EFFECT OF OWNERSHIP STRUCTURE ON FINANCIAL PERFORMANCE OF COMPANYS LISTED AT THE NAIROBI SECURITIES EXCHANGE.

BY

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DECLARATION

I, the undersigned, declare that this is my original work and has not been presented to any institution or university other than the University of Nairobi for examination.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Researchers in corporate governance (Donaldson, 2005; Huse, 2005; Frentrop, 2003) have reported that there is still lack of concurrence on the ideal corporate governance structure that could safeguard shareholders’ assets while promoting wealth creation ventures. The corporate governance debate has largely centered on the powers of the Board of Directors vis-à-vis the discretion of top management in decision making processes.

The traditional approach to corporate governance has typically ignored the unique influence that firm owners exert on the board, and by extension, the top management, to behave or make decisions in a particular way. Consequently, studies on corporate governance (Cubbin and Leech, 1982; Monks, 1998; Jensen, 2000; Shleifer, 2001; Frentrop, 2003; Donaldson, 2005; Huse, 2005) have not comprehensively identified and dealt with the complexities that are inherent in corporate governance processes. Perhaps, this is where the greatest problem of corporate governance lies.

Owner preferences and investment choices are influenced by, among other factors, the extent to which they can take risks. To the extent that owners have economic relations with the firm, their priority would be to protect their interests even though this may lead to low investment returns, and generally low profitability. In this regard, Thomsen and Pedersen (1997) argue that banks which play a dual role as lenders and owners would not favor high risk ventures with great potential for returns since such a policy is inimical to loan repayment. Government may also play the dual role of regulator and owner. For each of these owners (stakeholders), preferences regarding company strategy will involve a tradeoff between the pursuit of shareholder value and other goals (Hill and Jones, 1982). All these issues have been ignored in the ongoing debate on corporate governance structure, and instead the role of the Board exalted as the panacea to all the corporate governance problems.

Thus, the corporate governance framework in its current form is evidently lacking in a monitoring system or contract, aligning the role of the firm owners, board of directors and managers' interests and actions within the wealth creation and welfare motivation
of stakeholders. In other words, holders of a majority of the voting shares in a corporation, through their ability to elect and control a majority of the directors and to determine the outcome of shareholders’ votes on other matters, have tremendous power to benefit themselves at the expense of minority shareholders. Thus, the type of owners as well as the distribution of ownership stakes will undoubtedly have an impact on the performance of firms. Most of the empirical literature studying the link between corporate governance and firm performance usually concentrates on a particular aspect of governance, such as board of directors, shareholders’ activism, compensation, anti-takeover provisions, investor protection etc. This paper is a moderate attempt to examine the relationship of ownership structure

1.1.1 Ownership Structure

Ownership structure, as a mechanism in corporate governance to facilitate increased efficiency of a firm, has been believed to effect firm performance for many years. For example, Adam Smith (1776) points out that the joint-stock companies are less efficient than private copartner companies because the directors would not watch over ‘other people’s money’ with ‘the same anxious vigilance’ as their own. Transaction cost theory considers a firm as an offer of contracts where the activities are cheaper internal than external. However, inside of the firm, there are conflicts between different parties. The Principal-agent theory mentions the conflict between shareholders and management. The conflict is led by the different agendas of shareholders and managers, more specifically, the divergence between the control right and cash flow right.

The question of what may be the most efficient ownership structure is therefore as relevant as ever. Shareholders and managers are making effort to combine their interests to reduce agency costs. In a structure-conduct-performance framework, a set of conditions determines the ownership structure of the firm, which then determines the corporate behaviour and performance. The relationship between ownership structure and corporate performance are assumed to exist, because ownership concentration and owner identity influence the incentives of each party within the firm, and thus influence the firm’s ability to solve agency problems. However, the relationship between ownership structure and firm performance remains blurred in previous studies, (Aggarwal, 2003).
Apart from that, most empirical studies use the data from United Kingdom and United States, in which the ownership structures are quite different from the markets in North Europe. The Nordic countries show higher ownership concentration and higher divergence of voting right and capital right through more complex shareholdings such as multiple control chains, pyramiding and crossholding. Furthermore, the firms in the Nordic countries are normally controlled by family/foundation, institutions or the government, (Samwick, 2003).

### 1.1.2 Financial Performance

Firms with dispersed ownership are the firms that have low ownership concentration. When there is not a single large shareholder or a group of shareholders that can control the firm, the managers, under the assumption of information asymmetry and opportunity behavior, is believed to take control over the firm. Furthermore, managers may, in many cases, own a portion of the shares large enough to provide a sufficient performance incentive. Studies about the effect of insider ownership on firm performance first became popular in 1970s when stake compensation to management was widely applied to align the incentives of managers and shareholders, (Villalonga, 2001)

The earliest argument of the positive effect of insider ownership on corporate performance is brought by Jensen & Meckling (1976), and is based on the principal agent theory. In Jensen’s article, he assumes a positive effect of managerial ownership on corporate performance because managerial ownership combines the incentives of managers and shareholders and thus reduces the agency problems. In later studies16, the incentive alignment argument is further developed. Furthermore, the arguments in support of the negative effect of ownership concentration also apply to the positive effect of dispersed (insider) ownership. A negative effect of ownership disbursement on corporate performance is also found (Demsetz & Lehn 1985).

Fama & Jensen (1983) introduce the argument that dispersed ownership leads to the creation of a hold-up problem, in which the shareholders cannot prevent manager’s opportunistic behavior even though they are able to recognize it. Finally some studies that find no observable effect between insider ownership and firm performance
explained by the *natural selection argument* (Demsetz & Lehn 1985) and *mutual neutralization argument* (Eckbo & Smith 1998, Himmelberg et al. 1999) as mentioned above. Firm valuation is measured by Tobin’s Q; firm profitability is measured by Return on Equity (ROE); firm growth is measured by the growth in total asset; and firm risk is measured by Beta.

### 1.1.3 Link Between ownership structure and Financial Performance

The interlink between ownership structure and corporate has a direct bearing on the risk-taking orientation of the firm. Agency problems arise whenever investment ideas and preferences of principals (owners) are at variance with those of their agents (Leech, 1986). Hence the board of directors acts as the intermediary between the principals and their agents, and is charged with four main responsibilities: leadership; stewardship; monitoring; and reporting back to the principals. The effectiveness of the board helps in, among other ways, monitoring and controlling managerial discretion. Broadly speaking, there are two sources of influences on managerial discretion. Apart from the internal influences (imposed by the board) there are external influences that pertain to the role of markets in monitoring and disciplining managers (Jensen, 1989). The most significant market-related constraints arise from managerial labor markets, product markets and financial markets. Managerial labor markets pose multi-dimensional threat to inept managers in the form of imminent take-over or absorption by better-managed firms, replacement of the management team or simply being black-listed.

Managerial ineptitude, more often than not, leads to poor financial management and erodes confidence of potential creditors (Brown Governance, Inc., 2004). These constraints impose on managers extra vigilance as they exercise their discretion. Other factors that moderate managerial discretion include intangible (idiosyncratic) resources, firm leverage, size, and industry structure. Demsetz and Villalonga (2001) found out that there was a significant positive relationship between corporate performance and intangible resources among American companies. Intangible assets are firm-specific characteristics that are unique to, and influence performance of an organization.
Resource Based View (RBV) holds that firms can earn sustainable supra-normal returns if and only if they have superior intangible resources that are protected by some form of isolating mechanism preventing their diffusion throughout industry (Miller, 2003). According to Wernerfelt (1984) and Rumelt (1984), the fundamental principle of the RBV is that the basis for a competitive advantage of a firm lies primarily in the application of the bundle of valuable resources at the firm’s disposal. To transform a short-run competitive advantage into a sustained competitive advantage requires that these resources are heterogeneous in nature and not perfectly mobile (Barney, 1991; Peteraf, 1993). Essentially, these valuable resources become a source of sustained competitive advantage when they are neither perfectly imitable nor substitutable without great effort (Hoopes, 2003; Barney, 1991). In a nutshell therefore, to achieve these sustainable above average returns, the firm’s bundle of resources must be valuable, rare, imperfectly imitable and non-substitutable (Barney, 1991).

The extent to which external and internal factors affect managerial discretion will depend on, among other factors, the manager’s locus of control, perception of discretion and the amount of power that people perceive the manager to possess. The relationship between locus of control and how managers view their discretion is practically important to the extent that the variation in perceived discretion is systematically related to consequential managerial or organizational outcomes (Eisenhardt and Bourgeois, 1988). One such outcome is managerial power, defined as the ability to influence others. Managerial power is important because its use is especially likely at the strategic apex of the firm due to the ambiguity and uncertainty surrounding strategic issues (Eisenhardt and Bourgeois, 1988; Finkelstein, 1992; Tushman, 1977).

Child (1972) reported that managerial power is a positive predictor of managerial efficacy, the firm’s strategic choices and performance among manufacturing firms in Europe. Noteworthy about the conceptualization of managerial power is that a manager must be able to recognize himself/herself, and be recognized by others, as powerful in order to influence these others (Pfeffer, 1981, 1992). This condition is significant since it conceptualizes managerial power as theoretically and practically distinct from perceived managerial discretion. For example, managers may perceive themselves as having much discretion and as powerful, they are not powerful (Pfeffer,
Thus, managerial power is an interpersonal phenomenon, whereas perceived discretion is an intra personal phenomenon.

The relationship between locus of control and how managers view their discretion is systematically related to consequential managerial or organizational outcomes (Eisenhardt and Bourgeois, 1988). One such outcome is managerial power, defined as the ability to influence others. Managerial power is important because its use is especially likely at the strategic apex of the firm due to the ambiguity and uncertainty surrounding strategic issues (Eisenhardt and Bourgeois, 1988; Finkelstein, 1992; Tushman, 1977). While the theory introduces the concept of transaction cost, due to uncertainty and risk of opportunistic behavior; corporate governance theory introduces the principal-agent problems and review the subsequent agent costs. Ownership structure, as one dimension of corporate governance, is believed to influence firm performance through its influence on the principal-agent relationships.

1.1.4 Companies in the Nairobi Stock Exchange

The stock market is a platform, which deals in the exchange of shares of publicly quoted companies, and government, corporate and municipal bonds among other instruments for money. The Kenyan Stock market, the Nairobi Stock Exchange which was formed in 1954 through incorporation into a company as a voluntary organization of stock brokers, is now one of the most active markets in Africa. Nairobi Stock Exchange has been operating through the telephone with a weekly meeting at the Stanley Hotel till in 1994, when the market moved to its current location, on the 1st Floor of the Nation Centre, with the introduction of the Central Depository and Settlement Corporation (CDSC). The CDSC increased the market efficiency since investors are able to open share and bond accounts, in electronic accounts similar to their bank accounts hence buying and selling shares are made easier and quicker.

Currently there are 60 quoted companies representing different sectors namely the Agricultural, Commercial and Services, Finance and Investment, and Industrial and Allied sectors. Trading on the stock exchange has become a fashionable tool for raising capital. Investors have become increasingly aware of the potential of the Nairobi stock exchange (Kihumba, 1993). The mid-eighties and early nineties
witnessed many firms raising new equity from the stock market for the first time and consequently many investors investing in their shares through primary initial offering and secondary markets. NSE has grown to become the continent's fourth-largest exchange by trading volume and fifth largest by market capitalization as a percentage of GDP. It cross-lists some of its equities - most notably Kenya Airways - with neighboring East African bourses the Uganda Securities Exchange and the Dar es Salaam Stock Exchange in Tanzania. NSE market index comprises of a selection of listed companies which represent a significant portion of market capitalization and trade actively. The three main indices at the NSE are the Nairobi Stock Exchange (NSE) 20 Index, NSE All Share Index (NASI) and the American International Group (AIG) index which are the three main indicators of stock market trends.

1.2 Problem Statement

Relationship between ownership structure and corporate performance of any company has been a serious agenda for corporate governance and that of performance of a firm. Thus, who owns the firm’s equity and how does ownership affect firm value has been a topic investigated by researchers for decades. Thus, the impact of ownership structure on corporate performance has been widely tackled in various developed markets and more recently in emerging markets, but was less discussed before, in Kenya in recent changing environment. Though the modern organization emphasizes the divorce of management and ownership; in practice, the interests of group managing the company can differ from the interests of those that supply the capital to the firm. Corporate governance literature has devoted a great deal of attention to the ownership structure of corporations.

Shareholders of publicly held corporations are so numerous and small that they are unable to effectively control the decisions of the management team, and thus cannot be assured that the management team represents their interests. Many solutions to this problem have been advanced, as stated previously i.e. the disciplining effect of the takeover market, the positive incentive effects of the management shareholding stake and the benefits of large monitoring shareholders. A different problem, however, arises in firms with large controlling shareholders. Since a large controlling shareholder has both the incentives and the power to control the management team's
actions, management's misbehavior is a second order problem when such a large shareholder exists. Instead, the main problem becomes controlling the large shareholder's abuse of minority shareholders.

Empirical studies have found that negative effects are also found in the studies of Pound (1988) and Hand (1990). One argument to support this result is the institutional myopia argument, which implies that the institutional investors prefer short term returns and will use their influence to encourage managers to pursue short term gains. Wahal (1996) find only short term positive effects of institutional ownership but not long term, as he argues that institutional investors have a time preference for short term result. Other studies illustrate this argument: institutional investors are sensitive to earning news, because they might use current earnings as proxy under the information asymmetry circumstance (Porter 1992); institutional investors consider the investment in a firm as one asset in a portfolio (Coffee 1991); the managers in the investing institutions are measured on short term results by their principals (Badrinath et al 1989). Another argument is strategic-alignment-conflict-of-interest by Pound (1988).

Locally, Ndemo (2009) found out that 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. To meet the main objectives of this thesis, the relationship between ownership structure and corporate performance will be investigated. The following questions will be answered: how does ownership concentration influence the financial performance of Kenyan firms?

1.3 Research objective

i. To investigate the effect of ownership structure on financial performance of company’s listed at the Nairobi securities exchange.
1.4 Value of the study

The study will be invaluable to the following group of persons. By determining the investigate the relationship between ownership structure and corporate performance of listed firms in the Nairobi stock exchange, the study would be an eye opener to the current and would be investors in NSE. Stock market affects consumption and investment spending hence overall performance of the economy, thus the study findings would be invaluable to the government.

This study will also be of benefit to corporate management as they would learn how ownership structure and corporate performance would cause the market to react by the adjustment in the stock prices. Hence, they would determine whether the appropriate ownership structure for better market valuation through share price change.

Regulatory agencies such as NSE and Capital Market Authority (CMA) can use the study to regulate the operations of listed companies in the stock exchange. Though some studies have been conducted on market reaction to corporate events, they have been inconclusive. Thus, this study will beneficial to the academicians in Kenya by narrowing the knowledge gap. The study will form a good base upon which further research will be based since it will help in forming empirical study and act as a source of secondary material.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The following part will review literatures related to the relationship between ownership structure and firm performance and is divided into four sections. The first two sections are dedicated to the more general theories related to the topic, including transaction cost theory and principal-agent theory in order to draw up the universe within which this research is constructed. Section one introduces transaction cost theory which consider corporation as an offer of contracts to avoid the transaction costs existing in the market, the cost is generated from information asymmetry and opportunistic behaviors of the contracting parties. Section two focuses on the principal-agent problems within the firm and the related agent costs. Three detailed principal-agent problems are introduced: adverse selection, hold-up and moral hazard. The remaining two sections of the literature review are more concrete in the way that they deal with specific studies. Section three provides an overview of studies of ownership structure and corporate performance, the effects of ownership concentration and owner identities on firm performance are reviewed separately. Finally in section four studies on national effect and the ownership structure characteristics in Kenya are reviewed.

2.2 Theoretical Review

2.2.1 Transaction Cost Theory

The transaction cost theory is based on the work of Coase (1937) where he explains the existence of firms as an organization that is able to undertake the certain transactions at a lower cost comparing to the market until it expands to the point where ‘the costs of organising an extra transaction within the firm become equal to the costs of carrying out the same transaction by means of an exchange on the open market or the costs of organising in another firm.

Asset specificity refers to the extent the cost or investment in a transaction relationship is recoverable and can be used in another relationship. Thus high asset specificity brings risk in the contract because the party with higher bargaining power could try to renegotiate the contract by the thread of cancelation. Moreover, in the
process of transaction, information asymmetry and bounded rationality lead to the fact
that not all the contingencies can be predicted ex ante, and, as a consequence,
incomplete contracts occur. Transactions will therefore have to yield high rents or not
occur in the worst case due to unwillingness to take on inherent risk of opportunistic
behaviour.

A way to overcome this dilemma is through governance mechanisms (economic
organization), which varies in controlling instruments and consequently lead to
different levels of incentive intensity and control property, and therefore has impact
on the incurring transaction costs. Williamson (1991) further compares the cost-
effective choice of three organization forms (market, hierarchy and hybrid) and found
that market is optimal for the transactions that are “sharp in by clear agreement; sharp
out by clear performance, while hierarchy is optimal for the transactions with high
asset specificity.

Hybrid mechanism displays the intermediate characteristics comparing with market
and hierarchy. The choice of the organization form depends on the characteristic of
the transaction. The theory is applied in corporate governance theories to explain
principal-agent problems and ownership structure. Holmstrom & Milgrom (1991) use
the theory to analyze the multidimensional tasks in the principal-agent model.
Different instruments including employment contracts, ownership assignment, private
activities limitation, are analysed based on their cost and incentive benefit in solving
the principal-agent problems.

Considering the high performance measurement cost, the author suggests analyzing
incentive problems in totality. To be more specific, the corporate governance
instruments should be combined together in analysing the opportunity cost and
measurement cost of every aspect of the agent’s performance to achieve the lowest
uncertainty and cost. According to Grossman & Hart (1986), asset specificity and ex
post bargaining problems will drive the preference for integration of parties, to reduce
opportunity costs.

While in the process of integration, the allocation of ownership is accompanied by
costs and benefits. The optimal ownership structure is thus to ‘minimize the overall
loss in surplus due to investment distortions [instead of maximizing] the total ex ante net benefits’5. In another word, the optimal ownership structure is in place when transaction costs are minimized in the long run. The following section offers a review of corporate governance theory with focus on principal-agent theory and agency problems.

2.2.2 Corporate Governance Theory
The path dependent argument (Coffee 1999 and Dyck 2004) state that the ownership structures are path dependent, and are determined by the vested interests. Therefore, the current ownership structure may not be the most efficient one. Thus, testing the relationship between ownership structure and financial performance could help the investors to gain value by optimizing the firm’s ownership structure. The following two subsections review the literatures which investigate the effect of ownership structure on firm performance according to two dimensions: ownership concentration and owner identities.

Ownership concentration provides quantitative information about the capital right of the largest shareholder(s). Owner identity information provides qualitative information about the character of the controlling shareholder(s). One issue to pay attention to is the divergence of capital right and voting (control) right. Normally the two kinds of right are the same, however, when the voting right is different from the capital right due to control mechanisms the incentives of the principals and agents would get influenced.

2.2.3 Principal-Agent Theory
The forerunner of principal-agent theory is the expense-preference model of Williamson (1963). In Williamson’s statement, managerial discretionary spending can be in two forms: 1) Emolument which include perquisites and has no productivity; 2) Discretionary profits which include expenditures on the expansion of staff, physical plant and equipment. As the preference of the principal is profit maximization, while the preference of the agent is utility maximization (including both emolument and discretionary profits) conflicts may arise. Profit maximization and emolument maximization would go hand in hand if more emoluments would always lead to better management. However, as assumed by Williamson, when management has an
expense preference for emolument and unnecessary staff expenditures, the utility maximization of management will conflict with profit maximization. According to his conditions, utility-maximizing management will always spend more on staff rather than profit-maximizing expenditures. This is allowed because of the owners’ inability to monitor.

The economic principal-agent theory considers ‘institutions as nexus for contracts’ and according to Jensen & Meckling (1976) and Furubotn & Richter (2005), the principal agent relationship is a contract relationship where the principal establish appropriate incentives for the agent. However, since principal and agent have different incentives and because of information asymmetry and external disturbances, the principal is not able to adequately monitor the agent’s actions. Therefore the economic principal-agent theory is about the principal designing remuneration plans for the agent to protect himself against opportunistic behavior.

Under the assumption of self-interested behavior and rational expectations three roots of agency problems are discussed by Barnea et al (1981). These include: 1) Information asymmetry as market imperfections lead to the inability of the principals (equity as well as debt financiers) to be fully informed. 2) Debt financing under limited liability as equity holders have an incentive to undertake high-risk projects which will transfer wealth from debt holders to equity holders. 3) Partial ownership with controlling interests as an owner-manager may pursue non-pecuniary benefits conflicting with the other owner’s benefits. It should be noted that the latter two roots display conflicts of interest among the principals themselves and that the definition of principals include debt holders as well as equity holders.

The costs associated with the principle agent dilemma are various. As stated by Darrough & Stoughton (1986): 'The market impaction induced by unobservable actions, lack of contracting ability, and information asymmetry generally lead to second-best outcome in which the distribution of corporate ownership is achieved only at significant cost. These costs take the form of excessive perquisite consumption, overinvestment, underinvestment, and incomplete diversification of personal investment portfolios'. Everything else equal agency problems will reduce market value if the financial and human capital markets are not able to resolve the
problems without costs. In the following sub-section three agency problems (adverse selection, hold-up and moral hazard) are discussed in order of appearance.

2.3 Determinants of Financial Performance

2.3.1 Agency Problems
While adverse selection problems originate \textit{ex ante} the contract and arises because of hidden information; the moral hazard problems exists \textit{ex post} the contract and arises because of hidden actions - the principals inability to observe the actions by the agent (Arrow 1984). However, in between adverse selection and moral hazard, another principal-agency problem, hold-up; will be introduced as the managers hold up to take actions according to the contract, because they do not want to lose the flexibility towards the principals.

2.3.2 Adverse Selection
According to Furubotn & Richter (2005), adverse selection is related to the \textit{ex ante} opportunity of the agent to misrepresent his qualifications due to the principals inability to fully observe the qualities of the agents before the contract conclusion. The adverse selection problem may be explained by ‘the lemons principle’ (Akerlof 1970). One example is the secondhand car market where there is also information asymmetry between sellers and buyers since sellers are better informed about quality. Because buyers cannot tell the difference between above- and below-average quality cars, they will offer a price for the average quality car. Thus, above-average cars will not get sold and eventually be ‘driven out’ of the market by below-average cars. When searching for a qualified agent, the principal faces a similar problem as he does not know the quality of the agent, and therefore may offer an average remuneration based on his understanding of the agent market. While the above-average agent rejects the offer as being too low, below-average agents will accept and get over paid. Thus, the principal will ends up with an under qualified agent.

As a solution, Furubotn & Richter (2005) suggests that principals will ‘[propose] a menu of contracts that leads the individual agent, under certain conditions, to reveal his type (qualities) and at the same time promote the principal’s welfare’. The assumption of Furubotn & Richter is that firms behave as option fixers even under
perfect competition. The candidate has to choose between different contracts provided by the firm and is thereby forced to reveal truthful information about himself via the productivity signal he sends. This is because the agent will only accept the contract that pays off his implicit cost. This will end up at a zero-profit point, where there is equilibrium between the cost of labor and productivity. However, it is complicated for principals to design contracts that fit the investment in signaling for both the buyers and sellers in reality. Hence the adverse selection problem still widely exists in the corporate governance.

2.3.3 Hold-up Problem

As mentioned above the hold-up problem emerges in a situation where two parties refrain from cooperation due to a shared concern that the other party will gain increased bargaining power and, thus, acts opportunistically. In a corporate governance context Blair (1995) states that a hold-up problem occurs in a situation where the principal recognizes, but is unable to sanction or prevent the agent’s opportunistic actions.

Klein et al (1978) explain the concept by introducing the ‘quasi rent’ as the payment of production activity over the opportunity cost in the short run. Such quasi rents are created after the making of a specific investment. ‘The quasi-rent value of the asset is the excess of its value over its salvage value, that is, its value in its next best use to another renter’ (9). It is the existence of such quasi rents that facilitate the hold-up dilemma. Furthermore, asset specific investments are still subject to high risk even when all contingencies are accounted for in the contract because contracts are not always honored. Under such circumstances, small scale opportunism ex post is very normal. (Williamson et al. 1975).

The treat of the agent reneging on his contracts is stronger under the presence of quasi rents. Furthermore, it is impossible to make complete contracts that cover all contingencies that may arise (Grout 1984). From a transaction cost perspective, these inefficiencies lead to either a failure in making optimal investments or that resources are spent on wasteful defensive activities. This could be solved by internalizing the two parties into one unit. The corporate governance structure could be considered as a mechanism for solving the hold-up problem.
2.3.4 Moral Hazard

The problem of moral hazard arises after the contract completion and is caused by information asymmetry combined with diverging incentives between principal and agent (Jensen & Meckling 1976, Barnea et al 1981). It exists under the assumption that the principal is unable to fully observe not only the agent’s actions but also the causes of outcome, since the outcome is influenced by internal as well as external factors. As Arrow (1984) state it: ‘the outcome is a random variable whose distribution depends on the action taken’ 11 . Moreover, shareholders and management have differing utility functions (Jensen & Meckling 1976).

Consequently, the conflict of incentives and information asymmetry will lead to a situation in which management will act on their own incentives at the cost of the shareholders (Jensen & Meckling 1976). The management may pay themselves excessive salaries, do business with subcontractors that are controlled by themselves or pursue expansionary corporate strategies that will only yield personal benefit of control (La Porta et al. 1997).

To reduce the conflict between principals and agents, the principal may try to control the agent and reduce the information asymmetry wherefore performance-based compensation, prestige and career prospects are relied on, especially in the Anglo-America countries (Barnea et al 1981). Apart from that, trust building is also widely applied including the creation of positive reputation (Fama 1980). To reduce information asymmetry, monitoring efforts are made to gather information about the agent’s action (Bushee 1998) including the application of specified accounting standards (Jensen 2000).

However, all these actions to avoid agency problems come at a price. The sum of monitoring expenditure, bonding expenditures and the residual loss is defined as ‘agency costs’. Reducing the principal-agent challenges at a low cost is therefore an important topic in corporate governance (Jensen & Meckling 1976). In a study by Sinani et al. (2008), both formal institutions and informal networks are found helpful in mitigating the problem while decreasing the agency cost. The design of ownership
structure, as part of the formal institutional setup, is an important aspect of reducing the conflict between shareholders and management. Examples include: the existence of a block holder (high concentration) will increase the incentive and capability of the block holder to monitor management; and the inclusion of management among shareholders will align the incentives of managers and shareholders. The following section will elaborate further on the topic of ownership structure and its effect on firm performance.

2.4 Empirical review

Firm performance is supposed to be independent from the ownership structure in the absence of agency cost. However, in the real world, the agency cost generated from principal-agent problems exists widely. Equity ownership structure as an important mechanism in corporate governance (Denis & McConnell 2003), influence the quality of corporate governance and its ability to reduce agency costs (Berk & DeMarzo, 2007).

Three papers by Short (1994), Gross (2007) and Holderness (2003) review the studies that investigate the relationship between ownership structure and firm performance thoroughly. Some studies investigate the effect of ownership concentration on growth and risk. For example, Larner (1966) use the variance in profit/equity ratio as an expression of risk. The study finds that there is an insignificant positive relationship between manager-controlled firms (as opposed to owner-controlled) and a high variance in profit/equity. In other words low ownership concentration may imply higher risk. Another study by Radice (1971) tests the relationship between the growth in net assets and ownership concentration using a sample of 86 large UK firms. The study finds that owner-controlled firms tend to have higher profit rates and growth rate. Most other studies investigate the effect of ownership concentration on profitability and valuation rather than growth and risk.

Positive effect of ownership concentration on corporate performance (measured by profitability and valuation) is found in many studies. The main explanation of the positive effect is that block holders has both the ability and the incentive to monitor and control agents, in order to operate the firm for the good of the shareholders. This is defined as incentive alignment. As La Porta et al. (1998) explained: low investor protection will lead to higher ownership concentration in order to protect the benefits
of minority shareholders, even at the cost of increased private control benefits for block holder. The *cost-efficiency of monitoring* by block holders yields a better performance of the firm. However, in the cases where there is a large divergence of control right and cash flow right, block holder has less incentive to monitor the managers to pursue profit-maximization goal.

Other studies, which find negative effects, argue that the increased control by block holders reduces the self-realization of managers who consequently get discouraged. This phenomenon is defined as *over-monitoring* (Burkart et al 1997, Pagano & Röell 1998). Furthermore, some studies argue that high concentration will enable block holders to exploit their position and gain private control benefits, because they have more information and higher control power than the other shareholders (Dyck & Zingales 2004, Burkart et al. 1997, Zingales 1994). This argument can be defined as *private control benefit*. Another argument for the negative effect is the *cost-of-capital* argument first introduced by Fama & Jensen (1983a). They argue that the higher the ownership concentration is, the lower the liquidity of the stocks will be because there are less shares available for trade in the market. As a consequence, stocks become more risky as the beta of the firm increase and the cost of capital gets driven up (Barclay & Holderness 1989, Bolton & Von Thadden 1998). This argument is empirically supported by Beaver et al. (1970), Rosenberg (1976), Thompson (1976) and Hartzell & Starks (2003).

Yet other studies find no observable effect of ownership concentration on corporate performance. The *natural selection* argument by Alchian (1950), Friedman (1953) and Becker (1962) is applied to explain their study results. The argument is that corporations perform equally well under different ownership structures because market competition will eliminate all inefficient forms in the long run. Thus the selection of optimal ownership structure depends on the environment and there is no effect of ownership structure on performance. Another argument applied to explain the non-observable result is *mutual neutralization* argument. According to this argument, the positive and negative effects of different mechanisms offset each other.

Non-linear effects are also found by introducing thresholds in the concentration measurement and investigating the correlation in a certain range using piecewise regression techniques (Morck et al. 1988). Other methods include squared variable value in the regression and found curvilinear relationships between ownership concentration and performance (McConnell & Servaes 1990). The arguments introduced above are normally combined to explain the non-linear results.

Many studies combine ownership concentration and owner identity to have a broader view of the effects. Four types of owner identity would be introduced in the following sub-section. The effect of owner identities on corporate performance is a part of the management/strategy literature. The existence of an owner identity effect is based on the argument that different owners may have different strategic goals (valuation, profitability, growth and risk) and the controlling owner’s goal preference would influence the operation and performance of the firm.

Family ownership is very common worldwide. According to La Porta et al. (1999) and La Porta et al. (2000), family owned firms are the most common type of economic organization among the listed companies in 27 countries around the world. Anderson & Reeb (2003) found that more than one third of the S&P 500 companies are family firms. Many studies investigate whether family ownership influences firm performance from different aspects. For example, Anderson & Reeb (2003) investigate the founding family owner effect, Sonfield & Lussier (2004) investigate the generation difference of the family ownership and King & Santor (2008) investigate the difference between those family owned firms which are managed by the family and those which are not. However, because of their high specificity in research field, these are not included in the following review.

Some studies find a positive effect of family ownership on firm performance17. Here the Incentive alignment argument is applied to explain the positive effect especially when family members also act as managers. The conflicts between principal and agent are reduced. Another widely applied argument is the long-term orientation of
the family owner. While other owner types focus on profit maximization in the short term, family owners have a long term commitment to the firm and are willing to invest in the capacities that will create competitive advantages which require large investment in the beginning (Hsu & Chen, 2009).

The Private control benefit argument supports the view that the conflict between the family owner and the minority shareholders increases along with the increased degree of family ownership, especially when shareholder protection is low. Because the family owners have more opportunities to gain private control benefit by expropriating minority shareholders’ benefit. Furthermore, family ownership is usually accompanied with the family being involved in management. The hired professional managers become discouraged in improving their efficiency under this mechanism; this argument is manager discouragement. (Smith & Amoako-Adu 1999). Villalonga & Amit (2006) distinguish three elements in the definition of family firms: ownership, control and management. They find that family ownership creates value only when the founder serves as CEO of the firm because then the positive effect of incentive alignment outweigh the negative effect of potential private benefit. However, when the descendants serve as CEOs, firm value will deteriorate because the descendants may not have the same level of inspiration as the founder and thus the negative effect of private benefit and manager discouragement outweigh the positive effect of incentive alignment.

Taylor (1990) find that the percentage of US equity held by institutional owners has increased from 8% in 1950 to 45% in 1990. Institution ownership attracts much attention along with its increased importance in the equity markets. Although institutions can be divided into different types (financial and non-financial; domestic and foreign, etc.) in this review such distinctions are not made.

Between the 1930s and 1970s, the 1929 financial shock and following great depression had created a tendency to ‘socialization’ worldwide. It was intended that the state should play the role of planning in a market economy, to overcome the social monopoly cost. However, during 1970s and 1980s, most of the government owned firms went through a privatization process to reduce the involvement of government in the market mechanisms. Nowadays government ownership is mostly found in the
former socialist countries such as Russia, (China) and the East European countries. As changing political/economic regimes have shaped and reshaped ownership structures over time, a debate of government impact on firm performance has naturally emerged with arguments for as well as against government ownership.

On the positive side, traditionally, government ownership is argued to cure market failures. When the social cost of monopoly power becomes significant, government ownership is assumed to restore the purchasing power of the citizens (Atkinson & Stiglitz 1980). Furthermore government ownership in industries which is of strategic importance for the nation (ex. natural resources, utilities and infrastructure) could also be argued to benefit the society as a whole (Grout & Stevens 2003). However, this argumentation does not rely on the isolated performance of the individual firm as success criteria, but rather on the total benefit for society. Nevertheless some studies do find that government ownership expose higher firm efficiency than private ownership in some industries including electric utilities, refuse handling and water. A possible argument in favor of state ownership leading to higher firm performance is that active monitoring will decrease agency costs. A recent study of more than 1000 Chinese listed firms find a positive relationship between state ownership and firm performance, but it is in question whether the result is due to higher efficiency or higher power in the Chinese business environment which does not necessary imply higher efficiency (Le & Buck 2011).

On the negative side, however, state ownership is, in most cases, regarded as inefficient and bureaucratic. As Stulz (1988) and Shleifer & Vishny (1994) stated, the state-owned enterprises allow a big divergence between the control right and cash flow right of the decision maker. While the control right is concentrated to some bureaucrats or politicians, there is no significant cash flow since all profits generated are allocated back to the firm itself or to the national budget. The divergence and bureaucracy lead to a lack of incentives for decision-makers to pursue profit maximization, furthermore, they also increase information asymmetry in the decision making process. Thus concluded that, government ownership is highly inefficient comparing with private ownership, even in pursuing public interests. Furthermore, the dual-role argument is also widely applied. Government plays the dual roles of regulator and owner, thus its preferences regarding company strategy would involve a
trade-off between the pursuit of shareholder value and other goals (Hill & Jones 1992).

It should be noted that the quality of government owned firms may largely depend on the “quality” of the government itself as well as other factors such as path dependency, which vary greatly from country to country (La Porta et al 1999). Widely dispersed ownership is prevailing in North America, the UK and other advanced economies that use common law and have a high degree of investor protection (La Porta et al 1999). However, this is not necessarily the case in most other countries. Nationality may influence ownership structure and its effect on corporate performance (Roe 1993). In the following parts, the national effect is first reviewed, followed by a review of studies describing the characteristics of Kenyan ownership structure.

Roe (1993) compares the corporate ownership structures in Germany, Japan and the United States and find significant differences when comparing same industry and size classes. One should assume that the ownership structure adopted to reduce the cost of organization in similar industries with similar firm sizes would also be similar. Since this is not the case in reality, Roe finds that differing political histories, cultures and the paths of economics and financial markets development also matter when explaining the difference in ownership structures.

They also find that a national effect on ownership structure does exist in Europe. La Porta et al (1999) identify the 20 largest public firms in 26 wealthy economies to test the ownership patterns in these countries. They divide the 26 countries according to good and poor shareholder protection and investigate the effect on ownership concentration and owner identities. They find that the existence of good shareholder protection coexists with low ownership concentration and, in turn, poor shareholder protection coexists with high ownership concentration and the dominance of family and government ownership.

2.5 Summary of the Literature review

Positive effects of institution ownership on firm performance is found by McConnell & Servaes (1990), Han & Suk (1998) and Tsai & Gu (2007), who explain the positive effect by the active monitoring argument. The monitoring effect should be stronger
for institutional investors than general shareholders. According to Hand (1990), institutional investors are more sophisticated than other shareholders because they are more professional regarding capital markets, industries and businesses and they are better informed. Apart from that, institutional shareholders have higher capabilities in taking actions and can therefore monitor managers more effectively and less costly. One piece of evidence found by Hartzell & Starks (2003) is that the compensations level is negatively related with institutional ownership, as the institutional owners’ monitoring effect can replace the incentive alignment effect by management compensation whereby mitigating the agency problems. The conflict of interest and the strategic alignment hypothesis suggest that institutional investors tend to support managers instead of monitoring and controlling them, because of their interpersonal business relationship with the firm in which they are investing and because the benefit they gain from supporting the managers is higher than the effective monitoring gain. Therefore institutional investors may have incentives to cooperate with managers.
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the method that will be used in collecting and analyzing data that enabled the researcher study listed firms’ ownership structure. The chapter is thus structured into research design, population, sample design, data collection techniques and data analysis.

3.2 Research Design

A research design is the determination and statement of the general research approach or strategy adopted/or the particular project. This study will use a causal research design. Causal design investigates the cause and effect relationship between two or more variables, measures the extent of relationship between the variables and specifies the nature of functional relationship between two or more variables (Adèr, Mellenbergh and Hand, 2008). Casual research design is selected because it will enable the study test how the independent variables (ownership structure) affects/determines the performance of firms listed at the NSE.

3.3 Population

Population is the aggregate of the all the study unit. The population consists of companies listed at the NSE that had been listed by 2009. By the end of 2009, there were 53 firms listed at the NSE.

3.4 Sampling Technique

The study will use purposive sampling technique whereby inclusion and exclusion of firms was based on reason. Purposive sampling involve rejection of elements/people that do not fit a particular profile. That is, samples that might interfere with the results desired. This study will select those companies that have traded continuously for the period between January 2009 and December 2013. Firms that are suspended during the period will be left out as they do not publish their financial results will the NSE.
during the suspension period. The five year period will be long enough for any panel data analysis which other researchers have found suitable (Munyi, 2010).

3.5 Data Collection

This study will wholly be based on secondary data from published annual reports filed with NSE. For each of the firm in the sample and each of the years in the sample period, data that would enable computation of main variables: profitability and ownership structure. The data that will be collected from financial statements at the NSE offices will include block shareholding, institution shareholding, return on asset, diluted shareholding.

3.6 Data Analysis

The study will use multiple linear regression model which seek to establishing the relationship between ownership structure and profitability. The regression model will, thus, be:

\[ ROA = \alpha + \beta_1(INST) + \beta_2(BLO) + \beta_3(FAM) + \beta_4(CAP) + \epsilon_i \]

Whereby \( \alpha \) is the y-intercept, \( \beta_1 - \beta_3 \) are the coefficients of the independent variables and \( \epsilon_i \) is the model significance established by the f-significance from Analysis of Variance (ANOVA).

- \( ROA \): return on assets measuring profitability or financial performance calculated as the net profits divided by total assets;
- \( INST \): institutional ownership: whether majority of the firms shares are owned by a single institution or not;
- \( BLO \): block shareholding as measured by whether top ten shareholders are individuals owning over 30% of the shares;
- \( FAM \): whether the firms is family owned or not.
- \( CAP \): market capitalization as a moderating variable

The study will use the regression coefficients to test the magnitude of the relationship between ownership structure and profitability. The study will apply f and t-significance from ANOVA to establish the significances of such relationship.
ANOVA will be used as it compares group means by analyzing comparisons of variance estimates; that is, whether or not the means of several groups are all equal. This will help the study establish whether there is a significant relationship between the dependent and independent variables, hence the significance of the regression model. ANOVAs are helpful as they possess an advantage over a two-sample t-test which might result in an increased chance of committing a type I error (error of rejecting a null hypothesis when it is actually true). The study will use Pearson correlation coefficient to test the linearity and multicollinearity among the variables.

Cohen (1988) observed that a correlation coefficient of magnitude 0.3–0.5 shows a medium linear dependence between two variables while 0.5 to 1.0 shows a strong linear dependence. According to Rohlf and Sokals’ (1995) critical values for the correlation coefficient, using 26 degrees of freedom a critical value for correlation is 0.374 at 0.05 error margin.
CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter covers data analysis, findings and discussions of the research. Secondary data was collected from Nairobi Securities Exchange Handbooks and published books of accounts of firms listed at the Nairobi Securities Exchange. By 2013 there were 62 companies listed in the Nairobi Securities Exchange. The study targeted the 53 companies that were listed in the Nairobi Securities Exchange by 2009. The response in Table 4.1 shows that data was completely collected from 46 firms making a response rate of 86.8%. The data was thereafter analyzed using regression analysis.

<table>
<thead>
<tr>
<th>Table 4.1: Response Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Frequency</strong></td>
</tr>
<tr>
<td>Unresponsive Firms</td>
</tr>
<tr>
<td>Responsive Firms</td>
</tr>
<tr>
<td><strong>Total Firms Targeted</strong></td>
</tr>
</tbody>
</table>

Source: Research Data 2013

Descriptive Statistics

The study found that ROA ranged from 2.5% to 8.3% with a mean of 6.2% and a standard deviation of 3.1%. Performance of firms as measured by ROA was therefore high as they made an average of 62% return on their equity. Ownership concentration ranged from a low of 43% to a high of 75% with a mean of 52% and a standard deviation of 12%. Thus, on average firms had ownership concentration of 52% meaning that half of the shares were owned by blockholders in most of the firms. The study found that the number of shares owned by foreigners ranged from a low of 2,450,356 to a high of 27,125,450 with a mean of 15,475,025 and a standard deviation of 5,452,654. The study also found that the shares owned by domestic investors ranged from a low of 13,452,147 to a high of 75,450,689 with a mean of 48,632,450...
and a standard deviation of 14,452,457. The study further found that state ownership ranged from a low of 2,540,478 shares to a high of 85,456,812 shares with a mean of 64,321,461 shares and a standard deviation of 10,458,610 shares.

4.2 Regression analysis

The research study wanted to establish the impact of ownership structure on performance of the firms listed at the Nairobi securities exchange. To get performance of the firms listed in the Nairobi Securities Exchange, Return on assets (ROA) was calculated for the 75.41 percent of the firms whose financial statements were accessed by the researcher. On the other hand, ownership structure of the firms listed in the Nairobi Securities Exchange was obtained by calculating the ownership structure of the firms.

The research findings indicated that there was a weak positive relationship (R= 0.332) between the variables. The study also revealed that 11.0% of ownership structure of the firms listed at the Nairobi securities exchange can be explained by the independent variables. From this study it is evident that at 90% confidence level, the variables produce statistically significant values (high tvalues, p < 0.1.) hence when the variables are combined hence, they can be relied on to explain ownership structure of the firms listed at the Nairobi securities exchange. However, when tested individually only ownership structure produces statistically significant values while firm size produces statistically insignificant values.

Table 4.2: Model Goodness of Fit

<table>
<thead>
<tr>
<th>R</th>
<th>R Square</th>
<th>Adjusted Square</th>
<th>R</th>
<th>Std. Error of the Estimate</th>
<th>Durbin-Watson</th>
</tr>
</thead>
<tbody>
<tr>
<td>.976</td>
<td>.953</td>
<td>.919</td>
<td>2.30321</td>
<td>2.012</td>
<td></td>
</tr>
</tbody>
</table>

The study found that the independent variables had a very high correlation with ROA (R = 0.976). The results also show that the ownership structure variables accounted for 95.3% of the variance in ROA (R2 = 0.953). ANOVA results show that the F
statistic was significant at 5% level. Therefore, the model was fit to explain the relationships.

**Table 4.2.0 ANOVA**

<table>
<thead>
<tr>
<th></th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>439.484</td>
<td>4</td>
<td>109.871</td>
<td>6.7575</td>
<td>.000b</td>
</tr>
<tr>
<td>Residual</td>
<td>666.635</td>
<td>41</td>
<td>16.259</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1306.119</td>
<td>45</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source: Research Data 2013**

Significance value in the ANOVA table help us to determine if the condition means under study were relatively the same or if they were significantly different from one another the study found out sig value was $p < 0.001$. This value was less than 0.05 hence it can be concluded that there was statistically significant difference between the condition means.

**Table 4.3: Model Coefficients**

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>4.147</td>
<td>0.953</td>
<td>1.108</td>
<td>.191</td>
</tr>
<tr>
<td>Market capitalization</td>
<td>-1.727</td>
<td>.312</td>
<td>-1.571</td>
<td>-2.482</td>
</tr>
<tr>
<td>Institutional ownership</td>
<td>1.947</td>
<td>.365</td>
<td>1.282</td>
<td>2.869</td>
</tr>
<tr>
<td>Block shareholding</td>
<td>1.175</td>
<td>.024</td>
<td>.102</td>
<td>2.116</td>
</tr>
<tr>
<td>Family Ownership</td>
<td>-0.048</td>
<td>.684</td>
<td>-.536</td>
<td>-2.501</td>
</tr>
</tbody>
</table>

**Source: Research Data 2013**

The study sought to determine the relationship between market capitalization and firms profitability in Kenya. Market capitalization ranged from a low of 43% to a high of 75% with a mean of 52% and a standard deviation of 12%. The results show that market capitalization had a negative and significant effect on firms profitability ($\beta = -1.727$). This effect was significant at 5% level of confidence. What this means is that higher levels of market capitalization lead to lower profitability in firms.
The study sought to determine the relationship between institutional ownership and firms profitability in Kenya. The study found that the number of shares owned by foreigners ranged from a low of 2,450,356 to a high of 27,125,450 with a mean of 15,475,025 and a standard deviation of 5,452,654. The study found that institutional ownership had a positive and significant effect on firms profitability ($\beta = 1.947$). This effect was significant at 5% level of confidence. These results mean that higher levels of institutional ownership result in higher firms profitability.

The study sought to determine the relationship between block shareholding and firms profitability in Kenya. The study also found that the shares owned by domestic investors ranged from a low of 13,452,147 to a high of 75,450,689 with a mean of 48,632,450 and a standard deviation of 14,452,457. From the regression analysis, the results show that block shareholding had a positive and significant effect on firms profitability ($\beta = 1.175$). This effect was significant at 5% level of confidence. These results mean that higher levels of block shareholding result in higher firms profitability.

The study sought to determine the relationship between Family Ownership and firms profitability in Kenya. The study further found that Family Ownership ranged from a low of 2,540,478 shares to a high of 85,456,812 shares with a mean of 64,321,461 shares and a standard deviation of 10,458,610 shares. The results show that Family Ownership had a negative and significant effect on firms profitability ($\beta = -0.048$). This effect was significant at 5% level of confidence. What this means is that higher levels of Family Ownership lead to lower profitability in firms.

4.5 Summary and interpretation of findings

The ownership structure of the companies was measured by debt. Ownership structure was considered to be the various components of shareholders equity. The findings from the study revealed that ownership structure had an inverse relationship on return on assets. Ownership structure ($R = 0.976$ and $R^2 = 0.953$) indicates that with 95.3% of the changes in Return on assets is brought about by ownership structure. This result is consistent with findings by Zeitun and Tian (2007) who also established that ownership structure has a significant and negative impact on firm’s performance.
From the study it was evident that at 95% confidence level, the ownership structure variable produced statistically significant values (high t-values, p < 0.05). From statistical theory, if p > 0.1 then the model is said not to be significant. This is concluded that a relationship could not be found among the model variables. From the co-efficients table, findings indicate that the p value for ownership structure was 0.034. 0.034 is found to be less than 0.05. The model was therefore significant at 95% thus the findings can be accepted.

The result was also found not to be in agreement with Mwangi (2010) study on ownership structure on firms listed at the Nairobi Stock Exchange on the relationship between ownership structure and financial performance. Strong relationship was found to be between leverage and return on assets, liquidity, and return on investment. However, others find mixed results regarding the impact of ownership structure on firm’s performance. This can best be supported by the argument that borrowing introduces varying levels of risk to the company and on the return to shareholders.
CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter aims at linking and applying the results obtained from the study to solve real life ownership structure and financial performance misalignments as described afore in the problem statement. This chapter will also elucidate the policy recommendations that policy makers can implement in order to better align institutions capital raising initiatives with the firms performance. Indeed, policy and firm decision makers can play a bigger role in ensuring that leverage risk considerations forms part of the criteria that firms use when making financing decisions as they know that it will ultimately impact on the firm’s performance.

5.2 Summary and conclusions

The study found that ownership concentration is negatively correlated with firms profitability. The study concludes that higher ownership concentration leads to lower profitability of firms in Kenya. Therefore, as the number of blockholders rise in a firms, the performance of the firms falls while as the number falls, performance rises.

The study found that foreign ownership is positively correlated with firms profitability. The study therefore concludes that higher foreign ownership in a firms leads to higher profitability while lower foreign ownership leads to lower performance in firms in Kenya. The study found that domestic ownership is positively correlated with firms profitability. The study therefore concludes that higher domestic ownership in a firms leads to higher profitability while lower domestic ownership leads to lower performance in firms in Kenya. The study found that state ownership is negatively correlated with firms profitability. The study concludes that higher state ownership leads to lower profitability of firms in Kenya. Therefore, as the ownership of the state rises in firms, the performance of the firms falls while as the ownership falls, performance rises.

The main objective of this study was to establish the impact of Ownership structure on Performance of the firms listed at the Nairobi securities exchange. To achieve the objective the researcher sampled firms listed under the Nairobi securities exchange
that exhibited the characteristics for the study. Secondary data was used in this study. Data was collected by the review of documents, annual reports of the sampled companies published books of accounts.

The research findings indicated that there was a weak positive relationship (R= 0.332) between the variables. The study also revealed that 11.0% of ownership structure of the firms listed at the Nairobi securities exchange can be explained by the independent variables.

From this study it is evident that at 90% confidence level, the variables produce statistically significant values (high t-values, p < 0.1.) hence when the variables are combined hence, they can be relied on to explain ownership structure of the firms listed at the Nairobi securities exchange. From the study findings it would be safe to conclude that ownership structure had an inverse relationship with return on assets. Ownership structure theory as attributed to Modigliani and Miller concluded that it doesn’t matter how a firm finances its’ operations and that the value of a firm is independent of its’ ownership structure making ownership structure irrelevant.

The conclusion is supported by the results of the regression analysis that the higher the ownership structure, the less the return on assets therefore showed us the need to increase more capital injection rather than borrowing as supported by Jensen and Meckling (1976) to them the benefits of debt financing are less than it’s negative aspects, so firms will always prefer to fund investments by internal sources.

5.3 Policy Recommendations

The study recommends that firms should desist from higher levels of blockholder owners in order to reduce ownership concentration. This will help improve the profitability of firms in Kenya. Secondly, the study recommends that firms should encourage foreign investors to invest in their firms as the higher levels of foreign ownership would lead to better firm profitability. Thirdly, the study recommends that firms should encourage local investors to invest in their firms as the higher levels of local ownership would also lead to better firm profitability. There is need therefore to balance between local and foreign investors. Lastly, the study recommends that state ownership in firms in Kenya should be reduced. This is because higher levels of state ownership are detrimental to the profitability of firms.
It was considered to be very important when finance directors and managing directors trying to fund the firm’s assets to understand the impact of ownership structure on their financial performance as well the cost of funds. It was evident from the study and analysis arising thereof. This study established that capital analysis and asset structure analysis was a very important analysis used to boost firm’s competitive advantage and consequently profitability. In addition the capital market analyst as well investment analyst should advise the investors as well firms on the optimal ownership structure based on ownership structure analysis.

Borrowing introduces a risk to the company and on the return to shareholders in terms of reducing the amount of profit available to them, as well as exposing their assets to dissolution in the event of failing to repay the debt in the stipulated time. When a business’s returns are likely to fluctuate greatly the use of increased debt magnifies the risk. Adequate emphasis must be placed on enabling such companies to employ more shareholders’ funding than debt and reduce the risk that is inherent in the increased use of debt. Based on the results of the study the following recommendations were made.

5.4 Limitations of the Study

The researcher encountered quite a number of challenges related to the research and most particularly during the process of data collection. Due to inadequate resources, the researcher conducted this research under constraints of finances. In addition Nairobi Securities Exchange analysts had to be pushed to assist with data. This was done through many calls to remind them. Others wanted to be paid in order to give data. Other thought that the information they were requested to volunteer was confidential.

Time allocated for the study was insufficient while holding a full time job and studying part time. This was encountered during the collection of material as well as the data to see the study success. However the researcher tried to conduct the study within the time frame as specified.

5.5 Suggestions for Further Studies

Arising from this study, the following directions for future research in Finance were
recommended as follows: First, this study focused on all the 61 listed companies in the Nairobi Securities Exchange. Therefore, generalisations could not adequately be extended to every listed company as they have varying industry risk and asset structure. Based on this fact among others, it is therefore, recommended that a narrow based study covering a specific segment or company be done to find out the Impact of Ownership structure on Performance.
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