

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

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## DECLARATION

This research project report is my original work and has not been presented in any other University.

Signedí í í í í í í í í í í í í í .. Dateí í í í í í í í í í í í í í í í í í í ..

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## **DEDICATION**

This project is dedicated to my dear family for their invaluable support and encouragement during my entire academic period and towards the success of this project.

## Table of Contents

<b>DECLARATION</b> .....	ii
<b>ACKNOWLEDGEMENT</b> .....	iii
<b>DEDICATION</b> .....	iv
<b>ABSTRACT</b> .....	vii
<b>LIST OF ABBREVIATIONS</b> .....	viii
<b>LIST OF TABLES</b> .....	ix
<b>CHAPTER ONE: INTRODUCTION</b> .....	1
1.1 Background of the Study .....	1
1.1.1 Ownership Structure .....	2
1.1.2 Financial Performance .....	3
1.1.3 Ownership Structure and Financial Performance .....	5
1.1.4 Nairobi Securities Exchange .....	6
1.2 Research Problem.....	8
1.3 Research Objectives .....	9
1.4 Value of the Study.....	10
<b>CHAPTER TWO: LITERATURE REVIEW</b> .....	12
2.1 Introduction.....	12
2.2 Theoretical Review .....	12
2.2.1 Agency Theory .....	12
2.2.2 Stakeholder Theory.....	13
2.3 Determinants of Financial Performance .....	14
2.4 Empirical Literature Review.....	16
2.5 Summary of Literature Review.....	19
<b>CHAPTER THREE: RESEARCH METHODOLOGY</b> .....	20
3.1 Introduction.....	20
3.2 Research Design.....	20
3.3 Population .....	20
3.4 Data Collection.....	20
3.5 Data Analysis .....	21
3.5.1Operationalization of variables.....	22

3.5.2 Test of Significance .....	22
<b>CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION .....</b>	<b>23</b>
4.1 Introduction.....	23
4.2 Result of correlation analysis.....	23
4.3 Result of Regression Analysis .....	25
<b>CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS .....</b>	<b>29</b>
5.1 Introduction.....	29
5.2 Summary of the Findings.....	29
5.3 Conclusions.....	31
5.4 Recommendations .....	32
5.5 Limitations of the Study .....	32
5.6 Suggestions for Further Research .....	32
<b>REFERENCES.....</b>	<b>34</b>
<b>APPENDIX: Companies Listed on the Nairobi Securities Exchange .....</b>	<b>37</b>

## ABSTRACT

The overall objective of this study was to establish the relationship between ownership structure and financial performance of firms listed at the Nairobi Securities Exchange. The specific objectives of the study were; to determine the relationship between foreign investors' shareholding and financial performance, to determine the relationship between local institutional shareholding and financial performance and to determine the relationship between local individual shareholding and financial performance. The study used a descriptive research design. A census of all firms continuously listed on the Nairobi Securities Exchange between 2010 and 2014 was conducted. 58 companies qualified for inclusion in the study. Secondary data obtained from the Nairobi Securities Exchange handbook and annual returns of shareholding distribution by listed companies. Karl Pearson coefficient of correlation was used to evaluate the relationship between variables while multiple regression analysis was used to evaluate the effect of independent variables on return on assets. The study found that there existed a weak positive relationship between the percentage of foreign shareholding and return on assets. The result of t-test established that the relationship was not statistically significant at 5% level of significance. Local individual shareholding and return on assets were found to have a weak negative relationship; the relationship was not statistically significant at 5% level of significance. Local institutional share holding and return on assets were found to have a weak negative relationship. The relationship was not statistically significant at 5% level of significance. The result of regression indicated that percentage of shareholding by foreign investors had a negative effect on return on return on assets. However, using t-test the effect was found to be statistically insignificant at 5% level of significance. Percentage of shareholding by local individual investors had a negative effect on return on assets but the effect was not significant at 5% level of significance. Also the percentage of shareholding by local institutional investors had a negative effect on return on assets. However the result of t-test indicated that the result was not statistically significant at 5% level of significance. The study found that the assets turnover and leverage had a positive effect on return on assets. However the effect of assets turnover was not statistically significant while the effect of leverage was statistically significant at 5% significance level. The result of F-test indicated that the regression coefficients were collectively significant at 5% level of significance. The coefficient of determination  $R^2$  for the regression model was 21.7%. The study concluded that ownership distribution had a negative relationship with financial performance of firms listed on the Nairobi Securities Exchange but the relationship was not statistically significant. It also concluded that ownership distribution did not have a significant effect on the financial performance of listed companies. Further the study concluded that variations in ownership distribution, assets turnover and leverage had a moderate explanatory on the financial performance of companies listed on the Nairobi Securities exchange. This study recommended that managers of companies should not focus in placing the shares of their companies with a particular group of investors because the distribution of shareholding has not significant effect on their firms' financial performance. In addition in selecting investment share investors, investment analysts and advisors should not consider the ownership distribution of a particular stock because such distribution does not have a significant effect on firms' financial performance. Further research may seek to evaluate the effect of ownership distribution on market value of listed companies. In addition further research may consider the effect of the percentage of shares held by employees on financial performance of companies in addition to considering the effect of government stake in companies listed on the Nairobi Securities exchange.

## **LIST OF ABBREVIATIONS**

**ANOVA**- Analysis of Variance

**CDS**- Central Depository System

**CIS**- Collective Investment Schemes

**CMA**- Capital Markets Authority

**EBIT**- Earnings Before Interests and Taxes

**EPS**- Earnings per Share

**IPO**- Initial Public Offering

**NASI**- NSE All Share Index

**NI**- Net Income

**NIAT**- Net Income After Tax

**NSE**- Nairobi Securities Exchange

**ROA**- Return on Assets

**ROI**- Return on Investment



## LIST OF TABLES

Table 4.1 Correlation Coefficients	í í	24
Table 4.2 Regression Coefficients	í .í í í í í í í í í í í í í í í í í ...í í í í í í	.26
Table 4.3 Analysis of Variance	í í	..28
Table 4.3 Model Summary	í í í í í í í í í í í í í í í í í ...í í í í í í í í í	29

# CHAPTER ONE: INTRODUCTION

## 1.1 Background of the Study

Ownership structure is defined by Jensen and Meckling (1976) as the distribution of equity with regard to votes and capital as well as the identity of the equity owners. The ownership structure of companies is of much importance owing to it as an internal mechanism of corporate governance. Firms have several ways of building their ownership with the type of ownership structure adopted being informed by the vision of the company. Firm's market value is not only determined by the investments made but also by other factors such as financial structure, dividend policy, its governance and ownership structure also adding value. Several ownership structures exist including government ownership, foreign ownership, institutional ownership, individual ownership and ownership concentration that impact on the financial performance of a firm either positively or negatively.

Agency theory hypothesizes that, firms consist of two individuals; the agent (management) and the principal (owner). The principal delegates authority of decision making concerning utilization of the firm's scarce resources to the agent based upon a designated fee schedule. However, since the objectives of the agent may be incompatible with the principal's objectives and their incentives may not be congruent, the agent's performance must be appropriately evaluated (Mohamed, 2013). Further, agency theory argues that agency cost would arise when there is a separation between firm owners and firm managers. This is due to the conflict of goals between owners and managers. The conflict that forms agency problem is not only between shareholders and managers (principal & agent), but also between shareholders and shareholders

(principal ó principal), especially in developing countries (Dharwadkar, George & Brandes, 2000).

The Nairobi Securities Exchange has 64 listed firms spread across eleven broad categories of agriculture, automobiles and accessories, banking, commercial and services, construction and allied, energy and petroleum, insurance, investment, investment services, manufacturing and allied and finally the telecommunication and technology, ([www.nse.go.ke](http://www.nse.go.ke)). Oltetia (2000), established that, a typical listed company in Kenya has a mixed ownership structure with the legal persons (institutions) and foreign investors as the two predominant groups of shareholders, each controlling 41% and 34% ownership respectively. The state with 8% and domestic individuals with 17% hold minority shares in most local listed companies.

### **1.1.1 Ownership Structure**

The concept of ownership structure can be defined along two dimensions: ownership concentration and ownership mix (Gursoy & Aydogan, 2002). Ownership concentration refers to the share of the largest owner and is influenced by absolute risk and monitoring costs (Pedersen & Thomsen 1999), while ownership mix is related to the identity of the major shareholder. Firm's owners are those persons who share two formal rights: the right to control the firm and the right to appropriate the firm's profits, or residual earnings.

The importance of ownership structure is evident in the fact that corporate governance and the ownership structure of companies is currently characterized by change processes as the economies of the world become more and more globally integrated. Ownership structures are also of major

importance in corporate governance because they affect the incentives of managers, and thereby the efficiency of firms. The increased volatility of corporate ownership portfolios observed in recent years has led to renewed interest in ownership structures, especially with respect to multinational enterprises. As the economies of the world become more and more globally integrated, such issues will become more prominent and will affect our understanding of the interweaving systems of corporate relations, through which formal and invisible networks of power are established (Heubischl, 2006). Ownership structure decisions also affect firm's capital base and the decision of either going for equity financing or debt financing.

According to Raji (2012), there is no well-established tradition of selecting specific measures for the analysis of ownership structure performance relationship. The measure adopted by various researchers is based on the availability of information and the appropriateness of the method for the research questions. Most studies that looked at the impact of ownership concentration on performance have employed the Herfindahl index or the equity stake of several largest investors, typically the top five shareholders (Demsetz and Lehn, 1985). Most studies in developing countries, where data is limited, the equity stake of the largest shareholder (Kapelyushnikov, 2000) has been extensively used. Ownership structure could further be measured by calculating the percentage in shareholding of common stock for each particular form of ownership as will be used in this study to determine ownership structures of different firms.

### **1.1.2 Financial Performance**

Financial performance can be described as the measurement of the results of a firm's policies and operations in monetary terms. It is also measure of how well a company is using its resources to make a profit. Financial performance evaluation represents one of the key functions

of any business manager. The purpose of financial statements analysis is to assist statement users in predicting the future by means of comparison, evaluation and trend analysis. Performance evaluation is designed to answer pertinent questions such as whether the company is liquid enough to honour its maturing obligations, is it generating sufficient volume of sales to justify continued investments among others. An effective financial evaluation system should be able to attain the goals of promoting goal congruence and coordination, communicating expectations, motivating, providing feedback and benchmarking (Hongren, Harrison & Oliver, 2009)

Every business organization has to make important decision of making returns. This decision is important since the ability of a firm to make returns in this competitive environment determines its ability to survive in the future. This decision also affects its capital base and the decision of either going for equity financing or debt financing. In debt financing, companies borrow money or capital and resources from external sources that are to be repaid over a period of time, usually with interest. Common examples of financial performance measures include operating income (OI), earnings before interest and taxes (EBIT), Return on Assets (ROA), Earnings Per Share (EPS) and ratios on gearing, revenue from operations, operating income or cash flow statements.

It is important to note that no one measure of financial performance should be taken on its own. Rather, a thorough assessment of a company's performance should take into account many different measures. Getting top measures of financial performance is an important part of running a growing business for the listed firms at the NSE. Business success depends on developing and implementing a sound financial and management systems, updating original business plan and regular review of financial performance by reassessing the business goals and plan effectively for improving the business. Analysts and investors may wish to look deeper into

financial statements and seek out margin growth rates or any declining debt. A deeper analysis should also help adjust and improve working capital levels, leverage and gearing ratios, profitability margins, liquidity of the firm and more importantly efficiency ratios.

### **1.1.3 Ownership Structure and Financial Performance**

The type of ownership structure a firm adopts will impact on the firm either positively or negatively. More equity ownership by the manager may increase corporate performance because it means better alignment of the monetary incentives between the manager and other equity owners (Jensen and Meckling, 1999). Further, more equity ownership by the manager may increase corporate performance because the managers are more capable of opposing a takeover threat from the market for corporate control and as a result, the raiders in this market will have to pay higher takeover premiums (Stulz, 2001). On the other hand, Fama and Jensen (2000) argue that increased ownership concentration decreases financial performance because it raises the firm's cost of capital as a result of decreased market liquidity or decreased diversification opportunities on behalf of the investor.

Foreign ownership refers to the percentage of stock of the whole company which consist of foreign partners, foreign financial entities and foreign nationalities. Another category of ownership is institutional ownership which refers to the percentage of stock held by government entities and public companies of the whole stock of the company. The companies include insurance companies, financial entities, banks, government companies and other parts of government. Institutional ownership supports further indebtness if it promises to improve financial position and shareholder value in the long run. Managerial ownership on the other hand refers to percentage of stock reserved by family members of the board of directors. On one hand

it is considered as a tool for alignment of managerial interests with those of shareholders, while on the other hand it promotes entrenchment of managers which is especially costly when they don't act in the interest of shareholders (Mork et al., 1998).

State ownership has been regarded as inefficient and bureaucratic where individual citizens in these firms have no direct claim on residual income and are not able to transfer ownership rights. Ownership rights are exercised by some level of bureaucracy which does not have clear incentives to improve firm performance. An analysis of political control of state-owned firms decision making process show that transferring control rights from politicians to managers can improve firm performance largely because managers are more concerned with firm performance than the politicians (Boycko, et al., 1996)

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

In Kenya, dealing in shares and stocks started in the 1920s when the country was still a British colony. At that time, stock broking was a sideline business conducted by accountants, auctioneers, estate agents and lawyers who met to exchange prices over a cup of coffee. In 1954 the Nairobi Stock Exchange was then constituted as a voluntary association of stockbrokers registered under the Societies Act. In August 2000, NSE implemented a new trading cycle, (T+5). The Central Depository System (CDS) Act and the amended CMA Act (which covers Collective Investment Schemes (CIS)) were passed by Parliament and received presidential assent, paving the way for the full implementation of the CDS and for the introduction of collective investment schemes in the Kenyan market.

In 2008, the NSE All Share Index (NASI) was introduced as an alternative index. Its measure is an overall indicator of market performance. The Index incorporates all the traded shares of the

day. Its attention is therefore on the overall market capitalization rather than the price movements of select counters. In July 2011, the Nairobi Stock Exchange Limited changed its name to the Nairobi Securities Exchange Limited. The change of name reflected the strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments.

In September 2011 the Nairobi Securities Exchange converted from a company limited by guarantee to a company limited by shares and adopted a new Memorandum and Articles of Association reflecting the change. On June 27, 2014, The Capital Markets Authority approved the listing of the NSE stock through an IPO and subsequently self-list its shares on the Main Investment Market Segment.

According to the Economic Survey, 2010, Kenya's equities market recorded marked improvement in activity in both primary and secondary markets. Market capitalization rose by 40 % in 2010, exceeding the Kshs 1 trillion, with average annual return of 36 % based on the NSE 20 Share Index. As a result, NSE was among the best performing equity markets in Africa after the Uganda Securities Exchange, which recorded an index return of 53 %. Equity turnover and share volume recorded 190 % and 127 % respectively, as market capitalization rose by 40% compared to 2009. This impressive performance was attributed to improved business confidence in the market on account of economic recovery, adoption of best practice within capital markets, resumed participation by foreign and institutional investors. For instance, turnover attributed to foreign investors reached a historical high of Kshs 50 billion or 46 % of total annual turnover, with a Kshs 15 billion net foreign portfolio inflow (Mule, et al., 2013).



Most of the listed firms at the Nairobi Securities Exchange have mixed forms of ownership. The main forms of ownership structure at the NSE are; state ownership, domestic individuals ownership, foreign ownership and institutional ownership that affects the financial performance of the firms either positively or negatively. The stock market in Kenya averaged between 4710.81 index points from 2010 until 2015, reaching an all time high 5499.64 index points in March 2015 and a record low of 3103.04 index points in December 2011. The NSE all share index as at 7<sup>th</sup> August 2015 was 150.45 and total market capitalization stood at Ksh2,106.73Billion.

## **1.2 Research Problem**

Most businesses whether state-owned, private or individual are initiated with sole purpose revenue profit and shareholders wealth maximization. Through continuous monitoring and financial evaluations, owners may decide to change the form of ownership to match the challenges and demands of the day such as private companies converting to public to be able to raise more capital or loss making government owned firms would be sold off through privatization to offload the financial burden from the state. Choosing the right form of ownership means that one must understand the characteristics of each form and how well those characteristics match the business and personal circumstances (Norman, 2010).

Kenya being an emerging market economy, there are many widely dispersed corporate ownership. According to George and Nyambonga (2014), what are prevalent at the NSE are many firms with concentrated ownership. Despite the impressive performance at the Nairobi Securities Exchange, firms at the Nairobi Securities Exchange are still dogged with challenges of ownership structure with higher ownership concentration providing the controlling

shareholders with the opportunity to use their power to undertake activities intended to obtain personal gains to the detriment of minority shareholders and other stakeholders while adversely affecting the firms' performance (Mule, et.al 2013). Even the NSE as an entity has been demutualized with key players indicating this will increase competitiveness, diversifying ownership structure and also allow it raise capital from the public for further development.

A study by Mbatha (2012) on the effect of ownership structure on financial performance in the sugar industry found that ownership structure by shareholding did not influence performance. Another study by Mule et al.(2013) on ownership concentration and financial performance on listed firms in Kenya revealed that there was a non-significant relationship between ownership concentration and performance at the NSE. Lee (2008) study on equity ownership structure on financial performance of South Korea firms revealed that, as ownership concentration increases, firms' performance measured by accounting rate of return on assets generally improves but the effects on foreign ownership and institutional ownership are insignificant.

Given the importance of company's ownership structure in corporate governance mechanisms, studies on ownership structure and performance of firms have yielded conflicting empirical findings. Therefore, further studies should be conducted in order to examine the interaction between types of ownerships on firm performance in emerging markets. This leads to the question, is there a relationship between ownership structure and financial performance of the firms listed on the NSE?

### **1.3 Research Objectives**

The purpose of the study is to establish the relationship between ownership structure and financial performance of firms listed at the Nairobi Securities Exchange, Kenya.

Specifically, the study will seek to:

- i To determine the relationship between foreign investors shareholding and financial performance of listed firms in Kenya.
- ii To determine the relationship between local institutional shareholding and financial performance of listed firms in Kenya
- iii To determine the relationship between local individual shareholding and financial performance of listed firms in Kenya

#### **1.4 Value of the Study**

The motivation of the study is due to increasing major financial scandals around the world and the recent collapse of some reputable companies in Kenya that raised questions on control and ownership structure and financial performance of firms at the Nairobi Securities Exchange and erosion of investor confidence in the market (Ongore and Kibonyo, 2011). This study contributes to the literature in three dimensions: first by combining market based and standard accounting financial indicators as measures of firm performance to test the predictions of agency theory. Secondly, the study will provide new empirical evidence on the effect of ownership structure on firms' financial performance in a developing stock market in all the sectors of the stock market.

The government through the regulators will be interested to know how the various owners may make decisions that may affect some sectors of the economy and come up with relevant regulations. Consequently, policy makers will pursue economic reforms that will influence the corporate policies to be geared towards the welfare of the nation at large and protection against

minority investors. Scholars will have an insight of the relationship between various owners and corporate policies and the performance of these firms.

The results of this study will further sensitize financial managers on the influence that the various owners may have to the decisions they make with regard to the various corporate decisions such as dividend policy, investment policy and capital budgeting decisions. Financial Managers will further identify whether minority investors have a role to play in the overall management of these firms. This study will also serve as a future reference for researches in the subject of ownership structure and financial performance.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

This chapter presents a review of the literature on ownership structure and financial performance. The chapter briefly explores the literature on theoretical framework about ownership structure and further provides an empirical literature review from both global and local studies and a summary of the various studies.

### **2.2 Theoretical Review**

The theoretical framework presents the agency and stakeholders theories to explain the expected relationship between the ownership structures and financial performance.

#### **2.2.1 Agency Theory**

Research on the relationship between corporate ownership and firm performance are mainly based on agency theory which was proposed by (Jensen & Meckling 1976). Agency theory argues that agency cost would arise when there is a separation between firm owners and firm managers. This is due to the conflict of goals between owners and managers. The conflict that forms agency problem is not only between shareholders and managers (principal ó agent), but also between shareholders and shareholders (principal ó principal), especially in developing countries (Dharwadkar, George & Brandes, 2000).

The theory emanates from the fact that ownership and control of most modern firms is different. Jensen and Meckling (1976) drawn by the progress in property theory, agency and finance were motivated to come up with a theory on ownership of firms. They recognized the failure by literature on Economics to look at the organization structure of the firm. It basically looked at the firm as a "black box" operated so as to meet the relevant marginal conditions with respect to

inputs and outputs, thereby maximizing profits. They defined the agency relationship as where the principal engages the agent to act on his behalf. They noted that if the agent and principal are all utility maximizers, the agent would act on his own self interest. The principal needs to put in appropriate incentives and incur monitoring costs to ensure the agent serves his interest.

Managers in both private and state owned firms are assumed to maximize their own utility rather than that of the. In private firms this divergence is reduced through external mechanisms such as markets for managers, capital and corporate controls including internal mechanisms such as managerial participation in ownerships, reward systems and the board of directors. In state owned firms these mechanisms are virtually absent.

This theory brings out an understanding to the relationship between ownership concentration, foreign ownership and performance. Agency problems are seen to be more in dispersed ownership as shareholders tend to free ride and hence are less effective in their monitoring leading to ineffectiveness in performance. On the other hand, foreign owners are depicted to have more capacity and resources hence increasing their monitoring capabilities. Their investment decisions also tend to be more informed since they seek the services of professional managers. Foreign ownership therefore, would lead to better performance.

### **2.2.2 Stakeholder Theory**

The stakeholder theory is a theory of organizational management and business ethics that addresses morals and values in managing an organization. It was originally detailed by Edward Freeman in the book Strategic Management. A stakeholder approach identifies and models the groups which are stakeholders of a corporation and both describes and recommends methods by which management can give due regard to the interests of those groups. It attempts to address the principle of who or what really counts.

In the traditional view of a company, the shareholder view, only the owners or shareholders of the company are important, and the company has a binding fiduciary duty to put their needs first, to increase value for them. Stakeholder theory instead argues that there are other parties involved, including employees, customers, suppliers, financiers, communities, governmental bodies, political groups, trade associations, and trade unions. Even competitors are sometimes counted as stakeholders ó their status being derived from their capacity to affect the firm and its stakeholders.

The stakeholder view of strategy integrates both a resource-based view and a market-based view, and adds a socio-political level. One common version of stakeholder theory seeks to define the specific stakeholders of a company and then examine the conditions under which managers treat these parties as stakeholders. How a firm treats its stakeholders impacts either positively or negatively to its financial performance.

### **2.3 Determinants of Financial Performance**

The basic and fundamental duty of every finance manager is to maximize the wealth of shareholders and increase firm's value by improving the financial performance of the company. Financial performance is a function of many factors that should be optimally utilized to maximize the returns. Some of the determinants of financial performance include; capital adequacy, leverage (both long term and short term), growth level of the firm, size of the firm, firm's risk, tax policies, management efficiency, liquidity of the firm and tangibility which measures the fixed assets to total assets ratio and also the ownership structure of the firm plays a critical role in influencing its financial success.

Capital adequacy is one of the firm's specific factors that determine the level of profitability. It is the amount of own fund available to support firm's business and act as a buffer in case of adverse situation. Asset quality is another key factor that determines performance. Assets include both fixed and current, credit portfolio and other investments. The loan portfolio or leverage has a direct bearing of the profitability of a firm. Management efficiency is another key ingredient for the success of a firm. It is represented by several financial ratios like total assets growth and earnings growth rate. Operational efficiency in managing the operating expenses is a key component of efficiency.

Liquidity is another key determinant of financial success. Liquidity refers to the ability of a firm to honour maturing obligations. Adequate level of liquidity is positively related to financial success. Common measures of liquidity include, current ratio and the acid test ratios. The both measure the level of current assets in relation to other assets. Other external factors like government policies on taxation and business risk also impact on the financial performance of a company. Growth level and firm size are also major factors that determine financial performance. Economies of scale add a competitive edge to large and established companies.

Ownership structure is a great determinant of the financial success of any firm as it informs how the organization is legally set up. Entrepreneurs must decide on the ownership formula that will offer the greatest benefits as the form chosen affects profits, risk or value of the firm as this will influence decision making processes, control and sourcing and investment of funds.



## 2.4 Empirical Literature Review

Yu (2013) uses a panel data of Chinese listed firms during the period of 2003 and 2010 to investigate the effect of state ownership on firm performance. He found that, state ownership effects on firm performance is in a form of a U-shape. This means that, while state ownership initially decreases firm performance, it would enhance firm performance when it is concentrated. This effect can be explained by the fact that high concentration of state ownership helps firms get benefits from government's support and political connections. The research also indicates that government policy related to state ownership plays a role in positive link between state ownership and firm performance.

Alfaraih, Alanezi and Almujaed (2012) studied the impacts of institutional and state ownership on firm performance in Kuwait. They found that, while there was a positive connection between institutional ownership and firm performance, state ownership negatively affected firm performance. This result implies that state ownership tend to have political motivation rather than market drive. A related study by Pervan and Todoric (2012) using 2003-2010 data of listed Croatian firms to investigate the link between corporate ownership and firm performance, points out that state ownership make firm performance worse. Another study they carried out examining the association between corporate ownership and firm performance in Croatia indicated that listed firms controlled by foreign investors perform better than domestic firms do.

With respect of foreign ownership, previous studies show there is a positive relationship between foreign ownership and firm performance. Ongore (2011) investigates the effect of different types of ownership on firm performance in Kenya and contends that while state ownership has negative impact on firm performance, foreign ownership has significant positive impact on firm

performance. The author argues that foreign investors help to improve management system and accessing massive resources. Douma, George and Kabir (2006) also point out that foreign ownership has positive effect on the corporate performance in India because foreign shareholders can play a monitoring role in the internal corporate governance system of the firms.

Thomsen, Pedersen and Kvist (2006) found that, there were two types of systems including market-based systems and control-based systems. While the market-based systems have a dispersion of share ownership among institutions, individual and other investors; the control-based systems are characterized by high family, corporate, and state ownership. They found that, while the blockholder ownership has no impact on firm value in the market-based systems, there is negative relationship between the blockholder ownership and firm value in the control-based systems.

Andres (2008) argues that state ownership has negative effect on firm performance. This can be argued that the people who are representatives of state ownership in firms can act for their own benefits not for the state's benefits. State ownership may have a positive effect on firm performance due to its advantages. Borisova et al. (2012) argue that state ownership has plenty of advantages, such as resources and power, compared to other types of ownership. For example, government may raise fund easily, can establish regulations that impact firms, and has informational advantage. Thus, firms with state ownership may have better performance compared to other firms.

A study on Vietnam firms showed that its companies are characterized by high level of state ownership. Thus, state ownership is considered as large shareholders with high concentration.

Andres (2008) contends that large shareholders tend to focus on their own benefit and this could lead to the fact that they could use their power to maximize their interest at the other shareholders' expense. From the viewpoint of corporate governance, blockholders can be the element that helps to monitor and reduce the agency problem arising from the separation between management and finance (Konijn, Kraussl & Lucas 2011).

Most studies argue that foreign ownership has positive impact on the corporate performance because foreign shareholders can play a monitoring role in the internal corporate governance system of the firms in emerging markets. Yudaeva et al. (2003) found that, firms in Russia with foreign ownership have higher productivity than domestic firms. Oxelheim and Randoy (2003) also contend that the presence of foreign members in board of directors can improve corporate governance in Norway and Sweden. On institutional and managerial ownership structures, Gugong, et al.(2014) study on the impact of ownership structure on the financial performance of listed insurance firms in Nigeria using panel data for seventeen (17) firms for the period 2001-2010 focusing on two aspects namely, managerial and institutional shareholding, with firm performance measured through ROA and ROE found that there was a positive significant relationship between ownership structure and financial performance.

Kim (2011) argues that foreign owners help the firms reduce agency problems, which increase the firm value. He contends that managers in firms with foreign ownership are encouraged to focus on long-term value rather than short-term interest. This means that foreign ownership may be an active participant in corporate governance mechanism. However, foreign investors only do this when they have sufficient control in firms (they are large shareholders). Thus, it can be

argued that when foreign ownership become more concentrated, foreign shareholders would be active in their monitoring role of firms.

## **2.5 Summary of Literature Review**

Indeed, empirical studies show mixed results of the relationship between state ownership and firm performance. Research on state ownership often show a negative relationship between state ownership and firm performance. Buchanan & Tullock (1962) pioneered the Public choice theory postulating that government actors are politicians and bureaucrats who may be motivated to use state ownership to secure political office, accumulate power, or seek rents. They further predict that state actors will be most likely to act in self-interested ways in weak institutional settings where voters have less information and capacity to require good performance.

Alchian (1965) expresses that government may have less reason to monitor well than a profit motivated private owner. The theory depicts a negative relationship between government ownership and performance. Researches further show that there exists a positive relationship between institutional ownership and firm performance with the foreign ownership also showing positive relationship with corporate performance. On foreign ownership, highly concentrated foreign ownership would contribute to firm performance because foreign investors can transfer their financial, technological resources and experience to firms (Gurbuz & Aybars 2010). Therefore, foreign ownership may associate positively with firm performance when its level increases.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

This chapter covered the research methodology, research design, study area, target population, sampling design, data collection methods, and data analysis.

### **3.2 Research Design**

The study employed a descriptive research design to investigate the relationship between ownership structure and financial performance of the listed firms in Kenya. Descriptive design is helpful in revealing connections, patterns and relationships since it allows for analysis of data to determine a pre-existing relationship and researcher makes no attempt to manipulate the independent variable (Mule, et al., 2013).

### **3.3 Population**

The population of this study comprised of all firms listed at the Nairobi Securities Exchange as at 31<sup>st</sup> December, 2014. There were 64 firms listed at the NSE at this time. These firms were chosen because they have clear ownership structure and financial performance data available and audited for authenticity. A census approach was used but limited to the firms that were consistently registered at the NSE between 2010 to December 2014.

### **3.4 Data Collection**

The study used secondary data of firms listed on the Nairobi Securities Exchange over a period of 5 years between 2010 to 2014. The firms selected should have been consistently registered with the NSE over the five year period under review. Secondary data was collected from different sources including audited published financial statements of firms listed on the Nairobi

Securities Exchange as well as from the NSE Hand Books which are readily available at the NSE and the Capital Markets Authority (CMA) libraries. Secondary data on ownership concentration, assets, equity, revenue, profitability and firm's performance can be extracted and/or derived from financial reports of listed companies and summaries provided by the NSE and the CMA where relevant ratios were computed.

### 3.5 Data Analysis

Karl Pearson correlation coefficient was used to describe the nature and the strength of relationship between the variables. Multiple regression analysis was used to evaluate the effect of ownership structure on financial performance of listed companies. Besides ownership structure, other factors can cause the variation in company financial performance such as firm size, liquidity, leverage, asset utilization, business cycle and even employee efficiency. Some of these factors will be used as control variables in the study. Financial performance was measured using Return on Assets (ROA). The specific regression model used for the analysis was specified as follows;

$$ROA_{i,t} = \alpha + \beta_1 \%FI_{i,t} + \beta_2 \%LI_{i,t} + \beta_3 \%LC_{i,t} + \beta_4 TAT_{i,t} + \beta_5 LEV_{i,t}$$

Where;

ROA=Return on assets for firm *i* in year *t*

$\%FI_{i,t}$  =Percentage of foreign investors in firm *i* in year *t*

$\%LI_{i,t}$  =Percentage of local individual investors in firm *i* in year *t*

$\%LC_{i,t}$  = Percentage of local corporate (institutional) investors in firm *i* in year *t*

$TAT_{i,t}$  =Total asset turnover for firm *i* in year *t*

$LEV_{i,t}$  =Leverage for firm *i* in year *t*

### **3.5.1 Operationalization of variables**

For the purpose of this study, financial performance was measured by Return on Assets (ROA) which is the percentage of profit which a company earns in relation to its overall resources (total assets). ROA measurement includes all company assets thereby indicating how efficiently a firm is using her assets.

$$\text{ROA} = \text{Net income after Tax} / \text{Total Assets}$$

For the independent variables; percentage of foreign investors, percentage of local individual investors and percentage of local corporate/institutional investors was computed as the percentage of common shares held by each of the categories to the total common shares in issue.

For the control variables, total assets turnover was measured as revenue divided by total assets.

Leverage was measure as the ratio of equity to the total assets.

### **3.5.2 Test of Significance**

To test the significance of the relationships t-test was performed at 5% levels of significance.

The significance of each of the independent variables was tested using t-test at 5% level of significance. To test the overall reliability of the model, the co-efficient of determination and F-test were used.

## CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

### 4.1 Introduction

This chapter focused on the analysis of the data collected and discussions of the findings. Data was collected from secondary sources, the Nairobi Securities Exchange handbook and company annual shareholding returns to the Nairobi Securities Exchange. The study covered the companies listed on the NSE between 2010 and 2014. A total of 58 qualified for inclusion in the study providing 219 data points.

### 4.2 Result of correlation analysis

**Table 4.1 Correlations Coefficients**

	Return on assets	Foreign investors	Local individual	Local institutional	Assets turnover	Leverage
<b>Pearson Correlation</b>						
Return on assets	1.000					
Foreign investors	.042	1.000				
Local individual	-.012	-.438	1.000			
Local institutional	-.039	-.801	-.160	1.000		
Assets turnover	.125	.163	-.178	-.070	1.000	
Leverage	.461	.006	-.086	.057	.252	1.000
<b>Sig. (2-tailed)</b>						
Return on assets	.					
Foreign investors	.267	.				
Local individual	.428	.000	.			
Local institutional	.283	.000	.009	.		
Assets turnover	.033	.008	.004	.151	.	
Leverage	.000	.467	.103	.199	.000	.



Table 4.1 reported the correlation coefficients between the variable under study. As can be noted from the table, the correlation coefficient between return on assets and the percentage of shares held by foreign investors was found to be 0.042. This indicated a weak positive relationship between financial performance of listed companies and the percentage of shares held by foreign investors. The significance probability for this relationship was found to be 0.267. Since 0.267 is greater than 0.05, the relationship between financial performance and the percentage of shares held by foreign investors was not statistically significant at 5% level of significance.

The correlation coefficient between return on assets and percentage of share held by local individual investors was found to be -0.012 as reported in table 4.1. This indicated a weak negative relationship between financial performance and local individual shareholding. This correlation had a significance probability of 0.428. Noting that 0.428 is greater than 0.05, the relationship between financial performance and the percentage of shares held by local individual investors was not statistically significant at 5% level of significance.

As shown in table 4.1 the correlation coefficient between return on assets and percentage of shares held by local institutional investors was found to be -0.039. This result indicated a weak negative relationship between financial performance and the percentage of share held by local institutional investors. The significance probability for this correlation was found to be 0.283, since 0.283 is greater than 0.05, the relationship between financial performance and percentage of shares held by local institutional investors was not statistically significant at 5% level of significance.

The correlation coefficient between return on assets and assets turnover was found to 0.125 as shown in table 4.1. Return on assets and assets turnover were found to be positively correlated. This correlation had a significance probability of 0.033. Since 0.033 is less than 0.05, there existed a statistically significant relationship between financial performance measured using return on assets and assets turnover at the 5% level of significance.

Table 4.1 indicated that the correlation coefficient between return on assets and leverage was 0.461. This indicated a moderately strong relationship between return on assets and leverage. The significance probability of this coefficient was found to be 0.000. Since 0.000 is less than 0.05, the relationship between financial performance measured by return on assets and leverage was statistically significant at 5% level.

### 4.3 Result of Regression Analysis

The result of regression analysis are presented below

**Table 4.2 Regression Coefficients**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	4.323	14.056		.308	.759
Foreign investors	-.039	.140	-.099	-.281	.779
Local individual	-.027	.148	-.039	-.180	.857
Local institutional	-.065	.139	-.151	-.468	.640
Assets turnover	.075	.785	.006	.096	.924
Leverage	.176	.024	.465	7.386	.000

a. Dependent Variable: Return on assets

From table 4.2 the regression model was found to be;

$$\text{ROA} = 4.323 - 0.039\text{FI} - 0.027\text{LI} - 0.065\text{LC} + 0.075\text{AT} + 0.176\text{LEV}$$

As reported in table 4.2, the coefficient of foreign shareholding percentage was found to be -0.039. This indicated that foreign shareholding had a negative effect on return on assets. A percentage increase in foreign shareholding would result in a 0.039 percentage decrease in return on assets. The coefficient of foreign ownership had a significance probability of 0.779. Since 0.779 is greater than 0.05, a change in the level of foreign shareholding did not have a significant effect of the financial performance of firms listed on the NSE.

Local individual investors' shareholding had a coefficient of -0.027 as indicated in table 4.2. This result indicated that the percentage of shares held by local individual investors had a negative effect on return on assets. A percentage increase in local individual investor shareholding would decline return on assets by 0.027 percentage points. The probability of this effect being significant was found to be 0.857. Since 0.857 is greater than 0.05, the effect of change in local individual shareholding percentage on financial performance of firm listed at the NSE was not statistically significant at the 5% level of significance.

Local institutional investors' shareholding had a coefficient of 0.065 as reported in table 4.2. This result indicated that the percentage of shares held by local institutional investors had a negative effect on return on assets. A percentage increase in local individual investor shareholding would decline return on assets by 0.065 percentage points. The probability of this effect being significant was found to be 0.640. Since 0.64 is greater than 0.05, the effect of

change in local institutional shareholding percentage on financial performance of firm listed at the NSE was not statistically significant at the 5% level of significance.

As reported in table 4.2 assets turnover had a coefficient of 0.075. Asset turnover had a positive effect on return on assets. An increase in assets turnover would result in increase in return on assets of 0.075 percentage points. The coefficient of assets turnover had a significance probability of 0.924. Because 0.924 is greater than 0.05, the effect of assets turnover on return on assets was not statistically significant at the 5% level of significance.

Leverage had a coefficient of 0.176 as reported in table 4.2. This indicated that leverage had a positive effect on return on assets. A percentage increase in leverage would result in a 0.176% point increase in return on assets. The effect of leverage had a significance probability of 0.000. Since 0.000 is less than 0.05, leverage had a statistically significant effect on return on assets.

**Table 4.3: Analysis of Variance**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	5211.684	5	1042.337	11.810	.000 <sup>a</sup>
	Residual	18798.981	213	88.258		
	Total	24010.665	218			

Table 4.3 reported analysis of variance. From the table the F statistic was found to be 11.81 with a significance probability of 0.000. Because significance probability of 0.000 is less than 0.05, the overall regression was found to statistically significant at 5% level.

**Table 4.4: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
	.466 <sup>a</sup>	.217	.199	9.3945796

Table 4.4 reported the coefficient of determination R-square to be 0.217. this meant that variations in the percentage of foreign share ownership, local institutional investors, local individual investors, assets turnover and leverage jointly explained 21.7% of the variations in return on assets. This indicated that the variables had a moderate predictive/explanatory power on the financial performance of companies listed on the NSE.

## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Introduction

In this chapter, a summary of the findings from the study, conclusions and recommendations are presented. Also areas for further research are suggested.

#### 5.2 Summary of the Findings

This study sought to establish the relationship between ownership structure and financial performance of firms listed at the Nairobi Securities Exchange. Specifically the study sought; to determine the relationship between foreign investors' shareholding, local institutional shareholding and local individual shareholding and financial performance of listed firms.

Table 4.1 reported the coefficients of correlation. There was found to be a weak positive correlation return on assets and the percentage of shares held by foreign investors. The correlation was not statistically significant at 5% level of significance. Percentage of shares held by local individual investors had a weak negative relationship with return on assets but the relationship was not statistically significant at a 5% level of significance. Local institutional investors' shareholding had a weak negative relationship with return on assets but the relationship was not statistically significant.

The study also found that there existed a weak positive relationship between return on assets and assets turnover as indicated in table 4.1. The relationship between return on assets and assets

turnover was found to be statistically significant at 5% level of significance. Leverage and return on assets exhibited a moderately strong positive relationship which was statistically significant at 5% level of significance.

The result of regression reported in table 4.2 indicated that change in the percentage of shares held by foreign investors had a negative effect on return on assets. However the effect was not statistically significant at the 5% level of significance. The level of shareholding by local individual investors was found to have a negative effect on return on assets but the effect too was not statistically significant at 5% level. The percentage of shares held by local institutional investors had a positive effect on financial performance. The effect of local institutional investors' shareholding was not statistically significant at 5% level of significance.

Assets turnover was found to have a positive effect on return on assets. This effect was not statistically significant at 5% level of significance. Leverage was found to have a positive effect on return on assets. The effect of leverage on return on assets was significant at 5% level of significance.

The result of F test reported in table 4.3 indicated that collectively the regression coefficients had a statistically significant effect on return on assets. The coefficient of determination R-square reported in table 4.4 indicated that the regression coefficients jointly explained 21.7% of the variations in return on assets. Thus the regression had moderate return on assets predictive/explanatory power.

### **5.3 Conclusions**

This study sought to establish the relationship between ownership structure and financial performance of firms listed at the Nairobi Securities Exchange. The result of correlation analysis indicated that foreign shareholding had a weak positive relationship with on financial performance. The result of t-test indicated that the relationship was not significant at a 5% level of significance. Local individual shareholding had a weak negative relationship with financial performance. A t-test on the result indicated that the relationship was not significant at 5% level of significance. Local institutional individual shareholding had a weak negative relationship with financial performance. A t-test on the result indicated that the relationship was not significant at 5% level of significance. Assets turnover and leverage had a positive and statistically significant relationship with financial performance. The study therefore concluded that ownership structure had a weak negative relationship with financial performance but the relationship was not statistically significant at the 5% level of significance.

The level of shareholding by local individual investors had a negative but statistically insignificant effect on financial performance while the percentage of shares held by local institutional investors had a positive effect on return on assets. The level of shareholding by local institutional investors had a positive but statistically insignificant effect on financial performance. Therefore, the study reached a conclusion that ownership structure did not have a significant effect on the financial performance of companies listed on the Nairobi Securities Exchange. Collectively the F test indicated that the whole regression model was significant at 5% level of significance. This led to the conclusion that when the percentage of shares held by foreign investors, local individual and local institutional as well as assets turnover and leverage are considered jointly, they had a significant effect on financial performance of listed companies.



Further, with the coefficient of determination R-square being 21.7%, the study concluded that the ownership structure had moderate explanatory power of financial performance of listed firms at the NSE.

#### **5.4 Recommendations**

This study recommends that managers of companies should not focus in placing the shares of their companies with a particular group of investors because the distribution of shareholding has no significant effect on their firms' financial performance. In addition to selecting investment, investment analysts and advisors should not consider the ownership distribution of a particular stock because such distribution does not have a significant effect on firms' financial performance.

#### **5.5 Limitations of the Study**

The distribution of shareholding a publicly traded company may reflect the sentiment various investor categories. The effect of such sentiments is best reflected in the market value of the shares. This study evaluated the effect the effect of ownership distribution on a financial performance measure relating calculated using book value measure of return.

#### **5.6 Suggestions for Further Research**

Further research may seek to evaluate the effect of ownership distribution on market value of listed companies. Further it may consider whether the finding of this study could have been influenced by multicollinearity. In addition further research may consider the effect of the percentage of shares held by employees on financial performance of companies in addition to

considering the effect of government stake in companies listed on the Nairobi Securities exchange.

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## **APPENDIX: Companies Listed on the Nairobi Securities Exchange**

<p><b>AGRICULTURAL SECTOR</b></p> <p>Eaagands</p> <p>Kakuzi</p> <p>Kapchorua tea company</p> <p>Limuru tea company ltd</p> <p>Rea vipingo plantation ltd</p> <p>Sasini ltd</p> <p>Williamson tea (K) ltd</p> <p><b>COMMERCIAL AND SERVICES SECTOR</b></p> <p>Express Ltd</p> <p>Kenya airways Ltd</p> <p>Nation Media Group ltd</p> <p>Standard Group Ltd</p> <p>TPS Eastern Africa (Serena) Ltd</p> <p>Scangroup Ltd</p> <p>Uchumi Supermarket Ltd</p> <p>Hutching Beimer Ltd</p> <p>Longhorn (K) Ltd</p> <p><b>CONSTRUCTION AND ALLIED</b></p> <p>Athi River Mining ltd</p> <p>Bamburi Cement ltd</p> <p>Crown Berger ltd</p> <p>East African Cables ltd</p> <p>East African Cement ltd</p> <p><b>ENERGY AND PETROLEUM</b></p> <p>Kenolkobil ltd</p>	<p><b>MANUFACTURING AND ALLIED</b></p> <p>BOC Kenya ltd</p> <p>British American Tobacco ltd</p> <p>Carbacid Investments ltd</p> <p>East African Breweries ltd</p> <p>Mumias Sugar co ltd</p> <p>Unga Group ltd</p> <p>Eveready E.A ltd</p> <p>Kenya Orchards ltd</p> <p>A.Bauman co ltd</p> <p><b>INVESTMENT</b></p> <p>Olympia Capital ltd</p> <p>Centum Investment ltd</p> <p>Trans-Century ltd</p> <p><b>AUTOMOBILES AND ACCESSORIES</b></p> <p>Car and General ltd</p> <p>CMC ltd</p> <p>Sameer Africa ltd</p> <p>Marshals ltd</p> <p><b>TELECOMMUNICATIONS AND TECHNOLOGY</b></p> <p>Access Kenya Group ltd</p> <p>Safaricom ltd</p> <p><b>INSURANCE</b></p> <p>Jubilee Holding ltd</p> <p>Pan Africa Insurance Holding ltd</p> <p>Kenya Re-Insurance Corporation ltd</p>
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Total Kenya	CFC Insurance holding ltd
Kengen ltd	British American Investment Co (K) ltd
Kenya power and Lighting Co. ltd	CIC Insurance Group
<b>BANKING</b>	<b>INVESTMENT SERVICES</b>
Barclays Bank ltd	Nairobi securities exchange
CFC Stanbic Holding ltd	<b>GROWTH ENTERPRISE MARKET</b>
Diamond Trust Bank ltd	<b>SEGMENT</b>
Housing Finance	Atlas development and support service
Kenya Commercial Bank ltd	Kurwitu ltd
National Bank of Kenya	Flame tree group
NIC Bank ltd	
Standard Chartered Bank ltd	
Equity Bank ltd	
Cooperative Bank ltd	
I&M bank ltd	