

**THE EFFECT OF OWNERSHIP STRUCTURE ON FINANCIAL PERFORMANCE  
OF SUGAR MANUFACTURING FIRMS IN KENYA**

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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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This research project has been submitted for examination with my approval as the University supervisor

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## **DEDICATION**

I dedicate this study to my family and friends for their everlasting love, provision and prayers.

## **ACKNOWLEDGEMENT**

I thank God for the far that He has brought me, for granting me favor, wisdom and for the gift of life.

Secondly, I wish to sincerely acknowledge my Supervisor, Dr. Duncan Elly for his unwavering support, supervision and encouragement during the entire project period. I wouldn't have it this far. I would as well like to genuinely acknowledge my lecturers who successfully took me through the course units.

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## **LIST OF ABBREVIATIONS AND ACRONYMS**

APT	- Arbitrage Pricing Theory
CBK	- Central Bank of Kenya
CMA	- Capital Markets Authority
KSB	- Kenya Sugar Board
NSE	- Nairobi Securities Exchange
VIF	- Variance Inflation Factors

## **ABSTRACT**

The effect of ownership structure on firm performance can be evaluated in two dimensions: ownership concentration and owner identities. Ownership concentration provides quantifiable information about the rights of the largest investor(s). Owner identity offers qualitative information about the identity of the controlling investor(s). The objective of the study was to examine the effect of ownership structure on the economic performance of Sugar Manufacturing Companies in Kenya. The study adopted the descriptive research design. The data was acquired from document analysis of consolidated financial reports of years ending December: From 2008 to 2015 of the sugar companies. The data was analyzed using multiple regression and correlation analysis to establish the relationship between the independent and dependent variable. From the findings, the regression model describing the relationship between the study variables is significant at the 0.05 level. This indicates that the financial performance of these companies was significantly affected by their ownership structure and sizes. Also, the coefficients of the regression model were found to be significant, exemplifying the significant influence of the study independent variables on the companies' financial performance. The researcher recommends future studies that may, in an attempt to consider the effect of all types of debt comprehensively, separate different types of debt based on where they are issued. For example, corporate bonds or capital market issued debt can be separated from commercial bank loans, or debt from financial institutions. The separation can be done by introducing specific types of debt as distinct independent variables. This may allow evaluation of the effects of different types of debt on the financial performance.

# CHAPTER ONE: INTRODUCTION

## 1.1 Background of the Study

Jensen and Meckling (1976) hold that ownership structure revolves around the dissemination of equity with concern for voting rights and investment along with the stockholders' details. The ownership structure of firms is vital as it is an internal mechanism of corporate governance. Firms have many ways of structuring their ownership with the type of ownership structure adopted being in line with the vision of the company. Market capitalization / market value of an organization is not only dependent on the investments made but also by aspects such as capital structure, dividend policy, corporate governance and ownership structure. There are several ownership structures in existence amongst them government ownership, foreign ownership, institutional ownership and individual ownership that influence firm success and profitability either positively or adversely.

Agency theory states that, firms consist of two entities; the agent (management) and the principal (owner) Mohamed (2013). Agency expenses emanate from conflict of interest between owners and management. The conflict bringing into being agency problem is not only between the principal and the agent but also amongst shareholders, mostly in developing countries (Dharwadkar, George & Brandes, (2000). Jensen and Meckling, (1976) described an agency association as an agreement in which the principal engages the agent to accomplish some service on their behalf. This further entails handing over some power to make decisions to the agent. The stakeholder theory addresses morals and values in managing an organization. Distinct from agency premise where managers work and serve for the principal, stakeholder theorists maintain that management in

organizations has a web of relationships to attend to— this include the suppliers, staff and business associates (Freeman, 1999). The theory maintains that there are other stakeholders / parties other than the principal whose needs have to be met. These include; employees, clients, contractors, financial providers, communities, government institutions, political clusters, and trade associations / unions. Stewardship Theory states that senior management act stewards for the organization and performance in the greatest interests of the principal. The hypothesis in the theory is that management makes all judgments in the best interest of the firm putting collectivist options above self-interest. The steward maximizes on the success of the organization, and ensures that both the agent and the principal gain from a great business (Mallin, 2010).

The Kenya Sugar Board (2005) reported that government ownership in the sugar industry was: Muhoroni (82.78%); Miwani Sugar (49%); Chemelil (97.64%); South Nyanza (99.79%) and Nzoia (98.87%). Mumias and Miwani were privatized and government preserved 20% in Mumias, which is at the moment the sole sugar firm listed at the Nairobi Stock Exchange (NSE). Immense government involvement in the government is considered to increase political interference in the said organizations (Sucam, 2003). According to the KSB Report (2010) the performance of the sugar sector has been dismal. The companies with high state stake holding operated less profitably compared to the ones with low state stake holding due to political disruptions.

### **1.1.1 Ownership Structure**

Ownership mix and concentration are facets that Gursoy and Aydogan (2002) consider to be appropriate in defining ownership structure. Ownership concentration involves the percentage of share of the largest shareholder associate costs of managing the risks of

having a sole large shareholder as well as costs to monitor the shares (Pedersen & Thomsen 1999). On the other hand ownership mix relates to the uniqueness of the major shareholder.

Ownership structures are of key significance in commercial governance since they impact the motivation given to managers, and as a result affect the productivity of firms. The increased unpredictability of business portfolios experienced in the recent past has led to new attention towards the models of firm ownership especially for international organizations. Globalization plays a role in ensuring that economies become interconnected and this influences the manner in which ownership structures are formulated; with different investors in form of organizations or individuals who could be from a country different from which the firm is situated (Heubischl, 2006). Ownership structure decisions as well affect organization's amount of capital and productive resources and the decision as to whether the organization needs to be financed through debt or equity.

There are several factors that determine the firm's financial performance other than ownership concentration. Numerous studies have revealed that a number of internal factors influence firm performance. Amongst them are size of the firm, period the firm has been in existence, debt ratio, acid test ratio, stock level, revenue growth and capital turnover (Barbosa and Louri, 2005; Kuntluru, Muppani and Kan, 2008). Nonetheless, the influence of these aspects varies globally; from nation to nation and dependent on the nature of the different sectors within which the businesses operate. According to Raji (2012), there is no approach on how the link between firm performance and ownership

structure can be explicitly determined. Prior studies that investigated the relationship between of ownership structure organizational productivity adopted Herfindahl index or the equity stakes huge investors, usually the top five stockholders (Demsetz and Lehn, 1985). Several studies in least developed nations, where information is inadequate, the equity stake of the majority shareholder has been extensively used (Kapelyushnikov, 2000). In addition, ownership structure could 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 Organization Performance**

Combs, Crook, and Shook (2005) affirm that financial success is the common performance metric for most organizations. Letting (2009) argues that firm performance relates to the efficiency and effectiveness of the organization. Firms measure profitability using traditional performance measures amongst others to measure the extent of success. Effectiveness is measured by sum of clients served, quality of products, collaborative arrangements; Efficiency is quantified by the occurrence of machine failures, timeliness of service conveyance, employee turnover, employee nonattendance; Relevance is quantified in stakeholder satisfaction and level of innovation in terms of new products developed. Financial viability on the other hand is measured by debt to equity ratio, the current asset ratio and the percentage change in the sales and profit levels over a given period of time (Ochieng, 2012).

### **1.1.3 Ownership Structure and Firm Performance**

Ongore (2011) explained the theory of ownership along two facets that have been inferred to in the preceding sections; the percentage of share of the largest stockholder and the uniqueness of the major shareholder (Pedersen & Thomsen 1999). Wen (2010) stated that huge investors continually monitor and assesses the performances of managers. Close observation of the management can significantly decrease agency cost and increase firm performance. Having few stockholders owning huge proportions of shares could result in conflicts of interest as the majority and minority shareholders' financial interests or governance issues and hence could negatively affect firm performance (Ongore, 2011).

Dalton, Daily, Ellstrand, and Johnson, (1998) argued that neither board conformation nor board leadership structure nor ownership structure can be connected to financial performance of a firm. On the other hand, Rathish and Sujoy (2015) argued that there is a positive effect on performance only when the chairman is independent predominantly in the case of the larger firms. However, their study did not provide proof to the aspect of agency theory connected to board independence and firm financial performance. A significant and positive association was found between the size of the board and organizational performance. Demsetz and Lehn (1985) being pioneers in ascertaining the relationship amid ownership structure and organizational performance, found no relationship.

#### **1.1.4 Sugar Manufacturing Firms in Kenya**

The sugar industry in Kenya has been existence since the early 1920s with the creation of initial sugar factories. A report by the Export Processing Zone Authority (2005) indicated that the sugar industry supports more than five million people in the country; representing more than 15% of the entire Kenyan population. Majority of the sugarcane is grown flat regions in the Western, Nyanza, and Coastal regions of Kenya. Research has indicated that about 80-85% of the cane supply comes from small-scale growers while 15-20% is supplied by the nucleus estates of the sugar companies. The sector has had immense challenges with most industries requiring bailout from the government; for instance, Miwani and Muhoroni are currently under receivership. The large government ownership makes the industry prone to state and political interfering (Sucam, 2003).

The government monitors the sub-sector primarily through the Ministry of Agriculture (MoA) and the Kenya Sugar Board (KSB), the latter being made of representatives from the state, sugar companies, farmers' organization and general industry. The industry has over 150 smaller, artisanal competing for cane with the regular factories (Harding, 2005). Other related industries are: Agro-chemical and Food Company Limited started in the early 1980s with some government stake holding. This scenario has stimulated growth of rural infrastructure in feeder roads, transport services, spurring economic, educational, medical and other social services and the expansion of other rural facilities, all vital to western Kenya's economic well-being. Kenya has 11 sugar factories that produce an annual production capacity of about 600,000 tons of sugar against the yearly domestic requirements of 800,000 tons leading to a shortfall of 200,000 tons.



## **1.2 Research Problem**

The relationship amid ownership structure and organizational performance could be guided by the identity of the stockholders and the amount or the percentage outstanding shares held in the organization in the context. The identity of the shareholders offers qualitative information relating to the majority shareholders (Gross, 2007). Firm Performance on the other hand relates to qualitative and quantitative metrics that indicate the extent to which an organization has attained its operational goals (Kaplan & Norton, 1992).

Government stake holding in the Sugar Manufacturing firm industry is relatively high. The government divested in Mumias and Miwani, only holding 20 percent in Mumias Sugar which is the only sugar manufacturing company whose shares is traded on NSE. Immense government engagement in the sugar sector exposes sugar firms to political interference (Sucam, 2003).

A study by Mbatha (2012) on the effect of ownership structure on financial productivity in the sugar industry found out that there was no correlation at all. Lee (2008) conducted a study on ownership structure South Korean firms and revealed that, as ownership percentage increases, a firms' performance in form of ROA generally increases though the aspect of having foreigners or organizations as stockholders has immaterial impact.

Daily, Ellstrand, and Johnson, (1998) concluded that board composition, board management structure and ownership structure are not reliably related to firm financial performance. On the other hand, Rathish & Sujoy (2015) contended that there is an affirmative impact on performance only when the chairman is independent particularly in

the case of the larger institutions. However, their study did not give evidence to the aspect of agency theory linked to board independence and firm performance. A significant and positive relationship was found between board magnitude and firm economic performance. Demsetz and Lehn (1985) were the first to investigate the impact of ownership concentration on firm performance and they established no relationship.

It is usually considered that the private enterprise performs better than the state-owned enterprise. Majority of the Sugar Manufacturing firms are government owned and over the years, economic performance has declined. Kenyan sugar sector has been orbiting around sugar scarcity, inefficiencies, failure to battle with imported sugar, recurrent losses and political interference. In spite of the challenges in the sector, private factories are being set up to fill in the gap (Kivindu, 2012).

Given the discrepancy conveyed in the relationship between ownership structure on firm productivity in various industries in Kenya and the fact that little studies have been done in Kenya on sugar manufacturing firms, the study attempted to resolve the following research questions: How delicate is the performance of a firm to the ownership structure? What is the nature of the relationship between the two variables? The study also attempted to answer the unsettled debate on the effect of ownership structure on financial / economic performance of Sugar Manufacturing Companies in Kenya.

### **1.3 Objective of the Study**

The goal of the research was to examine the impact of ownership structure on the performance of Sugar Manufacturing Companies in Kenya.

Specifically, the study will seek to:

- (i) To ascertain the effect of foreign investors shareholding on financial performance of Sugar Manufacturing Companies in Kenya
- (ii) To determine the effect of local institutional shareholding on the financial performance of Sugar Manufacturing Companies in Kenya
- (iii) To determine effect of local individual shareholding on financial performance of Sugar Manufacturing Companies in Kenya

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

The study's conclusions aid the Sugar manufacturing firms in Kenya and other organizations make better financing and investment decisions to augment shareholder's wealth. The findings of this study are imperative to investors in not only the Sugar Manufacturing Companies, but also in other economic sectors in Kenya and beyond.

The findings provide additional information to academia and would act as a basis for future research. The results help scholars who may use the conclusions for corporate decision making purposes and aid in policy formulation for the Sugar sector for operational efficiency; it is also a key pillar to accomplishing vision 2030 and generally helps managers to improve economic performance of the firm.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

This chapter presents a review of the literature research topic and variables relating to ownership structure and organizational success. The Chapter examines the work that other researchers have done concerning the effect of ownership structure on financial performance of firms. Theoretical and empirical reviews are done in this chapter. The chapter commences with an evaluation of the models that underpin the concept of ownership structure. The chapter thereafter presents an empirical review of factors affecting performance of firms.

### **2.2 Theoretical Review**

The theoretical review presents the agency theory, stakeholders' theory and stewardship theory to explain the probable link amid the ownership structures and performance.

#### **2.2.1 Agency Theory**

Agency association is an agreement where one party (referred to as the principal) uses the services of an agent to conduct some activities on behalf of the principal which include assigning decision making power to the agent. The principal delegates the decision making authority to the agent in regards to utilization of a firms scarce resources. Divergence of attention is probable as the objective of the agent may be conflicting with the principals' objectives and their motives may not be similar leading to agency costs. Agent's performance must be appropriately assessed to minimize agency costs. Incentives are put in place to limit divergences by the agent through agency costs; which ought to be minimized at all instances (Jensen & Meckling, 1976).

In the agency theory, investors anticipate that agents perform and make choices in the interest of the principal. The agent on the other hand may not certainly have similar interests like those of the principal's but instead; they may give way to “self-centeredness” and opportunistic behavior and not come up to scratch the convergence of the goals of the principal and the agent’s pursuits”. Assuming that the managers may not perform to maximize the shareholders returns, it follows therefore, that the suitable governance structures need to be executed to protect the stake of shareholders. The executive board of directors is hence instituted to ameliorate the risk or cost of agency. The nomination of outside directors is to guarantee independence to other internal directors’ decisions (Finegold, 2007).

### **2.2.2 Stakeholder Theory**

This theory focuses on ethics and values in running an business. Unlike the agency associations between principals and agents as discussed in the preceding sections, stakeholder theorem suggests that management serves different interested parties— this entails the contractors, workers and other business associates including trade associations. This set of stakeholders is considered more vital compared to the agency relationship (Freeman, 1999). Besides the stated stakeholders, the theory posits that workers, clients, suppliers, sponsors, the public, parastatals, political groups, and trade unions also form the network of interested parties that the managers need to serve (Miles, 2012). How a firm treats its stakeholders impacts either positively or negatively to its financial performance (Miles, 2012).

### **2.2.3 Stewardship Theory**

This theory was authored by Donaldson and Davis (1991) in which they suggested that managers are basically trustworthy and value immensely their reputations. The main concept of the stewardship theory is trust; in which it is assumed that managers ought to be trusted as good stewards (Davis, 1997). The theory also holds that there are different forms of motivation for the managers, CEOs, and Boards; including but not limited to non-financial incentives, desire to achieve and advance in their career ladder. Managers are not considered as individualistic, opportunists, and self-serving people in this theory, but work in line with the interests of the owners of the business (Mallin, 2010).

Davis (1997) holds that stewards act in a pro-social manner which is aimed at attaining the interests of the owners, and thus the entire organization. Increase in sales, profits, and wider market share are the shared goals of stewardship relationship amid managers and owners (Abdullah & Valentine, 2009). The stewardship view point advocates for collectivist, involvement-oriented and low-power distance aspects within the leadership to ensure higher organizational performance. The stewardship theory, unlike the theory, disregards monitoring costs which in some way cannot be avoided as the theory's assumptions would not hold in a real case scenario due the differences in utility functions between managers and the stockholders.

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

Firm success is based on a set of financial and non-financial indicators which give details on the extent to which predetermined objectives are attained (Lebans & Euske, 2006). To define the concept of firm performance it is necessary to quantify the results. A firm's economic performance is influenced by several factors. Some of these factors include firm's ownership concentration and ownership mix, firm's Size and Firm's Leverage.

### **2.3.1 Ownership Structure**

A firm's ownership structure has been found to influence its worth. The nature of the association between ownership and financial posterity of an organization is a key aspect for management. Some studies show a positive relationship between these two variables (Jensen & Meckling, 1976) while others do not show any correlation (Chen et al 1993). Most of the studies conducted with empirical evidence in the past decade focused on the developed nations such as the U.S with little research conducted in developing nations, such as Kenya. There are immense organizational differences amid the developed and the developing nations, implying there could be differences in how ownership structure influences firm performance in developing economies such as Kenya. Ownership structure was assessed by means of the concentration or the percentage of the largest shareholder as (Gross, 2007) proposes.

### **2.3.2 Firm Size**

The size of the firm and how it influences organizational performance has been studied over time and researchers posit that firm size could positively impact organizational performance as it portends the presence of economies of scale and diseconomies of scale that act as deterrents for new entrants in the market. In recent studies, a positive relationship has been found to exist between the size of the firm and growth (Hall, 1987) though with some finding weak or negative relationship between the two variables (Molyneux & Wilson (2004). These assertions have an implication that concerted efforts have been made to address the aspect of firm size and profitability of businesses. The mixed reports mean opportunities still exist to conduct research and widen the understanding of the concept, hence this research. Size of the firm was determined by the natural log of the book value of the firms' total assets.

### **2.3.3 Firm Leverage**

The concept of firm value in relation to leverage was proposed by Modigliani and Miller (1958) and ever since different theoretical and empirical studies have been conducted to ascertain the relationship between these two variables. The fundamental issue investigated in most cases relates to corporate finance (specifically capital structure) in which the concern is on finding out to what extent should firms be financed with debt rather than equity. Modigliani and Miller hold that an organization's value is not influenced by the manner in which it is financed; whether by debt or equity. However, Ilyukhin (2015) stated that leverage could be used as a metric for assessing managerial efficiency and therefore, could influence firm performance positively. However, there is a need to have a balance of debt and equity; too much debt could result in high interest costs, while too much equity result in high monitoring costs; which both influence financial performance negatively (Stiglitz and Weiss 1981; Leland and Pyle (1977)). Firm Leverage was measured by total debt to equity ratio.

### **2.4 Empirical Studies**

Yu (2013) researched a panel data of Chinese listed firms during the period of 2003 and 2010 to investigate the impact of firms' ownership status and their financial prosperity. He discovered that, government influences organizational performance in a form of a U-shape. This meant that initially the government leads to lower profitability (maybe as a result of political interference) but eventually increases due to ownership concentration. This effect is explained by the fact that more percentage of state rights helps businesses get benefits from subsidies and political linkages that are benevolent to the organization.



The study indicated that policies made by the government also influence the firms' performance depending on whether they present favorable or unfavorable business environment.

Alfaraih, Alanezi and Almujaed (2012) studied the effects of institutional and government rights of ownership on firm success in Kuwait. They discovered that, though there was a positive link amid institutional ownership and firm success, government involvement negatively affected firm performance. This result implies that state ownership tend to have political motivation rather than market drive.

Dalton, Daily, Ellstrand, Johnson, (1998) concluded ownership, leadership and governance structure of an organization has no direct link to firm performance. On the other hand, Rathish & Sujoy (2015) argued that a positive impact on performance exists only when the chairman is independent especially in the case of the larger firms. However, their study failed to give evidence to the aspect of agency theory linked to board independence and firm performance. Initial studies conducted by Demsetz and Lehn (1985) and then subsequent ones by researchers such as Himmelberg et al. found no relationship between ownership status and firm performance.

In assessing the link amid structure of ownership rights on business success, Alam (2008) adopted five aspects that entailed non-financial features as metrics for evaluating firm performance. The study was focused on health care institutions and the findings indicated that there are substantial variations in organizational success in terms of financial productivity among public, non-profit, and for-profit health care institutions; data was retried for a period ranging from 1980 to 2003.

In an effort to determine the link between the nature of ownership and firm performance, Mutisya (2015) replicated a study to investigate the relationship between these variables, but with a focus on companies listed at the NSE. Correlation analysis was used and findings portrayed a weak negative relationship for locally owned firms but with a weak positive link among firms with foreign ownership. Since the findings were not statistically significant at the 0.05 significance level, there was a conclusion that ownership structure has no substantial effect on performance of firms listed at the NSE.

Ongore (2011) conducted a study to find out the link between the statuses of ownership of an organization on its fiscal prosperity. Various aspects were considered in the research including ownership identity, leadership discretion, and state involvement in firm activities, through ownership rights. The findings of the research indicated that state ownership is coupled with poor stewardship of the businesses; majorly through political influences and poor decision making (not based on appropriate policy issues). The results also showed that state-owned businesses performed dismally while firms with a huge concentration of institutional ownership showed better and high performance in form of ROA and dividend yield.

Abira (2014) investigated the effects of ownership composition on financial success of businesses listed at the NSE and found that ownership concentration is negatively correlated with firm's profitability. The study determined that higher ownership concentration leads to lower profitability of firms in Kenya. Hence, as the number of shareholders rise in a firms, the performance of the firms drops while as the number falls, performance increases. The study noted that foreign ownership is positively associated with firm's profitability. The study found out that higher foreign ownership in a firm

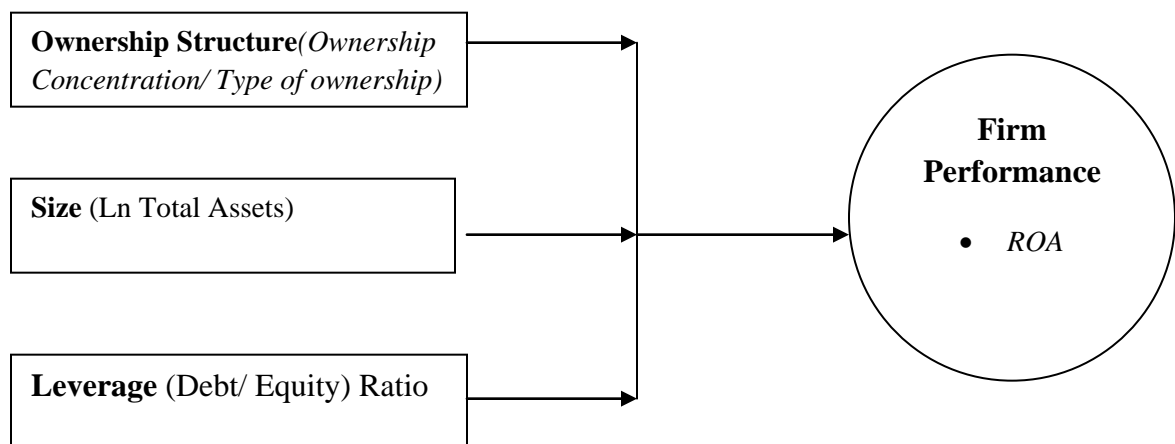
leads to higher profitability while lower foreign ownership leads to lower performance in firms in Kenya. The study also found that domestic ownership is positively correlated with firm's profitability. The study therefore concludes that higher domestic ownership in affirms leads to higher profitability while lower domestic ownership leads to lower performance in firms in Kenya. The study established that state ownership is negatively correlated with firm's profitability, that is, higher state ownership leads to lower profitability of firms in Kenya. Therefore, as the state-ownership rises in businesses, their performance declines while as the ownership falls, performance rises.

Anselm (2014) carried out a research on the relationship between ownership statuses on the fiscal success of organized trading at the NSE and concluded that the percentage of shares owned by large investors is negatively correlated with firm's profitability. The study determined that higher ownership concentration leads to lower profitability of firms in Kenya. Hence, as the number of shareholders rise in a firms, the performance of the firms drops while as the number falls, performance increases. The study highlighted that foreign ownership is proportionally liked to firm's profitability. The study found out 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 also found that domestic ownership is positively correlated with firms profitability. The study therefore concludes that higher domestic ownership in affirms leads to higher profitability while lower domestic ownership leads to lower performance in firms in Kenya. The study established that state ownership is negatively correlated with firm's profitability, that is, 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.

Ogega (2014) investigated the effect of ownership structure on the financial success of banks in Kenya and the study discovered that ownership structure positively impacts their financial prosperity. The study also discovered that there was solid positive link between ownership structure and financial performance in the banking sector in Kenya. The study further revealed that a unit increase in foreign ownership would result to growth in fiscal performance among banks in Kenya. The study found that domestic ownership of the bank significantly affects performance of and that government ownership significantly affects the banks' performance too.

## 2.5 Conceptual Framework

The conceptual framework shows the relationships between the diverse variables (dependent, independent, control variables) and how they aid in achieving the research's objective (Miles & Huberman, 1994). This research's conceptual model is presented underneath;



**Figure 2.1 Conceptual Framework**

As indicated in figure 2.1 above, firm performance measured as Return on assets is expected to be influenced by three independent variables. Firm ownership structure is measured as ownership concentration and type of ownership whether government or private owned. Firm size measured in terms of firm total assets and leverage measured as debt equity ratio.

## **2.6 Summary of the Literature Review**

A lot of research has been conducted to ascertain the link amid the ownership structure and fiscal prosperity of businesses, however, the results are contradicting. Given the inconsistency reported in Kenya and the fact that little study has been done on the relationship of the two variables in the sugar manufacturing companies in Kenya, this study sought to determine the impact of ownership structure on the productivity of Sugar producing companies in Kenya.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

This chapter presents the study methodology adopted towards attainment of the objectives. Specifically, it outlines the study design, targeted population, methods of data collection, research validity and reliability, and data analysis.

### **3.2 Research Design**

The study adopted the descriptive research approach. The study was concerned with the effects of ownership statuses on the monetary performance of sugar manufacturing firms in Kenya. A cross sectional study was used to ascertain the link amid the variables under investigation. The research approach enabled the researcher reach conclusions and make inferences that would be generalized in other similar sectors.

### **3.3 Population of the Study**

Population entails all the items or objects that form the basis of study from which a sample is derived. The findings, based on the sample would be generalized to the entire population. All the sugar factories in Kenya formed the population of this research.

### **3.4 Data Collection**

Secondary data was used and it was considered helpful in improving reliability of findings due to minimal inconsistencies. The data was acquired from annual financial reports of the companies under investigation over a period ranging from 2008 to 2015. Secondary data enabled the research spend less time organizing data, as most of it was available through the websites, and Kenya Sugar Board which is the supervisory agent of the sugar industry in Kenya.

Data to be collected include: Net Profit, Total Asset, Percentage of Block Ownership, Total Debt and Total Equity.

### **3.5 Data Analysis and Presentation**

Multiple regression and correlation analysis were adopted to determine the association amid the variables under investigation in this research. The following model guided the research so as to accomplish the study objectives;

$$Y = \beta_1(X_1) + \beta_2(X_2) + \beta_3(X_3) + \beta_4(X_4)$$

Where:

Y= Profitability: ROA = Net Profit / Total Assets

X<sub>1</sub> = Ownership Structure / Ownership Concentration: Proportion of block ownership

X<sub>2</sub> = Firm's Size: ln of Total Assets

X<sub>3</sub> = Firm's Leverage: Total Debt / Total Assets

X<sub>4</sub> = Ownership Type (Government/ Private)

#### **Control variables:**

**The Company Size (CS):** firms with high sales ideally record higher profitability. This was considered as a control variable in this research. The natural log of sales was used as a metric for determining firm size.

**Debt Ratio (DR):** this represented the extent of leverage and is estimated by dividing Total Debt by Total Assets. Data was derived 7 Sugar manufacturing firms in Kenya that had financial data available for the period 2008-2015. All data was collected from the annual reports of each firm.

# CHAPTER FOUR: DATA ANALYSIS, PRESENTATION AND INTERPRETATION

## 4.1 Introduction

Data collection was carried out as outlined in the research methodology. This chapter presents the data obtained, alongside the results of its analysis. The chapter includes the summary descriptive statistics for the key study variables, correlation and regression analysis. The chapter closes with a discussion of the findings within the framework of theoretical and empirical insights.

## 4.2 Descriptive Statistics

The study's dependent and independent variables were analyzed using descriptive statistics in order to obtain a preliminary understanding of the distribution underlying these variables. The table below illustrates the results obtained.

**Table 4.1: Descriptive Statistics**

	N	Minimum	Maximum	Mean	Std. Deviation
Leverage	45	-11.49000	6.97000	.4744444	2.39585206
ROA	45	-.09814	.28358	.0406757	.10114061
Size Ln Total Assets	45	20.60785	24.88838	22.7641335	1.02457858
Ownership Concentration	45	.20000	.99000	.7222222	.30776976
Ownership Type	45	1.00	2.00	1.4444	.50252
Valid N (listwise)	45				

**Source: Research Findings**



Return on assets (ROA) was computed from the net income and shareholders' equity for each company as at the end of each financial year in the study period. The company that earned the lowest return on shareholders' equity, among those studied realized a negative return of 81.29%. The best performing company among those studied in the entire period covered earned a return of 91.3984% on the shareholders' equity, which is almost twice the return realized by the poorest performing company in the same period. On average, the nonfinancial companies under study earned 14.13% as return on their equity. The standard deviation of the companies' return on equity from the mean return on equity stood at 26.38%, which suggests that the variability in the companies' financial performance was high. One factor that may explain the high variability in the financial performance of the select companies is the differences in the sectors from which they were drawn. Much as all the companies were nonfinancial, the sectors in which they operate are marked by wide structural differences which may end up influencing the financial performance. For instance, companies in the capital intensive manufacturing sector may incur higher costs of capital compared to those drawn from the service oriented commercial and allied sector.

The debt equity ratio was computed by evaluating each company's value of asset financing provided by debt in relation to the extent to which equity was employed in asset financing (Appendix 2). From the table 4.1 above, the lowest debt equity ratio among all the companies studied was 0.0882. The highest debt equity ratio was 6.5962, suggesting that some companies heavily employed debt in the financing of their assets. On average, the companies had a debt equity ratio of 1.0074, implying that the mix of debt and equity in most companies' capital structures was fairly equal. The standard

deviation of the companies' debt equity ratios from the average ratio was 1.2961. Considering that the standard deviation exceeds the average ratio, individual companies' debt equity ratios varied markedly from the average value. Also, the range between the lowest and highest ratio exemplifies the significant variation exhibited by individual companies' debt-equity ratios.

Company size was employed in order to minimize the lack of control for many other factors that influence the financial performance of the companies under study. As indicated under research methodology, company size was measured using the total assets as at the end of each financial year (Appendix 2). The absolute values of the total assets for each company were transformed into their natural logarithms. Summary descriptive statistics are illustrated in table 4.1 above. The smallest company among those studied had total assets whose natural logarithm is 13.0076. The largest company had total assets whose value's natural logarithm is 19.3378. On average, the companies had assets whose values had a natural logarithm of 15.7265, with a standard deviation of 1.6969. The summary descriptive statistics suggest that the companies were different in terms of their sizes, a factor that may help in explaining the wide differences in their financial performance apart from the capital structure.

### 4.3 Diagnostic Statistics

**Table 4.2: Diagnostic Statistics**

Model	Durbin-Watson
1	2.164 <sup>a</sup>

a. Predictors: (Constant), Ownership Type, Leverage, SizeLnTotalAssets, Ownership Concentration

b. Dependent Variable: ROA

The Durbin-Watson statistic is above the minimum threshold of 2, which shows that there is no problem of autocorrelation in the variables.

#### 4.4 Correlation Analysis

**Table 4.3: Correlation Analysis**

	Leverage	ROA	SizeLnTotalAssets	Ownership Concentration	Ownership Type
Leverage	1				
ROA	.034	1			
SizeLnTotalAssets	.084	-.280	1		
Ownership Concentration	-.122	.134	-.588**	1	
Ownership Type	.144	.261	.612**	-.844**	1
**. Correlation is significant at the 0.01 level (2-tailed).					

The coefficient of the correlation between the ROA of the companies under study and their debt equity ratio is 0.4893. This suggests that their financial performance had a positive and moderate correlation with their capital structure. Companies with higher debt equity ratios exhibited a higher ROE, whereas those with a lower debt equity ratio had a lower ROA. High financial leverage may lead to a company's costs being lowered through tax benefits and high value in the financial markets (Fama, 2002; Fischer, 2012). The use of debt in financing assets and operations may make a company eligible for tax exemptions, while increased firm value in the financial markets may make it easy to raise funds in the capital markets. Ease in raising funds in the capital markets may reduce some of the fixed costs that come with fund raising in the capital and financial markets, such as brokerage fees. Lower costs can be realized because a positive response may be elicited from investors within a short period of time, where the company has a high value.

The coefficient of the correlation between the sizes of the companies under study and their financial performance is 0.4702. This also suggests that the financial performance of the companies under study had a positive and moderate correlation with their sizes. Companies with larger sizes earned a higher return on equity, whereas where the size of the company was lower, the return on equity was equally lower. Larger companies enjoy benefits that predispose them to better financial performance (Valentine, 2014). They carry out their operations in a large scale, which in itself delivers economies of scale. Economies of scale may help in lowering costs of operations, which in turn yields higher financial performance. Also, large companies can leverage the benefits brought about by economies of scale to attain market leadership, which enhances consistently good financial performance. Company size can also influence financial performance through its impact on the cost of capital. Larger companies that perform well on a consistent basis have the ability to negotiate favorable debt contracts, in addition to having greater access to funding from the capital and financial markets (Vithessonthi and Tongurai, 2014).

The correlation between the sizes of the companies that were under study and their debt-equity ratio was weak and positive, considering the coefficient of correlation of 0.2720. Although the companies have a higher tendency to finance expansion and other operating requirements with debt more than equity, the same may not be said of the companies that were under study, given that the correlation is weak. The extent to which companies with various sizes are leveraged may be mediated by other intervening factors such as the industry type. For example, a manufacturing entity may require a higher leverage than an organization whose operations are service oriented.

#### 4.5 Regression Analysis

Each company's return on equity as at the end of each financial year in the period covered by the study was regressed against the debt equity ratio and the asset size. The table below shows the summary of the regression model obtained.

**Table 4.4: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.842 <sup>a</sup>	.708	.679	.05729940

a. Predictors: (Constant), Ownership Type, Leverage, SizeLnTotalAssets, Ownership Concentration

The coefficient of correlation, multiple R is 0.5261. This suggests that the correlation among the three study variables was moderate. The table also indicates the R Square, the coefficient of determination. Considering that the R Square has a value of 0.2768, approximately 27.68 % of the variation in the companies' ROE over the period 2012-2013 could have resulted from the variation in their debt equity ratios and their total asset values. The regression model was then tested for significance using the ANOVA technique. The table below illustrates the findings obtained.

**Table 4.5: ANOVA**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.319	4	.080	24.272	.000 <sup>b</sup>
	Residual	.131	40	.003		
	Total	.450	44			

a. Dependent Variable: ROA

b. Predictors: (Constant), Ownership Type, Leverage, Size Ln Total Assets, Ownership Concentration

The value of the F test statistic is 10.72. Given that the F test statistic essentially represents the ratio of the explained variation to the unexplained variation in the dependent variable, the F statistic in this case suggests that more variation in the dependent variable is explained by the study independent variables. The test statistic has a significance value of 0.0001. At the 0.05 level of significance at which the model was tested for significance, the regression model can be said to be significant since the significance value of the test statistic is substantively lower than the significance level at which the hypothesis of model significance was tested. Thus, the relationship between the studied companies' financial performance, capital structure and their sizes over the study period is a significant one.

Coefficients of the regression model were also tested for significance using the t test of significance of a regression coefficient. The results are tabulated as follows.

**Table 4.7: Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.637	.253		2.513	.016
	Leverage	.000	.004	-.006	-.064	.949
	Size Ln Total Assets	-.057	.011	-.579	-5.280	.000
	Ownership Concentration	.358	.053	1.088	6.731	.000
	Ownership Type	.309	.033	1.535	9.259	.000

a. Dependent Variable: ROA

The preceding table illustrates the coefficients of the regression model alongside the results of the tests of significance of the correlation coefficients. The intercept of the model is -73.49, which suggests that holding the value of all independent variables in the regression model at zero, the return on equity would be -73.49 %. The t statistic used to test the significance of the intercept has a p-value of 0.0125. At the 0.05 significance level, intercept is significant given that the p-value of the test statistic is substantively lower than the significance level at which the test of hypothesis was carried out.

The coefficient of the debt equity ratio is 6.6959. Thus, for every unit change in the debt equity ratio of the companies under study, the return on equity increased approximately 6.6959 times. The test of significance of this coefficient reveals that the changes in the return on equity that were occasioned by the variation in the debt equity ratio were significant. The test statistic has a probability value of 0.0073. This probability value is substantively lower than the 0.05 significance level at which the hypothesis of significance of the coefficient was tested, implying that capital structure significantly influenced the financial performance of the nonfinancial companies included in the study.

Company size had a coefficient of 5.1425 in the regression model. This indicates that for every unit increase in the natural logarithm of each company's total assets, the return on equity increased by approximately 5.1425 times. The test of significance of a regression coefficient was performed to examine whether the influence of company size on the return on equity was significant. The probability value of the test statistic is 0.0069. Given that the probability value is less than the significance level at which the hypothesis test was performed, company size had a significant influence on the financial performance of the nonfinancial companies included in this study over the study period.

#### **4.6 Discussion of Findings**

From the findings, the regression model describing the relationship between the return on equity, capital structure and company size of the nonfinancial companies over the period 2012-2014 is significant at the 0.05 level. This indicates that the financial performance of these companies was significantly affected by their capital structure and sizes. Also, the coefficients of the regression model were found to be significant, exemplifying the significant influence of the study independent variables on the companies' financial performance. These findings are consistent with theoretical propositions as well as empirical findings.

According to the framework suggested by the trade off and pecking order theories, the capital structure of a company has a profound impact on its financial performance (Fama, 2002; Myers, 1984). Capital structure exerts an influence on firm financial performance through the impact on the cost of capital and the tax implications brought about by a given choice of debt and equity mix. Empirical studies have documented these effects, just as this study has done. Kaumbuthu (2011) established that the return on equity of companies in the industrial and allied sector of the Nairobi Securities Exchange was significantly affected by their debt-equity ratios, suggesting that capital structure had a significant impact on financial performance. Kaumbuthu's (2011) findings were reiterated by Tale (2014) who established the debt equity ratio of nonfinancial firms listed at the NSE over the period 2008-2013 had a significant impact on the firms' return on equity.



## **CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS**

### **5.1 Introduction**

This chapter summarizes the study findings presented in the preceding chapter. Conclusions related to the study objective are also drawn, with recommendations being offered to various stakeholders. The chapter also acknowledges the study's limitations and suggests areas for further research.

### **5.2 Summary**

From the findings, the study variables exhibited moderate and weak positive correlation over the period covered by the study. The debt-equity ratio of all the firms that were under study, as at the end of each financial year that was covered by the study, was moderately and positively correlated with the corresponding return on equity. The correlation between the sizes of the companies under study and their return on equity was also found to be positive and moderate. The correlation between the companies' sizes as measured by their total assets; and their debt equity ratios was found to be weak and positive.

The regression model formulated to describe the relationship between the studied companies' financial performance and their capital structure and size revealed that indeed, a significant relationship exists between the companies' financial performance , size and capital structure over the period covered by the study. Although the study independent variables accounted for a relatively low percentage of the variation in the companies' return on equity over the study period, the results of significance tests of the

regression model suggest that the independent variables exerted a significant impact on financial performance. The study independent variables explained approximately 27.68% of the variation in the companies' return on equity as at the end of each financial year included in the study, and the regression model was found to be significant at the 0.05 level

Tests of significance of the regression model coefficients exemplified the preliminary findings which indicated that the independent variables significantly explained the variation in the companies' return on equity. The coefficients of the debt-equity ratio and the company size had test statistics that were significant at the 0.05 level.

### **5.3 Conclusion**

From the findings, the regression model describing relationship between the debt-equity ratio, company size and the return on equity of the nonfinancial companies included in the study, as at the end of each year covered in the study, is significant. Also, the coefficients were found to be significant, indicating that the independent variables significantly predicted financial performance. Given that the regression model representing the relationship among the study variables is significant, the results suggest that the companies' debt-equity ratio and their sizes significantly affected their financial performance over the study period. On this basis therefore, the capital structure of nonfinancial companies listed at the Nairobi Securities Exchange exerts a significant influence on their financial performance.

#### **5.4 Recommendations**

The findings suggest that the financial performance of the nonfinancial firms listed at the Nairobi Securities Exchange is significantly influenced by their capital structure. Thus, the management of nonfinancial companies listed at the Nairobi Securities Exchange should consider the mix of debt and equity in the financing of assets and operations when setting performance targets. Given that the coefficient of debt equity ratio in the regression model was found to be significant, the use of debt should be tailored towards achieving the maximum possible reduction in the cost of capital so as to enhance financial performance.

Investors interested in the stock of nonfinancial companies listed at the Nairobi Securities Exchange should also factor in the capital structure of the companies when making investment decisions. The findings indicated that for every unit change in the debt-equity ratio, the return on equity increased significantly. The increase was estimated to occur by a multiple of five. Thus, by tailoring their investment decisions to the capital structure of the company whose stock they intend to acquire, investors may enhance the returns to their investments in nonfinancial stocks.

#### **5.5 Study Limitations**

The study aggregated all debt that gave rise to liabilities for all the companies that were included in the study. This could not allow the evaluation of how different types of debt affect financial performance. For instance, corporate bonds, which are debt instruments issued in capital markets, may have different contracts from the debt instruments issued in financial markets, such as commercial banks loans. The differences in the structure underlying debt contracts may give rise to variations in the cost implications, and hence, differences in the effect on financial performance.

The study was only based on a select sample. However, there are many other companies that are not in the sample, which may limit the generalizability of the findings beyond the study context. Also, there are other companies whose stock is publicly issued but not traded at the Nairobi Securities Exchange. An example is those companies whose shares are traded in over the counter stock exchanges. There may be contextual differences that are likely to limit extension of the study's insights beyond the initial domain.

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

Future studies may, in an attempt to consider the effect of all types of debt comprehensively, separate different types of debt based on where they are issued. For example, corporate bonds or capital market issued debt can be separated from commercial bank loans, or debt from financial institutions. The separation can be done by introducing specific types of debt as distinct independent variables. This may allow evaluation of the effects of different types of debt on the financial performance.

This study can also be replicated using a sample of firms that is not limited to those listed at the Nairobi Securities Exchange. The sample can also be drawn by including firms from various geographical contexts within the country and beyond, in the East African region. Incorporating companies from diverse contexts will go a long way in enhancing the degree to which the study findings can be generalized across diverse contexts and settings.

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## **APPENDICES**

### **Appendix I: List of Sugar Companies**

#### **Government-owned sugar manufacturers**

1. Nzoia Sugar Factory
2. South Nyanza Sugar Company
3. Muhoroni Sugar Company
4. Chemelil Sugar Factory
5. Mumias Sugar Company
6. Miwani Sugar Company

#### **Private sugar manufacturers**

1. West Kenya Sugar Company
2. Kibos Sugar and Allied Industries Limited
3. Butali Sugar Mills
4. Transmara Sugar Company
5. Sukari Industries Limited
6. Kwale International Sugar Company Limited
7. Kisii Sugar Factory



**APPENDIX II: DATA COLLECTION SHEET**

**Name of Sugar Company:**

<b>Year</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
Net Profit								
Total Assets								
Percentage of Block Ownership								
Total Debt								
Total Equity								