

**EFFECT OF OWNERSHIP STRUCTURE ON FINANCIAL
PERFORMANCE OF COMMERCIAL BANKS IN KENYA**

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DECLARATION

This research project is my own original work and has never been presented for a degree at any other university 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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I would like to acknowledge my friends, family members, as well as colleagues whose immense support encouraged me to successfully undergo through the academia process.

Furthermore I specifically acknowledge my supervisors, who have given themselves tirelessly to guide me through the research project. Their guidance is indispensable.

DEDICATION

I humbly dedicate this research project to The Almighty God for his sufficient and also to my friends, family members, and colleagues for their motivation as well as assistance in my entire course.

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ABBREVIATIONS

BOI:	Bank of India
CBK:	Central Bank of Kenya
CEO:	Chief Executive Officer
CMA:	Capital Market Authority
KCB:	Kenya Commercial Bank
LTD:	Limited
MM:	Modigliani and Miller
NSE:	Nairobi Securities Exchange
ROA:	Return on Asset
ROE:	Return on Equity
SPSS:	Statistical Package for Social Science

ABSTRACT

Ownership structure leads to agency problems since majority shareholders have incentives and thus monitor actions of the management and influence on decisions. There has been a growing debate on whether ownership structure impacts on management decisions. This study was set out to determine the effect of ownership structure on financial performance of commercial banks in Kenya. The study used correlation and regression analysis to establish existing relationship between ownership structures and ROA. The study was guided by descriptive research design. The study population involved 42 commercial banks that were operational in the study period. Secondary sources of data spanning for a period between 2014 and 2018 were used. Analysis of data was executed using descriptive and inferential statistics: correlation and regression analysis. It was revealed that a negative and statistically insignificant correlation was noted between institutional ownership, state ownership and financial performance. Positive and statistically significant correlation was noted between bank size ($r = .251$, $p = .000$) and financial performance.

Results from regression analysis established that the coefficient of determination was 10.1%, implying that the regression model used was a poor predictor. However, analysis of variance was 0.003; implying that it was statistically significant. Foreign Ownership, Managerial Ownership, Bank Size and Capital Adequacy produced a positive effect on ROA while institutional and state ownership were negatively linked ROA. The study recommends that firms should maintain high levels of managerial ownership. These imply that when managers should have a share plan, the firm will pay huge dividends and minimize monitoring costs. Also, banks should consider increasing the size of their firms in terms of assets as this will help generate higher returns.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Firms have many ways of structuring their ownership with the type of ownership structure adopted being in tandem with the vision of the company. Ownership structure causes agency problems pointing out conflicts that manifest between shareholders and managers, or between minority and majority shareholders. Shareholders and managers have divergent interests. Shareholders, on one hand, wish to maximize value while managers opt for self- interested strategies. This may lead to a compromise on value maximization objective where managers exercise discretion to the detriment of owners (Jensen & Meckling, 1976). Consequently, this study looks at the relationship between concentration ownership, public ownership, domestic ownership, foreign ownership in the financial performance of banks.

This study is anchored on agency theory, stakeholder theory and stewardship theory. Agency theory urges that agency cost would arise in the circumstance where there is a separation between owners and managers of a firm creating conflicting goals between the two parties. (Jensen & Meckling, 1976).Stakeholder's theory maintains that there are other stakeholders/ parties other than the principal whose needs have to be met (Freeman, 1984). Stewardship Theory states that senior management act stewards for the organization and performance in the greatest interests of the principal (Donaldson & Davis, 1991).

Kenya had 43 commercial banks on 31st December 2012, which form the cohort population of this study. During the period under study, three banks were acquired and

three others all foreign owned were put in receivership due to ownership problems and malpractices (Deloitte, 2016). The number of fully functional banks in Kenya had reduced to 39 by the end of the study period on 31st December 2016. In the year 2017, Mayfair Bank and Dubai Islamic Bank were licensed (Central Bank of Kenya, 2017). Nonetheless, banking business in Kenya is robust with large banks controlling 80 percent of the market while small and medium bank share the remaining 20 percent (NSE, 2018).

1.1.1 Ownership Structure.

Ownership structure is described as the nature of majority stakeholders and their influence on management decisions (Rubach, 1999). Ownership concentration is described as allocation of shares that are owned by majority shareholders. Ownership structure can be defined from two perspectives notably the identity and concentration. Ownership concentration denotes shares of the largest owner influenced by monitoring cost and absolute risk determined by the Herfindhal index, which denotes the percentage shareholding. Ownership identity is linked to the principal shareholder or the stake held by insiders (Ang Cole & Lin, 2009). A later view by Mathiesen (2004) argued that ownership structure is the distribution of equity according to voting, according to capital and according to shareholder identity.

Ownership structure is of different types, these include management, family, government, foreign and institutions but institutional and managerial stakeholders hold a higher level of control over the firm's policies compared to other types. Holderness (2009) indicates that ownership structure can be in the form of state where in such a case, the state is entrusted with resources. For instance, when a firm has a direct state ownership, it works towards achieving political objectives of that firm with a limited focus on minority

shareholders. When large portion of ownership is held by large institutions, this is referred as institutional ownership. Foreign ownership occurs when large portion of ownership is held by foreign companies (Naceur et al., 2006).

The overlap in control and ownership should result to decrease in conflicted interests leading into increased firm value. The kind of conflicts that might exist includes conflicts between the shareholders and the managers, lenders and shareholders or among the shareholders. They also indicated that ownership structure can be measured by looking at managerial ownership, institutional ownership, foreign ownership and state ownership concentration. Ownership structure was measured by the percentage of shares held.

1.1.2 Financial Performance

Financial performance refers to how a firm uses its available resources in the generation of revenues (Leah, 2008). The survival of a business is reliant on its financials in the long-term. This is possible where the business has the ability to produce adequate returns from its activities as this is the principle objective of the firm. According to Ponce (2011) financial performance refers to the degree of accomplishment of the financial objectives. It involves gauging in monetary terms, the outcome of the actions and activities of a corporation to ascertain the financial well-being during a stated period. The performance of the company can be determined using the financial statement reported by the company. Financial statements provide important information which is a summary of all the activities of a firm.

The major objective of the firm is to increase the value of the shareholders. In this doing, the firm is able to generate adequate cash flows to finance its operations and pay off its

expenses as well as make favorable amounts of profits. The firm's performance is often used as a basis to determine the efficiency of its management and how effectively the assets of the firm are being utilized. There are various measurements used to check the financial performance of the firm. They include ROA, ROE, ROI, EPS, OP, ROCE, Tobin Q and DY among others. Mashayekhi and Bazazb, (2008) argue that Accounting based measurements are highly favored compared to the Market ones when investigating the association between CG and firm accomplishment as they present management actions outcome. However it is important to integrate both measurements to get a better view of the firm. This is because most accounting measurements like ROE determine short-term performance while the market measurements e.g. Tobin's Q depict future long-term growth and development. This study used ROA as a measure growth or changes in revenues.

1.1.3 Ownership structure and Financial Performance

Theoretically, Agency theory argues that board ownership structure, concentrated type is observed to reduce the agency problems as shareholder get involved in monitoring of managers, ensuring they do not get involved in hazardous activities and instead focusing on maximizing shareholders' wealth hence increased financial performance (Jensen & Meckling, 1976). This view is supported by stakeholder's theory which states that decisions arrived by managers should factor in interests of all the stakeholders in the firm. How a firm treats these groups and individuals comprising of the stakeholder's impacts either positively or negatively to its financial performance (Freeman, 1984).

Empirically various scholars have also found conflicting result linking performance and ownership structure. Thomsen and Pedersen (2000) viewed that a positive association

between ownership structure and profitability exists. 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. Further, Dyck & Zingales (2004) who conducted an international study on how ownership structure affected financial performance established a negative relationship.

However, Demsetz and Lehn (1985) investigated the impact of ownership concentration on firm performance and they established lack of relationship. Avulamusi (2013) did an examination on the link between ROA and commercial banks' structure of ownership and established affirmative nexus between foreign ownership and ROA. Mutisya (2015) did an exploration on effect that ownership structure had on ROA of listed firms and an insignificant relationship was found to exist amid ownership structure and financial performance.

1.1.4 Commercial Banks in Kenya

Central Bank of Kenya (CBK) is the regulator of commercial banks. The licensing and operation of commercial banks is done by CBK. In exercising its power as the regulator,. According to CBK's directory, there are forty-two banks in Kenya some of that are internationally based. The headquarters of these banks are in Nairobi and they serve both retail and corporate customers. Out of the forty two licensed banks in Kenya, the 11 listed banks on the security exchange. Out of the 42 commercial banks, the government of Kenya holds controlling stakes in 3 commercial banks while the other 39 are privately owned. Of the 39 privately owned, 24 banks are locally owned while 15 are foreign owned (CBK, 2017).

A majority of quoted firms at the NSE have various structures of ownership. Some major means of ownership structures include; managerial, state, domestic individual, foreign and institutional ownership that affects the financial performance of the firms either positively or negatively. The banking industry is a very crucial industry in every economy particularly in developing economies like Kenya. This is because, in most economies and for a majority of the firms, banks are the important sources of finance and they provide generally accepted means of payments. Other main functions of commercial banks, which are crucial to any economy, are accepting deposits since they are the main depository for the economy savings, issuing loans and discounting bills.

The CBK Prudential Guidelines (2013) require that every bank in Kenya must have a minimum core capital of Ksh 1 billion by 31st December 2012 (CBK, 2017). This has affected some banks especially the small banks which have been forced to seek other forms of financing in order to raise this minimum requirement. As a result, the capital structure and leverage levels of these banking institutions are affected. Use of debt to meet capital requirements raises the gearing level. Excessive debt results to financial distress costs which reduces profitability. Larger banks with a bigger asset base meet the capital requirements easily without having to increase their debt level (CBK, 2017).

1.2 Research Problem

Ownership structure impacts on agency problems. This is because major shareholders possess a higher incentive in monitoring the actions of the management thereby influencing financial decisions made by the firm (Lee, 2008). Agency theory argues that board ownership structure, concentrated type is observed to reduce the agency problems as shareholder get involved in monitoring of managers, ensuring they do not get involved

in hazardous activities and instead focusing on maximizing shareholders' wealth hence increased financial performance (Jensen & Meckling, 1976).

Majority of bank institutions including banks in Kenya are struggling a lot to execute local obligations let alone to apply ownership structure due to their limited capability. Therefore mechanisms including managerial ownership structure have been adopted to enhance the performance of these institutions. However, banks do not always experience good performance when this mechanism is implemented. This is evident with the ongoing financial crisis facing National bank of Kenya which is state owned. On the other hand managerial owned banks like KCB bank, Equity bank and Cooperative bank tend to perform better compared to foreign owned banks such as; Dubai bank and BOI. Other foreign banks including Imperial, Chasebank are being placed underreceivership by the CBK (CBK, 2018).

Globally, Pradhan and Khadka (2017) revealed there is a positive association of bank size, interest coverage and short-term debt on bank profitability as long-term debts showed a negative relationship on profitability. Phuong (2013) discovered foreign ownership was negatively linked to leverage and state ownership attained a positive impact. Further, leverage was found to be significantly and inversely linked to performance. Baugatef and Mgadmi (2016) concluded that prudential guidelines significantly affected banks performance. Al-Hawary (2011) established that percentage of nonexecutive directors and CEO duality significantly positively has impact on the revenue maximization; while proportion of financing had a strong and inverse impact on resource utilization.

Locally, Oketch (2017) found that the structure of ownership, ownership concentration and firm size negatively affect financial performance among firms listed in the Nairobi Securities Exchange and that institutional ownership positively affects ROA among firms quoted in the NSE. Ngotho (2018) found institutional ownership was negatively and significantly linked to long-term debt. Ownership structures (managerial, foreign and state) were negatively and insignificantly linked to long-term debt. Mudi (2017) found individual ownership of a firm has a positive and relationship that is significant with the ROA, the size of the firm does not have a significant relationship with the ROA of the firms while firm age in years has a positive and significant relationship with the ROA of the firms. Ndiba (2016) study outcomes indicated the performance financially of the firms was significantly affected by their ownership structures and sizes. Njiru (2016) outcomes indicated that ownership structure does not statistically contribute to financial performance hence the study recommended that both the largest shareholders and foreign owners should use their strength to influence decision making in firms to control agency for improved financial performance.

The lack of consensus among the various scholars is reason enough to conduct further examination on the area of study. Local studies also indicated conflicting findings and they looked at other sectors at NSE hence cannot be compared to banking sector. They are also quite few to give conclusive result and therefore, the need of more research in this area. This paper seeks to identify how ownership structure influences financial performance of commercial banks in Kenya. The research question is what is the effect of ownership structure on financial performance of commercial banks in Kenya?

1.3 Research Objectives

The objective was to determine the effect of ownership structure on financial performance of commercial banks in Kenya

1.4 Value of the Study

The empirical results benefits policy makers such as CMA, they might utilize the finding in setting policies that enable listed firms to have a balance between control and ownership to improve firm performance by reducing monitoring costs. Firms are also informed about the risk taking incentives by the management and how this can be mitigated by the nature of a firm's ownership.

Researchers and academic community benefits from the outcome of this research as a reference for further studies and as a basis for discussion on quoted organizations' in the Nairobi Securities Exchange. It also documents and makes available literature used by other scholars and researchers in assessing whether the findings are consistent with those in developing markets or not thus proving ground for further research.

The ordinary investors may find this study useful in formulating, selecting and implementing investment decisions despite of the market inefficiencies and anomalies. Government institutions may make use of the findings of this study on how various ownership structures affect other sectors of the economy and thus inform regulatory frameworks.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This part reviews the relevant literature associated with ownership structure effect and ROA. It explains the theoretical literature review and the determinants of firm value. Empirical literature from global and local studies, conceptual framework and summary based on the review is also discussed.

2.2 Theoretical Review

This section explains the CG theories that supporting this study. This study is anchored on agency theory, stakeholder theory and stewardship theory.

2.2.1 Agency Theory

This theory was established by Jensen and Meckling in (1976). The theory discusses agency relationship where a principal hires an agent to carry out services on his behalf. Managers in a firm are agents of shareholders who are guided by the principle of maximizing the shareholder wealth. However, there are several factors that affect the relationship. First, is the conflict of interest between the principals, the existence of information asymmetry amongst the principal and agency cost would arise in the circumstance where there is a separation between owners and managers of a firm creating conflicting goals between the two parties. (Jensen, 1986).

Jensen (1986) compared management behavior observed in 2 different structures of firms, where the manager owns 100% of the firm while the other is that which the manager sells equity shares to outsiders respectively. As the manager's stake decreases, his incentive to explore new profitable opportunities consequently falls. Managers of

state owned firms and private entities are assumed to exercise bias by maximizing their individual interest over that of shareholders. In listed companies, the discrepancy is lowered via intervention of mechanisms that are external like corporate controls and mechanisms that are internal like participation of the management in reward systems ownership and the BOD role. This theory brings out an understanding of the relationship between ownership concentration, managerial ownership and performance (Jensen & Meckling, 1976).

2.2.2 Stakeholders Theory

Stakeholder Theory proponents argue that managers in firms have a web of groups they are serving. The stakeholders are a group of people that influences the business and are in turn influenced by business activities. The groups have interest in the business that they need satisfied by the business. The groups may include the owners, the customers, suppliers, government and local society (Harrison & Freeman, 1999). Study by the Sundaram & Inkpen (2004) noted that stakeholder theory enables a manager to evaluate different stakeholders to establish the interests of the stakeholders in the business and identify the stakeholders that are critical to the performance and long-term survival of the firm (Donaldson & Preston, 1995).

Freeman (1984) argues that stakeholder theory plays a key role in establishing a framework for examining the influence of stakeholder management on the accomplishment of corporate goals. This view is supported by Blair (1995) where he states that decisions arrived by managers should factor in interests of all the stakeholders in the firm. Jensen (2001) while critiquing Freeman's theory came up with the 'Enlightened value maximization stakeholder theory'. In his theory, he advances that a

firm would find it impossible to maximize value if it looks down upon any stakeholder group. How a firm treats these groups and individuals comprising of the stakeholder's impacts either positively or negatively to its financial performance.

2.2.3 Stewardship Theory

Stewardship theory was developed by Davis & Donaldson (1997). This theory aims at reducing the heights of conflict between shareholders and managers as suggested by agency theory. Donaldson and Davis (1991) argued that a highly ranked representative of a firm would want to perform a task and provide good stewardship of the firm's assets. They also recommend that for better performance, a larger part of inside directors is ideal. For competence in decision making this theory proposes the position CEO and boards chairman be filled by one individual. Davis, Schoorman and Donaldson (1997) viewed stewardship relationship when management is not determined by own benefits but motivated by achieving the company's proposed objectives.

The theory's relevance to the research is evident because it advocates for top management role as stewards therefore, integrating these roles with the organization goals. The theory also highlights importance of ownership structures within the organization because they empower stewards and enable them execute maximum control thereby reducing monitoring costs. Stewards are worried of their reputation and therefore, they work in a manner that maximizes the firm's financial performance to ensure their reputation is not tainted. They are the organization decision makers and they try as much as possible to be effective in order to keep their careers safe (Fama, 1980).

2.3 Determinants of Financial Performance

A firms' financial performance could be affected by different variables and may be viewed from factors related to the firm internal and external determinants from diverse visions and in different ways. This research study will focus on firms' specific determinants exploit variables such as ownership, bank size and Capital Adequacy.

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 (Jensen & Meckling, 1976). 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 performance of firms 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 Bank Size

The size of the banks can potentially affect financial performance. This is because large banks can invest more and earn more income than the smaller banks. According to Khrawish (2011) banks performance is affected by the bank size, calculated as a ratio of total assets over total liabilities, exchange rates margin and net interest margin. The author noted that in Jordan, banks that had more assets had better performance since they could generate income from the assets as opposed to those banks whose income was

interest income from loans. It was also noted that both external and internal factors affect performance of banks. Hence, banks need to critically make proper decisions and within the law in order to enhance their performance.

Onuonga (2014) notes that bank size can be an indication of the ability of the banks to venture. Therefore, ownership of assets is crucial since assets are those resources that earn income. In this respect, theoretically banks with more assets are expected to exhibit higher financial performance. In addition, a large bank is capable of operating efficiently; this is attributed by economies of scale. Large banks also have capacity to recruit experienced management who can be helpful in making investment decisions thus enhancing financial performance of firms. More importantly the size of the bank may determine the capacity of banks to grant loans thus affecting interest income (Khrawish, 2010).

2.3.3 Liquidity

Liquidity is an important aspect of regulations of financial institutions. This is because liquidity ensures that depositors can access their money when they need to. However, liquid assets rarely earn high incomes. For this reason, this a critical decision that managers of banks must make. Ilhomovich (2009) maintains that liquidity is critical because when banks cannot meet customer calls when needed. Therefore, it is imperative that the decision is made critically with respect to regulation requirements. There has not been a consensus about the liquidity levels. However, holding too much liquidity may compromise investments. The CBK (2013) indicates that when the liquidity requirement affects performance of banks and the industry at whole. Perhaps, this is because the financial sectors run on public trust and where such is compromised, the stability of the

sector is at stake (Bashar & Islam, 2014).The CBK (2013) indicates that the minimum liquidity to be held should be at 20 %. Obamuyi (2013) views that liquidity of a bank fosters public trust and thus can potentially enhance performance.

2.3.4 Capital Adequacy

Banks have several stakeholders whose interests should be protected in order to ensure stability for the individual and the sector at large. To this end, banks should have adequate capital to act as cushion in terms of financial distress. The need to adhere to capital regulation is to ensure that customers are attended without cause of panic when there is turbulence in the financial sector. Banks are supposed to have minimum capital before they are issued with license and should be renewed every year (CBK, 2013).

Sharma and Gounder (2012) also echo this idea that capital may be utilized in projects that are not highly profitability depending on the risk appetite of the management. It is true to suffice that a firm can have less capital but channel it too risky but profitable ventures and this would result into a high Return on Assets. Thus it can be noted that in the event that capital is expensed into economically feasible project, it can enhance performance of banks. Saira et al (2011) established that capital ownership has no effect on performance of banks in the United States. The reason being that capital only translates to income when the right economic decisions are made by the management.

2.4 Empirical Review

Empirical literature from both international and local context shows relationship existence between form of ownership and ROA. However, these studies' findings are inconsistent because they have mixed results.

2.4.1 Global Studies

Pradhan and Khadka (2017) researched the effect of debt financing on financial performance of banks in Nepal. Population under study was twenty two commercial banks. The study used a descriptive design for research. Analysis of data was by using multiple regression models where relationship of independent variables (interest coverage, bank size, long and short term debt and total debt) and dependent variables (ROE and ROA) was shown. The results revealed a positive association of bank size, interest coverage and short-term debt on bank profitability as long-term debts showed a negative relationship on profitability. This study creates a conceptual knowledge gap because it was done on debt financing and ROA therefore the need of the current study.

Baugatef and Mgadmi (2016) analysed the effect of prudential regulations on banks' share capital ownership and risk appetite, the case of Middle East and North Africa countries. The study adopted a panel data analysis using descriptive statistics where 24 banks were considered for data collection. Data collection was for a period of eight years from year 2004 to 2012. It was concluded that prudential guidelines significantly affected banks performance.

Phuong (2013) investigated the linkage between foreign shareholding, state ownership structure of capital and firm performance of Vietnamese listed firms. An exploratory study design was applied with the help of unbalanced panel data drawn from all non-financial firms covering a period of 6 years (2007-2012). A pooled OLS and fixed-effect regression method were utilized. It was discovered foreign ownership was negatively linked to leverage and state ownership attained a positive impact. Further, leverage was

found to be significantly and inversely linked to performance. This study was done in a global setting which is different from the local setting.

Al-Hawary (2011) investigated Jordanian commercial banks to establish how performance was influenced by governance mechanisms including board size, ration of board members not involved in management, CEO duality, sufficiency in capital, proportion of high number of shares owned. This study tested the effect of governance and established that percentage of nonexecutive directors and CEO duality significantly positively have impact on the revenue maximization; while proportion of financing had a strong and inverse impact on resource utilization. The study was recognized as effective determinants on banking performance.

2.4.2 Local Studies

Oketch (2017) conducted a research on ownership structure effect on ROA of firms quoted at the NSE for the period 2012-2016. The study population was 64 quoted companies at the NSE with secondary data being obtained for form the company's annual reports. The study outcomes showed existence of a link that is significant between financial performance and ownership structure of the quoted companies. The study recommended that there was need for firms quoted at the NSE to have effective ownership structures by re-examining the criteria used in directors selection and ensure independences of corporate boards, diversification in gender, age, ethnic grouping and board size thus reducing poor performance and boost investor confidence. The study exhibits a contextual gap because it focused on listed firms but this study will specifically look into commercialized banks in Kenya.

Ngotho (2018) conducted research on effects of ownership structure on financial leverage of non-financial companies quoted at the NSE. The population for the research involved 50 quoted non-financial firms for the period 2012-2016 with secondary data being taken from CMA annual reports and analyzed using descriptive design. The research concluded that the firm size and profitability of quoted non-financial firms increased rapidly during the period of study hence leading to overall performance of the firms with ownership structures (institutional and foreign, state and managerial) recording slow growth. The study recommended that managerial ownership should serve a mechanism to reduce agency cost and improve firm value this is because management decisions impact on investor choice of investment. This research has a conceptual gap as it explored effects of ownership structure on financial leverage but this research will explore on effect of ownership structures on financial performance.

Mudi ((2017) conducted a research on structures of ownership and financial performance of firms listed at the NSE using descriptive survey and longitudinal research design. The population of the study involved all firms at the NSE for the period 2011-2016, with the sample of 52 firms. Data in secondary form was obtained from annual financial reports, CMA handbook, and NSE database and company prospectus. The study concluded that ownership structure has relationship that is significant with financial performance. Further the study recommended that policy makers should ensure that firms not only grow in age terms but also in size terms and ensure that there is balance between managerial and individual ownership. This study has a contextual gap as it focused firms on firms listed at the NSE but this research will specifically look into commercial banks in Kenya.

Ndiba (2016) conducted research on effect of ownership structure on financial performance of sugar manufacturing firms in Kenya. The population of research was 13 sugar companies locally (Kenya). Secondary data was obtained from document analysis of consolidated financial reports for the year 2008-2015. With a descriptive design for research being used for analysis. The study outcomes revealed that ROA of companies was significantly affected by their ownership structures and sizes. The research recommended that the management of non-financial companies quoted at NSE should consider a mixing equity and debt in financing of assets and operations when setting performance targets. The study presents a contextual gap because it concentrated on sugar manufacturing firms only but this study will look into listed commercial banks only

Njiru (2016) conducted research on linking the ownership structure and performance of listed firms in the manufacturing and allied sector of the NSE. The population for the study was 10 firms quoted in the manufacturing and allied segment over the period 2011-2015. Data in secondary form was obtained from NSE and companies published reports and a panel study was conducted for the firms. The research outcomes indicated that ownership structure does not statistically contribute to financial performance hence the study recommended that both the largest shareholders and foreign owners should use their strength to influence decision making in firms to control agency for improved performance financially. The study exhibits a contextual gap as it looked at ownership structure effect on financial performance of listed firms in the manufacturing sector out this research shall concentrate specifically on commercial banks.

2.5 Conceptual Framework

This is a framework that gives a road map of the researcher's conception of how

different variables in the study interact with each other. In this study the predictor variables are ownership structures while the response variable is ROA.

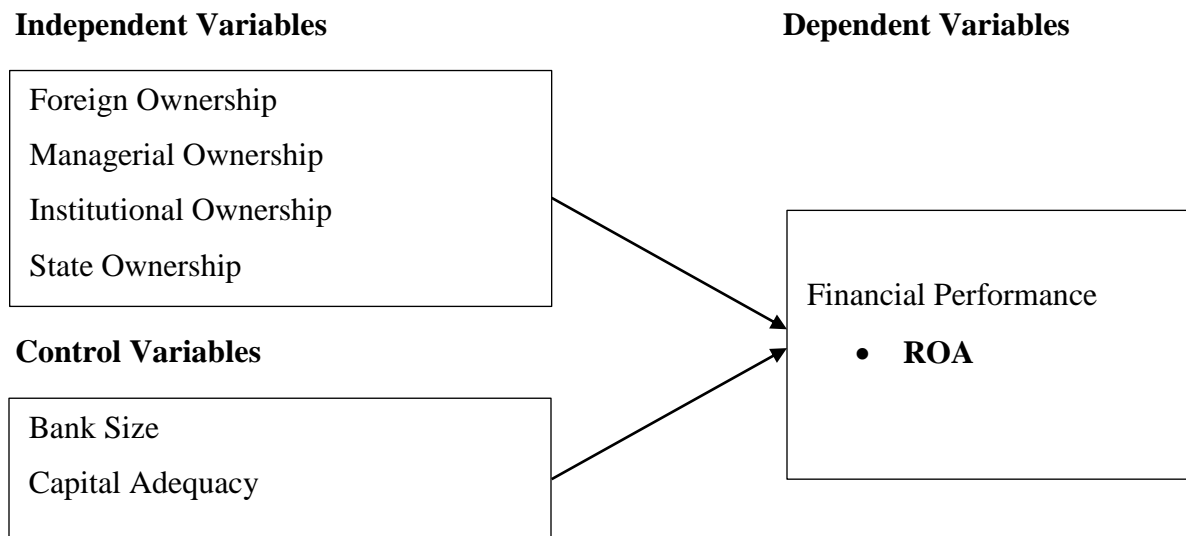


Figure 2.1: Conceptual Framework

Source: Research, 2019

2.6 Summary of Literature Review

Despite the empirical and theoretical studies that have looked at the ownership structure and financial performance, it is still not clear on existing link between the two variables. The ownership structure concept has been explained by several theories such as; agency theory, stewardship theory and stakeholders' theory. Main firm value determinants have also been explained in this chapter. In addition, findings from various empirical studies have been deliberated on in this chapter.

From empirical literature, there is no consensus among scholars with regards to the relationship that is between financial leverage and firm value. This lack of consensus is sufficient reason to carry out research further in the area. In their study, Phuong (2013) discovered foreign ownership was negatively linked to leverage and state ownership

attained a positive impact. Further, leverage was found to be significantly and inversely linked to performance. Also, Ngotho (2018) found institutional ownership was negatively and significantly linked to long-term debt. Ownership structures (managerial, foreign and state) were negatively and insignificantly linked to long-term debt. This is inconsistent with research conducted by Mudi (2017) found individual ownership of firms had positive and significant relationship with the ROA. However none of the local studies has looked into the link existing in ownership structures and financial performance in the banking sector. This limits these empirical studies because it is difficult to make a final conclusion on the relationship between variables.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This section outlines the research methods, population under study, sample survey that used in the study, data collection methods that were used and data analysis methods.

3.2 Research Design

Descriptive design was applied in the research. Kothari (2005) maintains that a descriptive design is relevant in enabling the researcher to identify the relationship between variables that included ownership structures and financial performance. Also, this form of design was useful when the researcher is seeking to find out hypothetical relationships between variables.

3.3 Population

The study focused on commercial banks in Kenya. According to CBK Annual Report 2018 there are 42 commercial banks as illustrated in Appendix 1. The census technique was applied in the study since all the 42 firms making up the sample size. A census technique is that system where all the elements of the population participate in the study. The advantage of census technique is that it improves the extent of accuracy and reliability (Mugenda, 2003).

3.4 Data Collection

Data collection methods refer to the systematic procedures applied by a researcher to gather and collect data for use in the study (Zikmund, et al., 2011). The study used secondary data collected from the yearly published financial statements and annual

reports of the firms for a period of 6 years (2013-2018). Data collected include: Net Profit, Total Asset, Percentage of Block Ownership, managerial equity, Percentage of shares held by institutional investors, Percentage of shares held by controlling shareholders and proportion of common shares held by state.

3.5 Diagnostic Tests

Various diagnostic tests such as the tests of normality, autocorrelation and multicollinearity tests were carried out. Normality test is done because it is impractical to achieve accurate and reliable deductions about the reality on whether the study population derived is normally distributed. This study used graphical histogram (Ghasemi & Zahediasl, 2012). To ensure the data collected is free from biasness and one variable data is not related to another variable data, the study conducted a multicollinearity test. Multicollinearity is detected when two variables have same linear relation. The variance of Inflation was used to test multicollinearity (Cohen, West & Aiken, 2013). Autocorrelation is tested to detect any similarity between time series at given a time interval which is carried out using Durbin-Watson. This test depicts a test statistic with a value of 0 to 4 where 2 no autocorrelation exists, where the statistic is less than two a positive autocorrelation exists and where greater than two, negative autocorrelation exists (Khan, 2012).

3.6 Data Analysis

This is a systematic process that applies statistics techniques to evaluate data through inspecting, changing and modeling data to derive fundamental information for sound decision making. The study used SPSS version 20 for data analysis. The study relied on

various regression techniques in evaluating the correlation between the selected variables. The analysis also involved figuring out of the various coefficients of correlation in the model for establishing the connection.

The regression model applied in analyzing the interrelation of the predictor variables on the response variable was:

$$Y_i = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon$$

Where;

α = constant

Y_i = Financial Performance; measured by ROA (Net Income/ Total Assets)

X_1 = Foreign Ownership; measured as a proportion of common shares held by foreign investors divided by cumulative shares in issue

X_3 = Managerial Ownership; measured as a proportion of common shares held by management divided by cumulative shares in issue

X_4 = Institutional Ownership; measured as a proportion of common shares held by large institutions divided by cumulative shares in issue

X_5 = State Ownership; measured as a proportion of common shares held by state investors divided by cumulative shares in issue

X_6 = Size of the firm; measured as a Log of total assets.

X_7 = Capital Adequacy (measured by Total Capital/Total Assets ratio)

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ = co-efficient of the model

ϵ = the stochastic error term

3.6.1 Test of Significance

The fitness of the model was measured through F and T tests. The F test check on significance of the regression equation while T test will check on variables significance.

CHAPTER FOUR

ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

This section represents the analysis, findings and interpretations of the secondary data extracted from the audited financial statements and annual reports of commercial banks in Kenya. The study period was five years (2014-2018). The researcher managed to get data from 39 out of 42 banks and it was considered an adequate representation of the target population.

4.2 Diagnostic Test Results

The pre-estimation tests carried out on the variables and the model revealed absence of autocorrelation and multi-collinearity among the variables while the model was found to be consistent and a good measure of the estimates. The diagnostic tests that were carried out include the Durbin-Watson test for autocorrelation, graphical histogram for normality and test for multi-collineality specified as follows:

4.2.1 Autocorrelation

Table 4.1: Test for Autocorrelation

Model	Durbin-Watson
1	1.953

Source: Research Findings (2019)

The result above suggest that there does not exist any form of autocorrelation since the test results (1.953) falls between 1.5 and 2.5 which is the accepted threshold for autocorrelation.

4.2.2 Normality Test

Test for normality was done on the data collected to establish whether it was collected from a normally distributed population.

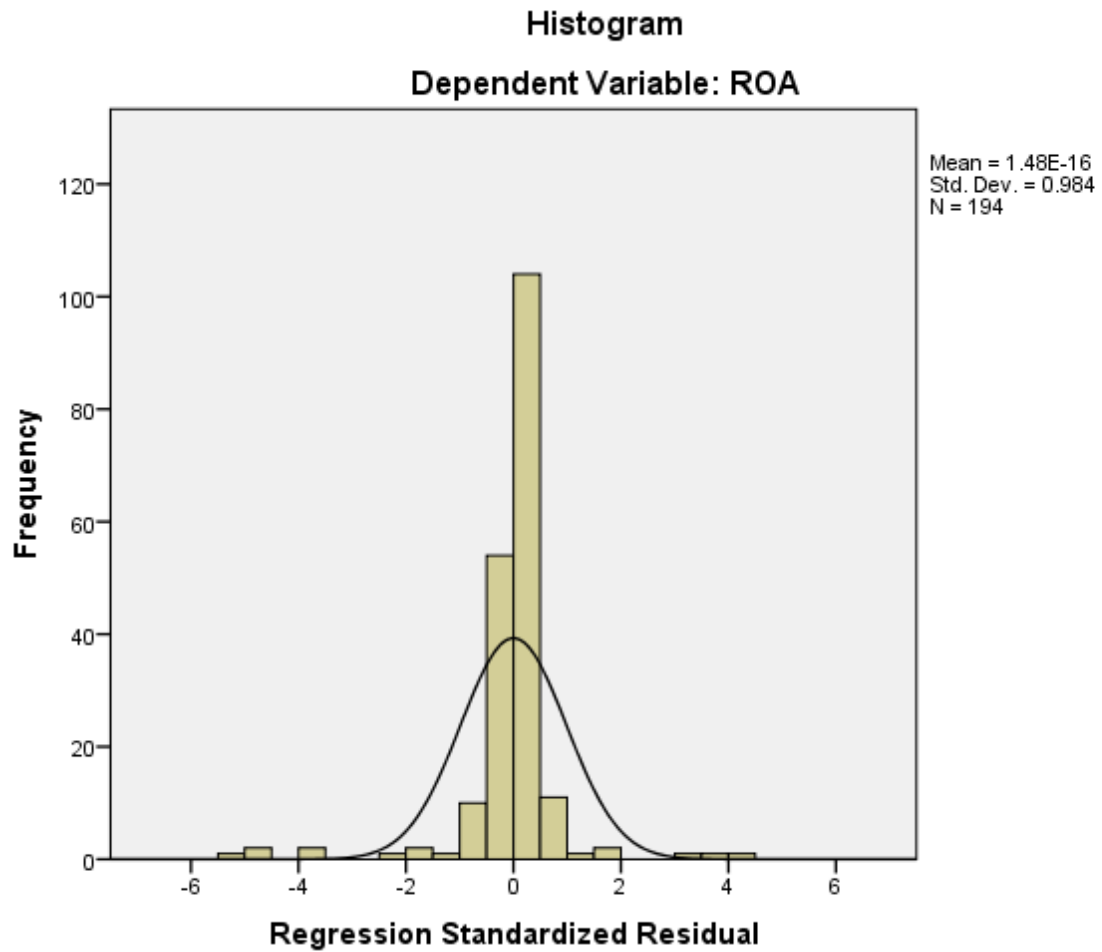


Figure 4.1: Histogram

Source: Research Findings (2019)

The graphical method (histogram) was used to test for normality. This ensured the variables used in the analysis were distributed normally as seen above.

4.2.3 Multicollinearity Test

Table 4.2: Test for Multicollinearity

Coefficients^a			
Model		Collinearity Statistics	
		Tolerance	VIF
1	Foreign Ownership	.543	1.842
	Managerial Ownership	.863	1.159
	Institutional Ownership	.486	2.059
	State Ownership	.593	1.687
	Bank Size	.935	1.069
	Capital Adequacy	.901	1.110

Source: Research Findings (2019)

As shown on the table all variables have a variance inflation factor which is less than 10 and above 1. This implies that the model does not have a problem of multicollinearity and therefore the model fits as a good measure of estimates.

4.3 Descriptive Analysis

Descriptive statistics was employed in converting the raw data into a manner by which it can be easily comprehended and explained. In order to perform the data analysis, means and frequencies were utilized. These assisted in deriving conclusions and generalizations pertaining to the population.

Table 4 3: Descriptive Statistics

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
ROA	195	-.2445	.2346	.008398	.0492528
Foreign Ownership	195	.0000	.9999	.273597	.3282750
Managerial Ownership	195	.0000	.4120	.048459	.0903410
Institutional Ownership	194	.0000	1.0000	.506905	.4038821
State Ownership	195	.0000	.8930	.063687	.2197556
Bank Size	195	4.0254	20.3868	17.245050	2.3072789
Capital Adequacy	195	-.2201	1.9617	.240842	.2041837
Valid N (listwise)	194				

Source: Research Findings (2019).

A summary on mean and standard deviation is given on all the variables used in the study. The mean shows the average on distribution of data for each respective variable while the standard deviation of each of the variable was calculated to measure the variability.

4.4 Correlation Analysis

Correlation analysis avails one with information on whether an association exists between two variables, the direction of that association and consequently the magnitude of the connection. Correlation coefficient values fluctuating between -1 and 1 gauges the extent the two variables are linearly linked. Consequently, greater magnitude denotes a higher extent of connection between two variables.

Table 4.4: Correlation Analysis

		Correlations						
		Y	X1	X2	X3	X4	X5	X6
ROA	Pearson Correlation	1	.154*	.058	-.171*	-.078	.251**	.069
	Sig. (2-tailed)		.031	.421	.017	.278	.000	.341
Foreign Ownership	Pearson Correlation	.154*	1	-.002	-.476**	-.243**	.029	.272**
	Sig. (2-tailed)	.031		.979	.000	.001	.689	.000
Managerial Ownership	Pearson Correlation	.058	-.002	1	-.172*	-.151*	-.026	-.031
	Sig. (2-tailed)	.421	.979		.017	.035	.722	.670
Institutional Ownership	Pearson Correlation	-.171*	-.476**	-.172*	1	-.327**	-.104	-.099
	Sig. (2-tailed)	.017	.000	.017		.000	.149	.169
State Ownership	Pearson Correlation	-.078	-.243**	-.151*	-.327**	1	-.095	-.152*
	Sig. (2-tailed)	.278	.001	.035	.000		.188	.033
Bank Size	Pearson Correlation	.251**	.029	-.026	-.104	-.095	1	-.092
	Sig. (2-tailed)	.000	.689	.722	.149	.188		.200
Capital Adequacy	Pearson Correlation	.069	.272**	-.031	-.099	-.152*	-.092	1
	Sig. (2-tailed)	.341	.000	.670	.169	.033	.200	

Source: Research Findings (2019)

The researchers established a negative and statistically insignificant correlation between institutional ownership, state ownership and financial performance. Positive and statistically significant correlation was noted between bank size ($r = .251$, $p = .000$) and financial performance. Positive and insignificant correlation was noted between foreign ownership, managerial ownership, capital adequacy and ROA.

4.5 Regression Analysis

This gives an explanation of the intensity of fluctuations of the response variable as explained by fluctuations in the predictor variables. It is the proportion of variation of the dependent variable (ROA) as rationalized by changes in the predictor variables (foreign ownership, managerial ownership, institutional ownership, state ownership, bank size and capital adequacy).

4.5.1 Model Summary

Table 4 5: Model Summary

Model	R	R Square	Adjusted RSquare	Std. Error of the Estimate
1	.319 ^a	.101	.073	.0475518

Source: Research Findings (2019)

Coefficient of relationship on independent factors against dependent variable is shown on the table above. The results show a moderate association between exist response variable (ROA) and the predictor variables as indicated by R value of 0.319. R square value of 0.101 indicate that 10.1% of variation in financial performance of commercial banks in Kenya can be explained or predicted by (foreign, managelial, state and institutional ownership, state ownership, bank size and capital adequacy). This implied that additional factors not examined in this study contributed 89.9% of commercial banks financial performance.

4.5.2 Analysis of Variance

Table 4 6: Analysis of Variance (ANOVA)

ANOVA ^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.048	6	.008	3.520	.003 ^b
	Residual	.423	187	.002		
	Total	.471	193			

F Critical Value = 2.242

Source: Research Findings (2019)

F computed was 3.520 and a P-value < 0.05, this translates a significant level between the variables. This indicates the model was significant in predicting independent and the dependent variables. The researcher used t-test to determine the significance of each individual variable used in this study as a predictor of ROA amongst banks in Kenya. The calculated F-value of the dependent variable was greater than the critical value (3.520 > 2.242). This is an indication that ownership structure has a significantly influences the ROA.

4.5.3 Model Coefficients

The researchers further computed co-efficients to assess the direction of the association between variables. The co-efficients are shown below.

Table 4.7: Coefficients

Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.074	.031		-2.365	.019
	Foreign Ownership	.007	.014	.048	.513	.608
	Managerial Ownership	.018	.041	.033	.445	.657

	Institutional Ownership	-.017	.012	-.138	-1.384	.168
	State Ownership	-.017	.020	-.076	-.848	.398
	Bank Size	.005	.002	.234	3.269	.001
	Capital Adequacy	.013	.018	.053	.719	.473

Source: Research Findings (2019).

The results indicated that Foreign Ownership ($t = .513$, $p = 0.608$), Managerial Ownership ($t = .445$, $p = 0.657$), Bank Size ($t = 3.269$, $p = 0.001$) and Capital Adequacy ($t = .719$, $p = 0.473$) produced a positive effect on ROA of commercial banks in Kenya. However, only the effect of bank size was found to be statistically significant. Institutional Ownership ($t = -1.384$, $p = 0.168$) and State Ownership ($t = -.848$, $p = 0.398$) produced a negative statistically insignificant effect on ROA. The equation for the regression model is estimated as follows:

$$Y = -0.074 + 0.007X_1 + 0.018X_2 - 0.017X_3 - 0.017X_4 + 0.005X_5 + 0.013X_6$$

Where;

Y_i = Financial Performance (ROA)

X_1 = Foreign Ownership

X_2 = Managerial Ownership

X_3 = Institutional Ownership

X_4 = State Ownership

X_5 = Bank Size

X_6 = Capital Adequacy

The Constant estimated in the analytical model above indicates that if selected response variables (foreign ownership, managerial ownership, institutional ownership, state ownership, bank size and capital adequacy) were rated zero, the ROA of commercial banks in Kenya would be -0.074. A unit increase bank size would enhance financial performance by 0.005. The other variables have no statistical significant influence on ROA.

4.6 Discussion of Research Findings

The study sought how ROA among commercial banks in Kenya was influenced by ownership structure. Financial performance was measured using ROA where data was sorted from audited financial statements. Ownership structure was measured through (foreign managerial, state and institutional ownership) ratios, where data on each was sorted from annual reports.

The results revealed a negative and statistically insignificant correlation was noted between ownership by institutions, ownership by states and financial performance. Positive and statistically significant correlation was noted between bank size ($r = .251$, $p = .000$) and financial performance. Positive and insignificant correlation was noted between foreign ownership, managerial ownership, capital adequacy and ROA. This means that banks should put more focus on their assets because they significantly affect the overall performance.

The findings agree with Pradhan and Khadka (2017) who revealed a positive association of bank size on bank profitability. Ngotho (2018) concluded that the firm size and

profitability of quoted non-financial firms. Ndiba (2016) revealed that the company's performance was significantly affected by their ownership structures and sizes.

The finding contradicts Phuong (2013) who discovered that foreign ownership was negatively linked to performance and state ownership attained a positive impact. Njiru (2016) indicated that ownership structure does not statistically contribute to financial performance

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This section summarizes the previous chapter's findings, gives conclusion and study limitations. The section also provides the policy recommendations that policy makers can implement to achieve the competitiveness. Suggestions on areas of further studies have also been discussed.

5.2 Summary of Findings

The correlation analysis shows inverse and statistically insignificant correlation between ownership of institutional, state ownership and financial performance. Positive and statistically significant correlation was noted between bank size ($r = .251$, $p = .000$) and financial performance. Positive and insignificant correlation was noted between foreign ownership, managerial ownership, capital adequacy and ROA.

The model summary shows a moderate association between exist response variable (ROA) and the predictor variables as indicated by R value of 0.319. R square value of 0.101 indicate that 10.1% of variation in ROA can be explained or predicted chosen variables. This implied that additional factors not examined in this study contributed 89.9% of commercial banks financial performance. The regression analysis demonstrated was measurably critical and subsequently reasonable in clarifying how the financial performance was influenced by the chose predictor factors at 95% confidence level.

From the findings, if selected response variables (foreign ownership, managerial ownership, institutional ownership, state ownership, bank size and capital adequacy) were rated zero, the ROA of commercial banks in Kenya would be -0.074. A unit increase in bank size would enhance financial performance by 0.005. The other variables have no statistically significant influence on ROA.

5.3 Conclusions

This study confirms that ownership structure has significant influence on ROA. Foreign Ownership, Managerial Ownership, Bank Size and Capital Adequacy produced a positive effect on ROA. However, only the effect of bank size was found to be statistically significant. Institutional Ownership and State Ownership produced a negative statistically insignificant effect on ROA. This study therefore confirms that bank size significantly influence ROA.

This study also concludes that the independent and control variables selected for the study: foreign ownership, managerial ownership, institutional ownership, state ownership, bank size and capital adequacy significantly influence ROA as evident by the ANOVA significance of 0.003. The model summary leads to the conclusion that the predictor variables explain 10.1% of the changes in ROA by banks. This means that 89.9% of changes in the sector's ROA are explainable through other variables not included in the fore mentioned variables.

5.4 Policy Recommendations

Agency theory indicates that managerial ownership is vital tool for effective corporate governance that may foster alignment between the interest of the managers and

stakeholders. Thus, study recommends that managerial ownership should serve a mechanism to reduce agency cost and improve firm value; this is because management decisions impact on investor choice of investment.

The study recommends that firms should maintain high levels of managerial ownership. These imply that when managers should have a share plan, the firm will pay huge dividends and minimize monitoring costs. It is important to note that institutions do not monitor firm operations directly; instead they force opportunist managers to distribute available free cashflows such that they do not have any projects to exploit and create value.

From the findings, it was noted that bank size affected financial performance in a positive and significant manner. Therefore, stakeholders of commercial banks in Kenya should consider increasing the size of their firms in terms of assets as this will help generate higher returns.

5.5 Limitations of the Study

The researchor found it difficult to obtain the data. This was because some of the data sought was not readily available in the financial statements. Another limitation was the quality of the data. It is fantasy to get conclusions from the examination since the authenticity of the circumstance can't be determined. The information that has been utilized is just thought to be exact. The measures utilized may continue deviating starting with one year then onto the next subject to the conditions in place. Secondary information that had just been collected was used for the investigation, unlike the primary information which is more reliant.

The research used a descriptive research design accompanied by research questions. The major study limitation was that although the researcher established the direction, and the nature of existing relationships between variables, it was difficult to establish the ‘cause and effect’ relationship among variables.

5.6 Suggestions for Future Studies

The following suggestions should be considered for further studies. Ownership Structure only explained 10.1% of ROA. Further studies would be necessary to establish the other key factors which influence ROA amongst commercial banks in Kenya. In future studies should be conducted to evaluate how ownership structure affects the satisfaction of the key stakeholders of listed banks in Kenya would be beneficial to the management of the organizations and the scholars in general.

Furthering knowledge on this relationship between ownership structure and financial performance, with particular emphasis on all the listed firms in Kenya, would trigger better formation of policy guidelines to aid all stakeholders in the ownership of firms. To this extent, management personnel are made conversant with best industry practice and the importance of ownership structure. Therefore, this study strengthens further judgment into this vital pillar of any organization that would build on further to the theory and enhance better appreciation of ownership structure vis-a-vis financial performance of listed firms in most emerging nations.

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APPENDIX I: LIST OF LICENSED COMMERCIAL BANKS

a) Foreign owned institutions

i) Foreign owned not locally incorporated

1. Bank of India
2. Citibank N.A. Kenya
3. Habib Bank A.G. Zurich

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

4. Bank of Baroda (K) Ltd.
5. Barclays Bank of Kenya Ltd.
6. Diamond Trust Bank Kenya Ltd.
7. Ecobank Ltd
8. First Community Bank
9. Gulf Africa Bank (K) Ltd
10. Sidian Bank (K-Rep Bank Ltd)
11. Standard Chartered Bank (K) Ltd.

iii) Foreign owned but locally incorporated institutions

12. Bank of Africa (K) Ltd.
13. UBA Kenya Bank Limited

b) Institutions with Government participation

14. Consolidated Bank of Kenya Ltd.
15. Development Bank of Kenya Ltd

16. Housing Finance Ltd.
17. Kenya Commercial Bank Ltd.
18. National Bank of Kenya Ltd.
19. Stanbic Bank Kenya Limited.

c) Institutions locally owned

20. African Banking Corporation Ltd.
21. Chase Bank (K) Ltd. (In Receivership)
22. Commercial Bank of Africa Ltd.
23. Co-operative Bank of Kenya Ltd.
24. Credit Bank Ltd.
25. Dubai Bank Kenya Ltd (Receivership)
26. Spire Bank (Equatorial Commercial Bank Ltd).
27. Equity Bank Ltd.
28. Family Bank Ltd.
29. SBM Bank Kenya (Fidelity Commercial Bank Ltd).
30. Guardian Bank Ltd.
31. Imperial Bank Ltd (In receivership).
32. Investment & Mortgages Bank Ltd (I &M).
33. Jamii Bora Bank Ltd.
34. Middle East Bank (K) Ltd.
35. NIC Bank Ltd.

36. Oriental Commercial Bank Ltd.
37. Paramount Universal Bank Ltd.
38. Prime Bank Ltd.
39. Trans-National Bank Ltd.
40. Victoria Commercial Bank Ltd.
41. Mayfair Bank
42. Guaranty Trust (GT) Bank (Kenya)

Source; (NSE, 2018)

APPENDIX II: DATA

	Y	X1	X2	X3	X4	X5
	ROA	Foreign Ownership	State Ownership	Managerial Ownership	Firm Size	Capital Adequacy
Years						
2014						
2015						
2016						
2017						
2018						