

## Ownership Structure and Financial Performance of Companies Listed at the Nairobi Securities Exchange, Kenya

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### ABSTRACT

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*Performance of firms is predominantly contingent on the deliberate decisions cautiously made and executed by the owners therefore a linkage exists between ownership structure and performance financially. Owners are part of a segment that makes decisions by the virtue of their relationship with the firm. Through the period 2014 to 2018, there was an increase in the listed firms that issued profit warnings with others like Kenya Airways and Uchumi Supermarket running into huge financial losses. This research aimed at establishing the relationship between structure of ownership on company's performance financially and was anchored on two explicit objectives: to ascertain whether institutional local ownership impact on financial performance and to evaluate whether managerial ownership impact on financial performance. This exploration was built on, stewardship, Agency and stakeholder theories which expound an association of structure of ownership and performance financially of all Kenyan listed firms through 2014 to 2018. The examination adopted a causal research design. A census of the 60 listed firms was drawn in this study. Secondary data relating to ownership structure and return on assets was collected using secondary data collection sheet. Panel regression model was utilised to ascertain the relationship between the predictor and dependent variables. The effect of Institutional local ownership on Return on assets is significant as shown by the p values of 0.007. Managerial ownership was found to have an insignificant impact on Return on assets as shown by the p values of 0.611. The study recommended that in pursuit for high Return on assets firm can come up with incentives to encourage institutions to invest more in the company to raise performance.*

**Key Words:** Ownership Structure, Institutional Local Ownership, Managerial Ownership, Financial Performance

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### 1. Introduction

The concept of ownership structure in organizations has become the foremost consideration among the business leaders and regulatory bodies globally. The owners of the company are described as shareholders while the representatives are described as managers. Directors are appointed to protect the owners' interest. In a bid to optimise the shareholder's wealth, it is imperative for the executives to do their duties by putting the shareholders' interest to the fore which is only possible if practices of best governance corporately are adhered to (Omondi, 2014). Globally, the financial crisis in Asia and scandals like those reported in Enron and WorldCom brought a new level of consciousness among the business executives on issues of ownership structure. The case of Enron scandal has been largely linked to corporate governance failures that were characterized by the conflicts of interests between ownership and executive (Dibra, 2016). In United States Of America and United Kingdom, ownership concentration acts as a tool for protection against the internal governance issues. The Tread way Commission Report of 2009 in the United. Other companies that have experienced a fall down due to corporate governance and

ownership issues are; Parmalat in Europe and Chuo Aoyama in Asia (Ongore, Obonyo & Ogutu, 2011).

The concept of the structure of ownership continues to be a topic of debate by European business leaders. Shareholding in many European nations is mostly concentrated, which makes the problems associated with corporate governance infrequent and less apparent. In any endeavour to comprehend the running of corporations, the responsibility of institutional investors, alongside other actors, such as bank employees, has to be considered to different extents in European countries. According to research done on the ownership structure across listed 481 firms in 5 countries in Europe, the level of ownership of voting shares in France, Italy, Germany, Spain and UK puts the levels at 33.3 percent, 30 percent, 30 percent, 25 percent and 30 percent respectively (CEP, 2004). Further, it was established that in Europe, the ownership structure of most top companies is very stable relatively when examined across a long time period. Additionally, seldom do most top firms in Europe ever get out of their ownership grouping where substantial changes to ownership occur thus making their ownership structure more stable while ensuring relatively good performance in these firms. In Africa, ownership structure has also been an area of concern. For instance, an analysis of 80 South African companies over a period of ten years (2001 to 2010), Return on assets was found to be influenced by the ownership structure of the companies (Mugobo, Mutize & Aspelling, 2016). It was specifically established that managerial ownership substantially pulls down the performance of most South African companies. In Nigeria, a study done by Adenikinju, Ayonrinde and Adeola, (2003) established a weak link when structure of ownership and performance were considered.

Within the Kenyan business environment, the concept of ownerships arrangement has become the paramount consideration by most firms including the government. Premised on the need to foster the financial performance of the weak performing parastatals, the privatisation Act of (2005) established a Privatisation Commission whose mandate was to sell 26 non performing parastatals to strategic investors (Anyanzwa, 2018). The idea was to transform the ownership structure of these parastatals from government ownership to private ownership with the foremost aim of making them perform financially. Other scholars include Ongore and KObonyo (2011) and Ochieng and Ahmed (2014) who raised doubts on whether the emerging ownership structure subsequent to privatization at the Kenya Airways would deliver the benefits associated with foreign ownership after results showed no noteworthy change.

### **1.1 Ownership Structure**

It is defined as the distinct characteristics of business identity. It is a requirement for a listed company in Kenya to keep its shareholder register; the purpose of which is to make a distinction between the domestic individual shareholders, domestic institutional shareholders and foreign investors. On a monthly basis, a listed company is needed to make available the reports of its share ownership to the Capital Markets Authority. It is also a mandatory requirement under section 975 (2) (b) of the Companies Act 2015, for foreign companies who want to register in Kenya to see to it that during the application for registration stage, that not less than 30% of the ownership goes to the Kenyan citizens by birth. Nevertheless, the 30% threshold is only applicable to the branch office registrations in Kenya and excludes the locally incorporated companies which can be 100% foreign owned (Capital Market Authority, 2016).

The Capital Markets Authority restricted the shareholding by individuals in NSE listed firms to five per cent in the year 2016 except under certain exceptions from the regulator. In such exceptions, the Capital Market Authority goes through the process of determining the eligibility of the applicant and whether he meets the requirements which encompass the non-existence of a criminal record, integrity and a good financial standing (CMA, 2016). The Nairobi Securities

Exchange's report obtained from Capital Markets Authority shows that out of the listed firms as at September 30<sup>th</sup> 2018, 29 per cent were predominantly owned by foreigners with 71 percent being owned by the local investors (Anyanzwa, 2018).

## 1.2 Nairobi Securities Exchange

NSE was established in 1954 as a voluntary Organization of controlling trading activities (Iraya & Musyoki, 2013). NSE is one of the members of the Association of African Securities Exchanges. Its mandate is to facilitate trading, settlement of equities, debts, derivatives and other securities. Among its core tasks is the listing of firms in the securities exchange besides facilitating different investors in securities trading and by doing so help in maintaining the strength of the securities exchange. This exchange market is under the regulation of the Capital Markets Authority (Musiega 2013). The Security exchange is structured in a way that makes it possible for investors to buy and sell the various securities that are available. To effectively perform this task, proper regulations have been put in place to administer the securities buying and its sale. Further it helps in shielding investors against dishonest brokers and therefore preserves the confidence of investors in the market. As at 2018 December 31<sup>st</sup>, there were 64 firms listed. These firms were categorized into; Agriculture, services, commercial and banking, construction, investment, investment services, insurance, energy and petroleum, manufacturing, technology and telecommunication, real estate trust, exchange-traded fund and automobile and accessories (CMA, 2018)

## 2. Statement of Problem

Firms' performance financially is influenced by several factors in the company but key among them is the ownership structure. During the period of the study 28 firms which represented 43 percent of the firms listed in the NSE issued profit warnings. In this case, profits were expected to decline by at least 25 percent (Anyanzwa, 2018). Firms listed at the NSE are characterised by significant ownership concentration that provides the majority shareholders a chance to undertake activities to benefit themselves hence adversely affecting performance (Mokaya & Jagongo 2015). Ownership arrangement and fiscal performance is somewhat complex and distinct area for the firms that are listed in the NSE for the reason that as long as their shares are trading, their ownership changes (Antony 2014). The delayed sale of 26 state-owned corporations like National Bank of Kenya and East African Portland Cement to private investors resulted to problems related to governance, increased mismanagement and funds' embezzlement (Anyanzwa 2018). The past literature on the connection of structure of ownership and financial performance have shown varied outcomes. A study by Mbaabu (2010) which focused on the insurance sector depicted an inverse connection between structure of ownership and performance. A study by Wanjiku (2015) ascertained a positive association between ownership structure and performance. Therefore, the study intended to address this research gap by looking into ownership structure and financial performance of NSE listed businesses.

## 3. Objectives of the Study

The specific objectives of the study were:

- i. To evaluate the impact of institutional local ownership on financial performance of firms listed in Nairobi Securities Exchange, Kenya.
- ii. To analyse the influence of managerial ownership on financial performance of firms listed in Nairobi Securities Exchange, Kenya.

#### **4. Theoretical framework**

The research was built on 3 perspectives; Stakeholder, Stewardship and Agency theories in analyzing the connection between structure of ownership and performance of all NSE listed Kenyan firms from 2014 to 2018.

##### **4.1 Stakeholder Theory**

This concept was advocated by Freeman (1984) and suggests that the action taken by managers should take into account the stakeholders' wishes as they can either punish or reward companies. Business entities do not exist in vacuum and hence people in form of employees, public agents, shareholders among others will always be present. Stakeholder theory is thus needed to manage companies in a complex environment as it gives an efficient, effective and practical way of doing things (Ramakrishnan, 2009). Jansson (2005) noted that it is not practical to give full property rights to all stakeholders hence this theory emphasizes on corporations creating value for its stakeholders who are affected by its decisions. Firms cannot achieve their **social responsibility** goals without the input, know-how and expertise of its stakeholders. Organizations are therefore accountable to all its stakeholders who have different interest in it (Kakabadse, Rozuel & Lee-Davies, 2005). This theory therefore tasks the management with the responsibility of making efforts to mitigate the conflicts between stakeholder interests. Stakeholders' theory is therefore relied upon in this examination to help examine and comprehend how diverse structures of ownership can embrace a hands-on method to harmonize all stakeholders' needs into decision-making framework and improve financial performance in the long term.

##### **4.2 Stewardship Theory**

This presumption was advanced by Donaldson & Davis (1991). The presumption considers executives as stewards who have a responsibility to act as custodians of the assets they control. The principle under this theory is that the business interests come first before other interests. According to Madison, Kellermanns and Munyon (2017), companies need to allow steward-like qualities flourish by properly communicating their preferences and incentivizing managers to control their behaviours. This proposes a principal-steward relationship with their goals working in Synchronicity. The propensity to act like stewards depends on individuals and hence firms should come up with pre-employment considerations which lays down the foundations for stewardship governance effectiveness (Tabor, Chrisman, Madison, & Vardaman, 2018). Firms that embrace stewardship align themselves with the needs of society and attempts to improve the life of others. The theory suggests that the firm's purpose is to contribute to humanity by serving community's (Karns, 2011). The CEO should for that reason be trustworthy and prepared to put individual gains aside for the good of the organization. This theory concludes that unless all the members of the team turn out to be stewards, it is difficult to achieve organizational goals of profit maximization hence it is utilized in this examination to aid the analysis of how steward interests are taken care of across the different ownership structures hence enhancing the performance financially in the long-term.

##### **4.3 Agency Theory**

The 1976 article, Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure by Meckling and Jensen helped alight the clashing interests of the agents and principals. This theory displays the inherent conflict of interest between executives and owners within a business setup. The dispute occurs when firm owners' contract executives to perform roles of management of a firm, and both seek to make the most of their own utility and self-interests. The consequence of this conflict of interest is that executives don't bear their actions' total consequences. According to Bebchuk, Cohen and Hirst (2017), the conflict of interest occurs

between investment manager and contributor of the fund in case of institutional investors while for the listed companies, it is between the shareholders and the management. Jensen and Meckling (1976) noted that the agency cost is zero in case of owner-manager firms. Therefore, managerial ownership can align the interest of the managers and owners. As the employee's ownership increases, the misuse of the assets by them decreases since they get the share in the firm's profit (Ang, Cole & Lin 2000). This is one among the many remedies of agency problem and thus this presumption is utilized in this research since it concentrates on link between agents and owners and the ways of mitigating this conflict in as far as structure of ownership and performance financially of all firms listed at NSE.

## **5. Empirical Review**

### **5.1 Institutional Local Ownership and Financial Performance of Listed Firms**

A portion of the shares an institution has in a firm is explained as institutional ownership. Hence, it excludes the portion of shares of individual investors. If institutional investors' penchant toward a cluster of companies was to be examined, there will be need to think about why institutional investors' fondness for those companies is expected to supersede that of individual investors. These investors are organised organizations which may act autonomously or be part of a big company (Chung & Zhang, 2009). Institutional investors can serve as a checking factor against opportunistic behaviours and earning manipulation by managers hence improving the value of the firm (Mokhtari & Makerni 2013). Institutional ownership is positively associated with financial performance which encourages companies to adhere to good practices of governance corporately hence protecting the shareholders' interests (Chen, Blenman & Chen, 2008). Incorporated companies' ownership and government institutional ownership have a significant negative correlation with firm performance while security investment trust funds and firm's performance are positively correlated as noted by Lee and Chuang (2009).

In another study, Matanda, Oyugi and Lishega (2015), indicated that there is no relationship between institutional ownership and performance of commercial banks in Kenya when Return on Equity and Return on Asset were used as performance measures. This outcome was contrary to the examination of Muthoni, Olweny, Nasieku (2018) who studied the effect of ownership structure on financial performance of quoted non-financial firms in Kenya and established that institutional ownership and return on capital employed was positively and insignificantly related.

### **5.2 Managerial Ownership and Financial Performance of Listed Firms.**

Insider ownership is premised on the incentive alignment principle and 'entrenchment argument'. Incentive alignment argument is anchored on the idea that added insider ownership may boost performance, due to enhanced alignment of the insider (managerial) and shareholder interests as (Meckling & Jensen, 1976). The benefits of this ownership on organizational performance thus arise from the intensity of association between owners and controllers (executives). This kind of ownership is thought of as a method of extenuating the agency problem, which is common where disagreements occur due to separation of control and ownership. By having a share of the company's equity, insiders will operate in a way that will maximize firm and shareholder value in that case due to their own interests. Managerial ownership structure has been considered vital towards the quality of structure of ownership usually presented as the number of shares owned by insiders as highlighted by Wahla, Shah and Hussain, (2012). According to Cubbin and Leech, (2011), a balance between entrenchment effects and incentive alignment is what will eventually ascertain the influence of inside ownership on performance. In an effort to combine the two rival ideas, a number of scholars appear to recommend a middle ground nonlinear association between insider shareholding and performance. This middle ground proposal is however put in danger by the apparent complexity of the nonlinear models (Chou, 2013).

In Kenya, this kind of ownership is often achieved through executive share options. The outcome advocates the idea that when executives become shareholders, their motivation towards achievement of the wealth creation goal of the shareholders is enhanced. Ling, Seng and Ngui (2008) opines a positive consequence of inside management on firms' value for the reason that the information that the insiders have vis that possessed by outsiders is very valuable. This information advantage brings about insider domination and good performance. Ng'ang'a 2017 studied the effect of ownership structure on financial performance of companies listed at the Nairobi Securities Exchange in Kenya where managerial ownership was considered. The Correlation results showed that there is a positive and significant relationship between management Shareholding and financial performance. This is contrary to the analysis by Muthoni, Olweny, Nasieku (2018), who revealed that Managerial ownership and financial performance measured using Tobin's Q (Q) was negative and statistically significant.

## 6. Research Methodology

This research adopted a causal research design. The causal research design helps in explaining the cause-and-effect relationship between the independent and dependent variables. Data was collected from 60 firms listed in NSE as at December 2018 out of the 64 listed firms. The choice of these firms was because of readily available financial statement at NSE handbook and CMA website as NSE exercises heavy control over them hence readily available secondary data. The examination relied on secondary data. Secondary data was sourced from the yearly audited financial statements for the period 2014-2018 from the particular company's websites and from NSE and CMA websites. Data obtained include; firm's total assets and net profit. A data collection checklist was employed and it guided the collection of data from the financial statements. Panel models and correlation analysis was utilised to settle on the connection among variables under exploration in this research.

## 7. Data Analysis Results

The model used is the panel regression and results exhibited in the Table 1.

Return on Asset	Coef.	Std. Err.	Z	P> Z	[95% Conf. Interval]	
Institutional ownership	.00200	0.07140	3.958	0.007	-0.13200	-0.02100
Managerial Ownership	-.00190	0.00290	-0.509	0.611	-0.00799	0.00401
Constant	-.07501	0.03700	-2.008	0.046	-0.14902	0.00200
Sigma_u	.02187					
Sigma_e	.02754					
Rho	.49032	(fraction of variance due to u_i)				

R-sq: within= 0.243

Between = 0.277

overall = 0.229

**Table 1: Panel Regression Model**

**Source (Researcher, 2021)**

The Panel model thus becomes;  $ROA = -0.07501 + 0.0020_1X_1 - 0.0019_2X_2 + \epsilon$ . In a scenario where there are no predictor variables, the ROA of the listed companies decrease by 0.07501. This decrease is significant going by p value of 0.046. A unit increase in institutional local ownership (IO) leads to an increase in the Return of assets (ROA) by 0.002 times all other variables held constant. The increase based on the p value of 0.007 is significant. A unit increase in managerial

ownership (MO) other variables kept constant decreases the ROA by 0.0019 times, the decline is non significant based on the p value of 0.611 obtained.

## 8. Conclusion

The study's conclusion is based on the empirical findings. The first objective was to determine the effect of institutional ownership on financial performance of listed firms in the NSE. In respect to this, the study concludes that the impact of institutional local ownership on financial performance is positive and statistically significant. The second objective was to establish the effect of managerial ownership on financial performance of listed firms in the NSE. However, the study concluded that managerial ownership negatively and insignificantly affects the performance of listed firms.

## 9. Recommendations

The policy recommendations are in line with the study's objectives. The research concludes that institutional ownership has a positive and significant effect on performance. Consequently, in pursuit for high Return on assets firm can come up with incentives to encourage institutions to invest more in the company to raise performance.

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