INTERNATIONAL JOURNAL OF
SCIENCE ARTS AND COMMERCE

EFFECT OF OWNERSHIP STRUCTURE ON FINANCIAL PERFORMANCE OF MANUFACTURING FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE, KENYA

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ABSTRACT

The study sought to examine the effect of ownership structure on financial performance of manufacturing firms listed at the Nairobi Securities Exchange in Kenya. The study focused on four types of ownership that include; government ownership, foreign ownership, management ownership and local ownership. The study adopted a descriptive research design and targeted a total of 10 manufacturing firms listed at the Nairobi Securities Exchange. Data was collected from targeted firm's financial statements for a period of 5 years (2016-2020). The study established: a significant and positive relationship between government ownership and financial performance of manufacturing firms listed at the Nairobi Securities Exchange; the study concluded that ownership structure of listed manufacturing firms affects financial performance. Based on the findings, the study recommended the need for firm managers and general investors to be trained on best ownership plan that can aid firm's productivity.

Key words: Ownership structure, Financial performance, Manufacturing firms.

1.0 INTRODUCTION

Ownership structure has been defined by scholars in different terms; first it is defined as the compositions of individual or institutional shareholding in a firm. Another definition terms ownership structure as the shareholding composition that includes managers as part of the firm owners in addition to being agents of the organization. Furthermore, ownership structure is defined as a term depicting the individuals and institutional that have a high stake and control on the operations of the firm based on the contribution to the firm capital structure (Abbasi & Malik, 2015). These consequences of ownership structure are conditioned by the legal and institutional setting of the country in which the firm operates. Financial performance can be described as, "a measure of how well a company is optimally deploying scarce resources to generate profits. It can also be described as a function of factors that should be optimally utilized to maximize the returns" (Ndiba, 2016).

The structure in most cases comprise of a few shareholders with a larger contribution to the capital of the firm. The structure varies from firm to firm based on the ownership type, however, many scholars agree that, whichever type of ownership may be, it dictates how a firm will be governed (Tanui, Yegon & Bonuke, 2019). Given that major shareholders are not directly engaged in the day to day running of the organizations, they appoint managers to control the operations of these firms which lead to an agency problem. Changing and unpredictable business environment has led to close scrutiny of ownership structures that include government ownership, local ownership, foreign ownership, institutional ownership and management ownership.

The spread of ownership through selling of shares in securities market is mostly preferred by managers as a source of equity as compared to borrowing from the bank. One of the advantages of share trading is that it boosts investors' confidence on the management of the firm which goes a long way in ensuring that sufficient resources are available to meet the financial needs of a firm (Alabdullah, 2018). Various scholars both locally and internationally has shown that preference for capital structures vary based on the need of the organization, as other change from private to public and public to private, there are a number of organizations that remain controlled by states due to the sensitivity of the operations they engage in. while other have remained private and controlled by a few individuals in order to enjoy all the profits realized. The structure of organization ownership is measured by calculating the percentage in shareholding of common stock for each particular form of ownership.
Financial performance stands for profits, extra payment, total or net sales, sales, investments and there returns (Mutisya, 2015). Most organizations strive to better their financial perfomance as a way of protecting investor's interest. Shareholders invest their money and expect returns at the end of the financial year, poor financial results can scare away potential investors, lead to losses and reduction of firm value in the market (Mudi, 2017). Measuring financial performance helps managers to arrive at a determination on whether they are achieving set objectives (Mukyala, Rono & Lagat, 2020). Prior to considering the numbers and types of measures to put in place, an understanding of the clarity on goals and objectives of the business entity becomes imperative. Financial performance was measured using various significant ratios, they include; the Return on Assets, Return on Investments and Return on Equity. This study used Return on Equity ratios to assess net income returned as a percentage of shareholder equity (Mishra & Kapil, 2017).

The relationship between ownership structure and management of firms is called agency relationship as owners of the firms are seen as managers who delegate authority to agents who are the board of directors who are fully involved in the activities of the firm. The separation of ownership from the day to day management of firms may lead to a possible conflict between owners and managers because both owners and managers have different objectives and this conflict may naturally reduce management incentives to maximize corporate efficiency. Ndiba (2016) investigate the effect of ownership structure on the economic perfomance of sugar manufacturing companies operating in Kenya. Through an analysis of auditor’s report on the targeted firms, the study established that financial performance of companies was significantly affected by ownership structure and sizes. Furthermore, Phung and Mishira (2015) made a related observation on the effect of ownership structure and financial performance of organization when they investigated firms operating and listed at Vietnam security exchange market. The study established a significant improvement on firms based on ownership structures.

1.1 RESEARCH PROBLEM

Ownership structure causes agency problems pointing out conflicts that exist between shareholders and managers, or between minority and majority shareholders. Shareholders and managers have divergent interests (Marouan & Moez, 2015). 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 (Amin & Hamdan, 2018). Different firm ownerships have been identified to have an influence on financial performance of manufacturing firms; however, there is no agreed minimum ownership threshold that positively enhances the financial performance of manufacturing firms (Mukyala, et al. 2020).

The manufacturing firms in Kenya are one of the sensitive sub-sectors for economic growth and development, therefore, it should be a sector expected to be monitored seriously (Mang'unyi, 2011). When firms trade shares at the securities market they gain more equity that gives them a leverage to undertake big investments with good returns, however, the number of shareholders increases and ownership concentration reduces (Khamis, Elali & Hamdan, 2015). The presence of different individuals in the ownership structure of listed manufacturing firms can lead to conflict of interest and the question that arises is whether difference in the ownership structure influences financial performance. The question which still needs to be answered is on whether there will ever be a difference in financial performance of listed manufacturing firms if the owners of companies consist of different groups such as the government, local ownership, management ownership or foreign ownership (Kakanda, 2016). This study therefore sought to solve this information gap by providing answers to the following question: Does public ownership affect financial performance of manufacturing firms listed at the Nairobi Securities Exchange in Kenya?

1.2 RESEARCH OBJECTIVE

To examine the effect of ownership structure on financial performance of manufacturing firms listed at the Nairobi Securities Exchange in Kenya

2.0 METHODS

The study adopted a descriptive research design. The study targeted 10 manufacturing firm listed at the Nairobi Securities Exchange for the past 5 years (2016-2020). 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 2016 to 2020. Computed secondary data were tabulated in an orderly manner, filtered and coded to facilitate data analysis. Descriptive and inferential statistics were used to establish the significance of independent variables on the dependent variable. The relationship between study variables was analysed using a linear regression model as indicated below.

$Y: \beta_0 + \beta_1X_1+\beta_2X_2+\beta_3X_3+\beta_4X_4+\acute{\varepsilon}$

Where $\beta_{1,}$ $\beta_{2,}$ $\beta_{3,}$ β_4 are the regression co-efficient of the independent variables

Y = Financial Performance

β_0 = Constant

X_1 = Government Ownership

X_2 = Foreign Ownership

X_3 = Local Ownership

X_4= Management Ownership

ε is the error term normally distributed about a mean of zero

3.0 RESULTS

As shown in the table below; it is evident financial performance (measured by use of ROE) has a positive relationship with Government ownership with r = .014, Foreign ownership also has a positive relationship with financial performance with the value of r = 0.193, Management ownership also has a positive relationship with the value of r = 0.536 while local ownership has a positive relation with financial performance with the value of r = .038.

Table 1: Correlation analysis

		Y	X_1	X_2	X_3	X_4
Y	**Pearson correlation**	1.000				
	Sig					

X_1	**Pearson correlation**	.014**	1.000			
	Sig	.474				
X_2	**Pearson correlation**	.193**	.167**	1.000		
	Sig	.178	.484			
X_3	**Pearson correlation**	.536**	.261**	.695 **	1.000	
	Sig	.003	.103	.000		
X_4	**Pearson correlation**	.038**	.442**	.519**	.391**	1.000
	Sig	.4290	.0130	.0040	.0120	0.000

Source: Researcher (2021)

Where Y= Financial Performance, X_1 = Government ownership X_2 = Foreign Ownership X_3 = Management ownership and X_4 = Local ownership. The results reveal a significant positive relationship between government ownership, foreign ownership, management ownership and local ownership and financial performance of manufacturing firms listed at the Nairobi Securities Exchange. This proves that ownership structure has an influence on financial performance of manufacturing firms listed at the Nairobi Securities Exchange.

Regression analysis was done on financial performance of manufacturing firms listed at the NSE against government ownership, foreign ownership, management ownership and local ownership. The regression model used for the study was:

$$\mathbf{Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon}$$

Data used for the analysis was collected from the firm's financial statement for the period ranging from 2016 to 2021.

Table 2: Regression analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	.071	.205		.548	.000	-	-
Government	.011	.019	.070	-.562	.579	.880	1.136
Foreign	2.495	.370	.797	6.744	.000	.972	1.029
Management	.610	1.462	.051	.417	.680	.892	1.121
Local	0.232	0.242	0.225	0.712	0.034	.789	1.021

Source: Researcher (2021)

As shown in the table above; it's evident that there is a relationship between firm financial performance and ownership structure. This relationship is as indicated in the equation that follows with the assigned co-efficients.

$Y= 0.071+ -0.011X_1 + 2.495X_2 + 0.610X_4 + 0.232X_3$

From the table above: when government ownership increases by one unit, the financial performance increases by 0.011; when foreign ownership increases by one unit, financial performance increases by 2.495; when management ownership increases by one unit, financial performance increases by 0.610 while an increase in local ownership by one unit, leads to an increase in financial performance by 0.232.

4.0CONCLUSION AND RECOMMENDATIONS

Based on the findings of the study, the results revealed a significant and positive relationship between government ownership and financial performance of manufacturing firms listed at the Nairobi Securities Exchange; it also confirmed a significant positive relationship between foreign ownership and financial performance of manufacturing firms listed at the Nairobi Securities Exchange. The study therefore concluded that there exists a significant positive relationship between management ownership and financial performance of manufacturing firms listed at the Nairobi Securities Exchange.

4.1 RECOMMENDATIONS

The study established that the listed manufacturing firms are affected by different ownership structures that were under study. As much as the relationship are positive and significant, it is evident that manufacturing firm managers are yet to settle on the form of ownership that lead to better financial performance which is attributed to the desire to raise more capital for their businesses. There is need for firm managers and general investors to be trained on best ownership plan that can aid firm's productivity.

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