Effect of Foreign Ownership on Financial Performance of Listed Firms in Nairobi Securities Exchange in Kenya

[1]Peter Ndungu Ng'ang'a

Ph.D Candidate ,Accounting and Finance/ Kenyatta University, Kenya pengash@yahoo.com ,

+254 722 282 249, P.O BOX 16778-80100 , Mombasa , KENYA)

[2]Prof. G. S. Namusonge

Dean, School of Entrepreneurship, Leadership, Procurement and Management, JKUAT,

+254 722 89 60 92, P.O.BOX 6200-00200, NAIROBI- KENYA

[3]Prof. M.M. Sakwa

Lecturer, School of Entrepreneurship, Leadership, Procurement and Management, JKUAT, +254 59 09 65, P.O.BOX 6200-00200, NAIROBI- KENYA

ABSTRACT

This study aimed to determine the effects of foreign ownership on firm's financial performance of listed firms. The study findings indicated correlation co-efficient of 0.683, implying a positive relationship between foreign ownership and financial performance. This was evidenced by the p value of 0.000 which is less than that of critical value (0.05). The study concluded that there was a significant positive relationship between foreign ownership and firm's financial performance.

Key Words: Foreign Ownership, Financial performance

1.0 INTRODUCTION

Clarkson and Chapple (2011) argues that many foreign scholars have verified that ownership and capital structure have significant effects on firm performance and that the effect of ownership structure on financial performance mainly considers ownership type, ownership concentration and capital market value of listed firms. Djankov and Simeon (2008) found a positive relationship between foreign ownership and the provision of generic and specific knowledge to the local company.

Chege (2013) examined the relationship between ownership structures and financial performance among commercial banks listed in the NSE in Kenya. He found out that there is a positive relationship between profitability and foreign shares ownership and observed that, foreign shares were significant in explaining results as a unit changes in foreign shares were found to be significant in explaining profitability. The findings were consistent with Avulamusi(2013) who established that there was positive a relationship between foreign ownership and different parameters of financial performance in a study of commercial banks in Kenya. He attributed high monitoring capabilities of foreign owners to improved financial performance of commercial banks in Kenya.

Aydin, Sayim and Yalama, (2007) argued that on an average foreign owned firms have performed better than the domestically owned firms because foreign owners are more likely to have the ability to monitor managers and give them performance based incentives to avoid behaviors that undermine the wealth creation motivation of the firm owners. According Pallathitta (2005) foreign ownership goes beyond financial contribution and extends to provision of managerial expertise and technical collaboration which helps them to increase the efficiency and effectiveness of the operational processes leading to improved performance

1.2 Statement of the problem

Kihara (2006) argues that the issues of ownership structure and company performance are driving investors and general public in making in-depth scrutiny of equity shareholders behind every firm. This has been caused partly by corporate failure or poor performance of public and private companies.Uzel (2015) argued that the major objective of businesses is to make profits and concluded that the concept of organizational performance is core to all investors. Ekadah and Mboya (2011) advocated that the issue of Equity ownership and firm's performance is rapidly gaining prominence in Kenya as is the case in other countries. However Iravo, Ongori and Munene (2013) raised concern as to why some companies succeed while others fail and this has influenced a study on ownership structure and financial performance of companies.

Aydin, Sayim and Yalama, (2007) argued that on an average foreign owned firms perform better than the domestically owned firms while Pallathitta (2005) argues that foreign ownership goes beyond financial contribution and extends to provision of managerial expertise and technical collaboration which helps them to increase the efficiency and effectiveness of the operational processes leading to improved performance. However Aguilera and Cuerra (2004) argued that foreign shareholders may only have a moderate impact on firm performance despite being endowed with good monitoring capabilities because their financial focus and emphasis on liquidity making them unwilling to commit to a long-term relationship with the firm that engages in a process of restructuring in case of poor performance. Most of them prefer strategies of exit rather than voice to monitor management. It was on the background of the above contradicting reports that the study was undertaken to determine the effects of foreign ownership on financial performance of companies listed in Nairobi Securities exchange and shed new light into corporate finance.

1.3 Research objective

The study was guided by the following general objective

To establish the effect of foreign ownership structure on financial performance of firms listed in the Nairobi Securities Exchange in Kenya.

1.4 scope of the study

The study investigated the influence of Foreign ownership on financial performance of public listed companies and was limited to only companies' listed in the Nairobi Securities Exchange in Kenya. According to companies Act, it's a legal requirement for all registered companies to submit audited published final accounts on yearly basis and provided a reliable and consistent source of the required data for comparison purposes.

2.0 THEORETICAL FRAMEWORK

The Agency theory rests on the assumption that the role of organizations is to maximize the wealth of the shareholders (Blair, 1995). Further the Agency theory explains a fundamental problem for absent or distant owners who employ professional executives to act on their behalf. According to Wheelen and Hunger (2002) the problems arises because agents (professional) are not willing to bear responsibility for their decisions since they don't own a substantial amount of stock in the firms and hence don't stand to benefit by perusing wealth maximizing objective. However Aydin, Sayim and Yalama, (2007) argued that on an average foreign owned firms have performed better because foreign owners have the ability to monitor managers and give them performance based incentives to avoid behaviours that undermine the wealth creation motivation of the firm.

Bender (2011) stewardship theory focuses on facilitating and empowering structures rather than monitoring and controls that are proposed by the agency theory which may interfere with the motivation of the steward leading to a loss of productivity and inciting opportunistic behaviour. Stewardship theory advocates that if both parties decide for a true stewardship relationship, this form they can create an environment where the agents could proceed effectively leading to an increase in productivity (Bender, 2011).

3.0 RESEARCH METHODOLOGY

3.1 Research Design

This study employed correlation research and cross-sectional study designs. According to Albright et al. (2011) a correlation research is a procedure in which subjects' score on two or more variables are simply measured, without manipulation of any variable, to determine whether there is a relationship. On the other hand cross-sectional design was used to gathered data just once to determine the interrelationship between the variables under consideration among the different firms in the study and permitted the researcher to make statistical inference on the broader population and generalize the findings to real life situations and thereby increase the external validity of the study.

3.2 Target population

The target population for this study was made up 264 executives which comprised of of one finance director, one corporate affairs manager, one internal auditor and one accountant from each 61firms listed at the NSE. According to Nairobi Stock Exchange (NSE) Handbook on profiles and performance of listed companies (2010-2014) there were 61 firms that had compiled their financial reports for the relevant period of study.

3.6 Data Collection methods

The study used questionnaires to obtain qualitative data for analysis which was further validated by secondary quantitative data acquired through analysis of the companies' published final accounts and quarterly market reports.

4.0 RESEARCH FINDINGS AND RESULTS

4.1 Descriptive statistics for Foreign Ownership

The objective of the study was to establish the effect of Foreign Ownership on Financial Performance of firms listed in Nairobi Securities Exchange in Kenya. Result in table 4.1indicated that 80% of the respondent agreed that foreign shareholding enables their company to attract highly qualified professional who improves the financial performance of the company, 66% of the respondent agreed that foreign shareholding enables their company to get foreign funding which improves their financial performance.

In addition 78% agreed that foreign shareholding helps company to set performance targets which makes the company to improve its performance, 63% agreed foreign shareholding helps in monitoring and evaluation of the company which leads to improved performance ,69% agreed that Foreign shareholding helps company in collaborative linkages and network which improves company performance, 70% of the respondents agreed that foreign shareholding reduces the agency costs by setting systems and procedures which improve company performance and 75% of the respondent agreed that foreign shareholding advices on adoption of new technology which leads to high productivity and improved performance.

Table 4.1: Foreign Ownership Structure on Financial Performance

Statement	1	2	3	4	5	Mean	STD
Foreign shareholding enables attraction of highly qualified professional	9%	5%	6%	47%	33%	3.91	0.688
Foreign shareholding enables getting foreign funding	10%	5%	19%	49%	17%	3.58	0.675
Foreign shareholding helps set performance targets	5%	3%	15%	44%	34%	4	0.95
Foreign shareholding helps in monitoring and evaluation	12%	20%	6%	46%	17%	3.37	0.735
Foreign shareholding helps in collaborative linkages and network	0%	21%	11%	33%	36%	3.84	0.659
Foreign shareholding influences stability of share prices	2%	23%	5%	39%	31%	3.75	0.653
Foreign shareholding reduces the agency costs	3%	16%	12%	46%	23%	3.71	0.665
Foreign shareholding helps adoption of new technology	0%	17%	8%	61%	14%	3.72	0.675

The mean score of responses regarding Foreign ownership was 3.75 on a 5 point scale which indicates that majority of the respondents agreed that foreign ownership structure is a key determinant on financial performance of a firm. The study finding agree with those of Aydin, Sayim and Yalama, (2007) argued that foreign owners have the ability to monitor managers and give them performance based incentives to avoid behaviours' that undermine the wealth creation. This is supported by Pallathitta (2005) argued that Foreign ownership goes beyond financial contribution and extends to provision of managerial expertise and technical collaboration which helps them to increase the efficiency and effectiveness of the operational processes leading to improved performance.

Chege (2013) found a positive relationship between profitability and foreign shares ownership among commercial banks listed in the NSE which according to Alumasi (2013) was due to high monitoring capabilities of foreign owners. The two studies are supported by Stulz (1988) who argued that foreign investors come to invest with expectations of a good return on their investment and therefore ensure effective monitoring of management which leads to improved financial performance of companies.

4.2 Sample adequacy for Foreign Ownership Factors

KMO and Bartlett's Test were conducted to test sample adequacy for foreign ownership measures before factor analysis was carried out.

Table 4.2: KMO and Bartlett's Test for Foreign Ownership Factors

Indicator	Coefficient
Kaiser-Meyer-Olkin Measure	.820
Bartlett's Chi- Square	997.196
Bartlett's df	45
Bartlett's Sig.	0.000

KMO measures on Foreign ownership measures yielded a result of 0.82 while Bartlett's test of Sphericity results were (chi-square=997.196, $p<0.000$) with 45 degrees of freedom. According to Field (2000) for a data set to be regarded as adequate and appropriate for further statistical analysis, the value of KMO should be greater than 0.5. and therefore the results for both tests were significant for further statistical analysis.

4.3 Total Variance Explained for Foreign Ownership factors

Factor analysis was conducted using Principal Components Method (PCM) approach. The extraction of the factors followed the Kaiser Criterion where an eigen value of 1 or more indicates a unique factor as presented on Table 4.3 below.

Table 4.3: Total Variance Explained for Foreign Ownership Factors

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	5.913	59.132	59.132	5.913	59.132	59.132
2	1.499	14.992	74.124	1.499	14.992	74.124
3	.853	8.528	82.653			
4	.443	4.432	87.085			
5	.401	4.014	91.099			
6	.342	3.416	94.516			
7	.222	2.221	96.737			
8	.177	1.775	100.000			

Extraction Method: Principal Component Analysis.

When the eight measures of foreign ownership were subjected to factor analysis, only five factors attracted coefficients of more than 0.4. According to Rahn (2010) and Zandi (2006) a factor loading equal to or greater than 0.4 is considered adequate. Therefore only five factors were retained for further analysis. Further analysis showed that among the five factors retained, there were two critical factors from foreign ownership measures that were affecting financial performance of listed firm which accumulated to 74.124% of the total variance in this construct. Factor I had the highest variance of 59.132 % while factor 2 had 14.992%. These two factors had the greatest influence on financial performance of firms listed in Nairobi Securities Exchange.

4.4. Rotation matrix for Foreign Ownership factor

. Rotation matrix was conducted using Principal Component Analysis with Promax Kaiser normalization.

Table 4.4 Rotated Component Foreign ownership factors

Foreign Ownership factors	Component 1	2
Foreign shareholding enables our company to attract highly qualified professional who improves the financial performance of the company		.520
Foreign shareholding enables our company to get foreign funding which improves our financial performance		.574
Foreign shareholding helps company to set performance targets which makes the company to improve its performance	.842	
Foreign shareholding helps in monitoring and evaluation of the company which leads to improved performance		.811
Foreign shareholding helps company in collaborative linkages and network which improves company performance		.716
Foreign shareholding influences the stability of share prices of a company	.969	
Foreign shareholding reduces the agency costs by setting systems and procedures which improve company performance	.950	
Foreign shareholding advices on adoption of new technology which leads to high productivity and improved performance	.610	

Extraction Method: Principal Component Analysis.

Rotation Method: Promax with Kaiser Normalization.

The factors were grouped into two factors namely FO 1 and FO 2. FO 1 had stability of share prices at 0.969, agency costs at 0.950, performance targets at 0.842 and new technology at 0.610. This factor was named Performance. The second factor had monitoring and evaluation at 0.811, collaborative linkages and network at 0.716, foreign funding at 0.574and highly qualified professional at 0.520. This factor was named Foreign linkages. Using the two factors, a scale was created using the average means of each construct. A scale of 1-5 was created and all the means of all the items in each component were analyzed. Other factors not included in group one or two were excluded from further analysis because they seemed to have low means and as such much of their influence could be explained by the other factors

4.5 Relationship between Foreign Ownership Structure and Financial Performance

A correlation study was conducted to test the relationship between foreign ownership and financial performance of firms listed in Nairobi Securities Exchange. The results indicated a correlation co-efficient of 0.683, implying a positive relationship between foreign ownership and financial performance and supported by the p value of 0.000 which is less than that of critical value (0.05).

Table 4.5: Relationship between Foreign Ownership and Financial Performance

Variable		Financial Performance	Foreign Ownership
Financial Performance	Pearson Correlation	1	
	Sig. (2-tailed)		
Foreign Ownership Structure	Pearson Correlation	0.683	1
	Sig. (2-tailed)	0.000	

Further, regression analysis was conducted to empirically determine whether foreign owned structure was a significant determinant of financial performance of firms listed in Nairobi Securities Exchange in Kenya. The coefficient of determination R^2 and correlation coefficient (r) shows the degree of association between the independent variable foreign ownership and dependent financial performance. The results of the linear regression indicate R= 0.683 which indicates that there is a significant positive relationship between foreign ownership and financial performance.

Table 4.6: Model Summary Foreign Ownership

Indicator	Coefficient
R	0.683
R Square	0.467
Adjusted R Square	0.462
Std. Error of the Estimate	0.59072

From the model summary results adjusted R^2 was 0.467 this indicates that foreign ownership explains 46.7% of variations financial performance.

Table 4.7: ANOVA for Foreign Ownership Structure

Indicator	Sum of Squares	Df	Mean Square	F	Sig.
Regression	33.636	1	33.636	96.392	0.000
Residual	38384	110	0.349		
Total	72.019	111			

Analysis of variance (ANOVA) was used to determine whether there is a regression relationship, between foreign ownership and financial performance. The ANOVA test in Table 4.7 shows that the significance of the F-statistic of 96.392 and significance level of 0.000 which is less than 0.05 meaning that null hypothesis is rejected. The findings implied that there is a positive relationship between foreign ownership and financial performance and that foreign ownership was statistically significant in explaining financial performance of listed firms.

4.6 Regression results for foreign ownership and financial performance

To establish the effect of foreign ownership on financial performance of listed firms hypotheses was stated as follows:-

Hypotheses

H01: There is no statistically significant correlation between foreign ownership and financial performance of listed firms in Kenya.

HOA: There is statistically significant correlation between foreign ownership and financial performance of listed firms in Kenya

The null hypothesis state that, β (beta) = 0, meaning there is no relationship between Foreign ownership and firms financial performance as the slope β (beta) = 0 (no relationship between the two variables).

Table 4.8: Regression coefficients of Foreign Ownership

Variable	Beta	Std. Error	T	Sig.
Constant	3.083	0.115	26.764	0.000
Foreign ownership	0.321	0.033	9.668	0.000

a. Dependent Variable: Financial performance

The results on the beta coefficient of the resulting model in Table 4.24 shows that the constant α = 3.083 is significantly different from 0, since the p- value = 0.000 is less than 0.05. The coefficient β = 0.321 significantly different from 0 with a p-value=0.000 which is less than 0.05.

This implies that the null hypothesis $\beta_1=0$ is rejected and the alternative hypothesis $\beta_1\neq 0$is taken to hold implying that there is significant correlation between foreign ownership and financial performance of listed firms in Kenya. The fitted equation is as shown below:

$Y=3.083+ 0.321X_2$ (Foreign ownership) + e, is significantly fit.

The model Firms financial performance= α + β (Foreign ownership) holds as suggested by the test above and this confirms that there is a positive linear relationship between Foreign ownership and Firms financial performance.

4.7 Discussions of key findings

Foreign Ownership on Financial Performance

Foreign ownership was assessed by eight measures namely stability of share prices, agency costs, performance targets , new technology, monitoring and evaluation , collaborative linkages and network a, foreign funding and highly qualified professional. The significant results showed that the means were statistically different and the alternative hypothesis was accepted. This is supported by a study of Douma *et al*. (2006) who analysed the effect of foreign ownership on the financial performance of Indian corporations with a distinction between foreign institutional and foreign corporate shareholders and found significant positive relationship between foreign ownership and Financial performance.

Relevant results show that on a scale of 1 to 5 (where 5 = strongly agree; 1 = strongly disagree, most respondents agree that foreign ownership to a great extent influenced the firm's financial performance by share prices(mean score =3.75), agency costs(with mean score = 3.71), performance targets(with mean score = 4) , new technology(with mean score =3.72) , monitoring and evaluation(with mean score =3.37) , collaborative linkages and network(with mean score = 3.84) a, foreign funding(with mean score =3.58) and highly qualified professional(with mean score = 3.91).Overall, the intensity of foreign ownership on financial performance of listed firms was considerably moderate (overall mean score = 3.735). Foreign ownership sig. value was .000 (which is less than .05), it was concluded that there is a significant relationship between foreign ownership and financial performance of firms listed in NSE. Regression analysis was used to test foreign ownership hypotheses that there is a significant effect of foreign ownership on financial performance of firms listed in NSE. The regression results showed a positive relationship between foreign ownership and financial performance. (R^2 =0.467, p- value 0.000). The results identified with a study by Chege (2013), which found a positive relationship between profitability and foreign shares ownership among commercial banks listed in the NSE. To further validate the results the ANOVA test showed a statistically significant positive relationship between foreign ownership and financial performance. (F= 96.392, p- value =0.000).

4.8 Summary of Results

The study results revealed that foreign ownership was statistically significant in explaining financial performance of firms listed in Nairobi securities exchange. Therefore the study concluded that foreign ownership had an effect on financial performance of firms and that there exists a positive significant relationship between foreign ownership and firm's financial performance.

5.0 CONCLUSION

This study ultimately finds a positive correlation between foreign ownership and financial performance of listed firms in NSE (r =0.683).Foreign ownership sig. value is .000 (which is less than .05), it was concluded that there is a significant relationship between foreign ownership and financial performance. It can be concluded that there is a statistically significant association between financial performance foreign ownership.

REFERENCES

Aguilera, R, & Cuerra, C. (2004). Codes of Good Governance Worldwide: What is the Trigger? Organizational, Studies. *Journal of Finance*, 27 (12), 274-271.

Albright, C., Winston, W AND ZAPPE,J. (2010). Data analysis and decision making, 4thed., South-Western College Pub, Mason, Ohio, USA, 1080

Avulamusi, F.A., (2013), Relationship between ownership structure and financial performance of commercial banks in Kenya. Unpublished MBA Project: University of Nairobi

Aydin, N., M. Sayim & A. Yalama (2007). Foreign Ownership and Firm Performance: Evidence from Turkey. International Research Journal of Financial Economics, Issue 11.

Bender, M. (2011). Spatial Proximity in Venture Capital Financing. A Theoretical and Empirical Analysis of Germany, 1isted, Gabler Verlag; Germany.

Blair, M. (1995). Ownership and Control: Rethinking Corporate Governance for the twenty-first century. The Brookings institution.

Capital Markets Authority. (2002). Guidelines on Corporate Governance in public listed Companies in Kenya. Nairobi: Government of Kenya. *Kenya Gazette Notice No.* 369, 122-128.

Centre for Corporate Governance. (2004). A study of corporate governance practices in the commercial banking sector in Kenya. Nairobi: Centre for Corporate Governance.

Cespedes, J., Gonzalez, M., Molina, C. (2010). Owner -ship and capital structure in Latin America *Journal of Business Research*, 63(3) , 248–254.

Chege, J.W. (2013), Relationship between ownership structure and financial performance among commercial banks listed in the Nairobi Securities Exchange in Kenya.

Claessens, S., Djankov, S., & Fan, J. (2002). Disentangling the incentives and Entrenchment effects of large shareholdings. *Journal of Finance,* 7 (12), 2741-2771.

Djankov, H., & Simeon, E. (2008). "The law and Economics of self dealing". *Journal of Financial Economics*, 430 (88), 162–192.

Ekadah, W., & Mboya, J. (2011). Effects of board gender diversity on performance of Commercial Banks in Kenya. *European Scientific Journal*, 8(7), 21-48.

Friedman, M., & Rothman, H. (2001). An empirical test of the impact of managerial self-interest on corporate capital structure. *Journal of Finance*, 43(2), 27l -281.

Iravo, M., Ongori, J. & Munene, C. (2013). Factors affecting the performance of hotels and restaurants in Kenya. A case of Kisii County. *Interdisciplinary Journal of Contemporary Research in Business*, 4(12), 897-928.

Kihara, M. (2006). Relationship Between, Ownership Structure, Governance Structure and Performance of Firms Listed with NSE. Nairobi: Unpublished University of Nairobi thesis.

Kothari, S., Leone, A., & Wasley, C. (2012). Performance matched discretionary accrual measures .Journal of Accounting and Economics 39(13), 163 -197.

Mugenda, M., & Mugenda, A. (2003). Research Methods. Quantitative and Qualitative Approaches. Nairobi: ACTS Press.

Nairobi Stock Exchange (NSE). (2012). Handbook on profiles and performance of listed Companies.(2006-2012).NSE.Nairobi, Kenya. http://www.hisanetafrica.com/nse.php

Pallathitta, R. (2005). Corporate governance and firm performance: An analysis of ownership structure, profit redistribution and diversification strategies of firms in India. Doctoral Thesis. University of Tilburg.

Saunders, A., Strick, E., & Travlos, G. (2000).''Ownership Structure, Deregulation, and Bank Risk Taking. *Journal of Finance,* 45(2), 643-654.

Stulz, R. (1988). Managerial Control of voting Rights: Financing policies and the markets for Corporate Control. *Journal of Business Finance and Accounting*, 29(3), 1-28.

Uzel, M. (2015). Effect of Strategic Management Drivers on the performance of the hotel industry in Kenyan Coast. *Unpublished PhD. Thesis*. Nairobi. Jomo Kenyatta University of Agriculture and Technology.

Wheelen, T., & Hunger, J. (2002). Strategic management and business policy (Eighth ed.). Upper Saddle River, NJ: Prentice Hall.