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Full Length Research Paper

The relationship between ownership structure and firm performance: An empirical analysis of listed companies in Kenya

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The study investigated the effects of ownership structure on performance of listed companies in Kenya using agency theory as an analytical framework. Ownership structure was operationalized in terms of ownership concentration (percentage of shares owned by the top five shareholders) and ownership identity (actual identity of shareholders). Measures of performance were return on assets, return on equity and dividend yield. Forty two (out of fifty four) listed companies were studied using both primary and secondary data. Reliability of data was tested using Cronbach's Alpha, while tolerance and variance-inflation factor were used to test multicolinearity. Using Pearson's product moment correlation and logistic regression, the study found that ownership concentration and government ownership have significant negative relationships with firm performance. On the other hand, foreign ownership, diffuse ownership, corporation ownership, and manager ownership were found to have significant positive relationships with firm performance.

Key words: Ownership structure, ownership concentration, ownership identity, firm performance, agency theory, corporate governance.

INTRODUCTION

The history of corporate governance systems is now well documented. According to Gomez (2005), the past one decade or so has however, witnessed significant transformations in corporate governance structures, leading to increased scholarly interest in the role of board of directors in driving corporate performance. Arising from many high profile corporate failures, coupled with generally low corporate profits across the globe, the credibility of the existing corporate governance structures has been put to question. Subsequent research (Shleifer and Vishny, 1997; Shleifer, 2001; Jensen, 2000) has thus, called for an intensified focus on the existing corporate governance structures, and how they ensure accountability and responsibility.

The now well-publicized cases of Enron Corporation, Adelphia, Health South, Tyco, Global Crossing, Cendant and WorldCom, among others, have repeatedly been put forward as typical scandals that justify corporate governance reform and the need for new mechanisms to counter the perceived abuse of power by top management. Monks (1998) argues that the numerous cases of corporate failures are an indictment of the effectiveness of the existing corporate governance structures.

Initially, these financial scandals appeared primarily to be an American phenomenon, arising from overheated U.S. stock markets, excessive greed, and a winner-take-all mindset of the American society. Over the past ten years, however, it has become clear that the vice of managerial fraud, accounting irregularities and other

Abbreviations: ROA, Return on assets; **ROE,** return on equity; **DY,** dividend yield; **OWNCONC,** ownership concentration; **FORENOWN,** foreign ownership; **CORPOWN,** ownership by corporations; **MANOWN,** ownership by managers; **GOVOWN,** ownership by government; **DIVOWN,** diverse ownership; **BOARDEFFECT,** board effectiveness; **MANDISC,** managerial discretion.

governance abuses is a global phenomenon, afflicting many non-U.S. companies including Parmalat, Vivendi, Hollinger, Ahold, Adecco, TV Azteca, Royal Dutch Shell, Seibu, China Aviation, among other high profile cases. Related to these disclosures of alleged gross corporate malfeasance, there was also a more widespread erosion of standards throughout the global markets, with questionable and unethical practices being accepted. The net effect has been to undermine the faith shareholders and investors have in the integrity of the world's capital markets.

Researchers in corporate governance (Donaldson, 2005; Huse, 2005; Frentrop, 2003) have reported that there is still lack of concurrence on the ideal corporate governance structure that could safeguard shareholders' assets while promoting wealth creation ventures. The corporate governance debate has largely centered on the powers of the Board of Directors vis-à-vis the discretion of top management in decision making processes.

The traditional approach to corporate governance has typically ignored the unique influence that firm owners exert on the board, and by extension, the top management, to behave or make decisions in a particular way. Consequently, studies on corporate governance (Cubbin and Leech, 1982; Monks, 1998; Jensen, 2000; Shleifer, 2001; Frentrop, 2003; Donaldson, 2005; Huse, 2005) have not comprehensively identified and dealt with the complexities that are inherent in corporate governance processes. Perhaps, this is where the greatest problem of corporate governance lies.

Owner preferences and investment choices are influenced by, among other factors, the extent to which they can take risks. To the extent that owners have economic relations with the firm, their priority would be to protect their interests even though this may lead to low investment returns, and generally low profitability. In this regard, Thomsen and Pedersen (1997) argue that banks which play a dual role as lenders and owners would not favor high risk ventures with great potential for returns since such a policy is inimical to loan repayment. Government may also play the dual role of regulator and owner. For each of these owners (stakeholders), preferences regarding company strategy will involve a trade off between the pursuit of shareholder value and other goals (Hill and Jones, 1982). All these issues have been ignored in the ongoing debate on corporate governance structure, and instead the role of the Board exalted as the panacea to all the corporate governance problems.

Thus, the corporate governance framework in its current form is evidently lacking in a monitoring system or contract, aligning the role of the firm owners, board of directors and managers' interests and actions within the wealth creation and welfare motivation of stakeholders. This study, therefore, investigated the effect of ownership structure on firm performance, and has ultimately proposed a more vibrant conceptual framework that can help us better understand the corporate governance phenomenon.

Ownership structure and firm performance

There is no well-established tradition of selecting specific measures for the analysis of ownership structure-performance relationship. In each case, the choice of these measures depends on availability of information and their appropriateness for specific research questions. For example, studies focusing on the impact of ownership concentration tend to employ the Herfindahl index or the equity stake of several largest investors, typically the top five shareholders (Demsetz and Lehn, 1985). Other researchers, especially those who investigate developing economies with low availability of data, use equity stake of the largest shareholder (Kapelyushnikov, 2000).

For purposes of this study, ownership structure was analyzed in two dimensions, namely: ownership concentration and ownership identity. Ownership concentration refers to the percentage of shares held by an owner relative to the total shareholding of the firm while ownership identity refers to the actual names of major shareholders. According to Kuznetsov et al. (2001), studies that use either ownership concentration or ownership identity alone cannot claim to have exhaustively analyzed the relationship between ownership structure and firm performance.

The literature on ownership concentration pays more attention to the ability of the owners to monitor and control managerial discretion, but fails to take into consideration the investment preferences of the owner(s) and how they affect the priorities and strategies of the firm. On the other hand, studies which use ownership identity may well be in a position to address the issues of risk aversion, wealth creation and shareholder value but dismally fail to pay attention to the powers to control and monitor management that are conferred by actual shareholding (Cubbin and Leech, 1983).

Ownership concentration and corporate performance

The effect of ownership concentration on company profitability has been studied since Berle and Means (1932). Other studies comparing profitability of manager–and owner–controlled companies, often categorized by the share of the largest owner, generally found a higher rate of return in companies with concentrated ownership (Cubbin and Leech, 1983). These studies, however, were seriously lacking a theoretical foundation. They neither used nor provided a theory of ownership structure and seemed to imply that shareholders could profit by rearranging their portfolios. This point was emphasized by Demsetz (1983) who argued theoretically that the ownership structure of the firm is an endogenous outcome of the competitive selection in which various cost

advantages and disadvantages are balanced to arrive at an equilibrium organization of the firm.

Traditionally, concentrated ownership has been thought to provide better monitoring incentives, and lead to superior performance (Leech and Leahy, 1991). On the other hand, it might also lead to extraction of private benefits by the controlling shareholders at the expense of the minority shareholders (Maher and Andersson, 1999). The principal-agent model suggests that managers are less likely to engage in strictly profit maximizing behavior in the absence of strict monitoring by shareholders (Prowse, 1992; Agrawal and Knoeber, 1996). Therefore, if owner-controlled firms are more profitable than manager-controlled firms, it would seem that concentrated ownership provides better monitoring which leads to better performance.

Gugler (1999) provides a comprehensive survey of empirical studies of the effects of ownership concentration on corporate performance, beginning with the pioneering work of Berle and Means (1932) to more recent work by Leech and Leahy (1991), Prowse (1992), Agrawal and Knoeber (1996), and Cho (1998). Based on primary studies from the US and UK, he finds that although, the results are ambiguous, the majority of studies find that firms with concentrated ownership tend to significantly outperform manager-controlled firms.

Demsetz and Lehn (1985) found no association between ownership concentration and profitability (return on equity) in large US companies when controlling for determinants of concentration and other variables. According to standard agency theory (Shleifer and Vishny, 1997), the choice of a privately optimal ownership structure involves a trade off between risk and incentive efficiency. Other factors kept constant, larger owners will have a stronger incentive to monitor managers and more power to enforce their interests and this should increase the inclination of managers to maximize shareholder value. Generally speaking however, the owners' portfolio risk will also increase the larger ownership share. To the extent that companies differ in terms of firm specific risk, the privately optimal share of the largest shareholder (owner) will therefore, vary. Furthermore, the nature and complexity of activities carried out by individual firms may also vary, and so may the marginal effect of monitoring on the shareholder value of individual firms (Demsetz and Lehn, 1985).

Small shareholders may have an insufficient incentive to maximize total shareholder value because the control and monitoring gains from large block shareholdings are shared with other investors. And if one or a very small group of shareholders attempts to acquire a large ownership stake, the gains will largely be captured by the other shareholders who sell their shares at a premium reflecting increased demand for the shares and value of the firm. This in effect leads to a positive equilibrium effect of ownership concentration on company performance since companies with large owners will do better and since minority investors have insufficient incentives to change the ownership structure. But with increasing ownership shareholding, improved incentives will have less of an effect on performance if the marginal effect of monitoring effort is decreasing (Jensen and Ruback, 1983). Besides, a large ownership stake in a particular company indicates a less than fully diversified portfolio on the part of the owner so that the owner risk aversion may induce the company to trade off expected returns for lower risks. This is because a risk-averse investor, who has most of his investments in a particular line of assets, is always wary of the chances of his capital being substantially reduced or even wiped out in a hostile investment environment (Short, 1994).

Finally, the separation between ownership and management becomes blurred as ownership share increases with the added risk or owner "entrenchment" due to private benefits of control (information advantages, perks, etc.) (Short, 1994). From the aforementioned literature, and in accordance with Morck, Shleifer and Vishny (1988), the following hypothesis is suggested: There is a positive relationship between ownership concentration and firm performance.

Ownership Identity and firm performance

The pertinent literature on corporate governance pays much attention to the issue of shareholder identity (Shleifer and Vishny, 1997; Welch, 2000; Xu and Wang, 1997). The cited authors argue that the objective functions and the costs of exercising control over managers vary substantially for different types of owners. The implication is that, it is important, not only how much equity a shareholder owns, but also who this shareholder is, that is, a private person, manager, financial institution, non-financial institution enterprise, multi-national corporation or government. Investors differ in terms of wealth, risk aversion and the priority they attach to shareholder value relative to other goals.

Owner preferences and investment choices are influenced by shareholder interests that the owners may have in addition to their own interests (Cubbin and Leech, 1982; Nickel, 1997; Hill and Jones, 1982; Hansmann, 1988, 1996). To the extent that owners have their economic relations with the firm, conflicts of interest may arise. For example, banks may play a dual role as lenders and owners, government as regulators and owners (Thomsen and Pedersen, 1997). For each of these stakeholders, preferences regarding company strategy will involve a trade off between the pursuit of shareholder value and other goals.

A similar trade-off is implied for corporate owners such as multi-national parent companies that may want to sacrifice local profit maximization for global interest of the organization. Among the different ownership forms, managerial ownership seems to be the most controversial

as it has ambivalent effects on firm performance. On one hand, it is considered as a tool for alignment of managerial interests with those of shareholders, while on the other hand, it promotes entrenchment of managers, which is especially costly when they do not act in the interest of shareholders (Mork et al., 1988; Stulz, 1988).

Thomsen and Pedersen (2000) posit that the relationship between ownership concentration (as a proxy for shareholder control over managers) and firm performance depends on the identity of the large (controlling) shareholders. One possible interpretation of this finding is that different types of shareholders have different investment priorities, and preferences for how to deal with managers' agency problems. The overall impact of managerial ownership on corporate performance depends on the relative strengths of the incentive alignment and entrenchment effects.

Regarding government (state) ownership, there is much more unanimity in the academic circles. State ownership has been regarded as inefficient and bureaucratic. De Alessi (1980, 1982) defines state-owned enterprises as "political" firms with general public as a collective owner. A specific characteristic of these firms is that individual citizens have no direct claim on their residual income and are not able to transfer their owner-ship rights. Ownership rights are exercised by some level in the bureaucracy, which does not have clear incentives to improve firm performance. Vickers and Yarrow (1988) consider the lack of incentives as the major argument against state ownership. Other explanations include the price policy (Shapiro and Willig, 1990), political interven-tion and human capital problems (Shleifer and Vishny, 1994).

State ownership of firms is not without some benefits to the society. Traditionally, public enterprises are called upon to cure market failures. As social costs of monopoly power become significant, state control seems to be more economically desirable as a way of restoring the purchasing power of the citizenry (Atkinson and Stiglitz, 1980). Generally speaking, empirical evidence however, suggests that public firms are highly inefficient in comparison to private ones (Megginson et al., 1994), even in pursuing public interests. There are several reasons for such observed poor performance of state-owned firms.

According to Shleifer and Vishny (1994), state-owned firms are governed by bureaucrats or politicians that have extremely concentrated control rights, but no significant cash flow rights since all the profits generated by the firms are channeled to the government exchequer to finance the national budget. This is aggravated by political goals of bureaucrats that often deviate from prudent business principles (Repei, 2000). Such enormous inefficiency of state firms has precipitated a wave of governance transformations in economies around the world in the last two decades through heightened privatization of state-owned firms.

In their analysis of political control of state-owned firms' decision making processes, Boycko et al. (1996) argue that transferring control rights from politicians to managers (that is, increasing managerial discretion) can help improve firm performance largely because managers are more concerned with firm performance than are politicians. Banks and other financial institutions are most likely to be risk averse because of their concern with profit maximization. An organization that is heavily leveraged lacks the capacity to pursue risky investment options as these would jeopardize their chances of honoring loan repayment schedules, especially in loss making situations. Banks will also try to discourage further indebtedness as more loans might lead to liquidity problems and perhaps insolvency (Hansmann, 1988). Public companies, on the other hand, can support further indebtedness, if it promises to improve the financial position of the firm and shareholder value in the long-run.

Regarding diffuse shareholding, it is clear from the relevant literature on agency problem that this kind of ownership structure will not give adequate control to the shareholders due to lack of capacity and motivation to monitor management decisions (Jensen and Meckling, 1976). Hence, the control of the firm reverts to underhand dealings aimed at augmenting their income. This insider dealing might compromise company performance. Manager/insider ownership, on the other hand, has attracted a lot of attention and interest for a wide variety of reasons. Much of the interest has focused on the potential for better economic performance, particularly through enhanced motivation and commitment from employees who have a direct stake in the residual income of the firm. Strong majorities of the public believe that manager-owners work harder and pay meticulous attention to the quality of their work than non-owners, and are more likely than outside shareholders to influence firm performance. There have also been social arguments for manager/insider ownership of firms, based on its potential to broaden the distribution of wealth, decrease labor-management conflict, and enhance social cohesion and equality by distributing the fruits of economic success more widely and equitably (Gates, 1998).

The effect of foreign ownership on firm performance has been an issue of interest to academics and policy makers. According to Gorg and Greenaway (2004), the main challenging question in the international business strategy is the outcome gained from foreign ownership of firms. It is mainly accepted that foreign ownership plays a crucial role in firm performance, particularly in developing and transitional economies. Researchers (Aydin et al., 2007) have concluded that, on average, multi-national enterprises have performed better than the domestically owned firms. It is therefore, not surprising that the last two decades have witnessed increased levels of foreign direct investments in the developing economies.

Two main reasons have been put forward to explain the phenomenon of high performance associated with foreign

Table 1. Logistic regression results for the effects of predictor variables on firm performance (above market average).

Indicator variable	Column 1 ROA above market average	Column 2 ROE above market average	Column 3 DY above market average
Predictor variable	**Parameter estimates (β)**	**Parameter estimates (β)**	**Parameter estimates (β)**
Ownership concentration	-0.360*	-0.085	-0.102*
Foreign ownership	6.436*	3.810	6.579
Institution ownership	4.888	2.595	3.120
Government ownership	-15.794	-17.778	-17.021
Diverse ownership	6.041*	5.038	3.718
Board effectiveness	-0.033	-0.042	-0.035
Manager/ insider ownership	5.013	4.049	5.162

*p<0.05

ownership of firms. The first reason is that foreign owners are more likely to have the ability to monitor managers, and give them performance-based incentives, leading the managers to manage more seriously, and avoid behaviors and activities that undermine the wealth creation motivations of the firm owners. The second reason is the transfer of new technology and globally-tested management practices to the firm, which help to enhance efficiency by reducing operating expenses and generating savings for the firm.

DATA ANALYSIS AND RESULTS

The data in this study were analyzed using Pearson's product moment correlation and logistic regression. The results were presented in two categories:

1.) Ownership concentration and firm performance.
2.) Ownership identity and firm performance.

The general form of the models used was:

Firm performance = $b_1 OWNCONC + b_2 FORENOWN + b_3 INSTOWN + b_4 GOVOWN + b_5 DIVOWN + b_6 BOARDDEFFECT + b_7 MANDISC$ (Table 1)

Ownership concentration and firm performance

Hypothesis H_1: There is a positive relationship between ownership concentration and firm performance

The correlation results: ROA (r=-.028, p<0.05; ROE (r=-.030, p<0.05); and DY(r=-.176, p<0.05). Logistic regression results: ROA (β=0.360, p<0.05), ROE (β = -.645, p<0.05) and DY (β = -.888, p<0.05); and DY (β = -.102, p<0.05). These relationships were positive and significant, leading to a rejection of the hypothesis H_1.

Ownership identity and firm performance

Hypothesis H_{2a}: Manager (insider) ownership has a positive effect on firm performance.

The correlation results: ROA (r=0.026, p<0.05), ROE (r=0.038, p<0.05) and DY (r=0.041, p<0.05). Logistic Regression results: ROA (β=5.013, p<0.05), ROE (β= 4.409, p<0.05) and DY (β = 5.162, p<0.05). The relationship was positive and significant, and hypothesis H_{2a} was accepted.

Hypothesis H_{2b}: Government ownership has a negative effect on firm performance.

The correlation results: ROA (r=-.017, p<0.05), ROE (r=-.058, p<0.05); DY (r=-.077, p<0.05). Logistic Regression results: ROA (β=-15.794, p<0.05), ROE (β=-17.778, p<0.05) and DY (β=-17.021, p<0.05). The relationship was negative and significant, leading to acceptance of the hypothesis H_{2b}.

Hypothesis H_{2c}: Ownership by corporations has a positive effect on firm performance.

The correlation results: ROA (r=-.016, p<0.05), ROE (r=-.014, p<0.05); DY (r=-.029, p<0.05). Logistic Regression results: ROA (β=4.888, p<0.05), ROE (β=2.595, p<0.05) and DY (β=3.120, p<0.05).The results were positive and significant, leading to acceptance of the hypothesis H_{2c}.

Hypothesis H_{2d}: Diffuse (diverse) ownership has a negative effect on firm performance.

The correlation results: ROA (r= 0.012, p<0.05); ROE (r=0.023, p<0.05); DY (r=0.061, p<0.05). Regression results: ROA (β=6.041, p<0.05), and ROE (β=5.038, p<0.05); DY (β=3.718, p<0.05). The results led to a rejection of the hypothesis H_{2d}.

Hypothesis H_{2e}: Foreign ownership has a positive effect on firm performance.

The correlation results: ROA (r=0.044, p<0.05), ROE (r=.037, p<0.05); DY (r=.041, p<0.05). Logistic Regression results: ROA (β=6.436, p<0.05), ROE (β=3.810, p<0.05; DY (β=6.579, p<0.05), leading to acceptance of the hypothesis H_{2e}.

DISCUSSION OF RESULTS

Prior research has found significant links between ownership structure and firm performance. Studies comparing ownership concentration and firm performance have often found a higher rate of return in companies with concentrated ownership. Other studies have also shown that it is not only the amount of equity

held by shareholders that matter when studying firm performance but also the identity of the shareholder. The findings of this study therefore, appeared to contradict the position held by proponents of ownership concentration (Moldoveanu and Martin, 2001; Kuznetsov and Murvyev, 2001; Jensen and Murphy, 1990; Fama and Jensen, 1983; Jensen and Meckling, 1976; Berle and Mean, 1932) who argue that ownership concentration affords the shareholders the motivation and ability to monitor and control management decisions. This posits ensures that managers make decisions that support the wealth creation motivation of the shareholders.

Managerial ownership is seen as the most controversial where its overall effect depends on the relative strengths of the incentive alignment and entrenchment effects (Cho et al., 1998).

A diffusely owned firms have been shown in previous studies to have poor performers in part due to the fact that diverse/diffuse shareholders lack the wherewithal and motivation to monitor, control and ratify management decisions. The apologists of strict monitoring and control however, fail to clearly appreciate the fact that ultimately, the shareholders rely on the managers' creativity and innovation to deliver the desired superior corporate performance, and inordinate interference of shareholders in the management processes will certainly undermine corporate outcomes. The latter position is supported by Bergloef and Von Thadden (1999) who posits that concentrated ownership curtails the managers' creativity to a great extent, and therefore, force managers to adhere to only those strategies that are favored by shareholders, even if they genuinely doubt the efficacy of those strategies.

The results of this study appeared to vindicate the latter position, which essentially means that ownership concentration tends to place inordinate monitoring and ratification powers on shareholders, many of whom may not necessarily understand the business well, thereby undermining firm performance. The conclusion that may be drawn from the study findings is that in Kenya, ownership concentration is inimical to manager creativity and innovation, and curtails firm performance.

The typical agency problems that are very likely to arise in situations where professional managers control the assets of a corporation in which they are not shareholders are adverse selection (miscalculations) and moral hazard (failures of managerial integrity). It has been argued that these problems often arise because managers lack the requisite motivation to ensure prudence since they do not have a stake in the residual income of the firm (Moldoveanu and Martin, 2001; Fama and Jensen, 1983). According to Mork and colleagues (1988) and Stulz (1988), managerial ownership is the most controversial and ambivalent form of firm ownership, and has mixed effects on performance.

Whereas ownership by managers may be seen as a system of aligning the interests of managers with those of the shareholders in a way that enhances corporate performance, this form of ownership can also lead to entrenchment of managers, which is costly when they chose to pursue their self interests. It has been argued that the overall impact of managerial ownership on firm performance depends on how well the entrenchment effects and incentive alignment are balanced (Cubbin and Leech, 1982; Nickel, 1997 Hill and Jones, 1982; Hansmann, 1988, 1996). The findings of this study agreed to a significant extent with the argument that managerial ownership enhances corporate performance. In Kenya, manager ownership of firms has been actualized through executive share options. The findings therefore, suggest that when managers also double up as shareholders, they are motivated to work towards realization of the wealth creation objective of the shareholders of whom they are part. On the other hand, managers who are not shareholders are more likely to engage in insider dealings as a way of enhancing their personal wealth and prestige.

There is near convergence that Government ownership of firms leads to bureaucracy and inefficiency that negatively impacts firm performance (Nickel, 1997). Many researchers (De Alessi, 1980, 1982; Vickers and Yarrow, 1988; Shapiro and Willig, 1990; Shleifer and Vishny, 1997) have argued that state-owned enterprises are political firms with citizens as the shareholders, but these citizens have no direct claim to the residual income of those firms. The citizens thus cede their ownership rights to the bureaucracy which does not have clear incentives to improve performance of the corporations. Others (Nickel et al., 1997) have attributed the prevalent poor performance of Government owned firms to the tendency of those firms not to strictly adhere to government statutory requirements and regulations. Political manipulation and poor human resource policies are other factors that have been blamed for the general poor performance of state-owned enterprises (Shapiro et al., 1990).

Since the early 1990's, the Kenyan Government has pursued a deliberate policy of divestiture, aimed at reducing state ownership of corporations with a view to attracting private sector participation in management of the fledgling state corporations. It was envisaged that this policy would infuse modern management styles into the public sector that would ultimately improve performance of these companies. The fact that Government ownership of firms was found to still impact firm performance negatively is perhaps an indication that the divestiture program in Kenya is yet to reach a critical level where its value can begin to reflect on corporate performance.

Pertinent literature regarding the relationship between ownership by corporations and firm performance emphasizes that investors differ in the degree to which they are prepared to take risks (Shleifer and Vishny, 1997; Welch, 2000; Xu and Wang, 1997). Firm owners make investment choices that are influenced by their interests and preferences.

When a firm acquires shares in another firm, the shareholders of the first firm extend their investment preferences, interests and risk taking behavior to that new firm. The interesting thing about firm ownership by other firms in Kenya is that the holding firms are typically large corporations with the ability to reorganize their branch/affiliate operations to bail out non-performing affiliates. Most of these holding firms have also reported good performance during the period of study. The good performance of the firms they own is therefore, consistent with the documented practice by firms to extend their investment preferences and risk-taking behavior to the firms they acquire.

Regarding the impact of diverse ownership on firm performance, the findings of this study appear to contradict those of previous researchers (Fama and Jensen, 1983; Jensen and Meckling 1976; Berle and Mean, 1932) who have argued that agency problems are more severe in diffusely held firms due to lack of capacity to collectively monitor the activities of managers, a situation that gives managers unlimited leeway to run the affairs of the corporation in their own self interest. This argument, however, fails to appreciate that shareholder-managers will almost invariably demonstrate more commitment to the firm than will their counterparts who are not shareholders since the latter have no stake in the residual income of the firm.

Although, some researchers have tended to favor concentrated ownership over diverse ownership, the reality is that the agency costs incurred in monitoring managers (especially if they are not shareholders) are huge, and may undermine firm performance. Thus, it is a lot cheaper for managers to be able to make independent decisions that support shareholder objectives than have shareholders to impose imprudent ideas on them. The import of the study findings is that in Kenya, managers work better in an environment where they are afforded an opportunity to own shares of the firm, then allowed freehand to exercise their professional judgment without undue influence from shareholders. This arrangement works best in a diffusely held firm. It can also be argued that the high performing blue chip companies have high likelihood to attract more individual investors to buy their shares, thereby diversifying shareholdings. The hypothesis H_{2d} is therefore, rejected on the basis of the study findings.

The most definitive results were on the relationship between foreign ownership and firm performance. The significant positive relationships have vindicated the long-held belief that on average, foreign owned companies perform better than their counterparts with dominant local ownership. Thomsen and Pedersen (1997) posit that preferences regarding company strategies will often involve a trade-off between the pursuit of shareholder values, orientation and other goals. Successful companies with an international presence tend to be large, with well established management systems that are are replicated (with minimal customization) in all their branches and affiliates abroad.

International companies also tend to enjoy massive resources that can be used, whenever need arises, to buttress financial strength of their affiliates that are facing difficulty. These companies also tend to use their unique advantage of international presence to defeat local tax authorities by designing complex tax avoidance schemes that re-allocate huge costs to harsh tax regimes in order to minimize tax liability. These factors give foreign companies undue advantages that are not available to the local counterparts, hence their superior performance.

In Kenya, all the listed foreign companies happen to be large and successful. In fact, in the period under review, all the foreign companies made accounting profits while many of the local ones were struggling to remain afloat. This is a clear indication that the foreign companies were enjoying an extra advantage that was not accessible by the local firms.

Implications of the research findings

1.) The existing framework of corporate governance that relies on the Board as the most critical organ of governance, has evidently ignored others equally, if not, more important aspects, including ownership structure.

2.) The monitoring and control school of thought argues that the free-rider problems associated with diffuse ownership do not arise with concentrated ownership, since the majority shareholder captures most of the benefits associated with this monitoring. This found out that the reverse is actually true in the Kenyan context. The implication is that when more than 30% or more of shares are concentrated on a few hands (that is, five shareholders or less), there is a tendency for the shareholders to be overzealous in their monitoring, controlling and ratification roles over managers. This stifles managers' creativity and innovation, and ultimately affects firm performance adversely. It is even worse when the shareholders lack specific and general knowledge about the business of the firm. The results of the study have therefore, shown there is dire need to reasonably diversify shareholding as a way of attracting more skills and competencies among the shareholders that can be tapped to improve firm performance. At the same time, the managers should be protected from unnecessary direct interference by the shareholders.

3.) The findings of the study have shed light on the contentious relationship between manager/insider ownership and firm performance. It has been argued that when managers own shares in their company, they become more committed to the organization since they have a stake in the residual income of the firm, and are likely to bear the cost of mismanagement. This commitment translates to superior performance. In fact, the study reaffirmed this position among listed companies

in Kenya. What was not established by the study however is the critical level of shareholding, beyond which there would be accelerated firm performance arising from commitment of managers.

4.) Government ownership has been roundly criticized for contributing to generally poor performance of firms, due to excessive bureaucracy, tribalism, nepotism, poor human resource policies, political expediency in appointments and lack of respect for laws and regulations. This study found a very significant negative relationship between government ownership and firm performance. The implication is that government should infuse private sector-like management systems and progress the divestiture program to attract more private individuals and institutions to co-own the state corporations. The performance contracting policy that was recently introduced by the Kenya Government should be developed further and supported as a way of promoting performance-based management in the public sector. This system, if fully implemented, has the potential to move Kenya to the next level where appointments and promotions in the public sector are based on merit.

5.) Previous studies have found ambiguity in the relationship between ownership by corporations and firm performance, due mainly to the differences in investment preferences and shareholders' goals. The results of this study were very categorical: the relationship is positive for all the listed firms that are owned by other firms, a position attributed to the fact that all the holding companies happened to be large corporations which were themselves performing well. So the good performance is attributable to the investment choices and orientation of the parent companies, and not necessarily the ability of managers. The results are a pointer that companies that are performing poorly need to carefully chose strategic partners to prop up their poor performance.

6.) The global trend toward diffuse ownership has confounded many researchers, since it undermines the popular belief that managers are inherently self-seeking and can easily wreck the organization if left without close monitoring. For a long time, corporate governance has been premised on the need for concentrated ownership to check on managers' insider dealings, and that diffused ownership is bereft of sufficient motivation and wherewithal to monitor managers' actions. The findings have brought a new dimension that emphasizes managerial discretion for creativity and innovation, and less monitoring by shareholders. Thus, diffuse ownership of firms provides a good environment for excellent policies to be developed and implemented by managers. In principle, this is true since the reason why owners hire managers in the first place is because they needed the managers' specialized human capital to run the firm and to generate returns on their investments. The managers are therefore best informed regarding alternative uses for the investors' funds. As a result, the managers end up with substantial residual control rights and discretion to allocate funds as they choose. The downside of this argument is that it presumes that managers are honest, and always prepared to work in the objective interest of the shareholders, a position that is often not true. The fact that managers have most of the control rights can lead to problems of management entrenchment and rent – seeking behavior by managers. The question of how much discretion (limits) managers should have, and performance accountability by managers is therefore, fundamental. One of the consequences of the possibility of opportunistic behavior by managers is that it reduces the amount of resources that investors are willing to invest in the firm, leading to socially inefficient levels of investment that, in turn, can have direct implications for economic growth and development. Accordingly therefore, there should be developed corporate governance mechanisms that align interests of managers with those of investors. An effective corporate governance framework can minimize the agency costs associated with separation of ownership and control of firms. This study has shown that managers work best when they have sufficient latitude for innovation and creativity, that is, less monitoring by principals.

7.) Shareholders are unlikely to be comfortable with an arrangement that almost completely removes their monitoring and ratification roles. To remedy this situation, this study suggested three broad mechanisms that can be used to align the interests and objectives of managers with those of shareholders, and overcome the problem of management entrenchment. The first mechanism is to motivate managers to enhance their management practices by directly aligning their interests with those of the shareholders, through executive compensation plans and stock options. The second method is to entrench shareholders' rights in the legal instruments so that they enjoy legal protection from managers' expropriation (moral hazard, insider dealings, etc.). Last but not least, is to strengthen the statutory bodies such as Capital Markets Authority and Nairobi Stock Exchange to provide more effective role in managerial labor markets and markets for corporate control.

8.) The positive and significant relationship between foreign ownership and firm performance appears to have gained universal acceptance across the globe, and therefore, this study went further to investigate the real issues behind the phenomenon. The results are as interesting as they are saddening. First, foreign owned companies have access to management systems whose efficacy has been tested in many contexts. The massive resource base and bail-out plans for fledgling affiliates are other factors that enhance performance of foreign owned firms. However, the ability of these companies to re-organize their global operations to be able to assign more costs to harsh tax regimes and profits to tax havens in a bid to reduce their overall tax liability, is the most damning feature of foreign ownership. The practice of designing complex tax avoidance schemes is quite

devastating to locally-owned firms which have to pay all their taxes, thereby incurring huge costs of operation. Besides the playing field not being level for both foreign and local players, the foreign owned firms actually undermine the host economies through repatriation of profits and stifling growth of local industries. Whereas there is need to attract foreign direct investment, the host countries should develop their capacity to effectively deal with cases of transfer pricing and related practices.

9.) This study found a non-hierarchical relationship between ownership structure and firm performance. What this means essentially is that ownership structure has a direct bearing on firm performance. This finding has been vindicated by the significant relationships between firm performance and ownership concentration and ownership identity. It is therefore, important for companies to address the issues surrounding ownership concentration and identity, to ensure that a careful balancing act is done to promote managerial discretion while at the same time maintaining sufficient monitoring, control and ratification in the hands of the shareholders.

10.) The challenging task that policy makers must confront is to design a corporate governance framework that secures the benefits of large shareholders whilst preventing them from extracting excessive private benefits. At the same time, the corporate governance framework should protect the minority shareholders from expropriation, as a way of encouraging the development of equity market in Kenya since small investors will be encouraged to buy more of the listed companies' stocks. The Nairobi Stock Exchange and Capital Markets Authority should encourage high standards of disclosure and transparency among market players, to help ensure that the investment environment encourages all types of investors (large and small) feel comfortable to participate in the stock market. Disclosure requirements should be mandatory and enforcement should be strict.

Limitations of the study and directions for further research

1.) The small number of listed companies in Kenya made it difficult to include many more variables since data analysis would have been very difficult.

2.) The inability to fully investigate industry-specific issues due to the general approach of this study. Although, there are advantages in studying listed companies, especially the availability of data, this target population does not have good representation of all the industries, with Industrial and Allied sector having the bulk of listed companies, followed by Financial and Investment. The Agricultural sector, which is the mainstay of the Kenyan economy, comes last in terms of represen-tation with less than ten listed companies. Generaliza-tions have therefore, been made regarding performance of sectors, but which require further investigations.

3.) There are other types of firm ownership identity in Kenya, such as family ownership, but they were not considered due to the restrictive nature of the require-ments for listing at the Nairobi Stock Exchange which bar privately held companies from listing.

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