

## **Implications of Firm Ownership Identity and Managerial Discretion on Financial Performance: Empirical Evidence from Nairobi Stock Exchange**

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### **Abstract**

*Research on the implications of ownership identity and managerial discretion on firm performance has been yielded mixed results. Further, there is scanty literature, if any, on studies combining these variables in a single research. Yet there is near-convergence in literature that ownership identity impacts managerial discretion in decision making processes. This paper presents results of a study that shows the interrelationships between ownership identity and managerial discretion, and their impact on financial performance as measured by ROA, ROE and DY. State ownership of firms is particularly indicted for poor stewardship, whereas foreign, insider, diverse and institutional ownership gave the best results. The results also show significant positive relationship between managerial discretion and performance. Collectively, these results are consistent with pertinent literature with regard to the implications of government, foreign, manager (insider) and institutional ownership forms, but significantly differ concerning the effects of diverse ownership on firm performance.*

**Key Words:** Ownership Structure; Agency Theory; Ownership Concentration; Ownership Identity; Managerial Discretion; Firm Performance.

**ABBREVIATIONS:** FOREOWN-foreign ownership, GOVOWN-government ownership, INSTOWN-institution ownership, DIVOWN-diverse ownership, MANOWN-manager ownership, MANDISC-managerial discretion, ROA-Return on Assets, ROE-Return on Equity, DY-Dividend Yield

### **1.0 Introduction**

The separation of ownership and control of capital in publicly held companies precipitates conflicts of interest between principals and agents (Berle and Means, 1932). Whereas the basic motivation of owners of capital is to maximize their wealth by enhancing the value of the firm, the objectives of agents are diverse and may include enhancement of personal wealth and prestige. This divergence of interests often leads agents to engage in insider dealings where there are no mechanisms for effective monitoring, ratification and sanctioning of managerial decisions. It has been argued (Jensen and Meckling, 1976) that agents resort to extraction of private benefits from firms that they manage if they are not shareholders, and thus neither meet the full cost of mismanagement nor share in the residual income of those firms. To remedy managerial failings, a number of governance mechanisms aimed at aligning the interests of agents with those of principals, including equity ownership by managers, may be considered. To enhance their monitoring role, and ensure capital is applied to its intended purpose, shareholders choose from amongst their ranks, individuals to represent them on the board of directors. The Board is therefore, put in place to safeguard the interests of principals from agents who are bent on extracting private benefits from the organization (McDonald, 2005).

Research has however, shown that the board of directors does not always protect the interests of shareholders, and some of them, in fact, get entrenched. They thus become a threat to shareholders rather than a panacea to managerial failings. To mitigate the collective failings of both agents and board, shareholders are forced to incur agency costs by hiring independent auditors to help monitor managerial decisions that are ratified by board of directors. Managerial discretion has been a subject of academic investigation for sometime, especially after initial researches showed mixed results on its relationship with firm performance. Research has shown that most of managerial failings are largely attributable to the fact that managers, more often than not, do not meet the full costs of mismanagement. Besides, managers in many companies do not share in the residual income of the firms that they run, especially where they are not shareholders. The study, whose results are reported by this paper was thus, conceived to bridge the glaring gap in literature. Kenya has experienced turbulent times with regard to its corporate governance practices in the last two-and-a-half decades, resulting in generally low corporate profits across the economy. Coincidentally, this picture is fairly well replicated globally in the same period.

## **2.0. 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 ownership 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 intervention 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, however, empirical evidence 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, Shleifer and Vishny (1996) argue that transferring control rights from politicians to managers (i.e. 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, Sayim and Yalama, 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 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.

### ***3.0. Managerial Discretion and Firm Performance***

Hambrick and Finkelstein (1987) have defined managerial discretion as the executives' ability to effect important organizational outcome; a function of the task environment, the internal organization, and the managerial characteristics. While concurring with this definition, Hitt, Ireland, and Hoskisson (2003) specify factors affecting managerial discretion to include industry structure, rate of market growth, number and type of competitors, nature and degree of political, legal constraints, degree to which products can be differentiated, organizational characteristics of the manager. Hambrick and Abrahamson (1995) and Finkelstein and Hambrick (1990) posit that managerial discretion moderates the correlation between top management effectiveness and both strategic continuity and firm performance. Agency theory hypothesizes that managerial discretion is related negatively to firm performance if managers use their discretion to pursue their own selfish objectives. According to Chang and Wong (2003), strategic management of managerial discretion is dependent, to a large extent, on a comparison of the objectives of controlling shareholders and those of managers. Although it is now a well established fact that managers may have self-serving objectives, there is no priori that restricting managerial discretion will better serve the goal of maximizing firm performance.

When controlling shareholders also have self-serving objectives, increasing managerial discretion can be a useful way to partially protect the interests of investors, and improve firm performance (Ibid, 2003, pp. 4). Typical agency theory views managerial discretion as an opportunity for managers to serve their own objectives rather than the objectives of their controlling shareholders. The controlling shareholders may develop various strategies to prevent managers from using their decision making discretion to pursue self-serving objectives at the expense of firm performance. These strategies would include doubling managers' compensation with firm performance (Jensen and Murphy, 1990), and establishing monitoring and bonding mechanisms to limit opportunistic actions by managers (Fama and Jensen, 1983). Such measures may discourage managers from pursuing their own goals even if they have the discretion to do so. Furthermore, it may be in managers' best interest to maintain a certain level of firm performance because of both the discipline and opportunities provided by markets for their services, both within and outside the firm (Fama, 1989). Nevertheless, the core hypothesis within agency theory is that managerial discretion is negatively associated with firm performance if managers use their discretion to pursue self-serving objectives. Many studies have examined the empirical relationship between managerial discretion and firm performance. Existing evidence about the relationship is however, inconclusive. Some studies (Williamson, 1963a; Palmer, 1973; Baysinger and Butler, 1985; Berger *et al*, 1997; Denis *et al*, 1997; Brush *et al*, 2000). Other studies find that managerial discretion is unrelated to firm performance (e.g. Chaganti *et al*, 1985; Demsetz and Lehn, 1985; Zahra and Stanton, 1988; Agrawal and Knoeber, 1996).

The absence of a relationship is interpreted as evidence that various controlling shareholders have made optimal use of various mechanisms to control managers' agency problems and therefore, is considered to be consistent with agency theory's hypothesis. There are however, some studies (Kesner, 1987; Donaldson and Davis, 1991) that find a positive association between managerial discretion and firm performance. While researchers have focused their efforts on identifying the indicators of discretion, they have not examined whether managers' perception of discretion vary within similar organizations and industries. Consequently, they also have not examined the sources of such variation. The goal of this study is to extend research on managerial discretion, and, more generally, to enrich our understanding of why managers and organizations may respond differently when confronted with similar strategic opportunities. Cognitively oriented studies have attributed managers' perceptions to industry conditions (Hambrick & Abrahamson, 1995) and organizational performance (Dutton and Duncan, 1987).

These studies, have, unfortunately, not addressed the critical issue of managers personality characteristics; that is, whether the managers' actions are controlled by inner drive or some external influence (i.e. locus of control). Rotter (1966) suggests that one's locus of control may affect the extent to which one perceives himself/herself to have discretion in a variety of situations. Locus of control reflects individual's generalized perceptions of the degree to which they control, or are controlled by their environment (Rotter, 1966). In fact, Rotter (1966) argues that the manager's perception of own discretion in decision making processes actually defines his/her perception of power relations within the organization. "External" individuals tend to believe that the events in their lives are beyond their control; in their view, luck or destiny determine their fate. In contrast, "internals" tend to view their fate as primarily under their control (Milles, Kets de Vries and Toulouse, 1982). These perceptions tend to be communicated through informal channels or "body language" to the managers' subordinates, and they ultimately define the authority that managers actually wield over those subordinates.

### **2.1.1. Constraints on Managerial Discretion**

According to the classical separation of ownership and control perspective, a dominant or majority shareholder has both the incentive and the ability to monitor management so that the firm is managed in a manner consistent with profit maximization. The incentive to monitor is high because the majority shareholder has a claim on all residual profit (Alchian and Demsetz, 1972), and the ability to monitor is high because the dominant shareholder can often control the Board of Directors (Tosi *et al*, 1989; Fama and Jensen, 1983; Salancik and Pfeffer, 1980). On the other hand, agency theory is premised on the assumption that managers have non-profit maximizing objectives. Various studies analyzing managers' objectives make many different assumptions about these objectives. For example, Baumol (1959) assumes that managers have an incentive to maximize sales subject to the constraints of satisfactory profit, while Williamson (1963a, 1963b) assumes that managers have a positive preference for incurring staff expenses, acquiring bigger managerial emoluments, and increasing funds available for discretionary use. Some studies suggest that managers prefer a non-optimal capital structure because such a structure enables them to pursue personal goals (Fama, 1980).

When the Board of Directors is under the control of a dominant shareholder, the cost of organizing a coalition to oppose existing management is avoided. In contrast, when shareholdings are widely diffused, neither the incentive nor the ability to monitor agents is present and so managers are afforded a greater degree of discretion that puts less pressure on them to maximize profits (and shareholder wealth). Thus concentrated ownership is a powerful restraint on managerial discretion. Research grounded in the separation of ownership and control thesis therefore typically makes the simplifying assumption that managerial discretion is essentially a function of ownership concentration. As such, individual, organizational and environmental factors other than ownership concentration that may impact upon managerial discretion are typically ignored (Hambrick and Finkelstein, 1987). Nevertheless, even though modern corporations are often characterized by diffused ownership, managers are not necessarily able to engage in unethical discretionary behavior due to the monitoring and control role of boards of directors (Ibid, 1987). There are two broad sources of constraint on managerial discretion. These constraints may be classified as internal or external (Walsh and Seward, 1990). Internal constraints largely emanate from the Board of Directors and are exercised on behalf of the shareholders (owners). These constraints reflect the composition and powers of the Board, including the ease by which shareholders can appoint or remove Board members, and the rules governing voting. External constraints, on the other hand, pertain to the role of markets in monitoring and disciplining managers.

The mostly noted market-related constraints arise from managerial labour markets, product markets and financial markets (Jensen, 1989). Managerial labor markets play a key role in influencing the behavior of managers. When the management of a firm is inefficient, or failing to maximize shareholder value, this exposes the company to the threat of a take-over bid, with the consequential removal of inefficient management (Maher and Andersson, 1999). While up until now the market for corporate control has not been a key feature of corporate governance systems in developing countries such this is gradually beginning to change, as mergers and acquisitions are becoming more common (Ibid, 1999, pp.22). According to Maher and colleagues (1999), product market competition can to some extent act to reduce the scope for managerial inefficiency and opportunism. This is because there are limited opportunities for supernormal profits and rent-seeking behavior when markets are competitive, forcing managers to enhance efficiency in order to survive. Competition also provides a benchmark by which the performance of the firm can be judged by comparing it with performance of other firms within the same sector. Providers of capital tend to maintain complex and long-term relationships with the corporate sector. According to Blair (1995), the long-term relationships between banks and their corporate clients provide greater access to firm-specific information. Due to this disclosure, the bank-firm relationships reduce asymmetric information problems, enabling banks to supply more finance to firms at a lower cost, and thus increasing investment.

In addition, bank-firm relationships increase monitoring, thus ensuring firms are run more efficiently (Ibid, 1995, pp. 25). The modern corporation is increasingly experiencing extra-ordinary vigilance by a wide range of stakeholders who manifest themselves either directly or indirectly. Stakeholders place a lot of constraints on managerial consultations before major decisions are made. A Board that represents shareholder (or stakeholder) interests can effectively monitor managers by virtue of its proximity to sources of information. Also, because the Board is a relatively small body, monitoring costs are low (Kesner, 1987; Baysinger and Hoskisson; 1990; Baysinger, Kosnik and Turk, 1991). Needless to say, the efficacy of internal constraints is dependent on the Board acting in the interests of shareholders (stakeholders), an assumption that may not always be justified (Herman, 1981). Unless Board members are significant shareholders, their incentive to monitor is low and will not approach that of a dominant or majority shareholder. In contrast to the classical agency theory position, there is evidence to suggest that vigilant Boards comprising independent outsiders may have a strong incentive to monitor managers when they are shareholders.

Further, even in the absence of share ownership, Board members have their personal reputations as directors at stake, which provides them with an incentive to be vigilant monitors (Fama and Jensen, 1983). In countries where employees or other stakeholders are represented on the Board, the incentive as well as the ability of stakeholders to monitor can be quite high. Based on this logic, some organizations have developed executive share ownership programs for their higher-level management and Board of Directors. Under this plan, an employee, usually an executive manager or a member of the Board is given a certain number of shares of the company or an option to buy them from the market place. This way, the manager or the Board member gets a stake in the profits of the business (Muruku *et al*, 1999).

The thesis is that it will be in the interest of the executive or board member to increase efficiency since that will result in increased stock prices, from which he also benefits. An essential characteristic of internal constraints is that the responsibility for monitoring falls on insiders (e.g. owners or Board) who are directly charged with the responsibility for corporate governance. What is common to the external constraints is that they rely on a variety of markets or market-based measures to align interests and thus, when effective, render monitoring of managers unnecessary. In the case of external constraints, shareholders are essentially transferring monitoring responsibility to the markets. In the case of markets for corporate control, managers who do not maximize returns to shareholders will see their firms acquired and themselves displaced in favor of more proficient managers (Jensen, 1989). The influence of internal and market influences on the relationship between managerial discretion and firm performance is presented in Table 1 (insert *Table 1 about here*). The  $\beta$  for the relationship between the independent predictor variable (Managerial Discretion), the moderator variable (Market Influence) and their product term (Market Influence x Managerial Discretion) were insignificant at the 5 per cent level (i.e.  $p > 0.05$ ). The above results lead to the deduction that the strength of the relationship between managerial discretion and ROA did not depend on market influences. Similarly, results in column II show that the relationship between managerial discretion and ROE did not depend on market influences.

### 3.0 Model Specification, Analysis and Results

Pearson's Product Moment Correlation and Logistic Regression were conducted on SPSS. The results of ownership identity were analyzed based on five elements: government; foreign; institution; diverse; and manager (insider). On the other hand, managerial discretion has three elements: perceived power; perceived discretion; and locus of control. The general form of the models used was:

$$FIRM\ PERFORMANCE = b_0 + b_2FORENOWN + b_3INSTOWN + b_4GOVOWN + b_5DIVOWN + b_6MANOWN + b_8MANDISC$$

The logistic regression results based on the model are summarized in Tables 2 and 3 (insert *Tables 2 and 3 about here*).

#### **Hypothesis H<sub>1</sub>: Manager (Insider) Ownership has a positive effect on firm performance.**

The Linear Regression 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 ( $\beta=5.013$ ,  $p<0.05$ ), ROE ( $\beta=4.409$ ,  $p<0.05$ ) and DY ( $\beta=5.162$ ,  $p<0.05$ ). The relationship was positive and significant, and hypothesis H<sub>2a</sub> was accepted.

#### **Hypothesis H<sub>2</sub>: Government ownership has a negative effect on firm performance.**

The Linear Regression results: ROA ( $r=-.017$ ,  $p<0.05$ ), ROE ( $r=-.058$ ,  $p<0.05$ ); DY ( $r=-.077$ ,  $p<0.05$ ). Logistic Regression results: ROA ( $\beta=-15.794$ ,  $p<0.05$ ), ROE ( $\beta=-17.778$ ,  $p<0.05$ ) and DY ( $\beta=-17.021$ ,  $p<0.05$ ). The relationship was negative and significant, leading to acceptance of the hypothesis H<sub>2b</sub>.

#### **Hypothesis H<sub>3</sub>: Ownership by Corporations has a positive effect on firm performance.**

The Linear Regression results: ROA ( $r=-.016$ ,  $p<0.05$ ), ROE ( $r=-.014$ ,  $p<0.05$ ); DY ( $r=-.029$ ,  $p<0.05$ ). Logistic Regression results: ROA ( $\beta=4.888$ ,  $p<0.05$ ), ROE ( $\beta=2.595$ ,  $p<0.05$ ) and DY ( $\beta=3.120$ ,  $p<0.05$ ). The results were positive and significant, leading to acceptance of the hypothesis H<sub>2c</sub>.

#### **Hypothesis H<sub>4</sub>: Diffuse (Diverse) ownership has a negative effect on firm performance.**

The Linear Regression 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 ( $\beta=6.041$ ,  $p<0.05$ ), and ROE ( $\beta=5.038$ ,  $p<0.05$ ); DY ( $\beta=3.718$ ,  $p<0.05$ ). The results led to a rejection of the hypothesis H<sub>2d</sub>.

#### **Hypothesis H<sub>5e</sub>: Foreign Ownership has a positive effect on firm performance.**

The Linear Regression results: ROA ( $r=0.044$ ,  $p<0.05$ ), ROE ( $r=.037$ ,  $p<0.05$ ); DY ( $r=.041$ ,  $p<0.05$ ). Logistic Regression results: ROA ( $\beta=6.436$ ,  $p<0.05$ ), ROE ( $\beta=3.810$ ,  $p<0.05$ ); DY ( $\beta=6.579$ ,  $p<0.05$ ), leading to acceptance of the hypothesis H<sub>2e</sub>...

### 4.0. Methodology

The relationship between ownership structure and firm performance is conceptualized based on pertinent literature on corporate governance. Ownership identity was conceptualized as comprising four categories were identified, namely: foreign; institutional; government; and diverse. Each of these ownership identities has different risk-taking orientations, which in effect impact investment decisions and firm performance differently.

Managerial discretion, on the other hand, is analyzed in terms of locus of control, perceived power and perceived discretion. To test whether the relationship between ownership structure and firm performance was direct or through board effectiveness and managerial discretion, step-wise regression was used, and the marginal changes in value of R monitored to confirm whether the additional variables were of significant or not.

#### **4.1. Sampling Approach**

A census approach was used, and thus the sampling frame consisted of all listed firms in Kenya. Using the Nairobi Stock Exchange Handbooks (2006, 2008), 54 firms were on the roll, out of which six had not compiled their financial reports for the relevant period of study. Another six failed to take part in the study. The final sample therefore, consisted of forty-two firms, representing about 78 percent response rate. The sample comprised four firms from the Agricultural sector (9.5%), seven from Commercial Services (16.7%), ten from Finance and Investment (23.8%), fourteen from Industrial and Allied (33.3%), and seven from Alternative Investment Market (16.7%).

#### **4.2. Reliability Analysis**

Reliability analysis was used to assess internal consistency (degree of homogeneity among the items). Cronbach's Alpha coefficients were computed for 18 items under board effectiveness and managerial discretion, and the overall assessment was 0.87. According to Nunnally (1978), a data collection instrument with a good internal consistency should have Cronbach's Alpha coefficients that are higher than 0.7. The items were therefore, found to be highly homogeneous.

#### **4.3. Empirical Findings and Implications**

The study found a significant positive relationship between 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. There is a significant negative relationship between government ownership and firm performance. 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 of the country. The current study has confirmed this long-held position. 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. Regarding the relationship between ownership by corporations and firm performance, the study found a significant positive relationship. 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.

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. A surprising finding of this study is the significant positive relationship between diverse ownership and firm performance. 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. 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. 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. This study has shown that managers work best when they have sufficient latitude for innovation and creativity, that is, less monitoring by principals. The positive and significant relationship between foreign ownership and firm performance appears to have gained universal acceptance across the globe due to a number of factors.

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. Finally, this study has found out that managerial discretion spurs innovation and creativity, thus supports firm performance.

**Table 1: Regression results for the effects of Market Influence on the relationship between Managerial Discretion and Firm Performance**

| Predictors                               | Col. I<br>Market Influence as Moderator<br>ROA<br>(β) | Col. II<br>Market Influence as Moderator<br>ROE<br>(β) | Col. III<br>Market Influence as Moderator<br>DY<br>(β) |
|--|---|--|--|
| Managerial Discretion                    | .980  | .237   | 1.598*   |
| Market Influence                         | 4.605   | .170   | 1.884*   |
| Market Influence x Managerial Discretion | -.119   | -.356  | -1.985*  |
| F (full model)                           | .412  | 0.289  | 1.249  |
| R <sup>2</sup>                           | .033  | 0.023  | 0.099  |
| Adj. R <sup>2</sup>                      | -.047   | -0.056   | 0.020  |

Standardized regression coefficients

\*p<.05

**Table 2: Logistic Regression Results for the effects of Predictor Variables on Firm Performance (Above Market Average)**

| Indicator Variable         | Column 1<br>ROA Above Market Average | Column 2<br>ROE Above Market Average | Column 3<br>DY Above Market Average |
|----------------------------|--------------------------------------|--------------------------------------|-------------------------------------|
| Predictor Variable         | Parameter Estimates (β)              | Parameter Estimates (β)              | Parameter Estimates (β)             |
| 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                               |
| Manager/ insider ownership | 5.013                                | 4.049                                | 5.162                               |

\*p<0.05

**Table 3: Regression Analysis of Response by Predictor Variables and Type of Investment Market Segment**

| Variable                     | Agriculture Sector | Commercial Services | Financial and Investment | Industrial and Allied | Alternative Investment Market Segment (Aims) | F-Value |
|------------------------------|--------------------|---------------------|--------------------------|-----------------------|--|---------|
| <b>Managerial Discretion</b> |                    |                     |                          |                       |  |         |
| Mean                         | 49.75              | 40                  | 43.9                     | 45.7857               | 43.4286                                      | 1.395   |
| Median                       | 52.5               | 39                  | 43.5                     | 44                    | 44   |         |
| <b>Ownership Identity</b>    |                    |                     |                          |                       |  |         |
| Mean                         | 63.025             | 64.15               | 53.113                   | 55.3792               | 71.0114                                      | 1.695   |
| Median                       | 62.95              | 67.5                | 51.045                   | 60.08                 | 72.2   |         |
| <b>Firm Listing Age</b>      |                    |                     |                          |                       |  |         |
| Mean                         | 35                 | 32                  | 25.7                     | 25.8462               | 39.7143                                      | 1.549   |
| Median                       | 37.5               | 33                  | 23                       | 33                    | 34   |         |



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