

CORPORATE OWNERSHIP AND FINANCIAL PERFORMANCE: A COMPARISON BETWEEN PRIVATIZED AND OTHER PUBLICLY LISTED COMPANIES IN KENYA

Gitundu^{1*} Esther Wanjugu, Sifunjo² E. Kisaka, Kiprop³ Symon Kibet, Kibet⁴ Lawrence Kangogo

1. Division of Research and Extension, Egerton University, P.O Box, 536-20115, Egerton, Kenya
 2. Department of Finance and Accounting, University of Nairobi, P.O Box, 30197-00100 Nairobi, Kenya
 3. Department of Economics, Egerton University P.O Box, 536-20115, Egerton, Kenya
 4. Department of Economics, Egerton University P.O Box, 536-20115, Egerton, Kenya
- *Email of corresponding author: ewgitundu@yahoo.com

ABSTRACT

This study examines whether there is significant difference between the ownership structure and financial performance of privatized companies and that of other publicly listed firms in Kenya. A sample comprises of 8 privatized companies and an equal number of other publicly listed firms for the period 2007-2013. Performance indicators used are; Return on Assets (ROA), Tobin's Q, cost efficiency and technical efficiency. Data was obtained from prospectuses and financial reports obtained from the Capital markets Authority (CMA) and the Nairobi Stock Exchange (NSE). A paired *t*-test was done also used to examine for significance in the means of performance between privatized and other publicly listed companies. The paired *t*-tests results show a significant difference in government, institutional, large and dispersed ownership between privatized and other listed companies. The paired *t*-tests also show no significant difference in ROA between privatized and other publicly listed firms. However, there was a significant difference between the Tobin's Q, cost efficiency and technical efficiency between privatized and other publicly listed firms. In light of these findings, this study recommends the Privatization Commission of Kenya should reduce percentage of the government and dispersed shareholding to compare with other publicly listed companies. The percentages of large institutional and foreign investors should be increased to allow privatized companies to bring in managerial and technical expertise to a firm to improve the market value and efficiency to the level of other publicly listed companies.

Key words: Privatization; SOEs; Ownership structure; financial performance

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1. INTRODUCTION

Privatization of State Owned Enterprises (SOEs) is attributed to the failure of the state as an owner to establish effective governance mechanisms leading to inefficiency and expropriation of corporate assets. State ownership is perceived to be inefficient due to wide separation between ownership and control which makes it difficult for the government to monitor managers and the civil servants. Privatization therefore aims to improve financial performance of privatized companies by passing ownership and control to private investors. The private investors are expected to enhance efficiency by monitoring managers, orienting firms to profit objectives, contribute to decision making in corporate boards and bring reforms to reduce operational costs. Privatized companies are expected to be listed at the stock exchanges to adopt the governance practices of other publicly listed companies.

While the underlying aim of privatization is shared globally, each country structures its privatization programmes uniquely to address its objectives. Consequently, this leads emergence of diverse ownership structures and financial performance. A number of studies have examined extent of corporate ownership following privatization and observed diverse ownership structures. Some studies found that the state remained an ultimate owner following privatization (Bortolotti & Faccio, 2008; Ghazouani, 2005; Omran, 2008; Wei *et al.*, 2005). However, Irena and Hashi (2001) observed majority of state ownership were transferred to investment funds and individuals in Czech Republic. Naceur *et al.* (2006) found that private firms held 59% ownership in Morocco. Omran (2008) found that the local institutions and individual investors held average of 40% in Egypt shares while Bortolotti and Faccio (2008) found that financial institutions held 17.02% ownership by 1996 and 9.93% by 2000 in OECD countries. These studies do not explain whether there are significant differences in the ownership structure of privatized companies compared to those of other listed companies.

The extent to which privatization has changed the performance of privatized companies has also remained controversial. Empirical studies largely compare performance before and after privatization and most of studies found that privatization increases profitability and efficiency of firms (Afeikhena, 2008; Boubakri & Cosset, 1998; Kamaruddin & Abokaresh, 2012). Studies on privatization in Kenya are also scanty and virtually focused on comparing performance before and after privatization (Ochieng & Ahmed 2014; Makokha, 2013; Yaw & Toroitich, 2005). Although privatized firms are expected to perform similarly to other publicly listed companies, none of the studies provide a comparison between the two types of firms. These studies largely use the accounting based ratios and therefore do capture the market value and efficiency of privatized firms which are key objectives of privatization.

The concern of policy makers and oversight authorities which motivates this study is to know whether the ownership structure and financial performance of privatized companies compares to that of other publicly listed companies. This study is different from previous studies as compares performance of privatized companies to those of firms operating under similar regulations. A combination of four financial performance indicators captures all four facets of financial performance. The indicators of performance include: ROA, the Tobin's Q, cost and technical efficiency. The cost and the technical efficiency values were computed using the Stochastic Frontier Analysis (SFA) approach which uses input and output approach. The study also compares the performance trends for the period 2007-2013. The paper is organized as follows:

section 1 presents the introduction, section 2 the literature review, section 3 the methodology while section 4 focuses on results and discussion. Section 5 presents the conclusion and policy recommendations derived from this study.

1.2 Privatization of State Owned Enterprises in Kenya

Privatization of SOEs in Kenya is attributed to inefficiency, poor corporate governance and failure by the state corporations to focus on their core objectives. The Sessional Paper No. 4 of 1991, issued by the Government of Kenya (GoK) also decried the poor financial performance of SOEs and called for effective privatization in view of the managerial problems and poor return on government investments. As a result, the GoK issued a Policy Paper on Public Enterprise Reform and Privatization whose objectives were to increase role of the private sector in the economy, improve efficiency, raise capital, reduce subsidies to SOEs, spread ownership and develop the capital markets (GoK, 1992). To address the objectives, the GoK established the Parastatal Reform Programme Committee (PRPC) and the Executive Secretariat and Technical Unit (ESTU) to coordinate the privatization of 207 SOEs classified as non-strategic. The non-strategic SOEs were privatized largely through liquidation, pre-emptive rights and sale of shares (GoK, 2005).

The GoK also established the Department of Government Investments and Public Enterprises to coordinate reforms of 33 SOEs classified as strategic which were to be restructured and retained under GoK control. Consequently, the GoK sold 26% of shares in Kenya Airways to Royal Dutch Airlines (KLM) in 1995 and a further 51% through an IPO in 1996 thereby reducing the GoK ownership to 23%. Some SOEs were restructured in 1997 to pave way for privatization. The Kenya Reinsurance Company and Safaricom Kenya Ltd were incorporated as limited liability companies while the Kenya Power and Lighting Company (KPLC) was split into generation unit (Ken Gen) and KPLC as the power distributor. The Kenya Posts and Telecommunications Company was also split into the Communication Corporation of Kenya, the Postal Corporation and the Telkom Kenya Ltd in 1999. The reforms made it possible to privatize the commercial units while the regulatory functions remained under state.

The Economic Recovery Strategy paper (2003-2007) called for a reduced role of the state in the economy and a legal framework leading to enactment of the Privatization Act and establishment of the Privatization Commission in 2005. Since, then, the Ken Gen IPO in 2006 reduced the GoK shares from 100% to 70% while Mumias Sugar Company second offer in 2006 lowered the state ownership from 38.04% to 20%. The Kenya Re-insurance Company IPO in 2007 reducing the GoK shares from 100% to 60% while the Safaricom Kenya Ltd issued an IPO in 2008 reduced GoK ownership from 60% to 35%. Under Vision 2030, the government aims to privatize more SOEs such as hotels, banks and sugar companies (GoK, 2007). Privatization of SOEs in Kenya is a controversial and issues of concern revolve around the corporate ownership and performance of privatized companies. For instance, the identity some shareholders has been questioned by a parliamentary committee while some companies continue to make losses although they are privatized. This study is therefore crucial for policy implications as privatization has continued to elicit concerns which call for empirical investigations.

2. LITERATURE REVIEW

This subsection presents the review of literature on ownership structure and the financial performance on privatized companies.

2.1 Ownership Structure and Control of Privatized Companies.

Studies examining the extent ownership structure and control in corporate entities were pioneered by Berle and Means (1932) who observed that large companies in the US were owned by a large number of small shareholders who could not exert influence on managers. Following this study, numerous studies have also examined the extent of corporate ownership and control in privatized firms. Claessens and Djakov (1999) examined the ownership structure of privatized companies in Czech Republic in 1997 and found that bank sponsored funds held 14.11%, while non bank sponsored funds 25.76%. The study also observes that the state held 3.31% ownership while local strategic investors held 17.3%. The foreign strategic investors owned 7.92%. Claessens *et al.* (2000) also analyzed the ownership and control of 2,980 corporations in nine East Asian countries and found that more than two-thirds of firms were controlled by a single shareholder. The study further found that significant corporate wealth in East Asia was concentrated among a few families.

Irena and Hashi (2001) examined the structure of ownership emerging following privatization of 1700 companies in Czech Republic carried out in two phases in 1991–92 and 1992–94. The studies document that in the first phase, 72% shares were transferred to investment funds while 28% was held by individuals. However during the second phase, the 64% shares were transferred to investment funds while individual held 36%. The same study also observes that in Poland, 60% of shares in each company were transferred to the 15 national investment funds, 15% to employees and 25% by treasury on behalf of the government. The study further observes that in each company, one of the national investment funds received 33% of shares and thus became the lead fund for the firm. The remaining 27% were divided between the remaining 14 funds often holding under 2% of shares. Foreign financial institutions participated in program though for the management of investment funds.

Wei *et al.* (2005) examined the ownership structure of privatized companies in China and found that the mean state ownership was 30.9%, while institutional investors held 29.8%. In addition, the foreign investors owned 2.7%, managers 0.015% and employees 1.75% of the total shares. Naceur *et al.* (2006) analyzed the post-privatization ownership structure of firms in North Africa and observed that governments held an average of 44% in Egypt and 42% in Tunisia. However in Morocco, private firms held 59% ownership in of the privatized companies. The study also reports that foreigners held only 9% and 12% of the ownership in Egypt and Tunisia but took no part in Morocco. Ghazouani (2005) focused on newly privatized firms in selected Middle East and North Africa countries and found that the government held 37.04% in Egypt and 40.15% in Tunisia while private institutions held 55.27% in Morocco. The study further found that foreign investors held 11.6% in Tunisia and 5.27% in Egypt. The employee held 7.93% through share ownership schemes

Bortolotti and Faccio (2008) examined emerging ownership in a large sample of firms in OECD countries privatized between 1996 and 2000. The study found that the state remained the ultimate owner for privatized firms as the state held 34.75% ownership by 1996 and 29.79% by year 2000. Financial institutions held 17.02% ownership by 1996 and 9.93% by 2000. Families

owned 16.31% of firms in 1996 and 19.86% in 2000. Omran (2008) examined the post-privatization corporate governance of 52 newly privatized Egyptian firms from 1995 to 2005 and found that the state ownership declined from 44.7 % in the year of privatization to 39% six years later. The local institutions and individual investors held average of 40% shares compared to 5.8% by foreign investors in the year of privatization and 11.7 % six years later. Mrad and Hallara (2012) also examined government ownership, following privatization and found that the average shareholding by the government was 10.7%.

In Kenya, Mang'anyi, (2011) examined the type ownership in some selected banks in Kenya and found that 40% of the sampled banks were foreign owned while 32.5% had substantive state ownership. The study also found that 27.5% of the banks were locally owned. It is evident from the existing studies that each country structures its privatization program uniquely. Kiruri (2013) examined the ownership concentration of some banks in Kenya and found that the average number of shares owned by foreign investors was 15,475,025, domestic investors, 48,632,450 while the state ownership was 64,321,461 shares. More recently, Abira (2014) analyzed the ownership concentration of listed companies at the NSE and found that foreign investors owned an average of 27.78%, local institutions 34.69 %, government 2.48%, and dispersed shareholders 36.54% of the total shareholding. It is evident from the literature reviewed that each country and equally the companies structure their privatization program uniquely. However, although privatized companies are expected to operate similarly to other publicly listed companies, none of the existing studies compare the emerging ownership structure of the former SOEs to those of other publicly listed companies. One of the interests of the policy makers in privatization programmes is therefore to establish whether the emerging ownership structures and performance of privatized companies is similar to those of other publicly listed firms in Kenya.

2.2 The Financial Performance of Privatized Companies

Most of the studies examining the performance of privatized companies are conducted from perspective of a policy-maker weighing the adoption of a national privatization programs embraced around the world since 1979. A large number of studies compare performance of privatized firms before and after privatization. These studies are largely anchored on the property rights theory which views private ownership to be more efficient and profitable than the state ownership. Using this approach, Boubakri and Cosset (1998) also examined performance of 79 firms privatized over the period 1980-1992 and found significant improvement in output efficiency and profitability. Boubakri and Cosset (1999) document insignificant changes in profitability, efficiency, investment and leverage in 16 privatized firms drawn from Ghana, Morocco, Nigeria, Senegal and Tunisia. Dewenter and Malatesta (2001) compared the pre- and post-privatization performance of 63 firms divested during 1981-94 using data from the *Fortune* magazine. The study documented significant increase in profitability and significant decreases in leverage and labor intensity. However the operating profits were higher before privatization compared to the post privatization period. D'Souza and Megginson (1999) also analyzed the performance of 85 companies privatized in 1990 to 1996 and found significant increases in profitability, efficiency, and dividend pay and capital investment while leverage declines significantly. Naceur *et al.* (2006) examined performance of newly privatized firms in Egypt, Morocco, Tunisia, and Turkey and found significant increases in profitability and operating efficiency, and significant declines in employment and leverage following privatization.

A different line of study focuses on country specific cases. Following this approach, La Porta and López-de-Silanes (1999) analyzes the performance of 218 SOEs privatized in Mexico by 1992 and found that operating profitability increased by 24%, output 54.3%, while employment declined by 50%. In Argentina, Ramamurti (1997) examined performance of the national railroad following privatization and documents a 370% improvement in labor productivity and a 78.7% decline in total employment. In Egypt, Omran (2004) compared the performance of privatized firms against a similar number SOEs and found that sales efficiency and income efficiency increased in SOEs while there was no significant increase in sales efficiency in privatized firms. The mean output measured by sales decreased in privatized firms while surprisingly sales in SOEs increased. Gupta (2005) examined the performance of partially privatized firms and found that privatization had a positive impact on profitability, labor productivity and investment spending in India. However, there was no evidence that firms chosen for privatization had performed poorly in the before privatization. Using a similar approach Afeikhena (2008) found significant increases ROA, ROE, technical efficiency and capital investment following privatization of firms in Nigeria.

In Kenya, Yaw and Toroitich (2005) explored performance of Kenya Airways following privatization study and found that Kenya Airways realized profits after privatization and attributed it to its strategic partnership with KLM. Makokha (2013) investigated the effect of privatization on performance of firms listed at the NSE by comparing profitability, leverage and activity ratios before and after privatization. The study found that firms had an increase in profitability and activity ratios. Mwangi (2013) investigated the effect of privatization on financial and operational efficiency of firms in Kenya in the pre and post privatization period and found improvement in some indicators while other decreased after privatization. Ochieng and Ahmed (2014) examined the effect financial performance of Kenya Airways before and after privatization and found improvement on liquidity, profitability and efficiency ratios.

There are a number of studies focusing on the effects of privatized companies using efficiency indicators. Okten and Arin (2006) examined the effects of privatization on productive efficiency of 22 privatized cement plants in Turkey and found that ownership changes led to improvements in labor productivity. Kang (2009) measured the efficiency change at Chaughwa Telecom Company in Taiwan before and after privatization using the DEA technique and found that partial privatization enhanced the company's production efficiency significantly. Abdullahi, *et al.* (2012) compared the financial and operational efficiency of the privatized firms in Nigeria, five years before and after privatization and found insignificant change in ROA and ROE but positive increases in efficiency. Kamaruddin and Abokareh (2012) examined the technical efficiency of Libyan manufacturing firms over the period 2000 to 2008 and found that the change was insignificant.

In Kenya, there are a number of studies that have examined corporate performance using efficiency indicators. Mutanu (2002) compared the efficiency of highly capitalized banks with those of low capitalized banks for the period 1999 to 2001 and found out that low capitalized banks were more efficient than the highly capitalized banks. Sifunjo, *et al.* (2014) examined the X-efficiency of commercial banks in Kenya. The study found that X- efficiency was 18% and that inefficiency in large banks was more persistent than in small bank inefficiency as it was 23%. Kinara (2014) evaluates technical efficiency of technical and vocational education and training institutions for period 2008 to 2012 and found that the institutions could improve

performance by 32% using the same resources. These studies largely examine efficiency of commercial banks and hence do not focus on privatized companies.

It is apparent that most of the studies found that performance improves following privatization (Afeikhena, 2008; Kamaruddin & Abokaresh, 2012; Makokha, 2013). However, other studies found that performance decreased in privatized companies (Dewenter & Malatesta, 2001; Mwangi, 2013). These studies also rely on observations on a short period of time immediately after privatization and hence did not capture the longer-term effects of privatization. Most of the studies focusing on the impact of privatization on performance in Kenya largely used the accounting ratios (Ochieng & Ahmed, 2014; Makokha, 2013; Mwangi, 2013; Yaw & Toroitich, 2005). It is also apparent that most of the studies that used efficiency indicators did not focus on privatized companies (Mutanu 2002; Sifunjo *et al.*, 2014; Kinara, 2014). The studies also did not compare the performance of privatized firms to those of similar firms following privatization which limits the generalization of results. The inconsistencies in the empirical results call for more studies focusing on privatization programs.

3. METHODOLOGY

The population consists of all NSE listed companies in Kenya for the period 2007 to 2013. The companies purposely selected were those privatized by sale of shares, listed at the NSE and the in which the GoK has retained some ownership. By using the criteria, eight firms were selected as they had data for the period under study. A stratified random sampling was used to pick other publicly listed firms from a sampling frame of all listed companies at NSE. The population under this approach was divided into groups based the NSE classification of listed companies by industry sector. All privatized firms chosen through purposive sampling were excluded from the sampling framework as they were already selected. Using random sampling, one company was selected from each of the economic sectors which include agriculture, telecommunication, automobiles and accessories; construction and allied; manufacturing; banking, commercial and services, insurance, investment, energy and petroleum.

The data was extracted from annual reports of both privatized and other listed firms for the period 2007-2013, obtained from CMA and NSE. The ownership variables extracted from the annual reports included the percentage of shares of: state, local institutions foreign institutions, large individuals, and dispersed shareholders. Financial performance variables used are ROA, Tobin's Q, cost efficiency and technical efficiency. The values of ROA were computed by dividing profit after tax by total assets for each firm. Tobin's Q ratio was computed by dividing market capitalization (total shares of a company at end of financial year multiplied by the share price) by the total assets. The cost efficiency and technical efficiency values were computed using the SFA version 4.1c. The input values were; cost of sales, total expenses (financial & operating) and total assets while output was measured by total sales. a paired *t*- tests was used to examine whether there are significant differences in the means of both ownership and performance variables.

4. RESULTS AND DISCUSSION

4.1 Comparison of Ownership Structure between Privatized and Other Publicly Listed Companies

The following Table 1 presents a summary of the ownership structure of both privatized and other publicly listed companies for the period 2007-2013. The table has two panels. Panel A presents the summary of ownership structure of privatized companies while Panel B presents the ownership structure of other publicly listed companies. The results of a paired t- test between the ownership categories of the two types of companies is also provided below the panels.

Table 1: The Ownership Structure of Privatized and Other Publicly Listed Companies

Panel A: Privatized Companies. Figures in%					
YEAR	GOV	INST	FORI	LISH	DISP
2007	44.16	8.44	8.96	1.34	37.10
2008	43.38	9.12	8.67	1.48	37.35
2009	40.25	9.22	8.75	1.47	40.31
2010	40.03	10.11	8.51	0.76	40.59
2011	39.87	11.19	8.33	0.50	40.10
2012	39.62	11.90	8.31	0.66	39.51
2013	40.38	13.30	8.34	0.84	37.15
AVERAGE	41.10	10.47	8.55	1.01	38.87

Panel B: Other Publicly Listed Companies. (Figures in%)

YEAR	GOV	INST	FORI	LISH	DISP
2007	7.64	37.92	24.95	4.04	25.45
2008	7.59	37.78	24.96	4.03	25.65
2009	7.58	37.82	26.08	3.34	25.19
2010	7.56	37.74	26.08	3.56	25.06
2011	7.70	37.53	26.08	4.12	24.57
2012	7.42	38.00	26.91	4.15	23.52
2013	6.86	39.83	25.06	4.43	23.82
AVERAGE	7.48	38.09	25.70	3.95	24.75
Paired t-tests	t= 49.3751	t= -54.8790	t=-50.116	t= -11.9283	t= 19.9449
Key : GOV means the percentage of government ownership; INST is the percentage of Institutional Ownership ; FORI means the percentage of foreign Ownership ;LISH implies the percentage of ownership by large individual shareholders; DISP is percentage of ownership by dispersed shareholders					

The results indicate that government is the main share holder in privatized firms with a mean ownership of 41.1% compared to 7.48 % in other listed firms. A paired t-test to determine whether there was a statistically significant mean difference in government ownership between the privatized firms and other publicly listed companies. The t- test statistic is 49.3751 which is significant at 95% percent confidence level. A comparison of the ownership trends also show government ownership ranges from a high of 44.16% in 2007 to a low of 39.87% in 2011 in privatized firms compared to other publicly listed companies where state ownership ranges from a high of 7.70% in 2011 to a low of 6.86% in 2013. The results indicate that the government remained the largest shareholder in privatized throughout the study period. This is consistent to several studies which find that the government retains the ultimate control in privatized firms (Bortolotti & Faccio, 2008; Ghazouani, 2005; Naceur *et al.*, 2006; Omran, 2008; Wei *et al.*, 2005). A significant difference therefore implies that the government has not transferred sufficient ownership control to private investors through the privatization programme. This suggests that the government has more capacity to influence decision making in privatized companies through representation in corporate boards. From the agency theory perspective, privatized companies are likely to experience agency problems more than other publicly listed companies due to the wide separation between ownership and control.

Local institutions own a mean of 10 % shares in privatized firms compared to 38% in other listed companies. The ownership in privatized firms ranges from a high of 13.30% in 2013 to a low of 8.44% in 2007. In contrast, the local institutional ownership in other listed companies range from a high of 39.83% in 2013 to a low of 37.74%. A paired t-test to determine whether there is a significant difference in the means yield a statistic of -54.8790 which is an indicator that there is significant between the local institutional ownership in privatized and other publicly listed companies. A statistically significant difference implies that privatized companies have not acquired institutional ownership comparable to that of other listed companies. The local institutional ownership in privatized companies is lower compared to 17.3% documented by Claessens and Djakov (1999) in Czech Republic, 29.8% by Wei *et al.*, (2005) in privatized companies in China and 55.27% in Morocco (Ghazouani, 2005). In Poland Irena and Hashi (2001) indicate that one lead investment funds received 33% shareholding in each company. The significant difference imply that local institutions in privatized companies have a lesser capacity compared to other listed companies to monitor managers, influence decision making or provide the expertise required to enhance financial performance.

The average foreign institutional ownership in privatized firms is 9% compared to 26% in other publicly listed firms. A trend analysis shows that foreign ownership ranges from a high of 8.96 in 2007 to a low of 8.31% in 2012 in privatized companies. In contrast, foreign ownership in other listed companies ranges from a high of 26.91% in 2012 to a low of 24.95% in 2008. A comparison of the two set of companies show that that foreign institutional ownership remained higher in other listed firms throughout the period. A paired t-test yields a statistic of -50.116 which is significant at 95% percent confidence level. The significant difference imply that foreign institutional investors in privatized companies have a lesser capacity compared to other listed companies to influence decision making or provide the technical expertise required to enhance financial performance. The percentage in privatized companies is lower than 11.77% observed by Omran (2008) in privatized companies in Egypt. Naceur *et al.* (2006) also document

9% and 12% of foreign ownership in Egypt and Tunisia respectively. The results suggest that foreign ownership in privatized companies in Kenya is relatively low and may not have any significant influence on financial performance in privatized companies.

Large individual investors' own 1% shares in privatized firms compared to 4% in other listed firms in Kenya. The paired t-test statistic is -11.9283 which is significant at 95% percent confidence level. Large individual ownership in privatized firms range from a high of 1.48% in 2008 to a low of 0.50 % in 2011 compared to other publicly listed companies where it ranges from a high of 4.43% in 2013 to a low of 3.34%. The results indicate that large individual ownership remained higher in other publicly listed companies throughout the study period. A significant result implies that large individual investors have the potential to influence performance in other listed companies compared to other publicly listed firms. However, ownership by large individuals is considered too small to have any significant impact on firm performance. Maher and Anderson, (1999) indicates that individual should have at least 5% to have any significant influence on financial performance.

The dispersed shareholder in privatized firms is 39% compared to 25% in other publicly listed firms. The paired t-test value is 19.9449 which mean that there is a significant difference in dispersed ownership between privatized and other listed companies at 95% percent confidence level. The dispersed ownership also ranges from a high of 40.59% in 2010 to a low of 37.10 % in 2007. On the other hand, dispersed share ownership range from a high of 25.65% in 2008 to a low of 23.52% in 2012. The significant difference implies that dispersed share ownership is significantly higher in privatized companies. This means that privatized are still owned by a higher number of small shareholders often holding less than one percent of shares. According to Berle and Means (1932) such corporations have no control over the governance of their investments. The companies are therefore likely to experience the agency problems associated with a large separation between ownership and control.

4.2 Comparison of financial performance between Privatized and Other publicly Listed Companies in Kenya

This subsection compares the ROA, Tobin's Q, cost efficiency and technical efficiency between privatized and other listed companies for the period 2007-2013.

4.2.1 The Comparative Trend of ROA between Privatized and Other publicly Listed Companies in Kenya

Figure 1 below presents a graphical illustration of ROA between privatized and other publicly listed companies for the period 2007-2013.

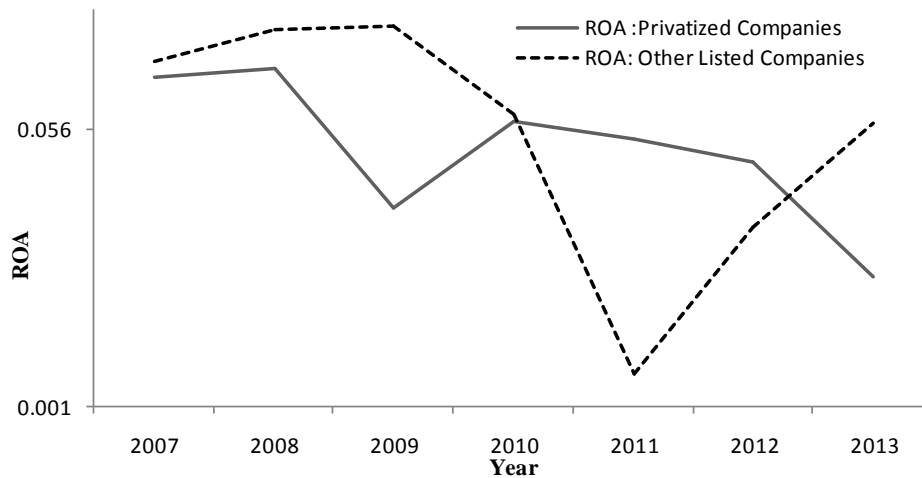


Figure 1: The ROA of Privatized and Other Publicly Listed Companies.

Source: Authors Compilation

The overall mean of ROA in privatized firms is 5.2% compared to 5.5% in other listed firms. A paired t -test to examine whether there is a significant difference between ROA of privatized companies and that of other listed companies yields a value of 0.2106. This means that there is no significant difference between ROA of privatized and other listed companies in Kenya. However, it is notable that mean of ROA in both privatized and other listed companies is lower than a mean of 6.18% reported by Boubakri and Cosset (1999) in privatized companies drawn from five African countries. It is also lower than the 7.17% documented by Sun and Tong (2002) in privatized firms in Malaysia and 6.71% reported by Rashid *et al.* (2010) in Pakistan.

An insignificant difference may imply that private investors and new corporate boards may have enhanced managerial monitoring, oriented firms to profit objectives and improved decision making which enabled the privatized firms to perform closely to other publicly listed companies. However, noting that performance has a declining trend, an insignificant difference may imply that the performance of both privatized and other listed firms may have been influenced by common local and global economic factors. For instance, the trend of ROA in privatized firm shows a rise up to 2008 and then a downward trend from 2010 to 2013 while in other listed companies, it rises from 2007 to 2009 and then declines to a low of 0.0074 in year 2011. The decline could also be associated to post election violence which affected the whole economy. The declining trend in performance has also been linked to the effects from instability in global markets that affected the economy. The unstable exchange rates, insecurity, drought and rise in petroleum prices affected most of the business enterprises negatively (GoK, 2011).

4.2.2 The Trend of the Tobin's Q of Privatized and Other Listed Companies

Figure 2 below presents the graphical representation of the market value privatized compared to a control group of other listed companies for the period 2007-2013.

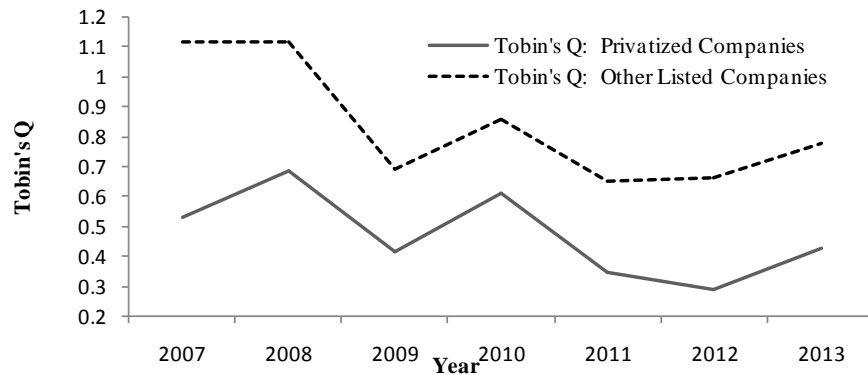


Figure 2: The Market Value of Privatized and Other Publicly Listed Companies.
Source: Authors Compilation

The average Tobin's of privatized companies is 48% compared to 83% in other listed firms. A paired *t*-test to examine whether there is a significant difference between the means of Tobin's Q of privatized and other listed companies yielded a *t* value of -2.0185. This implies that there is a significant difference in market value between privatized and other publicly listed firms. This is an indicator that privatized firms are valued lesser than other publicly listed companies. It is also an indicator that investors' opinion and confidence is higher in other listed companies. A general declining trend of the Tobin's Q in privatized firms however is indicator of diminishing market value and investor's favorable opinion in both privatized and other publicly listed companies. The Tobin's Q of privatized companies is also lower than 82.9% observed by Mrad and Hallara (2012) privatized French companies.

The significant difference is manifested by the gap in market value between the two set of companies throughout the study period as depicted by figure 2 above. The Tobin's Q of privatized ranges from a high of 68% in 2008 to a low of 29% in year 2012 while that of other publicly listed companies range from a high of 112% in 2007 to a low of 65% in 2011. The significant difference could be attributed to the lower and declining returns as evidenced by the ROA of privatized companies. The lower Tobin's Q in privatized companies could also mean that the market was reacting to low institutional ownership and representation in corporate boards of privatized companies. This is an indicator that privatized companies had lesser capacity to attract skill and expertise from private investors.

4.2.3 The Trend of Cost Efficiency of Privatized and Other Listed Companies

Figure 3 presents a graphical representation of technical efficiency of privatized firms compared to other listed companies for the period 2007-2013.

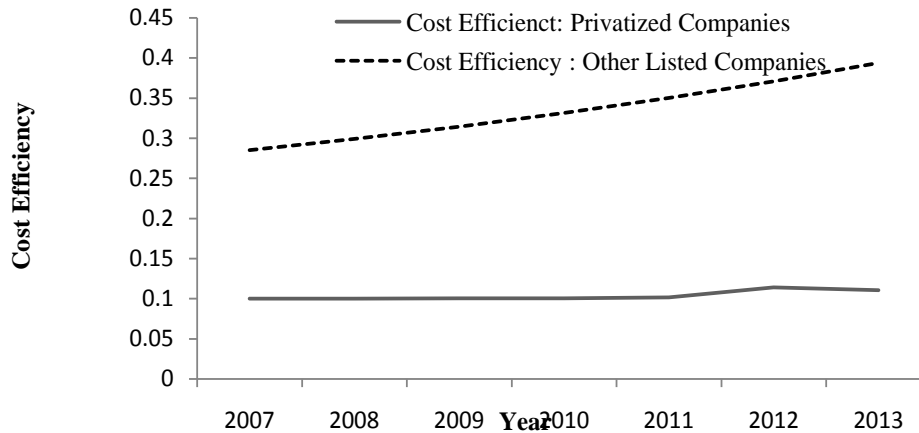


Figure 3: The Cost Efficiency of Privatized and Other Publicly Listed Companies.

Source: Authors Compilation

The mean cost efficiency in privatized firms is 10% compared to 34% in other listed companies. A paired *t*-test yielded a *t*-value of -7.8370 which implies that there is a significant difference in the means of cost efficiency between privatized and other listed firms. The significance difference could be manifested by the gap between efficiency in privatized companies and other listed companies throughout the study period. The mean cost efficiency in privatized firms ranges from 10% in 2007 to 11% and compared to 28% in 2007 to 39% in other listed companies. The result show that both privatized and other publicly listed firms were not operating on the efficient frontier although performance was increasing gradually. These results are similar to those documented in other studies which found that cost inefficiency existed in corporate entities in Kenya (Kinara, 2014; Sifunjo *et al.*, 2014).

Lower cost efficiency could arise in firms with high state ownership as they could still be addressing both social and economic objectives. However, the inefficiency in privatized firms could be attributed to high input costs and technical inability in transforming inputs at minimum costs. It is also evident privatized firms were technically inefficient as they were operating at 42.5% efficiency level. Technical inefficiency in privatized firms could be ascribed to low utilization capacity and obsolete technologies in the firms that particularly made losses during the period. This is supported by reports of various sectors which have continued to post losses. A report on the sugar industry indicated the sub-sector experiences managerial inefficiency, low utilization capacity and obsolete technologies (GoK, 2010). The Kenya Airways posted losses in year 2013 and the company attributed the loss to factors such as fuel prices, terrorism and exchange rates. However, financial analysts attribute the loss to poor investment decisions by management and partnerships which were no longer productive.

4.2.4 The Trend of Technical Efficiency of Privatized and Other Listed Companies

The following Figure 4 presents the trend of the technical efficiency of privatized compared to that of other listed companies at the NSE for the period 2007-2013.

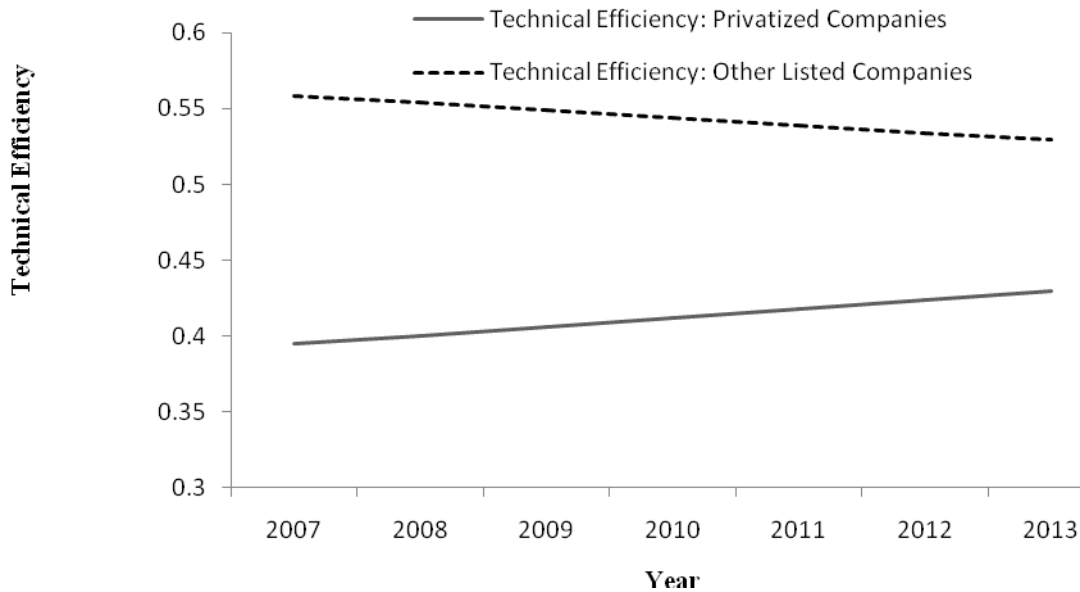


Figure 4: The Trend of Technical Efficiency of Privatized and Other Publicly Listed Companies.

Source: Authors Compilation

The mean technical efficiency in privatized companies is 43% compared to 55% in other listed companies. This level of technical efficiency in both privatized and other listed companies is low compared to 62.9% documented by Kamaruddin and Abokaresh (2012) in Libyan privatized firms. The result shows that the technical efficiency for privatized firms rises from 39% in 2007 to 43% in 2013 while it declines from 56% to 53% in other listed firms. The slight upward trend in technical efficiency of privatized companies is an indicator that the firms were slowly closing the efficiency gap between privatized and other listed companies. This is consistent to studies that found that efficiency increased following privatization (Abdullahi, *et al.* 2012; Kamaruddin & Abokaresh, 2012; Okten & Arin, 2006). An improvement of the technical efficiency in privatized firms was predictable as they are expected to employ their human, financial and technical resources more efficiently. The efficiency gains could also be ascribed to reforms associated with privatization programs such as changes in managerial positions, employment and reduction of subsidies which exposes them to greater competition.

However, a paired *t*-test yields a value of -2.2741 which implies that there is a significant difference in technical efficiency between privatized and other listed firms. This is an indicator that privatized companies were not operating as efficiently as other privatized companies. The results could therefore mean that privatized companies attracted sufficient skills and expertise from private investors to match those of other listed companies. The difference could also be mean that privatized companies were still experiencing agency problems associated with firms that have large government ownership as some companies could still be addressing both welfare and economic goals which could impact negatively on technical efficiency.

5. CONCLUSION AND RECOMMENDATIONS

This study compared the ownership structure and performance between privatized and other publicly listed companies in Kenya. The study found significant difference in all the ownership variables between privatized and other listed companies. The ROA of privatized firms was not significantly different from that of other listed companies. A comparison of the Tobin's Q, cost and technical efficiency shows that there was a significant difference in performance between privatized firms and other publicly listed companies. The market value and efficiency of privatized companies is lower than that of other listed companies. The significant difference in performance implies that privatized firms had not achieved sufficient foreign and institutional ownership to increase, efficiency and firm value to match the performance of other listed companies. This may also suggest that privatized firms were still experiencing agency problems as a result of having a high state and dispersed shareholders.

In view of these results it is recommended that the Privatization Commission of Kenya should reduce state ownership in privatized companies to allow them to attract large institutional shareholders with expertise and resources to improve financial performance. In the process, it is further recommended that a strategic institutional investor should be identified for each company and allocated at least 25% to be able to impact on governance and performance of privatized companies. The strategic investors should have the capacity to bring managerial and technical expertise required by a firm to improve financial performance. The size of dispersed shareholders should be reduced in privatized as they are likely to experience agency problems due the wide gap between ownership and control. Privatization should also be accompanied by reforms in order to turn around corporate financial performance. The reforms should focus on reducing costs and improving technical efficiency as privatized companies are operating at a cost efficiency of 10.2% and technical efficiency of 42.5%. Privatized companies should therefore target to improve cost efficiency by 89.8% and technical efficiency by 57.5%.

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