

# **INFLUENCE OF PERCEIVED EXTERNAL OWNERSHIP RISKS ON MARKET CAPITALIZATION PERFORMANCE OF LISTED COMMERCIAL BANKS IN KENYA**

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## **Abstract**

*Investor behavior is critical to the performance of stocks and the stability of capital markets. However, while the implications of heterogeneous beliefs among investors for long-run stock returns have been examined in some detail in relation to most of the determinants of capital structure outlined, research on external ownership risk as a market capitalization determinant in the banking sector in Kenya is virtually non-existent. Therefore, the purpose of the study was to determine the influence of external ownership risk on performance of market capitalization of commercial banks in Kenya listed in the Nairobi Securities Exchange. Descriptive study design was adopted for the study which also used quantitative methods. The target population comprised the three top executives in each of the 11 banks listed in the Nairobi Securities Exchange as well as 6165 branch managers. From these, a sample size of 98 branch managers was randomly selected for the study, 81 respondents completed and returned the questionnaires administered to them. Both descriptive and inferential statistics were used to*

*analyze data with the aid of STATA statistical package. The study found a negative yet statistically significant effect of External ownership risk on both debt and equity capitalization decisions. The study recommends that the banks need to review their pecking order policies to allow for more debt financing that will lead to increased leverage and lower external ownership risks.*

*Keywords: Heterogeneous beliefs, External ownership risk, Market capitalization, Nairobi Securities Exchange, Pecking order*

## **INTRODUCTION**

Capitalization is one of the crucial factors to make a business success. For most big businesses, capitalization is done in the financial markets which allow a firm to use a variety of instruments to attract an often diverse community of investors. Financial markets play an important role in mobilizing capital for investments in viable areas that bring the most value to the economy. Characteristically the financial markets consist of four important segments which include the money market; the discount market; the capital market and the securities market. Of these the securities market play a very fundamental role in providing a very vital interface between the investors and the producers in terms of providing veritable platform for raising finance to fund their projects both in the short term and in the long term. Capitalization decisions require detailed consideration capital structure of a firm so that the firm's managers are able to take effective investment decision. Capital structure is defined as the composition of all the securities the firm issues in order to finance its operations (Brav & Mathews, 2011). Capital structure is the way a firm combines equity and debt to gain the maximum value. The value of a firm is therefore defined as the market value of debt plus the market value of equity (Ross, Westerfield, Jaffe & Kakani, 2009). Therefore, in most cases, capital structure mainly consists of debt and equity of a firm. Essentially, in the Kenya's context, the capital structure of a firm is the way it chooses to finance its assets and projects (Ndungu, 2012). This is usually in the form of equity and debt where the ratio of debt to equity in the capital structure is known as the gearing ratio.

A firm should work towards maximizing its value and at the same time maximize the stockholders' interests and it should therefore establish what ratio maximizes the shareholders' interests (Ross et al., 2009). Capital structure of any institution should therefore be well managed to ensure that the firm is the firm remains in operation and it's able to finance its projects. The main responsibility of firm managers is to maximize value of firm more specifically

maximization of shareholder's wealth by subsidizing the cost of funds. Therefore, in order to maximize the shareholder's wealth, the firm managers need to investigate optimal capital structure to finance. For choosing the capital structure of a firm, it is required to consider different factors that are related to optimize the profitability and value of a firm. Moreover, every firm exhibits different specific factors that are related to capital structure that need to be put into consideration at the time of choosing optimal capital structure.

Capital composition matters to most firms in free markets, but there are differences. Various firms that have different capital structure techniques for optimizing shareholder's wealth leading to variations in the firms' capital structure over time (Gul *et al.*, 2012). Many firms would not be able to identify the best capital structure for maximizing their profits due to lack of proper forecasting regarding the factors related to capital structure. The groundbreaking work of Modigliani and Miller (1963) on the workings of the firm's capital structure paved the way for future researchers by making important postulations on the determinants of capital structure. The research community has since devoted significant time to test both theoretical and practical assumptions on the question of the optimal firm capital structure. Subsequently, several determinants of a capital structure have been developed and advanced by several researchers. The general observation is that the firm's capital structure depends on two factors, one being the company's leverage and the other is assets.

All firms have to analyze capital structure properly so as to obtain optimal capital structure for a firm for implementing financing decisions; otherwise, the firm will face different financial problems, such as bankruptcy and financial distress etc. So for the firm which has high leverage, it is necessary to make an efficient capital mixture to minimize cost and maximize net profit that maximizes the value of the firm. Therefore, leverage is an important determinant of the firm's capital structure. According to Myers and Majluf (1984), industry sector can be a determinant of firm's capital structure decisions, given that the nature and composition of assets influence financing needs, as well as the firm's capacity to provide creditors with assets as collateral. Therefore, firms whose activities are based on tangible assets obtain debt more easily. On the contrary, firms whose activities are based on intangible assets associated with future growth opportunities experience more difficulty in obtaining credit. However, of particular interest to the present study is the influence of external ownership risk on the performance of market capitalization of commercial banks listed in the Nairobi Securities Exchange.

### **Overview of Capitalization at the Nairobi Securities Exchange**

Currently, the Nairobi Stock Exchange market has got fifty-five companies listed at the market. The companies are categorized into four different sections; Agriculture, Commercial and

Services, Finance and Investment, Industrial and Allied. Market capitalization of listed companies (% of GDP) in Kenya was reported at 29.34 % in 2012, according to the World Bank collection of development indicators, compiled from officially recognized sources. According to Cytonn Investments (2017), there are thirty-nine licensed commercial banks in Kenya. Three of the banks are public banking institutions with majority shareholding being the Government and state corporations. The rest are private banking institutions. Of all the licensed commercial banks in Kenya only eleven are listed in the Nairobi Securities Exchange.

The Kenyan banking sector remained stable and resilient in 2014 as evidenced by the enhanced performance recorded. The total net assets which grew by 18.5 per cent from Ksh. 2.70 trillion in December 2013 to Ksh.3.2 trillion in December 2014, with the growth being supported by the increase in loans and advances (CBK, 2015). Customer deposits increased by 18.42 per cent from Ksh.1.93 trillion in December 2013 to sh.2.29 trillion in December 2014 and were attributed to increased deposit mobilization by banks. Analysis of the pre-tax profit for the banking sector shows that it increased by 12.2 per cent from Ksh.125.8 billion in December 2013 to Ksh.141.1 billion in December 2014. The growth was largely supported by the growth in the credit portfolio, investment in government securities and commissions and earnings from foreign exchange trading. Gross loans increased by 22.75 per cent from Ksh.1, 532.3 billion in December 2013 to Ksh.1, 881.0 billion in December 2014. The growth in loans was attributed to increased demand for credit by the various economic sectors. The liquidity ratio stood at 37.7 per cent as at December 2014 compared to 38.6 per cent registered in December 2013 (CBK, 2015).

Despite the relatively good performance of the banking sector, some banks have been performing worse than others and there have been changes in the ranking of the banks in terms of market share and asset base. Some of the performance problems could be traced back to market capitalization of the banks, however, research on banks performance vis-a vis market capitalization is still scant in the country and, as such, little is known concerning capitalization risk factors such as external ownership risk. Therefore, the present study examined the influence of external ownership risk on performance of market capitalization.

### **Statement of the Problem**

Investor behavior is critical to the performance of stocks and the stability of capital markets. It is this behavior which sets up the trading trends of securities is informed by the firms' valuation and the investors' beliefs. Various studies have shown that linking the firms' preferred capital structure to the investor behavior as contrasted to other factors likely to inform their beliefs presents a more analyzable situation. For example, if the firms' insiders' optimism about the

firms' future prospects are outweighed by the optimism of the firms' outsiders, they are likely to issue equity. They are also likely to issue debt in a reversal of this situation. The equilibrium of these two belief situations will determine the firms' financing decisions and consequently the optimal stock price. However, while the implications of heterogeneous beliefs among investors for long-run stock returns have been examined in some detail, the corporate governance implications of such beliefs have not been adequately studied. In practice, capital structure is informed by other factors such as the internal and external cost of capital, the return rate, the time preference, risk, liquidity situation and ownership of the firm and all these bear to some extent on the price and types of securities to be issued. While considerable studies have been carried out in relation to most of the determinants of capital structure outlined, research on external ownership risk as a market capitalization determinant in the banking sector in Kenya is virtually non-existent. Therefore, this made it imperative for the present study to investigate the influence of external ownership risk on performance of market capitalization of listed commercial banks in Kenya.

## LITERATURE REVIEW

### Agency Theory

Agency theory was proposed by Jensen and Meckling (1976). It suggests that the firm can be viewed as a nexus of contracts between resource holders. An agency relationship arises whenever one or more individuals, called principals, hire one or more other individuals, called agents, to perform some service and then delegate decision-making authority to the agents. The primary agency relationships in business are those between stockholders and managers and those between debt holders and stockholders. These relationships are not necessarily harmonious; agency theory is concerned with so-called agency conflicts, or conflicts of interest between agents and principals. This has implications for, among other things, corporate governance and business ethics. When agency is introduced, it also tends to give rise to agency costs, which are expenses incurred in order to sustain an effective agency relationship (such as offering management performance bonuses to encourage managers to act in the shareholders' interests). The firm has two options: to issue equity or debt. If the firm issues equity, the owner-manager's fractional interest within the firm decreases. This increases the incentives for an owner-manager to undertake excessive perk consumption since the costs to the owner of such activities have been lowered as a result of a reduction in his fractional interest (Mishkin, 2011).

Such costs include: the monitoring expenses of the principal (the equity holders); the bonding expenses of the agent (the manager); and the money value of the reduction in welfare experienced by the principal due to the divergence between the agent's decisions and those

which maximize the welfare of the principal. In the presence of efficient markets which incorporate expectations, external investors anticipate such actions by the owner-manager of the firm. Debt-holders can be thought of as having written a European Put on the firm's assets, with bankruptcy corresponding to exercise of the Put by shareholders (James, 1999). As the amount of debt increases, debt holders will demand a higher premium to compensate them for the increased probability of failure. Thus, the agency costs of debt include the opportunity costs caused by the impact of debt on the investment decisions of the firm; the monitoring and bond expenditures by both the bondholders and the owner-manager; and the costs associated with bankruptcy and reorganization (Hunsaker, 1999). Since equity and debt both incur agency costs; the optimal debt-equity ratio involves a trade-off between the two types of cost. Agency costs associated with equity are at a maximum when the owner-manager's share of equity is zero, and the firm is wholly owned by outside shareholders. These costs fall to zero as the owner-manager's equity share rises to 100%. Similarly, the agency costs of debt are at a maximum when all external funds are obtained from debt.

As the level of debt falls, agency costs are reduced: first, because the amount of wealth that can be reallocated away from debt-holders falls; and second, since the fraction of equity held by the owner-manager is being reduced, the owner-manager's share of any reallocation also falls. The total agency cost schedule is therefore a U-shaped function of the ratio of debt to outside equity; and the optimal ratio of debt to outside equity is that which minimizes total agency costs. When a firm is close to bankruptcy, equity holders have no incentive to inject new capital into value-increasing projects since the returns of such a venture will accrue mainly to debt holders. Thus, the larger the debt level of the firm, the less the incentive to invest in value-increasing projects (Meyers, 1977). The agency theory advantages are that the price of new equity is discounted to take into account the monitoring costs of external shareholders. Under these circumstances, the owner-manager would prefer to finance new projects using debt rather than equity. If the managers want to maximize the value of the firm, the difference between the benefits and costs of debt must be maximized. If the projects fail, the owner-manager's exposure is limited to the value of his equity holdings.

The disadvantage of the agency theory is from the perspective of debt-holders they do not share in the profits of success, but will still lose in case of a bankruptcy. They thus incur extra risk without additional expected returns. The agency theory is important to the current study as it indicates why banking institutions in NSE would make decisions in favor of the owner-managers at the expense of the debt-holders. The owner-manager would prefer to finance new projects using debt rather than equity as this does not come with the likelihood of change of ownership as it would if they adopted equity financing.

## External Ownership Risk and Market Capitalization

The standard capital structure of a firm includes retained earnings, debt and equity; these three components of capital structure reflect firm ownership structure in the sense that the first and third components reflect ownership by shareholders while the second component represents ownership by debt holders (Barbosa & Helen, 2002). Therefore, the nature of relationship between ownership structure and the capital structure is an emerging issue in the literature of the corporate finance (Din, Javid& Imran, 2013). The idea that the general characteristics of a firm's ownership structure can affect performance has achieved considerable attention, and related research brought forward relatively consistent empirical evidence, e.g. on the positive impact of managerial ownership on firm performance (Zhou, 2001; Anderson &Reeb, 2003; Dessi& Robertson, 2003). However, the evidence on the relation between ownership and capital structure is less consistent and numerous, although there are good reasons to believe that there may be such a relationship (Funke, 2003).Further, while conflict between managers and owners regarding the functioning of the firm and the impact ownership on financial decisions are well researched areas in developed markets, the issues are not seriously investigated for emerging markets at all. Existing research also suggests that there are variations of ownership structure and preferences relative to firm size.

Ownership control is regarded as a highly important factor in small firms since they appear to be largely dependent on their owners. For instance, a study by Persson and Dahlström (2010) found that retaining ownership control was viewed as the most important factor affecting capital structure decisions but this was moderated by firm size. A more recent study by Shoaib and Yasuhi (2016), however, established that the external ownership has a significant effect on capital structure in accordance with the presence of blockholders. In contrast, the internal ownership has a complicated effect; it shows significant positive and negative relationship to leverage at lower and certain higher proportion of managerial shareholding respectively. According to Prasad, Green and Murinde (2001), financing policy, capital structure and firm ownership are all strongly linked in explaining how economic agents form and modify their asset-acquisition behaviour through firms and capital markets, and thereby influence their incomes and returns to asset holdings, whether in the form of direct remuneration, capital gains or dividends. Porta et al., (1999) point out that as large share holdings are common characteristics of developing markets, it is argued that large shareholders' incentive and ability to collect information and to monitor management reduces agency costs (Shleifer &Vishny, 1986) and affects the financial decisions made by the firms. Therefore, the prevailing argument in that ownership structure is an incentive device for reducing the agency costs related with the separation of ownership and management

Different conclusions have, however, been arrived at by other scholars. For example, according to a study by Demsetz and Villonga (2001) involving 223 randomly selected firms from all sectors of the US economy, there was no statistically significant relation between ownership structure and firm performance. This finding is consistent with the view that diffuse ownership, while it may exacerbate some agency problems, also yields compensating advantages that generally offset such problems. Consequently, for data that reflect market-mediated ownership structures, no systematic relation between ownership structure and firm performance is to be expected. Javid and Iqbal (2008), investigated the effect of ownership concentration on the firm's performance using 60 firms from different manufacturing sectors of the Pakistan's economy during 2003 to 2008. The results suggested that firms where ownership was concentrated do not adopt better governance practices and disclose less. The firm specific factors affect the concentration of ownership more, increased investment opportunities provide greater incentives for ownership concentration, while size has the opposite effect and leads to diverse ownership to get wider access to funds and share ownership. However, while some previous studies suggest that ownership structure and control influence capital structure decisions, it still remains a difficult task to draw any conclusions about how these factors are incorporated into financial structure decisions especially when ownership risk is being considered.

### **Market Capitalization and Firm Performance**

Market capitalization (also known as market value) is the share price times the number of shares outstanding. Listed domestic companies are the domestically incorporated companies listed on the country's stock exchanges at the end of the year. Listed companies does not include investment companies, mutual funds, or other collective investment vehicles. Shares outstanding refers to all shares currently owned by stockholders, company officials, and investors in the public domain, but does not include shares repurchased by a company. They have rights and represent ownership in the corporation by the person who holds the shares and are unlike treasury shares, which are shares held by the corporation itself and have no exercisable rights. Market capitalization is an important measure for investors in the determination of the returns on their investment. Day-to-day stock price fluctuations provide freely available information on the health of a publicly traded company. Using market capitalization to show the size of a company is important because company size is a basic determinant of various characteristics in which investors are interested, including risk. Market capitalization can denote the amount of a company's future cash flows to its shareholders,

primarily the dividends, and the riskiness of receiving the cash flows, effectively the expected rate of return.

A study by Saeedi and Mahmoodi (2011) examined the relationship between capital structure and performance of listed firms in the Tehran Stock Exchange. They found that market measures of performance are positively related to capital structure and whereas ROA is positively related to capital structure, no significant relationship exists between ROE and capital structure. Totala and Pachori (2012) explored the effect of financial leverage on shareholders' return and market capitalization of automotive cluster companies of Pithampur, India. The results revealed that leverage is an important factor when considering the source of finance. It affects the market capitalization of listed institutions. In his study, Jalloh (2015) sought to understand whether or not stock market capitalization influences economic growth in Africa as evidenced by panel data. The study found that raising stock market capitalization by a marginal average of 10% results in growth by 5.4% in the countries the study was conducted. The study led to inference that African countries should explore stock markets as a potential avenue for expediting their economic growth.

Mihasonirina and Yartey (2009) examined the growth of African financial markets focusing on the determinants of financial market development in Africa. The emphasis was on banking systems and stock markets. The study revealed that the main determinants of the stock market development included political risk, domestic savings, banking sector development, and stock market liquidity. The study noted that the implication of political risk in stock market development underpins the fundamental role played by politics in economic development of African countries. Aduda and Onsongo (2012) analyzed the determinants of stock market development. The study focused on the Nairobi Stock Exchange. The study relied on secondary data for a five years period (2005 to 2009). The study established that macroeconomic factors such as stock market liquidity, institutional quality, income per capita, domestic savings and bank development are crucial determinants of stock market development in the NSE.

## **RESEARCH METHODOLOGY**

### **Research Design**

The study adopted a descriptive research design which specifically involved a survey of the 11 banking institutions listed in the Nairobi Securities Exchange. The descriptive research design was appropriate because it enabled the researcher to collect information from the target population and also to draw conclusions based on the study objectives (Whittemore & Knafli, 2005). The approach for the study entailed collection of quantitative data. Use of quantitative

techniques ensured that the study was able to capture the factors influencing performance of market capitalization of banking institutions listed at the NSE and enable the researcher explain the interrelationships between the same

### **Target Population**

The target population refers to the aggregate members of a population of interest who share certain common characteristics, and to whom the study findings are generated. In the context of the present study, the target population comprised of the three top executives in each of the 11 banking institutions listed in the NSE (total = 33) as well as the branch managers and their assistants for the branches of same banks (6165 individuals), making a total target population of 6198 (CBK Bank Supervision Annual Report, 2015). Data was collected relating to a 7-year period between January 2010 and December 2016.

### **Sample Size and Sampling Technique**

Simple random sampling was used to select the sample for this study because the target population was sufficiently large - 6165 branch managers - and had heterogeneous characteristics, thus, making it possible to randomly select bank branches and respondents. The sample size for the study was, thus, determined using the formula proposed by Nassiuma (2000);

$$n = \frac{Nc^2}{c^2 + (N-1)e^2}$$

Applying the formula yielded a total of 98 respondents who were branch managers who were drawn from the branches of each of the 11 banks listed at the NSE. Participants were selected from all these branches.

### **Research Instrumentation**

According to Mugenda and Mugenda (2009), research questionnaires are convenient to use and are also able to capture a wide scope of data pertinent to the study objectives. The study adopted a structured questionnaire developed by the researcher to collect primary data from the branch managers of the 11 listed banks. The questionnaire was structured in that the questions therein were not only be close-ended but also conformed to the study objectives. Secondary data was collected from critical analysis of securities exchange reports and banking institutions annual reports using a data collection sheet.

### **Pilot Testing, Validity and Reliability of the Research Instruments**

A pilot study was conducted among branch managers of 6 of the 11 listed banking firms with branches in Nakuru Town. A total of 12 questionnaires for pilot testing were issued in the month of February, 2017. The banks selected randomly in order to avoid bias. The essence of conducting the pilot study was to verify both the reliability and validity of the research instrument.

Mugenda and Mugenda (2003) define validity as the accuracy and meaningfulness of inferences which are based on research findings. An instrument can be validated by proving that its items or questions are representative of the skills or characteristic that it is intended to measure. The researcher ensured that the research instrument produces the expected results by pre-testing it in order to ensure that the questions are well framed and that they were understood. The Principal Axis Factoring (PAF) method was the primary test of the instrument's validity. The validity threshold was Eigen values greater than 1 (Girden, 2001). The instrument constructs achieved the aforesaid threshold meaning the items in the constructs brought out what they were meant to enquire. The researcher rephrased and edited items that were found to be unsuitable to the purpose of the inquiry.

The Cronbach alpha coefficient was used to test the instrument's reliability. According to Kimberlin and Winterstein (2008), the use of Cronbach alpha coefficient is the most widely used and recommended it reliability testing. An Alpha coefficient of at least 0.7 ( $\alpha \geq 0.7$ ) is considered appropriate as a reliability threshold of the research instrument. The study established an instrument Cronbach alpha value of 0.8118 for Market capitalization performance and a Cronbach alpha value of 0.9010 for External ownership risk which was a good indication of a reliable research instrument

### **Data Processing and Analysis**

Data was analyzed using descriptive and inferential statistics with the aid of Statistical Package for Social Sciences (SPSS) Version 22.0. Descriptive statistics included, frequencies, percentages, means and standard deviations. Inferential statistics was in form of simple linear regression. Linear regression enabled assessment of the effect of external ownership risk on market capitalization performance as a whole. The following regression model was used in the analysis:

$$Y = \beta_0 + \beta_1 X_1 + \varepsilon$$

Where:  $\beta_0$  is the constant,

$\beta_1, \beta_2, \beta_3, \beta_4$ ) are regression coefficients of the independent variables respectively.

Y =Market capitalization performance

$X_1$ =External ownership risk

$\varepsilon$  =error term.

The regression constant ' $\beta_0$ ' is the Y intercept; while  $\beta_1$  is the net change in Y for each change of  $X_1$ . The error term is a random variable with a mean of zero, which captures those variables that cannot be quantified. The research hypothesis was tested using the p-value approach at 95% confidence level based on the linear regression analysis STATA output. The decision rule was that the null hypothesis would be rejected if the calculated p-value is less than the significant level (0.05) and accepted if the calculated p-value is greater than the significance level (0.05).

### Model Assumptions

The model obtained from the study was also tested for normality, linearity, collinearity, and homoskedasticity assumptions in OLS (Ordinary Least Squares).

## ANALYSIS AND FINDINGS

### Response Rate

The researcher distributed 98 questionnaires to the respondents out of which 81 were received from the field and accepted as correctly filled translating to an 82% response rate.

### Perceived External Ownership Risk and Market Capitalization Performance

The respondents' views concerning external ownership risk during capitalization were determined by asking them to rate several statements related to this objective. The status of this variable was measured through five constructs; Debt financiers, Debt convertibility, Internal financing, Rights issue and Solvency. The findings are presented in Table 1.

Table 1: Perceived External Ownership Risk and Market Capitalization Performance

Statement	SA	A	N	D	SD	Std.			
	(%)	(%)	(%)	(%)	(%)	Min	Max	Mean	Dev
1. When considering debt financing, the investors are discreetly chosen to reduce the interest paid to them	35	42	10	6	7	1	5	3.95	0.772
2. It is common practice for our firm to seek internal financing for its projects as the first financing option	39	46	3	11	1	1	5	4.13	0.692
3. We avoid issuing convertible bonds to avoid external ownership of our bank	25	51	8	10	6	1	5	3.78	1.238

4. Our bond coupon rates are deliberately made high so as to be more attractive to the bond holders than equity	29	55	11	5	0	2	5	3.66	1.067
5. As a salutary measure, we only issue rights when the bonds do not seem attractive enough and when our equities are not performing well	8	11	10	37	34	1	5	2.24	1.135
6. We limit our rights issue so as not to encourage oversubscription	26	47	13	8	6	1	5	3.73	1.268
7. We often try not to deplete our capital reserves so as to remain solvent always	38	40	12	5	5	1	5	4.01	0.903
8. We often retain earnings and they are usually forthcoming for the bank's investments	29	44	10	7	10	1	5	3.77	1.058

(n=81)

The results in Table 1 suggest that most banks (Mean = 3.95; SD = 0.772) chose their investors discreetly during debt financing so as to minimize the interest paid to them. This meant that preference was given to long term investors with low interests demands. The findings also suggest that it was common practice for most banks (Mean = 4.13; SD = 0.692) to seek internal financing for their projects as the first financing option. With a mean of 3.78 and a standard deviation of 1.238, it was evident that most banks avoided issuing convertible bonds to avoid external ownership. Most banks also deliberately raised their bond coupon rates so as to make them more attractive to the bond holders than equity (Mean = 3.66; SD = 1.067). However, it was evident that most banks (Mean = 2.24; SD = 1.135) were reluctant to issue rights as a salutary measure even when the bonds did not seem attractive enough and their equities were not performing well. The rights issuing was limited in most banks (Mean = 3.73; SD = 1.268) so as not to encourage oversubscription. Other findings indicate that the banks often tried to conserve their capital reserves so as to remain solvent (Mean = 4.01; SD = 0.903) and often retain earnings which turned out to be forthcoming for their investments (Mean = 3.77; SD = 1.058).

### Regression Results for Capital Structure on Market Capitalization Performance

The study estimated a robust model treating heteroskedasticity to avoid spurious regression results as shown in Table 2.

Table 2: Robust Regression for Capital Structure on Market Capitalization

Regression Results: Dependent variable Market Capitalization Performance			
		Statistic	P-Value
R Squared		0.4044	
F-Statistic (df, n)	(5, 102)	22.67	0.000
Ramsey specification test	(3, 103)	3.89	0.0121
	Coefficients	Statistics	P-Value
Constant	3.892	16.3	0.00
Cost-benefit trade-off	0.571	3.14	0.017
Financial leverage	5.118	8.3	0
External ownership risk	-0.115	2.23	0.028
Market risk	-0.718	3.94	0.009
Assets Size	0.212	4.18	0

The results in Table 2 indicate that the R-square is 40.44% which shows that the model could explain up to 40.44% of variations in the dependent variable while the rest are explained by other factors not specified in the model. The F-statistic is 22.67,  $p < .05$ ; therefore, suggesting that all the explanatory variables are jointly significant in explaining variations in market capitalization performance. The Ramsey specification test statistic has a P value of 0.0121  $< .05$  and, as a result, we fail to reject the null hypotheses that the model is not mis-specified. However, since the study estimated a robust model, the issue of heteroskedasticity was addressed, therefore, the standard normal test such as t-statistics and p-values can be used to explain the significance of the coefficients in the regression model. Further, looking at the results in Table 2, the constant coefficient is significant at 3.892,  $t = 16.30 > 1.96$ , and  $p < .05$ , indicating that the presence of other explanatory variables not specified in the model are significant and can also explain the variations in the dependent variable. The results further indicate that External ownership risk coefficient is significant at -0.115,  $t = 2.23 > 1.96$ ,  $p < 0.05$  and that the control variable Asset Size also contributed significantly to the model at 0.212,  $t = 4.18$ ,  $p < 0.05$ .

***H<sub>0</sub>:*** External ownership risk has no significant influence on market capitalization performance of listed commercial banks in Kenya

***H<sub>a</sub>:*** A significant influence exists between external ownership risk and market capitalization performance of listed commercial banks in Kenya

The t-statistic was used as the test statistic at the  $t > 1.96$ ,  $p \leq 0.05$  significance level. External ownership risk coefficient was found to be significant at -0.115,  $t = 2.23 > 1.96$ ,  $p < 0.05$  leading to the rejection of the null hypothesis. This result agrees with that of Shoaib and Yasuhi (2016),

who established that the external ownership has a significant effect on capital structure in accordance with the presence of blockholders. The findings also support those of Persson and Dahlström (2010) who found that retaining ownership control was viewed as the most important factor affecting capital structure decisions though this was contingent on firm size.

## **DISCUSSIONS**

The results on external ownership risk reveal that its effect varied across the market capitalization performance measures. Particularly, it did not significantly influence competition in the robust model estimation, and the investor preferences model. However, it had a negative yet statistically significant effect on both debt and equity capitalization decisions and also on the weighted market capitalization performance variable. This implied that external ownership risk limited the instrumentation of the banks as most were careful not to lose control of their projects and assets. Thus, it is evident that external ownership risks influenced market capitalization performance. Therefore, most banks choose their investors discreetly during debt financing and also tended to seek internal financing for their projects as the first financing option. They also avoided issuing convertible bonds which had a high external ownership risk and instead preferred raising their bond coupon rates so as to make them more attractive to the bond holders than equity. However, it was evident that most banks were reluctant to issue rights as a salutary measure even when the bonds did not seem attractive enough and their equities were not performing well. The rights issuing was limited in most banks so as not to encourage oversubscription. These findings support those of Prasad et al., (2001) who established that financing policy, capital structure and firm ownership are all strongly linked in explaining how economic agents form and modify their asset-acquisition behaviour through firms and capital markets. However, they disagree with findings of an earlier study by Demsetz and Villonga (2001) which failed to establish a statistically significant relation between ownership structure and firm performance.

## **CONCLUSIONS**

Based on the results of the study, it can be concluded that the effects external ownership risk varied across the market capitalization performance measures. Particularly, it did not significantly influence competition in the robust model estimation, and the investor preferences model. However, it had a negative yet statistically significant effect on both debt and equity capitalization decisions and also on the weighted market capitalization performance variable. Thus, it can be concluded that external ownership risks influenced market capitalization

performance. Apart from guarding against control by external owners, the external ownership control was also seen as being instrumental in reducing agency costs during capitalization.

## RECOMMENDATIONS

- i. The banks should focus on increasing their retained earnings as this may further reduce the external ownership risk and concentrate ownership internally which has the effect of increasing management entrenchment, therefore, further reducing the agency problems.
- ii. The banks should also review their pecking order policies to allow for more debt financing that will lead to increased leverage and lower external ownership risks.
- iii. The banks need to do better market timing when issuing rights so as to encourage the desired subscription of the rights.

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