# THE IMPACT OF PRIVATE EQUITY ON VALUE CREATION AMONG LISTED FIRMS AT THE NAIROBI SECURITIES EXCHANGE

**James Murimi Mwenje** ✉

Jomo Kenyatta University of Agriculture and Technology/ Kenya School of Monetary Studies, Kenya

jasmwenje@gmail.com


**Tobias Olweny**

Lecturer, Department of Commerce and Economic Studies,

Jomo Kenyatta University of Agriculture and Technology, Kenya

toolweny@yahoo.com

**Abstract**

*The subject of private equity is gradually gaining prominence in emerging markets with equity funds and their related transactions on the increase. Private equity offers an alternative means of capital acquisition while also influencing the overall corporate organizational form. This paper investigated the impact of private equity on value creation among listed firms at the Nairobi Securities Exchange. A causal research design was adopted having return on assets and return on equity as value creation proxies which were analyzed against independent variables generated from three central pillars of the private equity model comprising of financial, operational and strategic segments. The research used secondary data drawn from financial statements to generate financial ratios which reflected outcomes of P.E involvement on its central pillars. The findings of the study revealed that financial modification in the capital structure had a little to no impact on the value creation metrics reflecting Modigliani and Miller's capital structure irrelevance theory. On the other hand, both operational and strategic indicators demonstrated predominantly significant causal association with value creation. Structural influences introduced in operational and strategic segments coupled with the expertise of the general partners would therefore be beneficial to enterprise growth and value creation.*

*Keywords: Private Equity, Metrics, Value Creation, Listed Firms, Capital*

## INTRODUCTION

Private equity and other pools of private capital like hedge funds are forming part of the growing shadow banking system all over the world. These new financial intermediaries provide an alternative investment mechanism to the traditional banking system (Applebaum and Batt, 2012). Africa's participation in private equity as an asset class is slowly but surely growing. The growing view is that business and not aid will make sub Saharan Africa gain economic independence and P.E provides the capital necessary to stimulate business enterprises at any stage in the business life cycle. These sentiments are shared by (Choi, 2012) who said "Private equity offers tremendous additionality to capital-starved companies at saner prices than are commanded elsewhere in emerging markets"

The term private equity includes funding for early stage venture capital investments (Gilligan and Wright, 2008). This is because P.E is not only the financing that is required to start a business but also covers subsequent financing in the business life cycle. Gilligan and Wright therefore concluded that the term 'private equity' has no consistently applied definition and can applied to any investor that is not quoted on a recognized financial market. This is quite useful for entrepreneurs who are looking to start up businesses or turnaround companies because P.E could help them to achieve this.

P.E takes a different approach in firm strategy, structure and objective compared to other kinds of investment methods. The fund managers in private equity funding basically seek to control the businesses they invest in and to choose an optimum capital structure for their investee companies. Gilligan and Wright, (2008) noted that private equity funds operate with much better information and stronger controls and influence over management than funds holding quoted equities. Kaplan and Stromberg (2009) showed changes implemented may include: changes in capital structures, management incentives, and corporate governance introduced by private equity investors.

According the British Venture Capital Association BVCA (2004), PE backed companies have been shown to grow faster than other types of companies. The reason given for this extraordinary performance is the PE's unique fiscal capital offering combined with highly skilled and experienced human capital from the PE executives.

Successful companies too small to go public that are having difficulty raising capital for expansion may turn to private equity for the infusion of capital they need in order to grow. Publicly-traded companies that are doing okay but lag the industry's leaders can benefit from management know-how as well as capital that private equity can provide.

Shachmurove (2004) indicated "The private sector in the region has been under capitalized and under developed even though development research indicates that the private

sector is the main driver of economic growth" a position considered pivotal in development theory, DFID (2011). In order to achieve Kenya's developmental ambitions contained in vision 2030, the private sector needs to have sufficient capital to facilitate growth.

Tumising (2012) is of the opinion that the Kenyan government should be engaged in the development process but emphasis should lean more towards providing a conducive environment through creating adequate infrastructure and suitable systems that spur innovation and investment within the private sector which then would act as the engine of development. The ever increasing interests in Private Equity and Venture Capital funds provide a good opportunity for promising entrepreneurs and businesses in the country to tap into these lucrative sources of capital.

Recent growth through infrastructure projects in the country and future potential highlight the fantastic types of opportunities available to PE funds resulting from the growing Kenyan consumer demand led growth through which the country aims to turn into a middle class economy by 2030. De Souza et al, (2012) noted that in Brazil, publicly traded companies and remaining private institutions represent a considerably large pool of potential star investments for PE funds and this is certainly also the case in the Kenyan scenario.

## Statement of the Problem

Africa's growth performance has long been disappointing and it has been described as a tragedy by some commentators e.g., Easterly and Levine (1997). (Allen et al, 2012) also indicate that "although less well-documented and perhaps not surprising, the financial sectors of sub-Saharan African countries remain woefully under-developed, even relative to the standards of developing countries".

Emerging Markets Private Equity Association [EMPEA], (2012) statistics indicate private equity capital raised for investment in dedicated sub-Saharan African funds between 2006 and 2008 totaled USD 6 billion. Prior years show sub-Saharan Africa raised only USD 2 billion in funds between 2000 and 2005, the scale of private equity in the region is therefore at best modest in global context. Sub-Saharan Africa accounted for less than four percent of the USD 159 billion raised for all emerging markets between 2006 and 2008, and less than a half percent of the USD 1.4 trillion raised globally by private equity funds during the same period. The variance in investment between sub Saharan Africa and other regions of the world is therefore clearly evident.

According to Choi (2011), the lack of knowledge about of private equity and venture capital industries is cited as one of the biggest hurdles in unlocking local sources of capital to fund small and medium scale enterprises. There is therefore the need to understand the impact

of P.E as an alternative asset class on value creation. This knowledge has created a gap which will form the crux of this paper.

**Specific Research Objectives**

1. To analyze the effect of changes in financial structure on value creation.

2. To determine the impact of P.E operational influencers on value creation.

3. To identify the impact P.E strategy on value creation.

**LITERATURE REVIEW**

The conceptual framework section highlighted the relationship between the independent variables engaged during P.E activities to value creation which was the dependent variable.

Panigrhi et al (2014), stated that the ability of the business to create shareholder wealth is a key indicator of management and business performance. Powers (2010) indicated total return to shareholders as a shareholder value measure and pointed it out as one most direct measures of the return that is received by shareholders. In this research, shareholder value analysis provided a framework for linking the outcomes management decision and strategies in P.E pillars to value creation metrics.

**Theoretical Review**

*Agency Theory*

Jensen and Meckling (1976), made the argument that the employment of a professional staff of salaried managers to run large corporations and the wide dispersion of ownership of shares of stock of publicly-traded companies allow managers who are the agents to pursue their own agendas rather than manage the firm in the interest of its shareholders or principals. In this context, corporate managers used the free cash flow generated by company operations to pursue selfish motives and alternative strategies. The managers therefore do not maximize value for the company's shareholders (Applebaum and Batt, 2012).

Private equity mitigates these issues in two ways: First, it concentrates ownership in a few hands and this allows these shareholders to monitor managers closely. This would solve the principal-agent problem in agency theory and lead to increased efficiency and higher returns to shareholders. Secondly, loading the acquired companies with debt makes it impossible for spending decisions to be financed out of retained earnings. Instead, managers would need to borrow from credit markets. This reduces the amount of free cash flow available and disciplines managers as a result.

Lehn and Poulsen, (1989) found empirical evidence in support of Jensen's free cash flow hypothesis. They found that undistributed cash flows are significantly related to a firm's decision to go private, and premiums paid to stockholders are significantly related to undistributed cash flows. Private equity and leveraged buyouts "help to improve corporate governance by reducing agency conflicts that may be present in firms before they go private" (Zirugat, 2009). The major beneficiary in this case becomes the shareholder whose interests' managers may often overlook. These studies ascribe these outcomes to the private equity contracting model, which introduces close monitoring of management action and the overall impact. This would lead to stronger business entities within an economy.

### *Modigliani and Miller Theory of Optimal Capital Structure*

(Modigliani and Miller, 1958) argued that the "firm value is independent of its capital structure". They stated that a firm's value depends upon the profitability of its assets and not on the way in which such assets are financed. The market value of a firm is therefore not determined if the firm uses debt and/or equity in it's financing activities. This theory also falls within the arena of private equity since P.E firms take up more leverage in order to generate greater value in their investments.

Modigliani and Miller based their argument on the assumption that when a financial market is not distorted by any frictions, the investors can freely replicate a company's financial actions. This is because rational investors are able to borrow at the same interest rate as firms. In this case investors will have the same financial opportunities as firms, and hence, they can untie firms' capital structure decisions on the financial markets as was indicated by Pedersen and Arup (2010). Thus the enterprise value of the firm depends only on the cash flow generated by assets and not by the capital structure.

Dudley (2007) stated that the Modigliani and miller theory relied on some impracticable assumptions such as: No taxes (neither corporate nor personal), no costs of bankruptcy, no operational effects of gearing (positive as well as negative), and perfect/efficient capital markets (firms and investors can borrow or lend at the same rate).

These assumptions are however criticized since the imperfections in capital markets and taxes do exist. The assumption of no taxes is broken down by Modigliani and Miller themselves in 1963 when they argued that debt provides a tax benefit shield and hence, the value of the firm is maximized by using as much debt as possible Modigliani and Miller (1963).

**Conceptual Framework**

A conceptual framework is an interconnected set of ideas about how a particular phenomenon functions or is related to its parts thus providing the basis for understanding the causal or correlational patterns of interconnections across events, ideas and observations (Svinicki, 2010). Memba (2011) stated that a dependant variable is the outcome variable, the one being predicted, with variation in the dependent variable being what the researcher tries to explain.

The conceptual framework summarized the relationship between private equity pillars as the independent variables on value creation as the dependent variable. This is based on Kaplan and Stromberg (2009)'s argument of P.E creating technically superior organizational forms.

Figure 1: Conceptual Framework
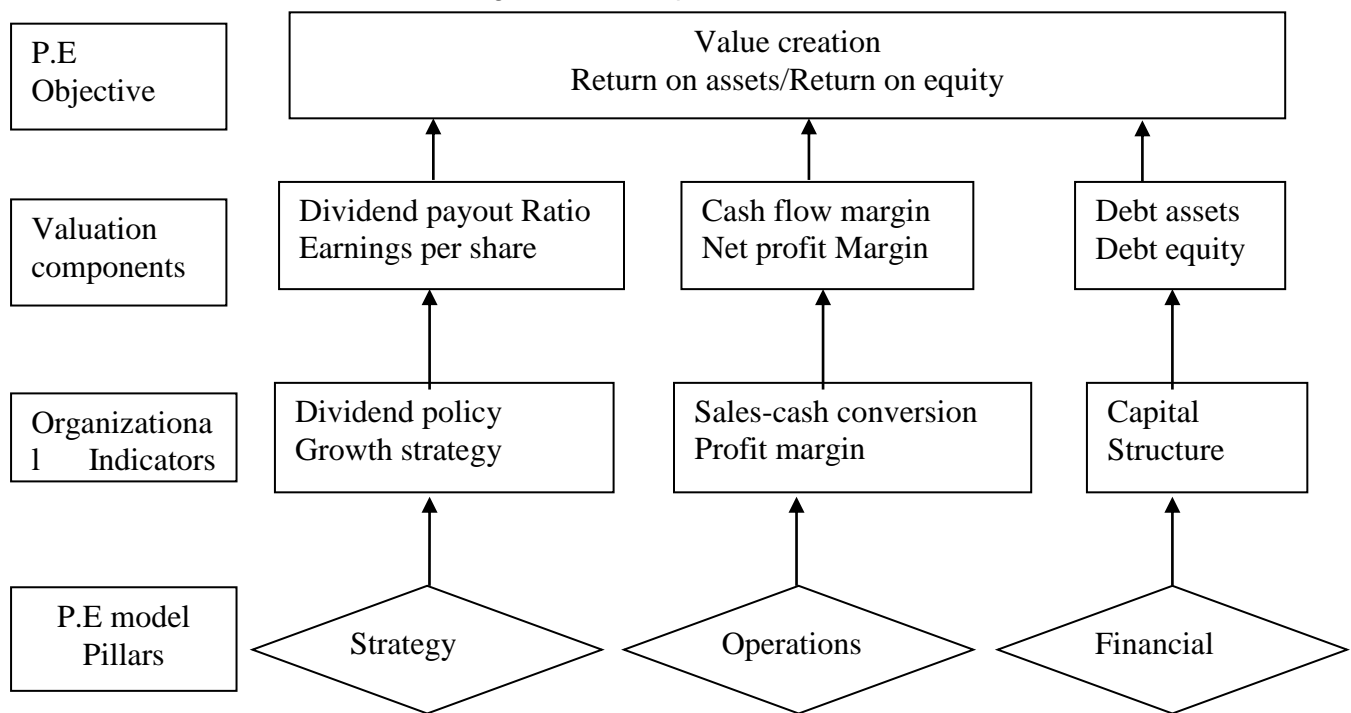


**Value Addition Proxies**

The debt to equity ratio measures the riskiness of the company's capital structure in terms of the relationship between the funds supplied by creditors (Fraser & Ormiston, 1998).It acts as an indicator of what proportion of equity and debt the company is using to finance its assets. Modigliani and Miller (1963) showed that firm value is an increasing function of leverage due to the tax deductibility of interest payments at the corporate level. This study sought to establish the impact of debt equity ratio on firm value during P.E activity. This is especially important

since Pedersen et al (2010) noted that private equity funds often focus on companies with low debt-equity ratio, as this means that they have unused debt-capacity that can be utilized.

The debt-asset-ratio refers to the percentage of all assets that are financed by debt (Fraser & Ormiston, 1998). Gitman (2009) stated that the more debt a firm uses in relation to total assets, the greater risk it stands of being unable to meet its contractual debt payments. This ratio is very similar to the debt-equity-ratio, but since the asset-base is also a key point of the funds, this figure provides useful information because the funds often try to streamline the assets through disposals. The reason for this is that the "private equity funds will look to concentrate solely on value adding elements of the company" (Jensen et al., 2006).

Cash flow margin relates cash flow from operations to net sales and measures how well a company's daily operations can be used to transform sales of their products and services into cash. The free cash flow hypothesis advanced by Jensen (1988), states that managers endowed with free cash flow will invest it in negative net present value (NPV) projects rather than pay it out to shareholders. According to Efobi (2008), due to the relevance of cash flows in the company's operations and performance, corporate organizations need to develop a suitable cash flow mix and apply it in order to maximize shareholders values. He goes further to state that the ability of a company to effectively choose adequate sources of funds to finance its operations will differentiate strong cash flow governance and poorly managed cash flows. Positive or negative cash flows reveal whether money is created or lost as a business is generating sales. In this research the ratio is derived from cash flows of operating activities and was used as indicator of operational efficiency.

Earnings per share according to Gitman (2009), represents the monetary value earned during a period on behalf of each outstanding share of common stock. Ulzanah and Murtaqi (2015) stated that EPS is an important indicator of corporate success and is an analytical tool for the investing public. Companies provide this ratio in their financial statements as it is a common tool that is used to identify the profitability of an investment, whether earning power has improved or deteriorated and it is also used to show the comparative value provided for the shareholders.

Apart from EPS being important to potential investors and shareholders it also reveals performance with regard to the continuing investment and growth strategies as indicated by Graham et al (2005).

The Net profit margin establishes the relationship between net profit and sales and indicates management's efficiency in manufacturing, administering and selling the products (Pandey, 2000). Soumadi et al (2013) stated that the most widely pursued corporate directional strategies are those designed to achieve growth in sales, assets and profits. It can thus give a

reflection of the price strategy adopted by the firm. This ratio is also influenced by changes in capital since net income will vary depending on the interest or tax amounts paid on the source of capital determined.

The dividend payout ratio is the amount of dividends paid relative to net income or earnings per share (Keown et al, 2005). It provides a relationship between dividends paid to stockholders relative and the amount of total net income a company earns. This ratio reveals a board's propensity for paying dividends to shareholders from earned income which could alternatively be reinvested in the form of retained earnings (Kuswanto et al, 2012). The ratio will be related to strategic decisions on dividend policy.

**Value Creation Metrics**

These variables were chosen for two reasons:

1) Return on assets (ROA) is commonly used as an accounting based measure of firm performance (Kim, 2005). ROA also expresses a company's ability to generate profit as a consequence of the productive use of resources and the efficiency of  management (Burja, 2010).

Return on equity (ROE) measured profitability by revealing how much profit a company generates with the money shareholders have invested. Taani and Banykhaled (2011) pointed out that a higher ROE indicates that the firm can earn higher return on shareholder's equity which means higher efficiency in spending money invested by shareholder to earn profit growth.

2) ROE and ROA were also drawn from the theoretical review which covered Agency theory and the Modigliani and Miller theory of optimal capital structure. ROA relates to the Modigliani and miller theory which argues that a firm's value is dependent on the profitability of it's assets and not on the way such assets are financed while ROE relates to the agency theory in which principal-agent conflicts arise as a result agents or managers pursuing their own agendas rather than focusing on maximizing returns from outlays invested by shareholders.

**Empirical Review**

*Financial - Private Equity and Performance*

Academic papers such as Ljungqvist and Richardson (2003), find that private equity investments outperformed the S&P 500 by six to eight percent. Kaplan and Schoar (2005) also report superior returns for private equity investments.

Bernstein et al (2010), analyzed the impact of buyouts on industry performance across nations (U.S., U.K., and continental Europe) and find that high BO activity is associated with faster growth in productivity and employment.

LBO performance has been under scrutiny after the economic crisis of 2008 since these firms hold huge sums of money for individual investors and are also highly leveraged. Campbell and Campbell (2010) stated that private equity-backed firms may do better during downturns because their investors constitute a concentrated shareholder base, which can continue to provide equity financing in a way that might be difficult to arrange for other companies during downturns.

Jensen (1989), Showed that the high levels of debt in PE transactions force firms to respond earlier and more forcefully to negative shocks to their business. As a result, private equity-backed firms may be forced to adjust their operations more rapidly at the beginning of an industry downturn, enabling them to better weather a recession.

Kaplan et al (1998), when they studied 31 distressed leveraged buyouts from the 1980s that were under financial distress, and found that the value of the firms post-distress was slightly higher than the value before the buyout, suggesting that even the leveraged buyouts that were hit most severely by adverse shocks add economic value.

Using debt in leveraged buyout transactions gives rise to interest tax deductions that are valuable to the investor firms. Kaplan (1989), finds that, depending on the assumption, the reduced taxes from higher interest deductions can explain from 4 percent to 40 percent of a firm's value. These estimates would differ for subsequent decades because depending on the corporate tax rate and the extent of leverage used in these deals. Greater leverage therefore creates value for private equity investors by reducing taxes.

### Capital Structure

Saad (2010) stated that the term capital structure means the way a firm finances it's assets through the mix of equity, debt or hybrid securities. Consequently capital structure is used to connote the proportionate relationship between debt and equity. The composition of the Capital structure changes when a company opts for equity financing over debt financing or vice versa and is therefore central when considering the Private equity model. Jensen and Meckling (1976), suggests that firms have a unique optimal capital structure that balances between the tax advantage of debt financing.

Associated literature regarding the impact of capital structure on performance draws mixed conclusions with investigations such as Saeedi and Mahmoodi (2011) and Derayat (2012) stating that a positive correlation exists while Bokhari and Khan (2013), Singh (2013) and

Shubita et al (2012) identified a negative relationship. Other researches such as Ebaid (2009) established a weak to no relationship between capital structure and performance.

### Operations

Jensen (2007) noted that private equity influencers cause the acquired company to experience operational changes. The importance of this opinion is highlighted by McKinsey and company (2005) who studied deals completed by 11 leading private equity firms revealed that company outperformance was the main driver of increased value.

Kaplan (1989), researched the accounting performance for 76 large management buyouts of public companies between 1980 and 1986. He showed that in the three years after the transaction operating income, cash flow and market value all increase. He argued that these increases reflect the impact of improved incentives rather than layoffs.

Harris et al (2005) proposed that U.K. buyout target plants are less productive pre-transaction and experience a substantial increase in productivity after a buyout, due to reduction in the labor intensity of production via outsourcing of intermediate goods and materials. He argues that labor reduction is driven towards sustainability of firms since they are already underperforming.

Kortum and Lerner (2000), found that increases in venture capital funding in an industry is associated with significantly higher patenting rates. This is particularly useful for companies who want to retain exclusive rights to product ownership.

Hellmann and Puri (2000), find that VC backing is associated with a significant reduction in the time to bring a product to market and that this is especially true for firms with first mover positions in the markets. This is due to the skills and expertise that are brought on board by the P.E investors who have extensive experience on running of effective businesses.

A number of studies further consider the impact of leverage, which is a prominent feature of private equity investments, on innovation. They identify that there is a clear association between greater leverage and lower levels of research and development spending, as documented by Hall's (1992) examination of over 1,200 manufacturing firms. This is in line with Ames (2002) who urged that "private equity drives economic development because it promotes innovation".

### Strategy

Changing the ownership of the acquired company will likely affect the existing strategy. The reason given for this is that the "private equity funds will look to concentrate solely on value adding elements of the company" (Jensen, et al., 2006).

P.E managers of portfolio firms may collaborate as well as compete with each other. Lindsey (2008), illustrates that strategic alliances are more frequent among companies sharing a common venture capitalist. This means that alliances are made easier more so for companies which have had difficulties coming together prior to the buyout.

Forms of strategic modifications may include: divestment of divisions and subsidiaries, selling off buildings or other assets, acquisition of other companies, National and International expansion, changing or modifying business strategy, introduction of new products and outsourcing of activities.

## METHODOLOGY

### Research Design

The research adopted a causal research design. Hidalgo and Sekhon (2011) define causality as the relationship between events where one set of events (the effects) is a direct consequence of another set of events (the causes). Causal inference therefore determines how variation in one phenomenon (independent variable) leads to or results in variation in another phenomenon, the (dependent variable). The design is classified under retrospective causal-comparative research since it - investigates a particular question when outcomes have already occurred and the researcher attempts to determine whether one variable may have influenced another variable - (Gay et al 2006).

### Target Population

The period under consideration included all the years after entry by a private equity firm. The relevant years covered are up to 2014 since none of the investee firms exited their investments by this time.

The period considered for Equity bank spans from 2007 when Helios EB Investors acquired a 24.9% stake. East African Cables data coverage period  spans from 2004 when Transcentury investments acquired (64%) of the company while Longhorn publishers has Centum investment company being the investor firm following 35% equity acquisition in 2008.

### Instruments

Financial statements were used to generate the data for the independent variables based on the financial, operational and strategic pillars of the P.E model by calculating measurable outcomes through ratio analysis. The concept of shareholder value analysis developed Rappaport (1986) was used to link this data to the dependent variables which were a proxy for value creation.

**Data Processing and Analysis**

Correlation coefficients measured the extent of interdependence of value creation metrics return on assets and return on equity. This allowed the determination of the interdependence of the valuation metrics thus establishing the extent of joint comparison of the two metrics in this research.

Regression analysis was used to ascertain statistical dependence between the dependent and independent variables. This relationship between the variables was analyzed using econometric (Eviews) software through multiple linear regression.

Regression coefficients were considered statistically significant at 5% significance level ($α= 0.05$). Statistical significance indicated statistically different from zero meaning the maintained hypothesis $β=0$ is rejected.

Durbin Watson test for first order serial correlation in the errors of a regression model results are cited by Hill et al (2011) as being biased toward 2 once explanatory variables are lagged and so the findings were validated using Breusch-Godfrey serial correlation test.

**EMPIRICAL FINDINGS AND DISCUSSION**

**Correlation of Value Creation Metrics**

Return on assets and return on equity are both based on the primary accounting equation where

Assets= Liabilities/debt+ Owner's equity

From the equation, assets would always be expected to be more than shareholder's equity with the difference being leverage/debt. The only exception to this would be if liabilities did not exist. Since both ratios have net income as a common numerator, ROE would therefore be expected to be greater than ROA.

This is observed in the chart representation of the value creation metrics. The line chart also shows similarities in the movements of the trend lines between ROE and ROA.

Figure 2: Return on Assets



| ROA | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|
| equity | 0.000 | 0.000 | 0.000 | 0.046 | 0.044 | 0.041 | 0.051 | 0.051 | 0.048 | 0.052 |
| CABL | 0.202 | 0.149 | 0.130 | 0.152 | 0.084 | 0.041 | 0.063 | 0.084 | 0.058 | 0.043 |
| Longhorn | 0.000 | 0.000 | 0.000 | 0.000 | 0.047 | 0.041 | 0.193 | -0.034 | 0.137 | 0.127 |
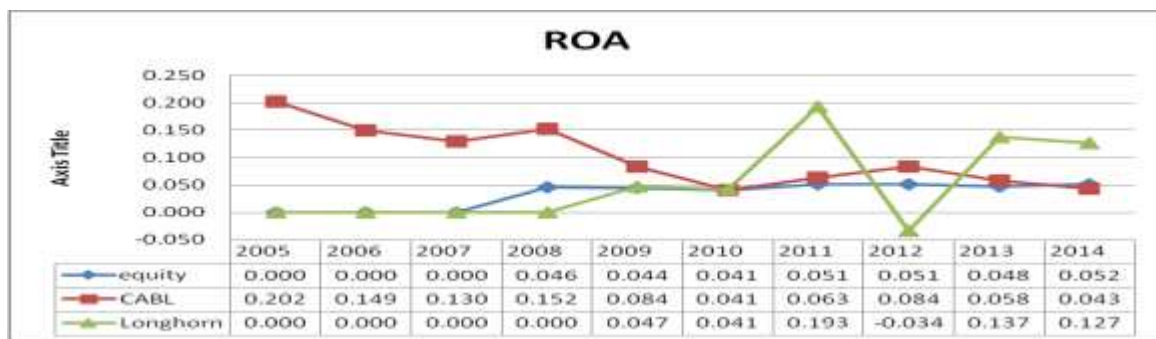
Figure 3: Return on Equity
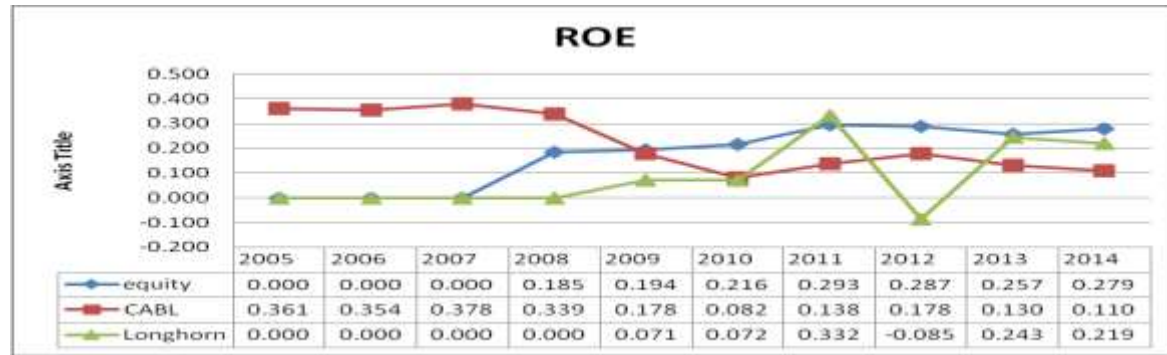


Table 1: Correlation of Valuation Metrics

|  | EQUITY_ROA | EQUITY_ROE |
|---|---|---|
| EQUITY_ROA | 1 | 0.908634 |
| EQUITY_ROE | 0.908634 | 1 |
|  | CABL_ROA | CABL_ROE |
| EAST AFRICAN CABLES _ROA | 1 | 0.93594 |
| EAST AFRICAN CABLES _ROE | 0.935945 | 1 |
|  | LONGHORN_ROA | LONGHORN_ROE |
| LONGHORN_ROA | 1 | 0.998728 |
| LONGHORN_ROE | 0.9987282 | 1 |

This established the extent to which the results of ROE and ROA could be related for each individual company.

**Regression Equations**

*Effect of Financial Modification on Value Creation*

$ROE_{it} = \beta_0 + \beta_1 DER_{it} + \beta_2 DAR_{it} + \varepsilon$

$ROA_{it} = \beta_0 + \beta_1 DER_{it} + \beta_2 DAR_{it} + \varepsilon$

Where,

$ROE_{it}$ = Return on equity of firm i for time period t

$ROA_{it}$ = Return on assets of firm i for time period t

$DER_{it}$ = Ratio of Debt to Equity for firm i for time period t

$DAR_{it}$ = Ratio of Debt to Total Assets of firm i for time period t

**Impact of Operational Drivers on Value Creation**

$ROA_{it} = \beta_0 + \beta_1 CFM_{it} + \beta_2 NPM_{it} + \varepsilon$

$ROE_{it} = \beta_0 + \beta_1 CFM_{it} + \beta_2 NPM_{it} + \varepsilon$

Where,

$ROE_{it}$ = Return on equity of firm i for time period t

$ROA_{it}$ = Return on assets of firm i for time period t

$CFM_{it}$ = Cash flow margin of firm i for time period t

$NPM_{it}$ = Net profit margin of firm i for time period t

**Impact of Strategic Changes on Value Creation**

$$ROA_{it} = \beta_0 + \beta_1 DPR_{it} + \beta_2 EPS_{it} + \varepsilon$$

$$ROE_{it} = \beta_0 + \beta_1 DPR_{it} + \beta_2 EPS_{it} + \varepsilon$$

Where,

$ROE_{it}$ = Return on equity of firm i for time period t

$ROA_{it}$ = Return on assets of firm i for time period t

$DPR_{it}$ = Dividend payout ratio of firm i for time period t

$EPS_{it}$ = Earnings per share i for time period t

## SUMMARY

### The Effect of Financial Modification on Value Creation

Value creation metrics exhibited little to no association with financial modification in the capital structure. The financial orientation adopted in the case study companies was not reflected in their earning capacity which follows the Modigliani and miller capital structure irrelevance theory.

### The Impact of Operational Drivers on Value Creation

The business operational directives adopted by private equity firms exhibited an influence on the value that was created by the case studies. The approach implemented by operating units therefore influences cash flow levels and also impacts overall profitability. Maintaining an efficient operational structure therefore plays a major role in yielding superior returns.

### The Impact of Strategic Changes on Value Creation

Strategic decisions undertaken by the private equity firms predominantly indicated an influence on overall returns and hence impacted value creation during the years of study. Decisions with regard to dividends allocation and growth strategies pursued are enhanced by having skilled private equity managers on board. This also directly impacts the nature of the principal-agent relations.

## CONCLUSION AND RECOMMENDATIONS

Private equity has made a case for value creation in terms of strategic and operational involvement even though little influence was identified in terms of the impact the model had through modifying the financial structure. Overall, the private equity model posses the potential of transforming the nature of business functions as well influencing the performance and value of companies.

Local enterprises should be encouraged to partner with private equity firms as this would provide valuable information as well as experience related to streamlining operations as well as strategic decision making. Budding enterprises also face challenges in terms capital acquisition as well as funds to finance business growth in latter stages. Partnership with private equity funds would therefore enhance economic as well as structural improvements. There is also an added advantage of having management with ownership interests in a business because as shareholders, they would also bear associated risk.

Necessary policy amendments by government would be required to enable growth of other forms of alternative funding as well as establish Kenya as a prime location for fund establishment. These amendments may include setting up appropriate tax structures for funds as well as lowering the number of required filings made to the public registry in order to boost confidentiality.

Management should create incentives for executives of operating units. This however needs to be contingent on performance based on value addition metrics that standardize the output of those operating units. Cash should also be returned to share holders where there are no credible value creating opportunities the business can invest in. Cash distributed to shareholders gives them a better opportunity to earn greater returns and also reduces the risk that management will use the excess cash to engage in unscrupulous activities or invest in activities that do not improve the value of the business.

## SUGGESTIONS FOR FURTHER RESEARCH

The study recommends further researches be carried out on more value maximization strategies which would link business valuation metrics to appropriate management objectives. Value maximization could also include further research on optimal capital structure.

The adjusted R-squared findings showed that independent variables did not explain all the variation in the valuation metrics. Other factors influenced variance in the dependent variables which still remain unexplained. These factors may include: Macro economic conditions, government industrial policy and technical aspects within firms that could be identified.

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## APPENDICES

Table 1: $ROA_{it} = \beta_0 + \beta_1 DPR_{it} + \beta_2 EPS_{it} + \varepsilon$

| EQUITY BANK | | | | |
|---|---|---|---|---|
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
| DAR | -0.929954 | 0.600049 | -1.549796 | 0.1961 |
| DER | 0.043534 | 0.025973 | 1.676151 | 0.169 |
| C | 0.613552 | 0.374413 | 1.638705 | 0.1766 |
| Durbin-Watson stat | 1.589499 | | | |
| R-squared | 0.567984 | F-statistic | | 2.629459 |
| Adjusted R-squared | 0.351976 | Prob(F-statistic) | | 0.186638 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 0.002553 | Probability | 0.959699 | |
| EAST AFRICAN CABLES | | | | |
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
| ROA(-1) | 0.59903 | 0.227568 | 2.632307 | 0.0464 |
| DER | -0.139424 | 0.297276 | -0.469 | 0.6588 |
| DAR | 0.898321 | 1.650281 | 0.544344 | 0.6096 |
| C | -0.296525 | 0.538698 | -0.55045 | 0.6057 |
| Durbin-Watson stat | 1.939077 | | | |
| R-squared | 0.667108 | F-statistic | | 3.339956 |
| Adjusted R-squared | 0.467372 | Prob(F-statistic) | | 0.113599 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 4.40172 | Probability | 0.110708 | |

**LONGHORN**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| DAR | 2.368654 | 1.902401 | 1.245087 | 0.3015 |
| DER | -0.662156 | 0.447692 | -1.479044 | 0.2357 |
| C | -0.400644 | 0.480179 | -0.834365 | 0.4653 |
| | | | | |
| Durbin-Watson stat | 2.786491 | | | |
| R-squared | 0.497795 | F-statistic | | 1.486827 |
| Adjusted R-squared | 0.162991 | Prob(F-statistic) | | 0.355895 |

Table 2: $ROE_{it} = \beta_0 + \beta_1 DER_{it} + \beta_2 DAR_{it} + \varepsilon$

**EQUITY BANK**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| | | | | |
| DAR | -5.052606 | 3.211957 | -1.57306 | 0.1908 |
| DER | 0.282456 | 0.139027 | 2.031668 | 0.112 |
| C | 3.130693 | 2.004166 | 1.562093 | 0.1933 |
| | | | | |
| Durbin-Watson stat | 1.741324 | | | |
| R-squared | 0.905227 | F-statistic | | 19.10308 |
| Adjusted R-squared | 0.857841 | Prob(F-statistic) | | 0.008982 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 0.134187 | Probability | 0.935108 | |

**EAST AFRICAN CABLES**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| ROE(-1) | 0.687333 | 0.210747 | 3.261416 | 0.0224 |
| DER | -0.135601 | 0.607396 | -0.22325 | 0.8322 |
| DAR | 1.562954 | 3.358313 | 0.465399 | 0.6612 |
| C | -0.651689 | 1.097049 | -0.59404 | 0.5783 |
| | | | | |
| Durbin-Watson stat | 1.484814 | | | |
| R-squared | 0.788986 | F-statistic | | 6.231707 |
| Adjusted R-squared | 0.662378 | Prob(F-statistic) | | 0.038387 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 0.216799 | Probability | 0.64149 | |

**LONGHORN**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| DAR | 5.011493 | 3.324862 | 1.507278 | 0.2288 |
| DER | -1.440394 | 0.78244 | -1.8409 | 0.1629 |
| C | -0.866812 | 0.839217 | -1.032882 | 0.3776 |
| Durbin-Watson stat | 2.803527 | | | |
| R-squared | 0.628004 | F-statistic | | 2.532301 |
| Adjusted R-squared | 0.380007 | Prob(F-statistic) | | 0.226886 |

Table 3: $ROA_{it} = \beta_0 + \beta 1 CFM_{it} + \beta 2 NPM_{it} + \epsilon$

**EQUITY**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| CFM | -0.018528 | 0.003533 | -5.243905 | 0.0063 |
| NPM | 0.052959 | 0.009451 | 5.603427 | 0.005 |
| C | 0.050775 | 0.007763 | 6.541016 | 0.0028 |
| Durbin-Watson stat | 1.513812 | | | |
| R-squared | 0.933598 | F-statistic | | 28.11953 |
| Adjusted R-squared | 0.900397 | Prob(F-statistic) | | 0.004409 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 0.022763 | Probability | 0.880075 | |

**EAST AFRICAN CABLES**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| CFM | -0.014169 | 0.080333 | -0.176378 | 0.865 |
| NPM | 1.277328 | 0.212509 | 6.010708 | 0.0005 |
| C | -0.034767 | 0.024426 | -1.423344 | 0.1976 |
| Durbin-Watson stat | 1.940801 | | | |
| R-squared | 0.839376 | F-statistic | | 18.28995 |
| Adjusted R-squared | 0.793483 | Prob(F-statistic) | | 0.001661 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 0.041607 | Probability | 0.979412 | |

**LONGHORN**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| CFM | 0.191081 | 0.146447 | 1.304781 | 0.283 |
| NPM | 1.371954 | 0.171345 | 8.00698 | 0.0041 |
| C | 0.006531 | 0.015626 | 0.417965 | 0.7041 |

| | | | | |
|---|---|---|---|---|
| Durbin-Watson stat | 2.623327 | | | |
| R-squared | 0.955439 | F-statistic | | 32.16177 |
| Adjusted R-squared | 0.925732 | Prob(F-statistic) | | 0.009407 |

Table 4: $ROE_{it} = \beta_0 + \beta_1 DPR_{it} + \beta_2 EPS_{it} + \varepsilon$

**EQUITY**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| CFM | -0.21402 | 0.076228 | -2.80765 | 0.0484 |
| NPM | 0.483514 | 0.2039 | 2.371326 | 0.0767 |
| C | 0.351846 | 0.167471 | 2.100936 | 0.1035 |
| | | | | |
| Durbin-Watson stat | 1.186024 | | | |
| R-squared | 0.763372 | F-statistic | | 6.452103 |
| Adjusted R-squared | 0.645059 | Prob(F-statistic) | | 0.055993 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 3.748448 | Probability | 0.153474 | |

**EAST AFRICAN CABLES**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| CFM | -0.166894 | 0.231752 | -0.720142 | 0.4948 |
| NPM | 2.547568 | 0.613064 | 4.15547 | 0.0043 |
| C | -0.025849 | 0.070468 | -0.366826 | 0.7246 |
| | | | | |
| Durbin-Watson stat | 1.173715 | | | |
| R-squared | 0.711785 | F-statistic | | 8.643726 |
| Adjusted R-squared | 0.629438 | Prob(F-statistic) | | 0.012853 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 2.724116 | Probability | 0.256133 | |

**LONGHORN**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| CFM | 0.127708 | 0.192902 | 0.662034 | 0.5553 |
| NPM | 2.824061 | 0.225698 | 12.51257 | 0.0011 |
| C | -0.016612 | 0.020582 | -0.807126 | 0.4787 |
| | | | | |
| Durbin-Watson stat | 2.005977 | | | |
| R-squared | 0.981251 | F-statistic | | 78.5037 |
| Adjusted R-squared | 0.968751 | Prob(F-statistic) | | 0.002567 |

Table 5: $ROA_{it} = \beta_0 + \beta_1 DPR_{it} + \beta_2 EPS_{it} + \varepsilon$

**EQUITY**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| DPR | -0.036221 | 0.012399 | -2.921186 | 0.0432 |
| EPS | 0.002623 | 0.000594 | 4.412788 | 0.0116 |
| C | 0.054449 | 0.00469 | 11.61031 | 0.0003 |
| | | | | |
| Durbin-Watson stat | 1.293559 | | | |
| R-squared | 0.852972 | F-statistic | | 11.60284 |
| Adjusted R-squared | 0.779458 | Prob(F-statistic) | | 0.021617 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 0.73816 | Probability | 0.390251 | |

**EAST AFRICAN CABLES**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| DPR | -0.207429 | 0.055821 | -3.715952 | 0.0075 |
| EPS | -0.019696 | 0.039501 | -0.498629 | 0.6333 |
| C | 0.248492 | 0.076682 | 3.240539 | 0.0142 |
| Durbin-Watson stat | 1.145338 | | | |
| R-squared | 0.682567 | F-statistic | | 7.525959 |
| Adjusted R-squared | 0.591872 | Prob(F-statistic) | | 0.018021 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 1.720247 | Probability | 0.42311 | |

**LONGHORN**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| DPR | -0.00086 | 0.001765 | -0.487139 | 0.6595 |
| EPS | 0.072061 | 0.003468 | 20.77707 | 0.0002 |
| C | 0.020451 | 0.004404 | 4.643908 | 0.0188 |
| | | | | |
| Durbin-Watson stat | 2.499288 | | | |
| R-squared | 0.994657 | F-statistic | | 279.2496 |
| Adjusted R-squared | 0.991095 | Prob(F-statistic) | | 0.000391 |

Table 6: $ROE_{it} = \beta_0 + \beta_1 DPR_{it} + \beta_2 EPS_{it} + \varepsilon$

**EQUITY**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| DPR | -0.027587 | 0.199131 | -0.13853 | 0.8965 |

| | | | | |
|---|---|---|---|---|
| EPS | 0.029285 | 0.009546 | 3.067873 | 0.0374 |
| C | 0.178053 | 0.075316 | 2.364064 | 0.0773 |
| | | | | |
| Durbin-Watson stat | 1.186512 | | | |
| R-squared | 0.709664 | F-statistic | | 4.888568 |
| Adjusted R-squared | 0.564496 | Prob(F-statistic) | | 0.084295 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 0.783718 | Probability | 0.376006 | |

**EAST AFRICAN CABLES**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| ROE(-1) | 0.526318 | 0.192675 | 2.731636 | 0.0412 |
| EPS | 0.017141 | 0.087488 | 0.19593 | 0.8524 |
| DPR | -0.261385 | 0.106475 | -2.45491 | 0.0576 |
| C | 0.219934 | 0.165201 | 1.33131 | 0.2406 |
| | | | | |
| Durbin-Watson stat | 2.040732 | | | |
| R-squared | 0.886782 | F-statistic | | 13.05425 |
| Adjusted R-squared | 0.818852 | Prob(F-statistic) | | 0.008423 |
| Breusch-Godfrey Serial Correlation LM Test: | | | | |
| Obs*R-squared | 0.01906 | Probability | 0.890195 | |

**LONGHORN**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| DPR | 0.008564 | 0.003327 | 2.574054 | 0.0822 |
| EPS | 0.135661 | 0.006536 | 20.75534 | 0.0002 |
| C | 0.00825 | 0.008299 | 0.994069 | 0.3935 |
| Durbin-Watson stat | 2.000729 | | | |
| R-squared | 0.995398 | F-statistic | | 324.4797 |
| Adjusted R-squared | 0.992331 | Prob(F-statistic) | | 0.000312 |