EFFECT OF PORTFOLIO RESTRUCTURING ON SHAREHOLDERS' WEALTH OF FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE, KENYA

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ABSTRACT

In a contemporary globalized economic landscape, competition for shareholders' wealth is becoming increasingly intense thus companies must strive to offer adequate rate of return to investors to remain relevant and ensure continuous funding. Portfolio restructuring aims to optimize portfolio performance, enhance portfolio returns and manage risk thereby boosting shareholders' wealth. However, portfolio restructuring may also lead to increased cost such as advisory and service fees, transaction cost, tax implications, loss of synergies and reduced economies of scale that may lower shareholders' wealth. Therefore, this study sought to investigate the effect of portfolio restructuring on the shareholders' wealth of firms listed at the Nairobi Securities Exchange (NSE). The study was anchored on agency theory and resource-based view theory and a causal research design was used. The target population consisted of 64 listed firms at the Nairobi Securities Exchange as at 31st December 2023. However, adequate data for 54 firms was obtained yielding 534 firm-year observations for the period 2014 to 2023. Descriptive and inferential statistics were used for data analysis. Structural equation modelling was fitted for the analysis. The study found that portfolio restructuring positively influences the shareholders' wealth of firms listed at the NSE ($\beta = 1.433$, $p < 0.001$). The study recommends that managers of listed firms should adopt a strategic approach to portfolio restructuring by continuously evaluating their business units or investments to identify areas for divestiture or reinvestment. This helps concentrate resources on core profitable areas while eliminating operational inefficiencies associated with underperforming or non-core segments to maximize shareholders' wealth.

Keywords: portfolio restructuring, shareholders' wealth, return on investment, fixed assets to total assets, change in total assets

INTRODUCTION

In a contemporary globalized economic landscape, competition for shareholders' wealth is becoming increasingly intense thus companies must strive to offer adequate rate of return to investors in order to remain relevant and ensure continuous funding. Creating shareholder wealth is among the most important element in the current marketplace and this has led to significant pressure on management to measure and report the value created (Caballero *et al*., 2019). Shareholders' wealth maximization objective provides a convenient framework for evaluating both the timing and risks associated with various investment and financing strategies (Giannopoulos *et al*., 2023). Boosting shareholders' wealth has a direct effect on a company's long-term growth and even its ability to continue as a going concern. Growth in a company's shareholders' wealth may inspire confidence in investors by signaling the company's ability to have bright prospects, which in turn will result to high returns on equity (Putranto & Kurniawan, 2018). Managers should restructure firms to improve the shareholders' wealth otherwise; external raiders will get an opportunity to take-over the company. Therefore, it is in the best interest of both managers and shareholders to resolve agency conflicts and undertake restructuring strategies that position the firm well in the market.

Portfolio restructuring involves major changes in the asset or the lines of business, which includes strategies such as liquidation, asset sales, spin-off and divestitures to align with the investors' financial goals, risk tolerance, market conditions and changing circumstances (Liu *et al*., 2023). Portfolio restructuring can improve firm performance and enhance shareholders' wealth by reducing managerial expropriation, cutting costs, and improving expected cash flows that can be distributed to shareholders in form of dividends (Hayes & Scott, 2021). However, portfolio restructuring may also lead to increased cost such as advisory and service fees, transaction cost, tax implications, loss of synergies and reduced economies of scale that may lower shareholders' wealth (Nguyen *et al*., 2023). In 2017, Eveready East Africa undertook portfolio restructuring through sale of assets but still recorded a 24% decline in revenues. Flame Tree Group Holdings have reported an increase in profits of 18% in 2023 after undertaking portfolio restructuring. The mixed outcomes raise the question of whether portfolio restructuring enhances or diminishes shareholders' wealth. Despite the growing use of portfolio restructuring strategies, evidence on their impact on shareholders' wealth in emerging markets remain inconclusive.

The study is grounded on agency theory and resource-based view theory. Agency theory by Jensen and Meckling (1956) which posits that agency costs that arise from the conflicts between managerial interests with those of shareholders' and debt holders' can be minimized through mergers, acquisitions, divestitures, and reallocation of strategic business units for better synergy to maximize shareholders wealth. resource-based view theory championed by Penrose (1959) and advanced by Barney (1991) posits that firms are profit maximizers and uses owned, controlled, inimitable and available resources to gain a competitive advantage through portfolio restructuring to enhance shareholders' wealth.

Zhang et al. (2022) using event study methodology concluded that portfolio restructuring had a positive significant effect on the stock prices of 24 purposive selected Chinese listed firms from 2017 to 2020. Li *et al* (2019) revealed that portfolio restructuring had a positive significant effect on the performance of 33 randomly selected China financially distressed firms from 2014 to 2018 using multi variate regression. However, Savovic (2016) reported a negative insignificant effect of portfolio restructuring on the financial performance of 30 acquired companies in the Republic of Serbia from the period 2002 to 2011 using Multiple linear regression. Further, using multiple linear regression Kipelian (2020) concluded that portfolio restructuring had a negative significant effect on the financial performance of tier three commercial banks in Kenya for the period spanning from 2010 to 2019 using census approach.

Prior studies show mixed evidence on whether portfolio restructuring enhances shareholders' wealth. with some reporting positive effects and others finding non-significant or negative effect. Most of the studies were conducted in developed countries and adopted different data analysis methods. Moreover, gaps also arise from the period of study and operationalization of portfolio restructuring concept because most studies used single indicators limiting generalizability to non-financial listed firms in emerging markets like Kenya. Therefore, the need to carry out the research in a different context in Kenya to corroborate the findings about the link between financial restructuring and shareholders' wealth. This study therefore examines the effect of portfolio restructuring on shareholders' wealth among firms listed at the Nairobi Securities Exchange in Kenya.

Methodology

Research Design

The study adopted a causal research design within a balanced panel framework to enable examination of dynamic relationships between portfolio restructuring and shareholders' wealth.

Population

The population of this study was the 64 firms listed at the NSE for the period of ten years spanning from 2014 to 2023 yielding

640 firm-year observations. The research concentrated on the firms' listed at the Nairobi Securities Exchange because they have undergone different forms of portfolio restructuring such as divestiture, spin- offs, liquidation, purchase of new assets and asset sale offs to maximize shareholders' wealth. The selection of the period of study 2014 to 2023 was influenced by the fact that in 2014 many of the listed firms in Kenya engaged in restructuring activities driven by financial distress and the need to adapt to changes in the economic environment due to Covid- 19, Russian and Gaza war and climatic changes.

Sampling Procedure and Sample Size

The study adopted census approach where all the 64 listed firms were considered. Census approach was suitable because the population was reckoned as small and hence did not warrant the need for sampling.

Structural Equation Model Fit Indices

The goodness of fit of the structural equation modelling was assessed using Root Mean Square Error of Approximation (RMSEA), Tucker and Lewis Index (TLI), Comparative Fit Index (CFI), Normed Fit Index (NFI), Incremental Fit Index (IFI) and Goodness of Fit Index (GFI). The values of GFI, CFI, NFI, IFI and TLI should range between zero to one. Values greater than 0.90 indicate that the model fits the observed data well while values less than 0.9 implies that the model does not fit the observed data well. Root Mean Square Error of Approximation values range between 0 to 0.1 thus a value below 0.08 indicates that the model fits the data well. Chi-square/df (CMIN/DF) value below 3 indicates that the model fits the data well (Hair *et al*., 2021).

Data Collection

Secondary quantitative data was obtained from individual firm's financial statements collected from the NSE handbooks, firms audited annual reports, published book of accounts, individual firms' online websites and the CMA reports for a period of ten years from the period 2014 to 2023.

Data Analysis

Data was analyzed by adopting descriptive and inferential statistics. Inferential statistics involving correlations and structural equation model was used. Diagnostics tests of normality, autocorrelation, heteroskedasticity and multicollinearity were undertaken. Data analysis was done using SPSS Analysis of Moments Structure (AMOS).

Operationalization of Variables

Operationalization of variables as guided by review of previous studies was presented in Table 1

Table 1: Operationalization of Variables

Variable	Indicators	Measurement	Similar Studies
Portfolio Restructuring	Percentage change in total assets	$\frac{I_1 - I_0}{I_0}$	Zhang *et al* (2022) and Murugi *et al*. (2022)
	Return on Investment	$\frac{\text{Profit afer tax}}{\text{Total Assets}}$	Muhammad *et al.* (2022) and Kumaraswamy *et al*. (2019)
	Fixed assets to total assets	$\frac{\text{Fixed assets}}{\text{Total Assets}}$	Li *et al*. (2019), Savovic (2016) and Srivastava and Mushtaq (2011)

Shareholders' Wealth	Tobin's Q Market value to book value Earnings per share	$\frac{\text{Market capitalization}}{\text{Total Equity}}$ $\frac{\text{Market value per share}}{\textit{Book value per share}}$ $\frac{\text{Profit after tax}}{\text{Number of ordinary shares}}$	Gupta (2022), Kao *et al*. 2019) and Bhatt (2017) Nisarg (2022) and Azhagaiah and Kumar (2011) Hong *et al*. (2021), Kamal (2022) and Gupta (2017)

Model Specification

The study adopted Covariance-based Structural Equation Modelling (CB-SEM) for testing hypothesis. Covariance-Based Structural Equation Modelling also handled multiple indicators, both observed and latent variables thereby reducing the measurement errors and increasing the reliability of measurement (Zyphur *et al.,* 2023). The study further, applied a Maximum likelihood estimation (MLE) method to estimate the parameters of the probability distribution based on observed data in SEM and estimate non-recursive causal relations in path models. To determine the effect of portfolio restructuring on shareholders' wealth of firms listed at the NSE, the study adopted the following path analysis and structural equation outlined in Figure 1 and model 1.

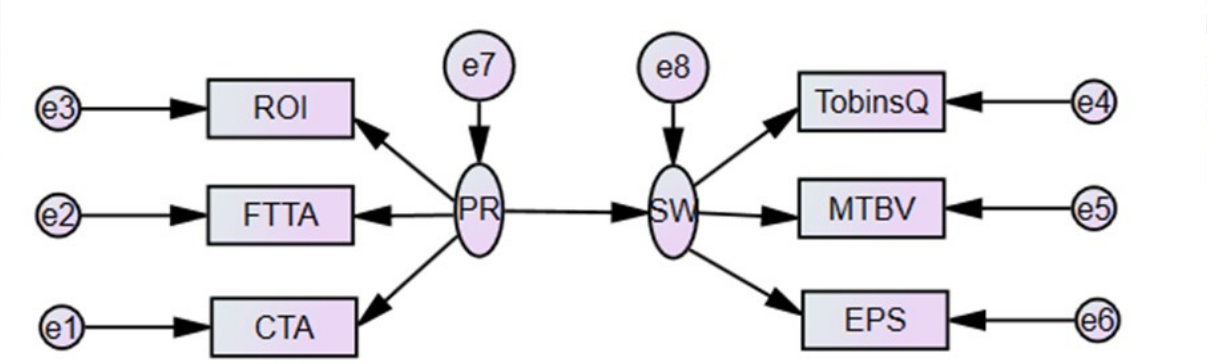

Figure 1: Path Analysis Model of Portfolio Restructuring and Shareholders' Wealth

where,

PR= Portfolio restructuring (Latent variable)

CTA= Change in total assets (Observed Variable)

ROI= Return on investment (Observed Variable)

FTTA= Fixed assets to total assets (Observed Variable)

PR= Portfolio restructuring (Latent Variable)

SW= Shareholders' wealth (Latent Variable)

EPS= Earnings per share (Observed Variable)

MTBV=Market value to Book value (Observed Variable)

Tobin's Q (Observed Variable)

γ = Parameters representing relationships from independent latent constructs to dependent latent variable

ζ = Error term for a latent dependent variable

λ = Factor loadings which represent how strongly each indicator is related to the latent variable

α = Constant term

δ = Measurement errors that represents the error term for each observed variable, capturing the variance not explained by the latent variable

In order to determine the importance and contribution of each variable to a factor, the

following measurement models were adopted.
EPS = λ_1SW+ δ_4
Tobin's Q = λ_2SW+ δ_5
MTBV = λ_3SW+ δ_6
ROI = λ_4PR + δ_7
FTTA = λ_5PR + δ_8
CTA = λ_6PR + δ_9

The following structural equation model was adopted to test the direct effect of portfolio restructuring on shareholders' wealth.

SW= α_1 + γ_2 PR + ζ……...Model 1

RESULTS AND DISCUSSIONS

Data Capture Rate

Data analysis covered all the 64 firms listed at the NSE. However, firms whose accounting information was unavailable, incomplete and have been delisted during the sampled period were excluded. Thus, only the 54 firms that met the specification selection criteria were included in the sample that yielded 534 firm year observations.

Descriptive Statistics

Descriptive statistics were based on the minimum, maximum, mean, standard deviation, skewness and kurtosis. Descriptive statistics results are presented in Table 2.

Table 2: Descriptive statistics of portfolio restructuring

Indicators	N	Min	Max	Mean	Std. Deviation	Skewness	Kurtosis
CTA	534	0.57	0.65	0.608	0.199	2.288 -1.259 -.094	23.066 1.745 -1.324
ROI	534	0.67	0.77	0.722	0.151		
FTTA	534	0.77	0.89	0.785	0.287		
Tobin's Q	534	0.87	0.96	0.902	0.023	0.573	-0.329
MTBV	534	0.85	0.97	0.905	0.031	0.246	-0.414
EPS	534	0.87	0.99	0.914	0.032	0.534	-0.501

The results presented in Table 2 show that the mean value of change in total assets among the listed firms was 0.108, signaling that the change in total assets was 10.8% for most of the firms. The standard deviation of 0.199 indicates low dispersion. The minimum and maximum values ranged from 0.57 to 0.65. The distribution of change in total assets was positively skewed (Skewness = 2.288), indicating that most firms experienced lower changes in total assets. Furthermore, the kurtosis value of 23.066 indicates a leptokurtic distribution, implying the most listed firms had higher change in total assets thus extreme outliers.

The return on investment (ROI) had a mean of 0.722, indicating that, on average the investment yielded a profit of 72.2%. The standard deviation of 0.151 indicates low volatility. The maximum and minimum values were 0.77 and 0.67. The ROI was negatively skewed (Skewness = -1.259), suggesting that few firms have lower returns on investment.

The kurtosis value of 1.745 showed a platykurtic distribution, meaning the ROI data was relatively flat compared to a normal distribution and thus few firms have low ROI.

The mean value of fixed asset to total asset ratio was 0.785, signaling that fixed asset accounted for 78.5% of the firms' total assets. The standard deviation of 0.287, this implies that there is significant variation in the fixed assets to total assets among the sampled firms. The minimum and maximum values ranged from 0.77 to 0.89. The distribution of this ratio was approximately symmetric with a skewness value of -0.094 which is close to zero, indicating no asymmetry in the distribution. However, the kurtosis value of -1.324 indicated a platykurtic distribution, suggesting a flatter peak and thinner tails which suggests that most firms have low fixed to total assets.

The mean value for Tobin's Q was 0.902 which means that the market capitalization was less than total equity. This implies undervaluation which presents an opportunity for the investor to purchase the shares of the firms at a discount. The standard deviation was 0.023, indicating that the Tobin's Q ratios in the sampled firms are closely clustered around the mean. The minimum and maximum values for Tobin's Q were 0.87 and 0.96 respectively revealing a slight variation in valuation among the listed firms. The skewness value of 0.573 suggests a moderate positive skew indicating that the data from the firms was closely clustered around the mean with a few higher values pulling the distribution to the right. The negative kurtosis value (-0.329) indicates that the data from the sampled were closely clustered.

Market-to-Book Value (MTBV) had a mean of 0.905, implying that the firms are undervalued by the market thus, investors can purchase the shares of the firms at a discount. The standard deviation was 0.031, indicating that the market to book value ratio in the sampled firms are highly clustered with very little variability around the mean. The MTBV varies from 0.85 to 0.97. The skewness of 0.246 suggests a slight positive skew, indicating that few firms had higher MTBV while the kurtosis of -0.414 confirms a flat distribution with light tails. This indicates that most firms were valued close to their book value with limited extreme valuations.

Earnings per Share (EPS) recorded a mean of 0.914, this indicates that for every I outstanding common share held, the company generated 0.914 of the net profit. The standard deviation was 0.032 indicates that the data points in the sampled firms are closely clustered around the mean. Earnings per share values varies from 0.87 to 0.99. The skewness value of 0.534 indicates a moderate positive skew implying that most of the firms had average earnings per share. The kurtosis value of -0.501 reflects a flat distribution revealing that few listed firms had higher earnings per share.

Correlation between Portfolio Restructuring and Shareholders' Wealth

The relationship between shareholders' wealth measured by EPS, Tobin's Q and MTBV and the indicators of portfolio restructuring measured by CTA, ROI and FTTA was determined based on Pearson product moment correlation. These were further combined into a composite index labelled PR (Portfolio Restructuring) and SW. The composite index of PR and SW was determined by averaging the three indicators of PR and SW. The results of the correlation between portfolio restructuring and shareholders' wealth are summarized in Table 3.

Table 3: Correlation between Portfolio Restructuring and Shareholders' Wealth

		SW	PR
SW	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	534	
PR	Pearson Correlation	0.907**	1
	Sig. (2-tailed)	0.000	
	N	534	534

The results presented in Table 3 indicate a strong and statistically significant positive correlation between portfolio restructuring (PR) and shareholders' wealth (SW) with a correlation coefficient of r = 0.907, p < 0.01. This implies that changes in portfolio configurations especially asset reallocation and reinvestment decisions are positively associated with enhanced shareholders' wealth.

Effect of Portfolio Restructuring on Shareholders' Wealth

The stated hypothesis aimed to evaluate the effect of portfolio restructuring on shareholders' wealth. The analysis commenced with structural equation modeling (SEM) diagnostics to assess multivariate normality, autocorrelation, heteroskedasticity, and multicollinearity, followed by evaluation of model fit and measurement models. Preliminary diagnostic tests confirmed that the data met the assumptions required for SEM, including normality (Jarque-Bera, p > 0.05), homoskedasticity (Breusch-Pagan, p = 0.610), absence of multicollinearity (VIF < 5), and no evidence of serial correlation (Wooldridge, p = 0.901).

Various model fit indices were then examined to determine whether the overall model adequately represented the observed data and whether the hypothesized pathways in the path diagram were statistically significant. The results of the model fit tests are presented in Table 4.

Table 4: Model fit indices

Model	CMIN	CMIN/DF	P value	GFI	TLI	IFI	CFI	NFI	RMSEA
Modified Model	29.784	2.482	0.064	0.954	0.956	0.923	0.963	0.922	0.048
Threshold		< 3.0	> 0.05	> 0.9	> 0.9	> 0.9	> 0.9	> 0.9	< 0.08

The model fit indices test result in Table 4 provides a chi-square statistic (CMIN) of 29.784 with a CMIN/DF of 2.482 which is less than 3. The P-value is 0.064 which was greater than 0.05 implying that the model did not significantly deviate from the observed data suggesting a good model fit. Goodness-of-Fit Index (GFI), Tucker Lewis Index (TLI), Incremental Fit Index (IFI), Comparative Fit Index (CFI) and Normed Fit Index (NFI) were all above 0.9. Furthermore, the RMSEA value was 0.048 which was below 0.08. Altogether, these indices indicated a good model fit.

Further, measurement model was adopted to determine how well CTA, ROI and FTTA measures portfolio restructuring and also how well shareholders' wealth was represented by Tobin's Q, MTBV and EPS. The results of the measurement model of portfolio restructuring and shareholders' wealth are presented in Figure 2.

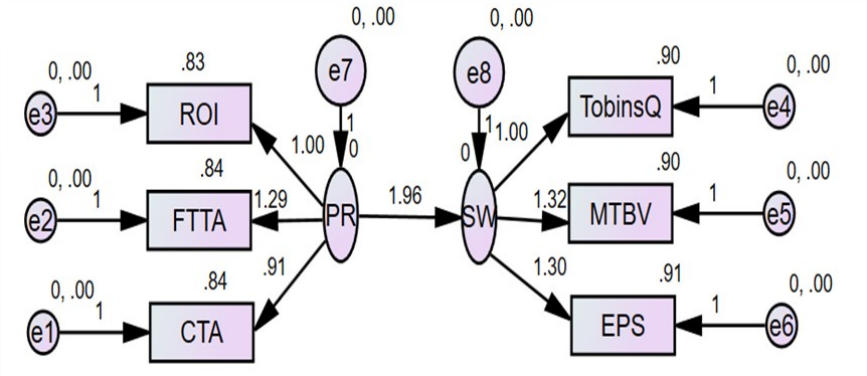

Figure 2: Portfolio Restructuring and Shareholders' Wealth

The results of the measurement model presented in Figure 2 show the relationship between portfolio restructuring and shareholders' wealth. Portfolio restructuring (PR) and shareholders' wealth (SW) was each measured using three observed indicators. All the factor loadings of the observed variables were above 0.5 and thus portfolio restructuring and shareholders' wealth indicators were retained. A bootstrap was performed using 1000 samples to obtain robust estimates. The relationship between the PR and SW was positive as indicated by the path coefficient ($\beta = 1.96)$, indicating that portfolio restructuring is beneficial in predicting shareholders' wealth

The findings of the effect of portfolio restructuring on shareholders' wealth of firms listed at the NSE are presented in Table 5.

Table 5: Effect of Portfolio Restructuring on Shareholders' Wealth

Model		Unstandardized Coefficients		t	Sig.
		B	Std. Error		
1	(Constant)	0.291	0.024	12.058	0.000
	PR	1.433	0.029	49.651	0.000

The results presented in Table 5 show the effect of portfolio restructuring on shareholders' wealth of firms listed at the NSE. Portfolio restructuring (PR) was measured as the composite index of ROI, CTA and FTTA while shareholders wealth (SW) was represented as the aggregate index of Tobin's Q, MTBV and EPS. The results showed that the intercept regression coefficient was positive and significant ($\beta = 0.291, p = 0.000)$. This implies that SW was 0.291 when all other predictors of the model were zero. Portfolio restructuring had a statistically significant positive effect on shareholders' wealth ($\beta = 1.433, p = 0.000).$ This indicates that one unit increase in PR leads to an increase in SW by 1.433. The findings led to the rejection of the null hypothesis that there is no statistically significant relationship between portfolio restructuring and shareholders' wealth among firms listed at the Nairobi Securities Exchange. The finding that portfolio restructuring is positively related with the firms' shareholders' wealth is similar to the study findings by (Zhang et al., 2023; Liu et al., 2022; Cascio, 2021; Murugi et al., 2022) and others finding no or negative effects (Kipelian, 2020; Savovic, 2016, Liu et al., 2021).

The following equation was derived from the results in Table 5.

$$SW = 0.291 + 1.433PR$$

Conclusion

The study established that portfolio restructuring significantly influences shareholders' wealth positively, hence rejecting the null hypothesis. This implies that firms that realigned or diversified their asset base showed improved performance in shareholders' wealth. Portfolio restructuring activities such as mergers, acquisitions, divestitures, and the reallocation of strategic business units enabled firms to focus on core competencies, eliminate underperforming divisions and reconfigure business operations for better synergy. This realignment often resulted in increased investor optimism, better resource utilization and enhanced financial performance, all of which translated into improved shareholders' wealth.

Recommendations

The existence of a positive significant effect of portfolio restructuring on shareholders' wealth of firms listed at the NSE supports agency and resource-based view theory. The study, therefore, recommends that managers of listed firms should adopt a strategic approach to portfolio restructuring by continuously evaluating their business units or investments to identify areas for divestiture or reinvestment. This helps concentrate resources on core profitable areas while eliminating operational inefficiencies associated with underperforming or non-core segments to maximize shareholders' wealth. Additionally, regulators should ensure that portfolio restructuring strategies such as mergers, acquisitions or spin-offs are guided by policies and practices in order to maximize shareholders' wealth.

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