Private Equity and Financial Performance of Investment Firms Listed at the Nairobi Security Exchange in Kenya

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ABSTRACT

Financial performance plays a significant role in enhancing investor confidence, attracts capital, and facilitates long-term strategic growth. In Kenya, investment firms listed on the Nairobi Securities Exchange (NSE) are expected to play a pivotal role in capital mobilization, investment channeling, and national economic development.

However, despite access to various investment portfolio, many listed investment firms continue to register inconsistent and often declining financial outcomes. The purpose of this study was to explore the effect of private equity on the financial performance of investment firms listed at the NSE in Kenya. The study was guided by risk-return tradeoff theory.

This study adopted a descriptive research design. Target population for the study was the 5 investment firms listed at NSE in Kenya. Census was used where all the 5 investment firms listed under the investment sector of the Nairobi Securities Exchange (NSE) as at December 2024 was used. This study relied exclusively on secondary data and this data was obtained using a secondary data collection sheet from 2015-2024.

Data was coded and entered into STATA used to perform statistical analysis. Data was analyzed using descriptive and inferential statistics. Descriptive statistics included minimum, maximum, means, standard deviation and variances. Inferential analysis included correlation and panel regression analysis Diagnostic tests including normality, multicollinearity, heteroscedasticity, unit root, Hausman, test of independence of residual and linearity tests were performed to ensure that the assumptions of regression model were not violated.

The overall panel regression results revealed that private equity positively influenced financial performance, with a coefficient of 0.00000112 (p=0.003), demonstrating its effectiveness as a high-return asset class. The study concluded that investment in private equity significantly influenced the financial performance of the investment firms listed at NSE in Kenya. The study recommends that investment firms should adopt proactive management and redevelopment portfolio strategies to enhance capital appreciation, thereby improving the overall financial performance.

Keywords: Investment portfolio, Financial Performance, Real Estate Properties, Government Securities, Private Equity, Fixed Income Securities, Return on Assets

Background of the Study

Financial performance is a fundamental measure of the success and sustainability of investment firms, particularly those listed on the Nairobi Securities Exchange (Mutua, 2020).

Key performance indicators such as return on assets (ROA), return on equity (ROE), net profit margin, shareholder value, and earnings per share (EPS) are commonly used to assess the financial performance of a firm (Abeerdeen, 2019). Strong financial performance among investment firms signals resilience, effective investment strategies or portfolio, and sound risk management practices (Mwalolo, 2024).

Financial performance also plays a vital role in attracting and retaining investors, as it signifies stability and profitability in an increasingly dynamic and competitive market environment. Furthermore, financial performance acts as an indicator for assessing the health of capital markets and gauging investor confidence, often reflecting broader economic conditions in the country (Omondi & Muturi, 2021). The financial performance of investment firms is influenced by a range of internal and external factors, with the composition of investment portfolio being one of the most significant (Kruschwitz & Löffler 2022). To achieve optimal financial outcomes, investment firms must allocate capital to portfolios that balance risk and return effectively.

Private equity is gaining popularity in Kenya due to its potential for substantial capital gains and its growing contribution to firm-level financial performance (AVCA, 2021). The private equity landscape is evolving rapidly, with both local and international firms targeting small and medium-sized enterprises (SMEs) that exhibit strong growth potential. According to the African Private Equity and Venture Capital Association (AVCA, 2021), private equity in East Africa has become a crucial driver of innovation, employment creation, and firm-level profitability, particularly in sectors such as healthcare, agriculture, and financial services. The long-term investment horizon associated with private equity also allows firms to implement strategic changes without the pressure of short-term market fluctuations, thereby enhancing sustainable growth.

Investment Portfolio and Financial Performance in Kenya

In Kenya, investment portfolios have become an essential component of the financial strategies adopted by firms listed on the Nairobi Securities Exchange (NSE). Investment firms in Kenya commonly diversify into real estate, government securities, private equity, and fixed income securities to stabilize earnings and mitigate risks (Wambua & Kalunda, 2018). Mungai and Mwangi (2021) noted that with diversified investment portfolios achieved higher return on equity (ROE) and return on assets (ROA) compared to firms focusing predominantly on equities.

Real estate is among the most popular portfolios in Kenya due to the perception of land and property as secure, appreciating assets. Similarly, Otieno and Wanjiru (2020) noted that multi-asset strategies, especially combining real estate and treasury instruments, resulted in more consistent financial returns and improved firm resilience.

For example, Centum Investment Company, one of the leading firms on the NSE, has made substantial investments in real estate developments like Two Rivers Mall and Vipingo Ridge, which have contributed positively to its revenue streams (Centum, 2023).

These developments are aligned with long-term wealth accumulation strategies that appeal to both institutional and retail investors. Investment in government securities like treasury bonds and bills have also offered predictable returns and liquidity in most firms making them ideal for portfolio balancing (Central Bank of Kenya [CBK], 2023; Githinji & Mungai, 2019). According to the Central Bank of Kenya

(2023), institutional investors held over 60% of outstanding government securities, showing their preference for stable, fixed-income returns. Private equity is also gaining traction, with local and international firms investing in promising start-ups and SMEs.

The Kenya Pension Funds Investment Consortium (KEPFIC) has facilitated private equity investments in sectors like agriculture and renewable energy, which have delivered strong financial and social returns (KEPFIC, 2022). These investments not only support enterprise growth but also contribute to the long-term performance of investment portfolios.

Moreover, fixed income securities such as corporate bonds have gained relevance, especially with the emergence of green bonds and infrastructure-focused instruments that offer attractive yields and align with ESG (Environmental, Social, and Governance) criteria (Kisaka & Ndegwa, 2021).

These innovations provide listed investment firms with new avenues to meet investor expectations for sustainable and responsible investing. These trends indicate that investment portfolio play a significant role in enhancing the financial performance and competitiveness of investment firms in Kenya (Mungai & Mwangi, 2021; Wambua & Kalunda, 2018).

Statement of the Problem

Financial performance is a vital measure of an organization's efficiency, profitability, and sustainability, serving as a key indicator for stakeholders and investors in assessing the health and viability of firms (Brigham & Ehrhardt, 2017). However, investment firms listed at the Nairobi Securities Exchange (NSE) continue to exhibit inconsistent and often declining financial outcomes (NSE, 2024). According to the Capital Markets Authority (CMA, 2024), the investment sector in Kenya has underperformed in recent years, with only a handful of firms demonstrating steady profitability.

In Kenya, most investment firms have used investment portfolio components and more especially the real estate and have experienced substantial growth, however, the trend of financial performance shows a persistent decline in ROA from 3.58% in 2015 to 2.66% in 2024, representing a 26% drop over the decade (CMA, 2024). This has affected their performance in some years due to COVID-19 disruptions, currency depreciation and regulatory changes affecting asset valuation.

The broader trend reveals a concerning pattern between 2019 and 2023, the return on assets (ROA) fell from 5.7% to 2.1% over the same period (CMA, 2023). Moreover, the NSE Annual Market Performance Report (2023) noted a 7.8% drop in market capitalization compared to 2022, a contraction partly driven by underwhelming returns within the investment services segment citing weak performance from the investment segment as a major contributor (NSE, 2023). The report also indicated reduced investor activity and declining share values across several listed investment companies, suggesting waning investor confidence (NSE, 2023).

Previous research has examined the relationship between investment choices and financial outcomes, but much of it has focused on other sectors such as commercial banks, SACCOs, pension funds, and parastatals. For instance, Bhuyan et al. (2019) assessed portfolio investments of commercial banks in US, identifying limited returns for smaller institutions largely concentrated in real estate. Locally, Mungai and Mwangi (2021) revealed that Kenyan investment firms with poor portfolio diversification were more susceptible to market volatility, resulting in diminished ROA and ROE.

This presents a clear conceptual, methodological, and contextual gap in existing literature specifically the lack of studies focusing on how a mix of investment portfolios affects the financial performance of listed investment firms in Kenya. It was based on this knowledge gaps that this current study sought to address

these gaps by examining the relationship between investment portfolio and the financial performance of investment firms listed on the NSE.

Objectives of the Study

The study was guided by the following objective;

To establish the effect of private equity on the financial performance of investment firms listed at the NSE in Kenya.

THEORETICAL REVIEW

The study was guided by risk-return tradeoff theory as explained below;

Risk-Return Tradeoff Theory

The risk-return tradeoff theory was developed by Sharpe in 1964. The risk-return tradeoff theory, as formalized in the capital asset pricing model (CAPM), asserts that higher returns on investment are generally associated with higher levels of risk, and conversely, lower-risk investments tend to yield lower returns. Investors, therefore, must balance their risk tolerance against the level of return they aim to achieve. According to Markowitz, rational investors construct portfolios that optimize the expected return for a given level of risk, emphasizing diversification to manage and mitigate risks efficiently. The core assumptions of the theory include the following: investors are rational and risk-averse; markets are efficient with no arbitrage opportunities; all investors have access to the same information; and asset returns are normally distributed. The theory also assumes that risk can be quantified through standard deviation or variance in returns.

Despite its importance, the theory has faced criticism over time. Critics such as Taleb (2007) argue that risk is not always quantifiable or predictable, especially during times of financial turmoil. Furthermore, Bodie, Kane, and Marcus (2014) point out that the assumption of normally distributed returns is often unrealistic in the real world, where asset prices can be volatile and exhibit skewness and kurtosis. In the context of investment in fixed income securities, the Risk-Return Tradeoff Theory is particularly relevant. Fixed income instruments like fixed deposits are generally seen as low-risk investments compared to equities or derivatives. In Kenya, investment firms often include fixed income securities in their portfolios to provide stable returns and reduce overall portfolio volatility.

The lower risk associated with such instruments aligns with the theory's principle of accepting lower returns in exchange for more predictable cash flows and capital preservation. However, investors and fund managers must still consider risks such as interest rate risk, credit risk, and inflation risk, which can affect the real return of fixed income assets. From the perspective of financial performance of investment firms in Kenya, particularly those listed on the Nairobi Securities Exchange (NSE), applying the Risk-Return Tradeoff Theory helps in making strategic asset allocation decisions. Firms that effectively manage this tradeoff by allocating a portion of their funds into fixed income securities can achieve more stable earnings and reduce exposure to market volatility.

This contributes to better risk-adjusted returns and enhances financial sustainability. Moreover, in an environment where interest rates and inflation are subject to frequent changes such as Kenya's managing the risk-return profile becomes essential for maintaining firm profitability and protecting investor capital. This theory was linked to objective four on fixed income securities such as fixed deposits that have an influence on financial performance. These instruments offer lower risk and stable returns, aligning with

investor preferences for predictable income. According to the theory, investment firms may include fixed income securities in their portfolios to balance risk and enhance long-term financial stability.

Empirical Review

The empirical literature review discussed studies, publications, journal articles as well as scholarly research on previous studies on investment on private equity and financial performance.

Private Equity and Financial Performance

Hendriks and Van Dijk (2022) explored the impact of private equity on financial outcomes of Dutch venture capital firms in Netherlands. The study used a cross-sectional design. The target population included 100 venture capital firms with a random sample of 40 firms engaged in private equity activities between 2017 and 2021. Primary data was collected using structured questionnaires distributed to fund managers and senior finance officers with secondary data extracted from annual reports. Analytical procedures included descriptive statistics and multiple regression analysis.Results demonstrated a strong positive correlation between private equity involvement and improved financial health, particularly in mid-sized venture firms that leveraged capital injections for expansion. making it less generalizable to the economic context of developing countries like Kenya.

Mensah and Boateng (2023) conducted a study on private equity and profitability of non-banking financial institutions in Ghana. The research utilized a descriptive survey design. The target population comprised NBFIs registered with the Ghana Investment Promotion Centre (GIPC). A stratified sampling technique was employed to select a representative sample of 25 firms. Primary data was gathered through structured interviews conducted with chief financial officers, while secondary data was sourced from audited financial statements covering a period of five years. The researchers used SPSS software for data analysis, applying descriptive statistics and regression models. Results showed that firms receiving private equity funding experienced greater profit growth and capital efficiency.

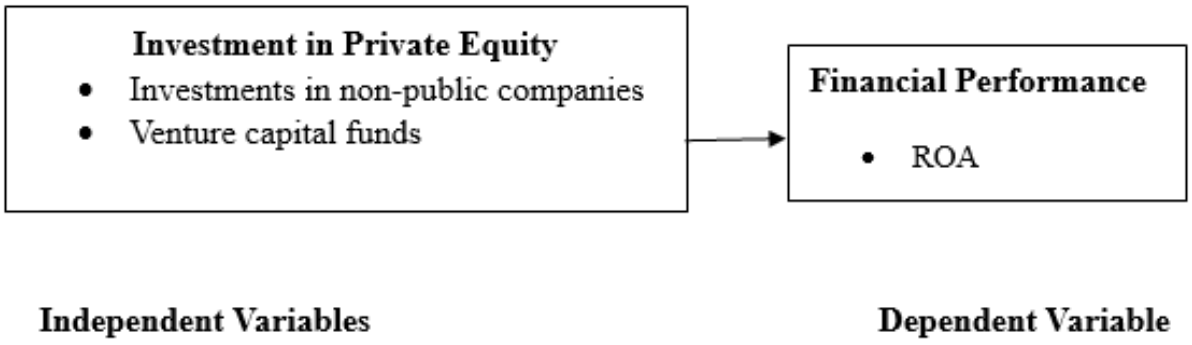
Naidoo and Sibanda (2022) investigated the effect of private equity investments on the financial sustainability of investment firms operating in South Africa. The study adopted a qualitative case study design, focusing on five large private equity firms. Data collection combined interviews with investment analysts and secondary data from financial statements, strategy reports, and market publications. The analysis relied heavily on content analysis techniques. The findings revealed that private equity contributed positively to firm sustainability through cost rationalization, corporate governance improvements, and targeted growth strategies. However, the outcomes were contingent on variables such as exit strategies, industry cycles, and economic conditions. The study did not fully explore the direct effect of private equity on short-term and long-term profitability indicators, such as ROA.

Odhiambo, Mutiso, and Wanjala (2024) carried out a study to investigate private equity and financial performance of investment firms listed at the Nairobi Securities Exchange (NSE) in Kenya. The researchers employed a correlational research design. The target population comprised of investment firms listed at the NSE as of 2023. A census sampling technique was used to include all eligible firms. Secondary data was extracted from audited financial statements and annual reports for the period 2018 to 2023.

The researchers analyzed data using Pearson correlation and linear regression models. The findings indicated that private equity had a moderate but statistically significant positive effect on firm performance in terms of Return on Assets (ROA), Return on Equity (ROE), and net profit margins. The study employed correlational research design while the current study employed descriptive research design.

CONCEPTUAL FRAMEWORK

The conceptual framework shows the relationships between investment in private equity, and financial performance, measured in terms of Return on Assets (ROA)



RESEARCH METHODOLOGY

This section discusses the research design, study population, census and data collection instruments, data collection procedure and data processing and analysis.

Research Design

This study adopted a descriptive research design. This design was chosen because it also allowed the researcher to observe and document aspects of the population under study without altering or manipulating any variables.

Population of the Study

The choice of the target population is crucial because it ensures that the research findings are both relevant and applicable to the context under investigation. In this study, the target population comprised of all the 5 investment firms listed under the Investment Sector of the market segment at the Nairobi Securities Exchange as at December 2024

Census

In this study, the census consisted of all the 5 investment firms listed under the investment sector of the Nairobi Securities Exchange (NSE) as at December 2024. Census was used since the population size of the firms is small, unique, and play a critical role in influencing the variables under study in this case, investment portfolio and financial performance of investment firms.

Data Collection Instruments

This study relied exclusively on secondary data that was collected by use of a secondary data collection sheet. Secondary data was used since it is cost-effective and time-efficient, allowing the researcher to access a large volume of structured and standardized information (Creswell, 2014).

Data Processing and Analysis

Data was analyzed using descriptive and inferential statistics. Descriptive statistics included minimum, maximum, means, standard deviations, skewness and kurtosis. Inferential analysis included correlation and panel regression analysis. The panel regression model that was used is as follows:

$Y_{it} = \beta_0 + \beta_1 X_{1it} + \varepsilon_{it}$……..……..... **Equation 3.1**

Research Findings and Discussions

The section presents the results of descriptive and inferential statistics.

Descriptive Statistics Results

Table 4.1 indicates the descriptive statistic results depicting minimum, maximum, means, standard deviations, as well as skewness and kurtosis

Table 4.1 Descriptive Statistics Results

Variable	N	Min	Max	Mean	Std dev	Skewness	Kurtosis
Private Equity	50	15,000	11,500,000	2,519,400	3,456,780	1.456	2.234
Financial Performance (ROA)	50	-2.50%	7.40%	3.42%	2.34%	-0.187	2.567

(Values in KES-Million)

Table 4.1 shows that private equity investments had a minimum exposure of KES 15 million, indicating that some firms had very limited private equity allocation during certain periods. The maximum investment reached KES 11.5 billion, with Centum Investment dominating this category through substantial equity investments. The mean value of KES 2.52 billion was the highest among all investment categories, reflecting the significant focus on equity investments among these firms. The highest standard deviation of KES 3.46 billion among all categories indicates substantial variation in private equity strategies across firms.

The skewness of 1.456 indicates a strong rightward distribution, suggesting most firms maintained moderate equity portfolios while a few concentrated heavily in this asset class. The kurtosis value of 2.234 confirms normal distribution patterns with moderate peaking characteristics.

Return on Assets (ROA) demonstrated a minimum value of -2.50%, showing that some firms experienced periods of negative financial performance. The maximum ROA reached 7.40%, with others achieving the highest operational efficiency and profitability. The mean ROA of 3.42% indicates moderate profitability across the investment firm's sector.

The standard deviation of 2.34% demonstrates reasonable consistency in financial performance compared to the more volatile investment categories. The skewness of -0.187 suggests a relatively balanced distribution around the mean, with slight tendency toward negative values due to underperforming firms. The kurtosis of 2.567 indicates normal distribution characteristics with moderate concentration of firms around the average performance level.

Trend Analysis for Private Equity Investments

The study sought to determine the trend analysis related to private equity investment firms over the 10-year period from 2015 to 2024. The findings are as shown in Figure 4.1.

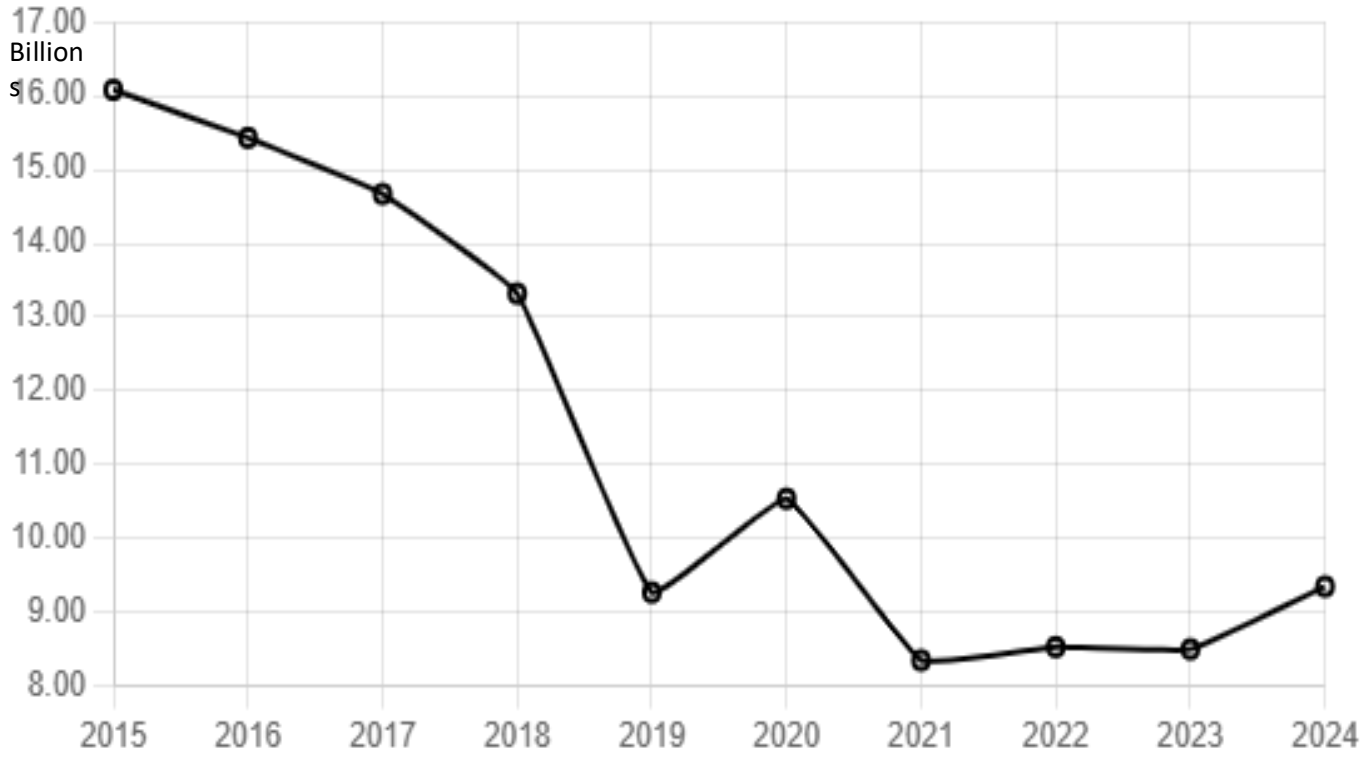


Figure 4.1: Trend Analysis for Private Equity Investments

Private equity investments demonstrated significant volatility throughout the study period, with the trend showing mixed performance despite achieving good performance in 2015 with KES 16.0 billion in 2015. However, the sector experienced a slight decline in 2016 from KES 16.0 billion in 2015 to KES 15.7 billion in 2016 and declined further in 2017 to KES 14.8 billion, which can be attributed to political uncertainty surrounding the 2017 elections that dampened investor confidence in private equity markets. There was also a sharp decline in 2018 to 2019 with dropping from KES 13.5 billion to KES 9.2 billion in 2019.

A modest recovery occurred in 2020 with investments reaching KES 10.88 billion, though still below 2015 levels, reflecting cautious market sentiment following the prolonged election period and directly linked to the COVID-19 pandemic's impact on private companies, reduced valuations, and increased investment risks that made private equity less attractive.

The value dropped further to KES 8.11 billion in 2021 and remained stagnant at that floor through 2022 (KES 8.12 billion) and 2023 (KES 8.12 billion). Recovery characterized the 2024 period, with investments reaching KES 9.33 billion in 2024.

This remarkable recovery can be attributed to post-pandemic economic revival, improved business performance of portfolio companies, new investment opportunities in emerging sectors like technology and renewable energy, and increased appetite for higher-return investments as interest rates remained relatively low.

Trend Analysis for Financial Performance (ROA)

The study sought to find out the trend analysis for financial performance from 2015-2024 using the Return on Assets as the indicator. The findings are shown in Figure 4.2.

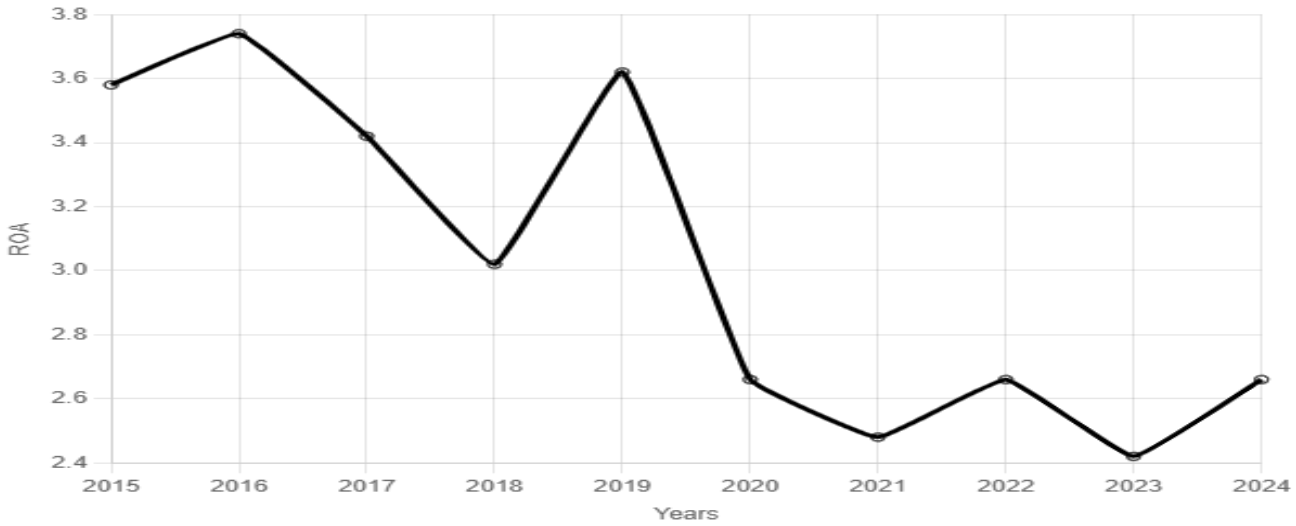


Figure 4.2: Trend Analysis for Return on Assets (ROA)

Return on Assets exhibited a concerning and persistent declining trend throughout the study period, falling from 3.58% in 2015 to 2.66% in 2024, representing a 26% deterioration in financial performance. The decline began after a brief peak of 3.74% in 2016, with ROA falling to 3.42% in 2017, which can be attributed to the challenging business environment during the prolonged 2017-election period that affected operational efficiency and profitability.

The downward trend continued in 2018 with ROA declining to 3.02%, reflecting the lingering effects of political uncertainty and slower economic growth that influenced investment firms' ability to generate returns on their assets. Further deterioration occurred from 2019 (2.89%) through 2020 (2.66%), with the 2020 decline particularly severe due to the COVID-19 pandemic's impact on investment performance, reduced asset valuations, and increased operational challenges.

The pandemic's effects continued to manifest in 2021 with ROA reaching its lowest point at 2.48%, attributed to portfolio companies' poor performance, reduced dividend income, and impairment of investment values.

Modest improvements occurred in 2022 (2.66%) and continued through 2023 (2.42%), though performance remained well below historical levels. A slight recovery to 2.66% in 2024 suggests some stabilization, but this remains significantly below the 2015 baseline.

This persistent declining trend indicates fundamental challenges including deteriorating operational efficiency, increased competition in investment markets, higher operational costs, regulatory changes affecting profitability, and the lingering effects of economic disruptions that require strategic interventions to restore performance to historical levels.

Inferential Statistics

The study analyzed the inferential statistics using both correlation and panel regression analysis.

Correlation Analysis

To test the correlation between the variables in the study, the Pearson's correlation coefficient was used where relationships between independent and dependent variables were significant at $P<0.05$. Correlation test results are shown in Table 4.1.

Table 4.1 Correlation Analysis Results

	Private Equity	ROA
Private Equity	1	
ROA	.756*	.834**

**. Correlation is significant at the 0.01 level (2-tailed). *. Correlation is significant at the 0.05 level (2-tailed).

Table 4.1 shows that private equity investment recorded strong positive and statistically significant relationship with ROA ($r = 0.756$, $P < 0.001$). This indicates that a unit increase in investment in private equity leads to an increase in return on assets by 0.756 (75.6%). This implies that private equity investments play a crucial role in driving profitability and enhancing the financial performance of investment firms due to their high return potential. This further indicated that firms with larger and better-performing private equity portfolios achieve superior financial performance.

Panel Regression Analysis for Investment in Private Equity and ROA

The study sought to determine the relationship that exists between investing in private equity and ROA of investment firms listed in NSE. The findings are presented in Table 4.2.

Table 4.2: Private Equity Regression Results

Private equity-ROA	**Coefficient**	**Std. Error**	**t-Statistic**	**P-Value**	**Significance**
Intercept (β_0)	1.753	0.312	5.623	0.000	-
Private Equity Investment (β_1)	0.00000118	0.00000035	3.371	0.002	**
Model Statistics					
R-Squared	0.341				
Adjusted R-Squared	0.327				
Observations	50				
Prob> F	0.002				

The regression results showed that firms investing in private equity had a significant and positive effect on their return on assets. It was revealed that for every 1 million increases in private equity investment, ROA increases by 0.00000118 percentage points. The coefficient for private equity investment was positive and statistically significant since the P-value was less than 0.05 ($p = 0.002$). The model statistics had an r^2 of 0.341. The R-squared value of 0.341 implied that 34.1% of the variation in ROA was explained by private equity investment. The findings concur with the findings of Naidoo and Sibanda (2022) who found that private equity contributed positively to firm sustainability through cost rationalization, corporate governance improvements, and targeted growth strategies. This clearly shows that investment in private equity positively influences the financial performance (ROA) of investment firms, highlighting its role as a safe and effective investment avenue.

Hypothesis Test Result

The study tested the following hypothesis;

H_{O3}: Private equity has no significant relationship on the financial performance of investment firms listed at the NSE in Kenya.

The findings of the study showed a positive and significant coefficient for investment in private equity where P-value was = 0.002 which was less than 0.05 level of significance. The study therefore rejected the null hypothesis and concluded that investments in private equity had a positive and significant effect on the ROA of investment firms listed at the NSE in Kenya.

Summary of Findings

The study examined the relationship between private equity investment and the financial performance of investment firms listed at the Nairobi Securities Exchange, focusing on return on assets as a key performance indicator. The findings reveal that private equity investment has a positive and statistically significant influence on return on assets, indicating that firms with greater exposure to private equity tend to utilize their asset base more efficiently and achieve higher profitability. These findings align with agency theory, which emphasizes the need to mitigate conflicts of interest between principals (owners or investors) and agents (managers). Private equity investors typically play an active monitoring role by participating in governance structures, setting performance targets, and enforcing accountability mechanisms. Such close oversight reduces agency costs arising from managerial opportunism, inefficiencies, or misalignment of interests, thereby improving firm performance.

CONCLUSIONS OF THE STUDY

The study investigated the effect of private equity on financial performance of investment firms at the NSE. The study established that private equity investments had the strongest and most significant positive relationship with financial performance. Descriptive statistics revealed that private equity constituted the largest portion of the firms' portfolios, while trend analysis showed steady growth from 2015 to 2024 despite occasional volatility. This implies that private equity is a high-yield investment category that enhances profitability due to the high potential for returns from innovative and growth-oriented ventures. Firms that strategically allocate more resources to private equity stand to benefit from superior financial outcomes.

income. The findings underscore the importance of portfolio diversification as a strategy for optimizing risk-adjusted returns and enhancing firm performance.

RECOMMENDATIONS OF THE STUDY

Based on the findings and conclusions of this study, the following recommendation was made. Investment firms should selectively increase private equity investments in sectors with strong growth potential to enhance asset utilization and profitability.

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