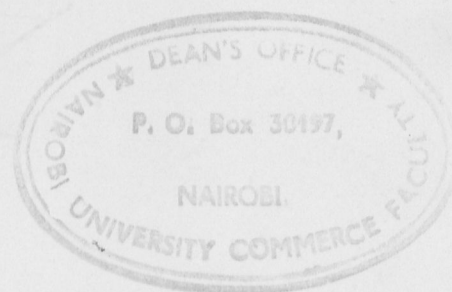


**AN ANALYSIS OF THE FINANCIAL AND OPERATING  
PERFORMANCE OF THE NEWLY PRIVATIZED  
ENTERPRISES IN KENYA**

**BY**

**ODONDI, KENNEDY OTIENO**

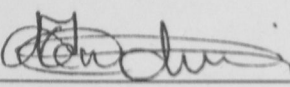


**A MANAGEMENT RESEARCH PROJECT SUBMITTED IN PARTIAL  
FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF  
MASTERS IN BUSINESS AND ADMINISTRATION, FACULTY OF  
COMMERCE, UNIVERSITY OF NAIROBI.**

**AUGUST, 1998**

## DECLARATION

This project is my original work and has not been presented for a degree in any other University

Signed  Date 5/11/98

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*Student*

This management research project has been submitted for examination with my approval as University Supervisor

Signed  Date 24/11/98

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**DEDICATION**

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To my beloved parents

WHO

nurtured me through years of austerity and self-denial

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The academic staff of the faculty of commerce and the MBA class 1996/97 must be remembered for the comments and suggestions which enriched this study. I'm especially indebted to my colleagues Ely Osewa, Washington Mc Ongulo, George Apaka and J.B. Ochieng for their close cooperation and partnership throughout the MBA programme.

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Finally I owe a special debt to my parents, brothers and sister for their forbearance and understanding.

May God Bless you.

## ACKNOWLEDGMENT

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## ABSTRACT

Privatization of state - owned enterprises has emerged as a major policy option in dealing with the public sector problem facing many developing countries. One of the challenges of economic development has been how to deal with the bloated and inefficient public sector. Most state-owned enterprises in these countries have made huge losses and have to rely on government support - leading to chronic budgetary constraints.

Privatization has been advocated by the World Bank and IMF. As a result, hundreds of state owned enterprises have been transferred to private hands. In Kenya over 140 state owned enterprises have been divested in the hope that the private sector should serve as the 'engine of growth' for the economy.

Various methods have been used to effect the programme. Public flotation, competitive bidding, liquidations, pre-emptive rights and employee buyouts. Most of these enterprises have continued to operate but now under private control and ownership. This study therefore sets out to undertake a follow-up study of the post privatization performance.

The study's findings indicate significant increases in profitability and efficiency of the firms after privatization. However, total employment seems to have declined as a result of retrenchment.

In the light of these findings the study's recommendations are that the process should be speeded

up and that other general economic reforms should be undertaken. It is also recommended that 'safety nets' to help retrenched workers be strengthened.

## INTRODUCTION

### 1.1 Background

In the last two decades there has been a major shift in thinking about the appropriate role of government in the economic sector. Privatization of State-Owned Enterprises (SOE's) has been at the heart of this shift. During 1960's and 1970's the practice in most developing countries reflected contemporary thinking that favoured expanding the role of the public sector.

It was argued that market-oriented systems were unsocial in nature. Some governments used control of strategic sectors to give real meaning to their political independence. Yet this extended role of the public sector did not yield the expected benefits.

It is now widely held that the public sector has become too large in many developing countries. The World Bank's 1981 Report on economic prospects in Sub-Saharan Africa concluded that this resulted in the slower economic growth and accounts for the economic stagnation facing these countries (World Bank : 1981). Problems arising from managing such a large and diversified range of economic activities became almost unmanageable for many governments in 1980's and called into question the existence of the large SOE sector.

# CHAPTER ONE

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Although many SOE's have been productive and profitable, a large number have failed to generate surpluses and instead have created a budgetary burden. The overall deficit of SOE's in developing countries averaged 4 per cent of GDP in the mid-1970's, as compared to an average of 1.7 per cent in the industrial countries. World Bank, 1984 deficit have been financed either from borrowing by the SOE's in domestic and international financial markets, or from central government transfers. In the period 1976-1980 SOEs accounted for one-third of all international borrowing by the developing countries (World Bank, 1980). A further 60 per cent of the overall SOE deficit was financed by the central government.

Virtually all developing countries, beginning in the 1970s and continuing through the 1980s, adopted programs to remedy the causes of poor SOE performance- but without changing ownership. The World Bank actually worked with borrowers to implement these reforms. Many of the reforms had positive results. However, they proved difficult to implement and even harder to sustain. A number of SOEs that the World Bank's Development Report 1983 cited as well on the road to improved performance because of exemplary reform efforts have either failed to improve or have in fact deteriorated.

The dismal financial performance and the growing recognition of the unsustainable nature of past reforms created new compulsions for rebalancing the roles of the public and private sectors. Privatization emerged as a major policy option to accelerate economic growth through lesser budget deficits and greater efficiency in the allocation and use of financial resources. This is reflected in the priority given in the International Monetary Fund's (IMF) adjustment programmes

to improved public enterprise financial performance - it not only advocates privatization but has made it an important component of adjustment for the affected countries.

### 1.2.1 Privatization

More than 80 countries have launched ambitious efforts to privatize their SOEs. Since 1980 more than 2000 SOEs have been privatized in developing countries and 6800 world wide (Kikeri, et al, 1992). Up to 1990 many of these SOEs sold in developing countries were small or medium sized but the last few years have witnessed an increase in both the number of large SOEs being sold and the overall pace of privatization.

Savas (1987) defined privatization as "the act of reducing the role of the government or

Experience from countries such as Argentina, Chile, Mexico, and UK demonstrates that private ownership itself makes a difference. Privatization has helped to improve enterprise performance and reduce fiscal burden in these countries.

means relying more on the society's private institutions and less on government to satisfy the

Kenya is one of the countries that have embraced this new philosophy. In 1991 the government embarked on a comprehensive public enterprise reform and privatization programme to privatize some 201 commercially oriented non-strategic enterprises in which it held equity stake. As at the end of 1997, 141 enterprises had been privatized through various methods. Apart from those enterprises that were liquidated a majority of these firms have continued to operate, but now under private ownership and control. The principal motivation of this study is the need to evaluate the post-privatization performance of these enterprises.

or management of a state-owned enterprise from the public to the private sector

Webster's New Collegiate Dictionary 1963 Edition

## 1.2 Definition of Terms

### 1.2.1 Privatization

Privatization is a new word that is rapidly coming into popular usage. The word "privatize" first appeared in a dictionary in 1983 and was defined narrowly as "to make private especially to change (as to business or industry) from public to private control or ownership."<sup>1</sup>

Savas (1987) defined privatization as "the act of reducing the role of the government or increasing the role of the private sector in an activity, or in the ownership of assets". In recent years, however, the term has acquired a broader meaning; it has come to symbolize a new way of looking at the society's needs and a rethinking of the role of government in fulfilling them. It means relying more on the society's private institutions and less on government to satisfy the needs of the people.

Hence privatization has come to be understood not merely in the sense of who owns an enterprise but in the sense of how far the operations of an enterprise are brought within the discipline of market forces (Ramanadham, 1989). It covers a wide continuum of possibilities between denationalization at one end and management contracts and leasing at the other. Based on these insights we can develop a working definition of privatization as the transfer of ownership, control or management of a state owned enterprise from the public to the private sector.

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<sup>1</sup>Webster's New Collegiate Dictionary 1983 Edition.

### 1.2.2 State - Owned Enterprise (SOE)

Also called public enterprise or parastatal, it means public production (i.e, ownership or management control of the enterprise is in government hands for private consumption). The World Bank has defined as SOE as “a government-owned or government-controlled economic entity that generates the bulk of its revenues from selling goods and service<sup>2</sup>”. This definition conveniently excludes much state owned activity, such as education, health services and road construction and maintenance.

### 1.2.3 Financial Ratios

Financial Ratios are coefficients which relate different and comparable financial statement items. They are a convenient way to summarize large quantities of data and compare firms performance (Myers, 1991).

### 1.3. Statement of the Problem

The history of public enterprises in Kenya has been one of poor results. Lack of incentives for good performance, bureaucratic procedures and controls, government patronage and interference have all contributed to poor performance. The privatization programme was launched in 1991 to turnaround these SOEs to profitable operations. Most of these were sold through public

---

<sup>2</sup>Bureaucrats in Business (New York: Oxford University Press, 1995)

flotations, competitive bidding and preemptive rights.

Several studies have attempted to evaluate post-privatization performance. The World Bank and Boston University analyzed twelve cases of privatization of SOEs in four countries. The team found that in eleven out of twelve cases the gains were positive and large, amounting to an average of 2.5 percent permanent increase in GDP. Beneficial changes that followed privatization included an increase investment, a rise in prices towards levels that reflect scarcity values, and greater productivity (Galal and Shirley, 1994).

Little research has, however, been undertaken in Kenya to compare the performance of these enterprises before and after privatization. Previous research has concentrated on comparing the relative efficiency and profitability of public and private firms. The major study to be cited here is one by Grosh (1991), covering the performance of 77 manufacturing firms in public and private sectors. Public firms had the highest average rate of return at 15.2 per cent while private firms had 9.5 per cent. Her conclusion was that the data reveal little reason to expect privatization to improve performance.

This study proposes to analyze the financial and operating performance of the newly privatized firms between 1990 and 1997. There is need for empirical evidence on how these enterprises have performed since privatization. The country's scarce resources and developmental needs means that the available resources should be employed efficiently. Privatization has been advocated by those who believe that the private sector, rather than the public sector, should serve

as the engine of growth for the economy. This study will generate empirical evidence on the allocational efficiency of the private sector in terms of profitability, efficiency and employment generation. It seeks to answer the research question: has performance improved since privatization?

#### **1.4 Objective of the Study**

To find out whether there is any significant difference between pre and post privatization financial and operating performance of the newly privatized enterprises, in Kenya.

#### **1.5 Importance of the Study**

This study will be important in the following ways:

- (i) It will bring new evidence based on actual results to lend credence to privatization as a policy option that emphasizes reliance on the society's private institutions for the provision of goods and services. In particular, the World Bank and IMF which have preached privatization and supported private sector development initiatives will find the study's results helpful in providing a necessary feedback on the success of the policy.
- (ii) It will help in determining whether to quicken or slow down the pace of privatization in the remaining public enterprises.

- (iii) It will add to the recent but rapidly growing stream of knowledge on privatization.

## LITERATURE REVIEW

### 2.1. Introduction

Privatization is the supply-side economics which targets on the neo-classical hypothesis that private ownership brings greater efficiency and more rapid growth (Todaro, 1994). Proponents of this view also argue that it curbs the growth of government expenditure, raises cash to reduce public internal and external debt, and promotes individual initiative while rewarding entrepreneurship. It is also seen as a way to broaden the base of ownership and participation in the economy (Ramadadiba, 1989).

### 2.2. Theory of Privatization

There has emerged in recent years a theory of privatization (Boycko et al: 1993). According to Ascto and Okello (1997), there are two main approaches to the theory of privatization. One approach focuses on the concept of utility maximization behavior of the property rights (principal) and agents (managers) and the consequences of this behavior for allocative efficiency. The second approach is the public choice theory, and focuses on political behavior as it affects public and private enterprises.

## CHAPTER TWO

### LITERATURE REVIEW

#### 2.1. Introduction

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### 2.2.1 Property Right Theory

The property rights, or principal - agent, theory is based on the argument that changes in the allocation of property rights alter the structure of incentives faced by decision makers in the firm and hence lead to changes in both managerial behavior and company performance. Company management can be regarded as agents for shareholders in case of private ownership. It is argued that privatization will immediately result in both a shift in the objectives of principals and the incentives to be offered to the management. As a result both the allocative efficiency in the market - producing the maximum level of output - as well as the internal efficiency of the firm - minimizing cost - will be altered (Borcherding, 1983).

When property rights are held by the state rather than by individuals, no individual has the incentive to exert the effort to see that the resources are used efficiently. This results in high cost production (Galal: 1994).

The theory recognizes that managerial incentive structures and economic performance are influenced in addition to ownership, by the degree of competition in the industry and the regulatory constraints within which the firms operate.

### 2.2.2 Public Choice Theory

The principal - agent theory may well be considered as the micro - theory of privatization. In the

public choice theory two additional groups come into play: politicians and bureaucrats; then four categories result in the hierarchy of monitoring public enterprises: the general public, politicians, bureaucrats and the managers of publicly owned firms, each with their distinct utility functions which they aim to maximize and none having access to identical information. The result is sub-optimality, i.e. internal inefficiency.

The politicians may find that improving the economic efficiency of the firm may not improve their electoral prospects; rather they find it to their advantage to set prices below marginal cost and to over staff. In the utility function of the bureaucrats the size of the departmental budget and the rents that accrue to them occupy a predominant role. The public managers themselves can secure higher pay, greater power and prestige than their private sector counterparts by forming coalitions with politicians and bureaucrats. As a result social objectives get to be replaced by political objectives, leading to higher costs and lower productive efficiency than comparable enterprises in the private sector. (Borchering, 1983).

### 2.3 Public - Private Comparisons

There is a rapidly increasing body of empirical literature about SOE performance and public versus private ownership. Aseto and Okello (1997) note that the literature on comparative efficiency of public and private enterprises has encountered many problems. One is the difficulty in accounting for many variables, other than ownership, that affect economic performance, such as market structure, regulatory framework and technological progress. The other one is that

research in this area has been hampered by data and methodology limitations and has concentrated on using easily observable variables, such as profitability, which tend to favor private ownership.

Literature on this issue has, however, not produced clear-cut results. Some studies find indicators of productivity or cost levels going in favor of privately owned firms, others find the reverse.

The first body of empirical literature finds private enterprises clearly superior. Boardman and Vining (1989) compared the performance of private, mixed and state-owned enterprises operating in competitive environments. They found that state enterprises and mixed enterprises were less efficient and less profitable than private corporation.

Boycko et al (1993) compared multinational enterprises and state owned enterprises. Their sample included firms in agriculture, manufacturing and transport sector. They concluded that privatization improves efficiency. Earlier Bennet and Johnson (1979) had carried out a study on public versus private provision of garbage collection services. Their findings were that;

“Without exception, the empirical findings indicate that the same level of output could be provided at substantially lower cost if output were produced by the private, rather than public sector”

A study by Ehlich, Gallais-Hamonno, Liu and Lutter (1981)<sup>3</sup> has shown that a switch from state to private ownership raises the rate of productivity growth.

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<sup>3</sup> Quoted by Aseto and Okelo in Privatization in Kenya Basic Books, Nairobi, 1997

A second body of literature draws rather different conclusions. The earliest and most influential formulation is that of Caves and Christensen (1980). They compared the relative efficiency of public and private Canadian railroad firms. Although the firms were operating in a competitive environment they found no evidence of inferior performance by the government owned railroad, and thus concluded that public ownership is not inherently less efficient than private ownership per se.

This basic insight to adjust for market structure has since been elaborated on and extended by several authors. For example, Aharoni (1986), while acknowledging that SOEs show dismal financial results, argues that these losses may be a result of social and political demands on the enterprises. As efficient users of resources, they may have done as well as private firms producing the same product in the same country. Boardman and Vining (1989) extends this argument to include sectorial factors. They say (that);

“The evidence suggests an edge for the private sector but the results vary considerably across sectors. In sectors where there is some evidence of superior public efficiency (electricity and water), there is either limited competition or the private firms are highly regulated:.

They also find that evidence of the greater efficiency of private companies appears to be in the delivery of services where governments subcontracts to the private sector and their monitoring costs - for example - refuse collection, fire protection - are relatively low.

On the Kenyan scene Grosh (1990) did a systematic analysis of the financial performance of 77 parastatals, quasi - public and private manufacturing firms during the 1984 period. When examined sector by sector, parastatals were found to be generally less protected, and more profitable and efficient than private firms. She concluded that the case for privatization is far from proven. This conclusion confirms those of many other scholars in the field. Adam observe that property ownership alone does not explain differences in efficiency of performance as between public and private enterprises; rather "the economic arguments for privatization rest on a number of hypotheses about the relationship between ownership information and incentives, and their impact on market structure and performance" (Adam 1992).

All these studies cited above almost exclusively compare different enterprises in public and private sectors. More recently attention has turned to the newly privatized enterprises and seeks to compare the performance of the same enterprise before privatization (i.e. when it was in the public sector) and after its transfers to the private sector.

The World Bank and Boston University analyzed twelve cases of privatization of SOEs in four countries. In eleven of the twelve cases, the gains were positive and large. Following privatization there was an increase in investment, arise in prices towards levels that reflect scarcity values, and greater productivity (Galal, 1994).

Another study by Megginson, Nash and Van Randenborgh compared the pre- and post privatization performance of 61 companies. It included firms that were fully or partially privatized

between 1981 and 1989. The study indicated that there were significant increases in profitability, output per employee, capital spending and employment (Megginson et al 1995). Profitability increased on average by 45 percent after privatization. Efficiency, as measured by net income per employee indicated increases of 32 percent. The study also indicated that investment and output increased on average by 44 percent and 27 per cent respectively after privatization.

A similar study was undertaken by Desilanes on behalf of the World Bank in 1993. It focused on Mexican enterprises. The gains were however larger than in the Megginson study.

So far little has been undertaken in Kenya to evaluate the post privatization performance of the newly privatized enterprises and is what this study sets out to achieve.

#### **2.4 Historical Development of the Public Sector in Kenya**

Public enterprises in Kenya date back to the days before independence. The colonial government in Kenya established many public enterprises because they were believed to be the most efficient mechanism for providing certain services. Thus infrastructure services, which are mostly, natural monopolies, were organized as public enterprises. This included the ports and railways, airlines, and posts and telecommunications.

Another major group of public enterprises set up during the colonial period were the crop marketing boards. These boards were organized primarily for the benefit of the white settler

farmers, whose produce they marketed. As independence approached the government began to develop progressive middle class African farmers. The existing marketing boards were reorganized to serve large numbers of small holders, and some new boards were created (including Cotton Lint and Seed Marketing Board and Kenya Tea Development Authority, KTDA).

At independence in 1963 the public sector contributed 11.2 percent of GDP. It can be generalized that the role of the public sector remained stable from independence until around 1980. Since that period their role has gradually declined. In 1965 the new government expressed its philosophy about the role of the state in the economy in the famous Sessional Paper No. 10, "African Socialism and Its Application to Planning in Kenya". The government committed itself to elimination of hunger, disease, ignorance and poverty, and called for decolonization of the economy. It laid out plans of promoting rapid economic growth as well as ensuring that the commanding heights of the economy were controlled by it in the overall interest of the citizens.

Africanization of commerce and industry was institutionalized and pursued vigorously by the new government. The establishment of Kenya National Trading Corporation in 1965 was aimed at helping the state take over a major share of the import -export trade. KNTC became the vehicle through which the state could compel multinational corporations to channel the sale and distribution of their commodities through African wholesale and retail traders.

The National Grindlays Bank was nationalized in 1968 and renamed Kenya Commercial Bank to

promote local entrepreneurship and avail credit availability to African traders. Agricultural Finance Corporation (AFC) was established to provide finance to acquire and develop farms, and Housing Finance Company of Kenya (HFCK) to help citizens acquire and develop urban real estate. Five Sugar companies were also established to promote small-holder cane farmers.

In addition, the government established development finance institutions specifically to promote industrialization in Kenya. Ikiara (1988) observes that the Kenya government recognized the need to develop financial infrastructure capable of providing financial back-up for faster industrialization and general economic development. The institutions created included Development Finance Company of Kenya (DFCK), the Industrial Development Bank (IDB), the Industrial and Commercial Development Corporation (ICDC). These institutions were specifically to provide development finance for industrial enterprises and to promote the participation of indigenous entrepreneurs in manufacturing.

The above institutions, acting as holding complexes, sponsored a chain of enterprises that stood at 255 as at 1992 (Daily Nation October 27, 1992). The government directly held equity in about 50 of these and indirectly in 200 through these development finance institutions (Swamy: 1994).

## **2.5 Contribution of the Public Sector in Kenya**

Aseto and Okello (1997) outlines a number of significant accomplishments of the public sector in Kenya. Through them, the government has eliminated private, mainly foreign, economic power

centers that might have controlled the economy. Parastatals have filled gaps left by the private sector, eliminated some sources of profiteering and established a significant industrial base where little existed before.

They also note that the parastatals have served as a training ground for a new generation of indigenous business managers and executives. Had the private sector been relied upon, fewer Africans would have received this training. This view is also shared by Ikiara (1988).

They have been responsible for rapid economic development through capital formation, especially in the fields where the gestation period is long and returns are low and delayed. They have also inspired economic growth in other sectors. Grosh observes that "much of the dynamism of the financial sector is due to the role of the government, via parastatal financial institutions..(which) played a key role in changing the behavior of what was once a tight oligopoly, making it more dynamic and competitive<sup>4</sup>".

Parastatals have generated employment opportunities to the unemployed masses. They have been responsible for removing regional imbalances through investing in areas neglected by the private sector, and is largely instrumental in establishing strategic and basic industries and providing many public utility services.

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<sup>4</sup> Grosh, Barbara "Parastatal - Led Development: The Financial Sector in Kenya, 1971 - 1987, African Development Review Vol. 2 No. 2, 1990.

In spite of the many valid reasons for their existence, these parastals are also faulted for their inefficiency, unprofitability and for wasting resources. These problems are not exclusive to Kenya's SOE sector only, but also to developing countries in general.

## 2.6 The Performance of the Public Sector Enterprises

Beginning in the early 1980's most SOEs in developing countries found themselves in management and financial difficulties. There is ample evidence that SOEs have failed in developing countries (Kikeri, 1989). Throughout Africa, Latin America and to some extent Asia, many SOEs that were supposed to generate investible surplus for governments now pose burdens on the national budgets. A Kenyan example is given whereby the rate of return on the estimated USD 1.4 billion invested in the sector was 0.4 per cent. Nellis summaries SOEs performance in Africa as follows.<sup>5</sup>

"African public enterprises present a depressing picture of inefficiency, losses, budgetary burdens, poor products and services and minimal accomplishment of the non-commercial objectives so frequently used to excuse the poor economic performance."

In financial terms specifically, numerous countries' SOE sector have performed poorly. In a sample from 12 West African Countries, 62 per cent showed net issues while 36 percent had negative net worth. In Tanzania between 1976 - 80, one - third of all SOEs run losses.

Cumulative SOE losses in Mali reached 6 percent of GDP by 1980 (Nellis:1986).

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<sup>5</sup> Nellis, J. R. Public Enterprises in Sub-Saharan Africa, Washington DC: The World Bank, 1986.

In terms of productivity the situation is no better. Based in a sample of parastatals and private In  
In terms of productivity the situation is no better. Based on a sample of parastatals and private  
enterprises, Swamy (1994) estimated that the Total Factor Productivity (TFP) growth during  
1986 to 1990 was negative for the parastatal sector, compared to 5.4 per cent for the private  
sector. He also found that the public sector accounted for more than one-third of the  
government's net lending and equity operations. Killic (1981) reports that average labour  
productivity in Ghanaian SOEs was only about half that of private enterprises, despite the fact  
that SOEs were found in the most capital intensive sector.

SOEs are often involved in price distortions. These may occur in either directions. In some  
commodities prices are kept down to make it affordable to the poorer section of the populace. In  
other prices are higher via monopoly or trade barriers in order to protect inefficient enterprises.

A good number of SOEs have thus been consistent loss-makers. The government has been called  
upon to assume the burden of servicing the SOE debts, and thus diverting resources from more  
productive uses. Swamy (1994) reports that the Kenya government assumed K pounds 66 million  
of the debt service payments in 1991.

SOEs are thus deeply implicated in the fiscal problems of African governments. The large losses  
have contributed to negative public savings, decreases in gross domestic savings and decreases in  
investment rates (Grosh; 1991). The poor performance has been attributed to the following;

- (I) The sheer oversize of the sector
- (ii) Too frequent changes in top management personnel resulting in instability and deviations in the pursuit of enterprise objectives.
- (iii) Lack of adequate managerial skills.
- (Iv) Excessive political interference in the day to day running of these enterprises
- (V) Lack of adequate incentives to stimulate higher performance and productivity
- (vi) Ineffective monitoring and evaluation of enterprise.
- (Vii) Adoption of outmoded accounting and financial management systems.

In 1990 the SOE sector in Kenya accounted for 11% of GDP and employed 120,000 people (Daily Nation October, 27. 1992). Given this important role it is true that before the economy can be turned on the path of growth, a solution to the 'public sector problem' must be found.

## 2.7 Past Reform Efforts

During the last 20 years virtually all developing countries have adopted reform programs short of ownership transfer - to remedy the causes of poor SOE performances. These reforms aimed at:

- (a) Exposing SOEs to domestic and external competition and ending preferential treatment in order to create a level playing field.
- b) Eliminating easy SOE access to credit from the budget

- c) Increasing the autonomy of SOEs and freeing managers from government interference in day to day operational decision making and from non-commercial goals.
- d) Developing institutional mechanisms such as contract plans and performance evaluation systems, to hold managers accountable for results.

Recent assessments of SOE reforms reveal that some improvements in performance have indeed taken place (Galal: 1991, Shirley and Nellis: 1991). But such reforms are technically and politically difficult to implement. Performance can only improve when the full package is put in place, but the necessary reforms are numerous and hard to co-ordinate. For these reasons performance improvements have proved difficult to sustain. A number of SOEs that were judged in World Development Report 1983 to be well on the road to major performance improvements - thanks to exemplary reform efforts - either have not improved in performance or have deteriorated.

Disappointed with the high cost and poor performance of SOEs, and faced with modest and unsustainable nature of reforms that do not involve change of ownership, many governments have turned to privatization. The World Bank and IMF played a key role in turning the thinking towards privatization by making it an important component of the structural adjustment programmes.

## 2.8 The Case for Privatization

Several arguments have been advanced in favour of privatization. First, many policy makers are disenchanted with the fact that a large number of public enterprises are making losses. Their financial performance as reflected in net profit remains disconcerting. Hence, it is argued, let the enterprises move to the private sector and they will be profit-making. In this way the allocational efficiency of the investments improves. Financial statistics extracted from a cross-section of public enterprises the world over lead many to such a conclusion. International institutions such as the World Bank and IMF, lend weight to privatization as an urgent policy option. (See, World Bank Discussion Papers).

Secondly, a powerful inference is drawn from the phenomenon of losses; namely, that they aggravate budgetary problems for the government. Since the government has eventually to finance these losses, the public exchequer is placed under strain. It is argued that if the net cash flow position as between the public exchequer and the enterprises is more favourable to the exchequer than in the pre-privatization era, privatization would be a desirable policy, from the angle of the government budget.

Thirdly, the government may wish to keep its borrowings under strict control, and chances of public enterprises receiving the required funds for expansion from the government are slim. Hence, it is argued, if they are privatized, private investors and lenders supply the funds and the investment programmes can be undertaken. If the government allows the SOEs to go direct to

the capital markets, the investment funds can be gathered without straining the public exchequer (we assume that the capital markets will respond adequately if the investments are justified on commercial grounds). Additionally, the inflow of foreign capital will augment the national pool of investable resources. Fourthly, in the factual context of certain countries, it can be argued that the original objectives have been achieved and that efforts through public aids, are no longer necessary in pursuing them; hence, it can be privatized.

### 2.3.1 Introduction

Fifthly, certain public enterprises have been adopting input and output policies which have negative value from the angle of income distribution. For example, low prices are offered which benefit even the rich sections of the population; high wage benefits accrue to workers who are not the poorest in the economy, and so on. If the enterprises are privatized the new managers will be under no impulse to continue such non-commercial policies. Thus, privatization would be a step in the direction of reducing anti-distributional effects.

Sixth, a large public enterprise implies that senior civil servants are constrained to expend a great deal of their time and energy in dealing with its problems. Two consequences follow: their main responsibilities in the departments tend to be ill-attended; and their involvement in public enterprise matters tends to be less than competent. Privatization minimizes this problem. Finally, Ramanadham (1989) has proposed a more positive and significant argument for privatization. He argues that where a public enterprise loses its comparative advantage it is preferable to privatize it. As long as a public enterprises is a superior means of making contribution to the national well-being, it should be reorganized into a private enterprise.

The comparative advantage is to be measured in terms of the commercial returns, social returns, and a desired trade-off between them both. To operationalise this approach there is need to quantify these items, and for this one needs to have comparative data for private enterprise in 'similar' operations.

## **2.9 Privatization in Kenya**

### **2.9.1 Introduction**

From independence in 1963 up to the late 1970s the Kenya government pursued a policy of mixed economy where the private sector enterprises are allowed to exist side by side with the Public Sector. The government's direct involvement in productive economic activities was aimed at achieving faster economic development, regional balance, local participation and control of the economy. To achieve these goals the government strengthened the parastatal sector by recognizing the one that existed and by creating new ones to perform specific functions. In a number of cases the government ought to stimulate the diversification of the economy through direct investment in private companies and corporations.

As a result the state got involved in nearly all sectors of the economy as a manufacturer and producer of goods and services. These sectors include agriculture, food processing, banking, insurance, distribution retail trade, transportation, hotels, etc. This participation takes the form of equity investments, loans, grants, subsidies and guarantees.

Early in the 1980's it was already noticeable that the parastatals in Kenya were not achieving their set objectives. A number of them accumulated huge losses and depended on the Treasury for financial survival. In June 1982, the government-appointed Working Party revealed that the growing gap between government revenue and expenditure was particularly due to state involvement in commercial activities and provision of services at subsidized rates. The Report further noted that most of the industrial and commercial activities undertaken by the government can be more efficiently handled by the private sector. Consequently the report recommended divestiture in some of these activities and full privatization in others. Accepting these recommendations the government appointed in June 1982 a "Task Force on Divestiture of Government Investments" chaired by Mr. V. Harding (Kiplagat 1994). Again in Sessional paper No. 1 of 1986 the government pronounced its new economic perception and set out appropriate policies aimed at restructuring the economy, government expenditure patterns and re-orientation of parastatal investment.

Although Kenya is a mixed economy the public sector is quite substantial. In December 1991, there were 250 commercially oriented enterprises in which the government held equity share holding either directly or indirectly. In just over half of these the government had majority share holding but the term 'parastatal' is used to include all those enterprises in which the government has minority holding.

In terms of employment the parastatal in Kenya employ 120,000 people. Between 1986-1990 the parastatals accounted for 11% of Gross Domestic Product and 16% of gross capital formation.

Thus privatization in Kenya will have a big impact on the economy as a whole. The exercise has proved to be difficult and slow as the very size of the parastatal sector makes it difficult to reform quickly because:

- (a) The institutional capacity to manage this programme can only be developed gradually.
- (b) The absorptive capacity of the financial sector places a limit on how much can be handled in a given time.
- (c) The capacity for the private sector to digest acquisitions effectively is limited.
- (d) 'Safety net' funds will be required to compensate retrenched workers.

In view of the above constraints it is important to create mechanism to minimize their effects and to establish priorities to permit a rate of progress which will enhance the credibility of the programme in the society.

### 2.9.2 Techniques of Privatization

Although the concept of privatization is well- defined and understood by policy makers there is no one method of implementing the programme. The underlying objectives dictate the methods chosen for a privatization programme. Among the basic methods of privatization are:

Public offering of shares

Private sale of shares through pre-emptive rights.

Liquidation

Sale of assets through receivership

New private investment

Management - employee buy out

Lease and management contracts.

Joint Ventures.

The sale of shares of state owned enterprises through the stock exchange offers one of the most desirable methods. It widens as well as deepens a country's capital market. This arises because it introduces dominant businesses which were brought into state ownership because of their position in the economy, their size and market dominance and their strategic importance. On privatization, they give depth to stock market. It also ensures broad-based ownership and avoids the criticism that privatization means "selling the family silver a few business groups at throw-away prices".

However, the option to disinvest through the stock exchange is likely to have optimal success only for profitable enterprises with sound capital bases and acceptable accounting procedures.

Loss-making units are not likely to attract investors.

Private sale of assets occurs when all or part of assets/shares of the SOE's are sold to a single entity of group under a private treaty or through competitive bidding. Where the sale is partial, the SOE is transformed into a joint venture. This method has two advantages:

- (a) Private sale is the most practical in a country where the capital market is not well

developed such as Kenya

(b) The need to turn around the enterprise usually encourages the new private owner to bring technology transfer, management development, quick access to new markets and hence export development.

The major problem with this method is that it may lend itself to gross abuse, besides the high costs that may be required for restructuring prior to privatization.

Liquidation is undertaken where the SOE is impossible to maintain as a going concern; the assets are either auctioned or disposed of under liquidation. Two limitations are associated with this method. It may take time to find a single buyer for all assets. In most cases the assets will have to be dismantled and sold piecemeal. The money realized from sale may not be adequate to settle all the outstanding liabilities.

### 2.10.3 Institutional Framework in Kenya

The government may seek joint ventures and privatize only a part of the enterprise concerned. As such a public or private offer is made to a private investor to purchase some of the shares. Form them on the enterprise is run as a joint venture. This method improves the equity base of the public enterprise concerned.

Management employee buy out occurs when the shares are offered on credit to the existing management and staff of the public enterprise concerned. The credit is extended either by the government or a selected financial institution. The main advantage is that it gives the existing

employees opportunity to own the company and thereby elicit their commitment in the running of the business. The drawback is that old employees may not have the management talent and new ideas to continue running the company.

Under leasing and contracting, the SOE is leased for a fixed period of time or in perpetuity. The entire control of the enterprise passes to the private company in return for which it is charged rent, besides paying corporate taxes. This method of privatization is most useful in the case of public enterprises producing ready marketable goods or services. Under management contracts, the state relinquishes the provision and control of public services to private companies or individuals. Examples of such public services are garbage collection, public telephone can collection or water supply. The contracting private company pays rent and corporate taxes to the government.

### **2.10.3 Institutional Framework in Kenya**

The institutional framework is laid out in the Policy Paper on Parastatal Reform and Privatization programme. Although the idea of government divesting from companies in the commercial sector was mooted early as 1982, no serious action was taken until 1991 when the Vice President and Minister for Finance, announced privatization measures in his budget speech on 13th June, 1991. This was followed by a press release announcing the government's intention to privatize some 139 companies as an initial stage of the programme. In November, 1991 the President appointed a high-powered Parastatal Reform Programme Committee (PRPC) under the chairmanship of the

Vice President. With the establishment of PRPC an Executive Secretariat and Technical Unit (ESTU) was created to co-ordinate and manage the privatization programme. Thus the government embarked on a comprehensive Public Enterprise Reform and Privatization Programme with overall objectives of:

- i) Enhancing the role of the private sector in the economy, by shifting more of the responsibility for production and delivery of products and services from the public to private sector, to create a more level playing field by eliminating preferential treatment, including monopoly rights:
- ii) Reducing the demands of the public enterprises on the Exchequer so as to Improve the use of Kenya's scarce resources by achieving greater efficiency in both public and private enterprises through responsiveness to market signals and commercial sector
- iii) Reducing the role and rationalizing the operations of public enterprise sector.
- iv) Improving the regulatory environment by selecting more economically rational means of regulation, thereby reducing conflicts of interest between the regulatory and commercial functions of public enterprises, that are consistent with government policy, and
- v) Broadening the base of ownership and enhancing capital market development.

- Vi) To provide political impetus for privatization and participate in building public awareness and the national consensus in support of the programme.

The management, co-ordination and implementation of the divestiture programme, as approved by PRPC, is the responsibility of Executive Secretariat and Technical Unit (ESTU), ESTU has been established as an autonomous executing agency and is insulated from any government or political interference. The functions of ESTU are:

- a) To formulate and recommend policies, procedures, programmes and operational guidelines for divestiture.
- b) To prepare enterprises for privatization and monitor all technical privatization matters undertaken by consultants, including; valuation, selection of optimal privatization method and sale techniques, preparation of prospectus or offering memorandum, and identification of financing options.
- c) To organize the bidding process, receive, evaluate offers and proposals and prepare recommendations to PRPC. In collaboration with Capital Market Authority (CMA) it carries out all activities required for issues.

In order to facilitate the divestiture process. ESTU may establish Privatization Implementation Teams (PIT's) to undertake the necessary technical work for each company being privatized. The PITS are composed of consultants - financial analysts, valuers, accountants, lawyers, industry specialists, etc.

Both PRPC and ESTU are mandated to ensure that the highest level of transparency and accountability is maintained in the entire programme.

**2.10.4 Principles of Privatization**

Sustainability of the privatization process is the main strategy in the long run. This sustainability is linked to the scope and speed of the programme. Experience in other countries show that rapid and large scale divestiture is unlikely in the developing countries owing to complexity of the

process and the absorptive capacity of the local financial markets. Success of the programme is also critically dependent on the public acceptance and participation. To elicit and maintain public support, transparency should be the overriding principle.

1		41	1,442,276,707.00
2	Competitive bidding	14	564,575,000.00
3	Liquidation	12	1,300,000.00
4	Public Boards	8	3,162,250,000.00
5	Dialogue with the private sector and labour unions and publicity campaigns to stimulate interest in the sale of assets and shares must be launched and sustained throughout the privatization process.		
6	Partial Privatization	11	1,399,000,000.00
7			8,700,000.00
8		102	9,574,665,132.00
9		39	3,750,000.00
	TOTAL	144	14,573,930,839.00

Dialogue with the private sector and labour unions and publicity campaigns to stimulate interest in the sale of assets and shares must be launched and sustained throughout the privatization process.

The government released the "Policy Paper on Public Enterprises Reform and Privatization on 1st July 1992. It lays down the guiding principles and procedures. In that policy paper, parastatals are classified as strategic or non-strategic. Strategic parastatals are those in which the government intends to retain its ownership and board control. The non-strategic ones are to be privatized.

## 2.10.5 Status of the Privatization Programme in Kenya

As of December 1996, the government had divested from 141 public enterprises out of 207 earmarked for privatization since the launching of the programme. The cumulative sales proceeds from these divestures amounted to Kshs.9,578.00 million.

**Table 1**

**NO. OF PUBLIC ENTERPRISES SOLD JAN, 1991 - DEC, 1996**

	METHOD OF SALE	NO OF FORMS	PROCEEDS OF SALE (KSHS)
1	Pre-emptive rights	41	1,442,276,707.00
2	Competitive bidding	14	564,575,000.00
3	Liquidation	12	1,300,000.00
4	Public floatation	8	5,162,296,890.00
5	Receivership	15	996,716,555.00
6	Partial Privatization	11	1,399,000,000.00
7	Management buy out	1	8,500,000.00
	Sub total	102	9,574,665,152.00
8	Tea factories	39	3,750,500.00
	TOTAL	141	9,578,415,652.00

Source: Ministry of Finance.

## 2.10 Measures of Performance

a) Profitability: Following ratios:

Profit measures are widely accepted as the indicator of financial performance of an enterprise.

This is because it is consistent with profit-maximizing behavior of firms in competitive environments. In this study profitability will be measured by the following ratios:

i) Rate of Return on Equity (ROE). This is the coefficient of net income to the permanent business capital and is calculated as:

$$\text{ROE} = \frac{\text{Net Income}}{\text{Average Equity}}$$

ii) Return on assets: This is the coefficient of net income to business assets and measures the earning power of the assets employed.

$$\text{ROE} = \frac{\text{Net Income}}{\text{Average Total Assets}}$$

iii) Return on sales: Measures net profit margin and is given by

$$\text{ROE} = \frac{\text{Net Income}}{\text{Sales}}$$

b) Efficiency:

Efficiency measures resource utilization by a firm. A firm is considered efficient if it can attain a maximum level of return at minimum cost. It has been argued that the poor performance of SOEs results from inefficiency. With privatization it is expected that a firm will be more efficient.

Efficiency gains will be used to explain the increase in profitability. In this study efficiency will be measured by the following ratios:

$$\text{i) Sales per employee} = \frac{\text{Sales}}{\text{Number of Employees}}$$

$$\text{ii) Net income per employee} = \frac{\text{Net Income}}{\text{Number of Employees}}$$

c) Investment

New investment in capital goods or fixed assets is important to any economy. It expands the productive capacity and leads to greater output of goods and services. One of the measures of a firm's performance therefore is the amount of new investments it generates. Investment in machinery and new technology is one of the expected benefits of privatization and will be measured by the ratio of capital expenditure to sales. However, if sufficient data is not obtained this measure may have to be dropped.

d) Employment

This is the number of employees engaged directly by an enterprise and includes unskilled, semi-skilled and skilled workers. One of the problems facing the country today is high level of unemployment. In this study employment generation will be measured by the change in the number of employees.

## **CHAPTER THREE**

### **RESEARCH DESIGN**

#### **3.1 Population**

The population of the current study comprises that had been privatized by the end of 1994. According to ESTU figures 67 enterprises has been privatized by that date through various methods. The choice of these firms is considered important because these are the ones with adequate post-privatization history that can be analyzed.

#### **3.2 Sampling plan**

The study will cover a census of all the 67 firms that had been privatized by 1994. Of the 67 firms, 20 were either liquidated or placed under receivership. The remaining 47 were fully or partly privatized by the government and are still in business.

#### **3.3 Data Collection Method**

The study will collect secondary data. A data collection form will be used to collect data, extracted from the financial statements of the enterprises. Data to be collected include:

- I) Owner's equity, (including all reserves)
- ii) Total assets
- iii) Net income
- iv) Sales revenue
- v) Capital expenditure

vi) No. Of employees

Most of the above data will be obtained from NSE secretariat, the Auditor-General (Corporation) library and at the Register of Companies office in the form of published financial statements. Any data that is not available from the above three sources will be sought directly from the individual firms.

### 3.4 Data Analysis

Various ratios will be used in this study to analyze performance. This is because they are a convenient way to summarize large quantities of data and to compare firm's performance in a time series perspective. Ratios are preferred to absolute values on mathematical ground and is basically to facilitate comparison by adjusting for size. Megginson, Nash and van Radenorgh (1995) have used ratios to analyze post privatization performance. They used return on sales as a measure of profitability. Efficiency was measured by real sales per employee and net income per employee. They also measured investment as the ratio of capital expenditures to sales.

In the Mexican case, De Silanes (1997) used the ratio of operating income to sales, net income per employee, net income to sales, net income to fixed assets and dividends per share to analyze the post-privatization performance of 214 enterprises in Mexico.

The application of these ratios is therefore justified because they have been successfully used in previous post-privatization studies.

The study will cover an eight year period from 1990 - 1997. The performance of the enterprises will be analyzed into two periods - before and after privatization. For each firm all the relevant ratios will be computed. These are return on equity, return on assets, return on sales, sales per employee, net income per employee, ratio of capital expenditure to sales and number of employees.

The objective of the study is to find out whether there is any significant difference in the financial

For each ratio a mean and standard deviation will be computed for all the firms before and after privatization. A total of six tests will be carried out. The tests fall under four main categories: profitability, efficiency, investment and employment.

Data is available for 26 out of the 47 firms that were originally intended for the study. This

In the second stage of data analysis, the difference of the means before and after privatization will be tested for statistical significance.

In the calculation of sales per employee there are firms in the financial sector for which sales figures are not reported, and have been therefore ignored.

In the first stage of data analysis a mean ratio for each company before and after privatization, was computed, as set out in Chapter 3. In the second stage the mean ratios extracted from each of the 26 firms were grouped to get an overall mean and standard deviation.

## CHAPTER 4 *or Significant Differences*

### DATA ANALYSIS AND FINDINGS

#### 4.1 **Introduction** *test is to aid in reaching a decision whether there is any significant*

*difference in performance. Two-tail-tests were done for all the measures. The two-tail test is*

The objective of the study is to find out whether there is any significant difference in the financial and operating performance before and after privatization. Various financial and operating ratios are used to analyze profitability and efficiency, while employment is measured in absolute terms.

*below the expected value would cause rejection of the null hypothesis.*

Data is available for 26 out of the 47 firms that were originally intended for the study. This number is considered appropriate for analysis because it comprises just over 55 percent of the firms which had been privatized by 1994.

*each test the following procedure was used.*

In the calculation of sales per employee there are firms in the financial sector for which sales figures are not reported, and have been therefore ignored.

*Ho: There is no significant difference in profitability, efficiency and employment before and after*

In the first stage of data analysis a mean ratio for each company before and after privatization, was computed, as set out in Chapter 3. In the second stage the mean ratios extracted from each of the 26 firms were grouped to get an overall mean and standard deviation.

## 4.2 Test for Significant Differences

### 4.2.1 Hypothesis Testing

The aim of the hypothesis testing is to aid in reaching a decision whether there is any significant difference in performance. Two-tail-tests were done for all the measures. The two-tail test is used when significant deviations from a specified parameter in either direction would need to be investigated. In this case the researcher would concentrate on both directions, as upward and downward variations in performance, if significant, would be of interest. A value too far above or below the expected value would cause rejection of the null hypothesis.

In the present study a two tail test is considered suitable as significant deviations in performance in either direction would be of interest to all parties concerned with privatization in Kenya. For each test the following procedure was used.

#### 1. Statement of the hypothesis

Ho: There is no significant difference in profitability, efficiency and employment before and after privatization

Ha: There is significant difference in profitability, efficiency and employment before and after privatization.

## 2. Test 1: Specifying the level of significance.

$$= 0.05$$

Critical t value +2.0063 and -2.0063

## 3. Test statistic

$$t = \frac{X_1 - X_2}{\frac{(n_1 - 1)S_1^2 + (n_2 - 1)S_2^2}{n_1 + n_2 - 2} \cdot \frac{n_1 + n_2}{n_1 n_2}}$$

Where

t - test statistic

$X_1$  and  $X_2$  - mean ratio for the two periods

$n_1$  and  $n_2$  - no. Of firms

## 4. Statistical Decision

The test statistic is computed and the resulting value is compared to the critical value. If it is

significantly greater or lesser than the critical t, the null hypothesis is rejected, otherwise we fail to reject it.

## 5. Make a managerial decision

This relates to the policy decision that should follow based on the results

### Test 1: Return on Equity

Ho: There is no significant difference in the return on equity before and after privatization.

Ha: There is significant difference in the return on equity before and after privatization

t - value = 3.9698

Since the calculated t-value is less than t-critical the null hypothesis is rejected and therefore we conclude that there is significant difference in the return on equity of the firms before and after privatization.

### Test 2: Return on Assets

Ho: There is no significant difference in the return on assets of the firms before and after privatization

Ha: There is significant difference in the return on assets of the firms before and after privatization.

t = -3.3168

Since the calculated t-value is less than t-critical the null hypothesis is rejected and we conclude that there is significant difference in the return on assets of the firms before and after privatization.

### Test 3: Return on sales.

Ho: There is no significant difference in the return on sales of the firms before and after privatization.

Ha: There is significant difference in the return on sales of the firms before and after privatization.

t - Value = -3.2833

Since the calculated t-value is less than the critical t value the null hypothesis is rejected. The conclusion is that there is significant difference in return on sales.

Test 4: Sales per Employee

Ho: There is no significant difference in the sales per employee before and after privatization.

Ha: There is significant difference in sales per employee before and after privatization.

t-value = -3.1439

Since the calculated t-value is less than the critical we reject the null hypothesis and conclude that there is significant difference in the sales per employee of the firms before and after privatization.

Test 5: Net Income per Employee.

Ho: There is no significant difference in the net income per employee of the firms before and after privatization.

Ha: There is significant difference in the net income per employee of the firms before and after privatization.

t-value = 3.2449

Since the calculated t-value is less than the critical t value we reject the null hypothesis and conclude that there is significant difference in the net income per employee of the firms before and after privatization.

## Test 6: Employment

Ho: There is no significant difference in employment in the firms before and after privatization.

Ha: There is significant difference in employment in the firms before and after privatization.

t-value = 0.0761

Since the calculated t value lies within the critical region we fail to reject the hypothesis. The data from the firms do not indicate significant difference in employment before and after privatization.

More investigation needs to be conducted as far as employment is concerned.

### 4.3 Overall Performance Findings

The measures showed better overall performance of the firms after privatization in terms of profitability and efficiency. The table below gives a summary of the findings.

**Table 2: Performance Findings**

Measure	Before	After	% Change
Return on Equity	0.1487	0.2408	61.9
Return on Assets	0.1193	0.1864	56.2
Return on Sales	0.0842	0.1236	46.7
Net Income Per Employee (Shs)	123955.53	178892.57	44.3
Sales per Employee (sh)	1460814.70	217988	48.7
Employment	605	589	-2.6

From the table it is clear that profitability of the firms increased significantly after privatization.

Return on Equity increased by 61 per cent. Return on assets registered an average increase of 56.2 per cent, while return on sales was up by 46.7 per cent after privatization.

Efficiency gains were also positive and large, with net income per employee increasing by 44.3 per cent. Sales per employee increased by 48.7 percent after privatization.

Employment figures show a marginal decline of 2.6 percent. This is almost certainly the result of employment cuts.

#### 4.4 Discussion of the Findings

Data analysis conducted in this chapter seems to confirm that the newly privatized enterprises in Kenya have improved in both financial and operating performance. Five out of the six measures

indicate statistically significant improvements in various indices of performance by the firms.

They have become not only more profitable, they have also been more efficient in the utilization of resources, than in the period before privatization.

Profitability increased significantly after privatization. Return on equity increased by 61 per cent from an average of 14 per cent before privatization to 24 per cent after. Return on assets increased on average from 11.9 per cent to 18.6 per cent after privatization. Return on Sales also posted significant increases from an average of 8 per cent to 12 per cent after privatization. These measures were found to be significant at 0.05 level of significance.

Efficiency gains were also positive and large, with net income for employee increasing by 44.3 per cent from an average of Kshs.123955 to Kshs.178892 after privatization. Sales per employee leaped by 48.7 per cent, from Kshs.1460814 to Kshs.2172988.

Employment figures recorded a marginal decline of 2.6 per cent from an average of 605 to 589 employees. This is the result of employment cuts, as newly privatized enterprises retrenched excess labour force.

The margin of gains are large for all ratios, ranging from 44.3 per cent to 61 per cent. Post privatization studies conducted in other countries have shown increases ranging from 13 percent in the industrial countries to 1075 percent in the former communist Europe. This apparent inconsistency can be attributed to country differences. The level of development of a country may

have an impact on the success of divestiture. Industrial countries typically possess better educated populations, among them people with substantial managerial experience, than do developing countries or the former communist states. This would suggest that public enterprises in industrial countries would be relatively well managed, which would mean less impact of divestiture on the performance of the enterprises.

In the developing countries, however, where the quality of management is poor, the impact of divestiture is much more significant. As for the former communist states the tremendous increases merely reflect the extent of inefficiency and waste inherent in those systems.

There is an inherent link between the increase in profitability, increase in efficiency and a fall in employment. An organization becomes more efficient if it can reduce the amount of labour force but maintain the same level of output. Efficiency gains through higher productivity and lower unit costs, ultimately translate into improved profitability. Higher profits is also generated is the organization adopts commercial pricing policy rather than social or welfare - pricing of its products and services.

## **CHAPTER 5**

### **CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Conclusion**

Based on the results of the analysis carried out in the previous Chapter the major conclusion emerging is that there has been better overall performance of the firms since privatization. They have become more profitable and efficient. Further more the magnitude of the gains were substantial, except for employment. The results therefore seem to vindicate the policy of divestiture of state owned enterprises.

#### **5.2 Implications of the Study**

In theory, divestiture is expected to remove various institutional constraints. In particular it is expected to narrow the objective of the enterprise to profit maximization. Private owners are expected to pursue this objective. They are also expected to better monitor and provide incentives to do so. Finally, management itself is expected to face fewer political and bureaucratic constraints in pursuing profit maximization. As a result enterprise profitability is enhanced. And when poorly managed public enterprises are converted to well managed private enterprises major efficiency gains should follow.

In general the results of this study support these expectations. One of the implications of this study relate to the source of higher profitability. Efficiency gains and employment cuts seem to have contributed to enhanced profit performance. Another contribution could emanate from the fact that the pricing of goods and services by the newly privatized enterprises follows commercial, rather than social or welfare, considerations.

### 5.3 Recommendations

Since the results of this study generally support privatization it is recommended that the government should speed up the process of privatizing the remaining public enterprises. While the government's commitment to privatization has been reiterated, the pace has been rather slow. Even the world Bank and IMF have raised concern about the slackened pace. The privatization of Mumias Sugar Company, for example which was expected to be completed in 1998 is not likely to be achieved.

Secondly, privatization should not be seen as an isolated process but as an integral part of the ongoing economic liberalization as well as public sector reform programme. For instance, privatization without appropriate market reforms will just convert public monopoly into a private monopoly. Hence it should be viewed as part of a broader effort to promote efficiency, strengthen competitive forces in the economy and support entrepreneurial development. Experience in fact indicate that divestiture programmes that follow regulatory and institutional reforms show better results than programmes undertaken in isolation. Thus the privatization

programme should be synchronized with removal of economic distortions and the development of a supportive macroeconomic environment. For example, most economists are agreed upon the important role which competitive markets play in inducing enterprises to operate efficiently.

Additionally, there is need for the creation of a private sector development body in Kenya. Its principal mandate should be to identify the problems facing the newly privatized enterprises and offer post-privatization assistance to these firms.

Finally, it is recommended that "safety nets" be strengthened to alleviate some of the difficulties associated with privatization. The results of this study indicate decline in employment as a result of retrenchment. Several measures may be taken including golden handshake schemes and other incentives. In the longer run, however, the effect of any reduction in employment opportunities in the process of divestiture can be effectively countered if the economy is growing at a faster rate as a result of restructuring and self-employment is promoted through easier access to credit and other schemes. With fast growth and an expanding private sector total employment can actually increase along with improved economic efficiency.

#### **5.4 Limitations of the study**

The degree to which the findings of this study may be generalized should be ascertained in the light of some limitations.

It was assumed in this study that the ratios used possess the appropriate statistical properties for handling and summarizing data. Ratio analysis has certain limitations such as window-dressing, variation in accounting methods, etc.

Future research should also undertake studies on the behavioral changes following divestiture.

The data was assumed to be normally distributed. We use normal distribution in attempts to answer many practical questions regarding data. However, its exact specifications are never met in real life. Terrel (1984) argues that normal distribution is a theoretical or ideal distribution, and there is no set of measurements conforming exactly to its specifications. The reader should therefore note that there are cases where these assumptions concerning distribution do not hold. Caution should therefore be taken before generalizing these findings.

privatization by public lotteries has resulted in both widening and deepening of the capital

Finally the study concentrated on analyzing the performance of the enterprises after privatization. It did not isolate the effect of other factors such as product, technology or age of the firm. Such was not possible within the scope of this study.

Finally, there is need to correlate these performance changes to the Gross Domestic Product

### **5.5 Suggestions for Future Research**

This would provide insight into how divestiture has affected the overall economic performance as well as the performance of the different sectors

The study analyzed the performance of the enterprises covering only four years after privatization. The findings therefore revealed only the immediate benefits. Many of the changes associated with divestiture, particularly for large firms do not manifest themselves immediately. They emerge only down the line as a result of better planning, better management and more forward-looking behavior. Future studies should seek to identify and measure these long run benefits. Such

studies will more appropriately use regression analysis, which cannot be applied in the short run because of few observation points.

Future research should also undertake studies on the behavioral changes following divestiture. Employee job satisfaction, career development and other motivational aspects may also have changed with divestiture.

Privatization has in recent years played an important role in the development of Kenya's capital markets. Capital markets support economic growth by channeling savings to long term productive investment on the basis of market signals and prospects for risk and return. Privatization by public flotations has resulted in both widening and deepening of the capital market. The magnitude and direction of this change is a challenging opportunity to future researchers.

Finally, there is need to correlate these performance changes to the Gross Domestic Product (GDP) and other leading economic indicators. This would provide insight into how divestiture has affected the overall economic performance as well as the performance of the different sectors in which the SOEs operate.

**APPENDIX 1: List of Companies Studied**

Comp	ROE Before Divestiture	Mean ROE After Divestiture
1. Associated Battery Manufacturers		
2. African Diatomite Industries		
3. Bamburi Portland cement co.	0.0814	0.1521
4. Chloride Oxide	0.2758	0.3587
5. E.A Oxygen ( BOC Gases Kenya Ltd)	0.1617	0.258
6. E.A Fine Spinners (Bed. Investors	0.1079	0.1568
7. Firestone	0.2513	0.2675
8. General Motors	0.21	0.282
9. Housing Finance Co. Kenya	0.071	0.181
10. ICDC- Minet	0.1303	0.201
11. Kenya Commercial Bank	0.146	0.316
12. Kenya Furfural Co. Ltd	0.253	0.301
13. Kenya Engineering Industries Ltd (Ashut Engineers	0.09	0.129
14. Metal plastics		0.382
15. Milling Corp. Of Kenya (Premier Flour Mills)	0.177	0.267
16. National Bank of Kenya		0.191
17. Panafric Hotel	0.211	0.279
18. Pollman Tours & Safaris	0.097	0.168
19. Pan Vegetable processor Ltd (Homegrown Kenya Ltd)	0.306	0.253
20. Salt manufacturers Kenya Ltd	0.081	0.211
21. Synthetic Fibres Kenya ltd (Sunrise Textile Mills)	0.153	0.212
22. Sera Coatings Kenya Ltd)	0.28	0.294
23. Uchumi Supermarkets Ltd	0.07	0.286
24. Yuken Textiles (Yuken Mills Ltd)	0.100	0.129
25. Y-Fashions	0.172	0.22
	0.213	0.288
	0.1487	0.341
	0.2085	0.2408
		0.072

**Table 3** RETURN ON SALES**RETURN ON EQUITY (ROE)**

Company code	Mean ROE Before Divestiture	Mean ROE After Divestiture
1	0.0814	0.1521
2	0.2758	0.3587
3	0.1617	0.258
4	0.1079	0.1588
5	0.2513	0.2675
6	0.23	0.282
7	(0.01)	0.181
8	0.1103	0.201
9	0.246	0.316
10	0.253	0.301
11	0.09	0.129
12	0.254	0.382
13	0.177	0.267
14	(0.065)	0.151
15	0.211	0.279
16	(0.095)	0.168
17	0.205	0.253
18	0.132	0.211
19	0.093	0.175
20	0.153	0.212
21	0.198	0.294
22	0.24	0.286
23	0.07	0.129
24	0.102	0.22
25	0.172	0.288
26	0.223	0.341
mean	0.1487	0.2408
std deviation	0.0985	0.072

**Table 5: RETURN ON SALES**

SALES PER EMPLOYEE (K\$)

Company Code	Mean ROS Before Divestiture	Mean ROS After Divestiture
1	0.083	0.0595
2	0.089	0.10
3	0.109	0.125
4	0.048	0.084
5	0.07	0.137
6	0.068	0.099
7	(0.069)	0.099
8	0.065	0.19
9	0.057	0.775
10	0.088	0.123
11	0.048	0.081
12	0.072	0.131
13	0.171	0.215
14	(0.053)	0.088
15	0.081	0.103
16	(0.055)	0.10
17	0.1225	0.155
18	0.075	0.155
19	0.067	0.106
20	0.12	0.2
21	0.041	0.08
22	0.14	0.212
<b>Mean</b>	<b>0.0842</b>	<b>0.1236</b>
<b>Standard deviation</b>	<b>0.0351</b>	<b>0.046</b>

**Table 6**  
**SALES PER EMPLOYEE (Ksh)**

Company Code	Before Divestiture	After Divestiture
1	1133283	3430023
2	702974	998266.45
3	1946335	2331376.68
4	2681368	2997010
5	282617	3127860
6	648973	886529
7	68945	162861
8	1689089	2553006
9	348932	606178
10	1913036	3976812.40
11	1072887.10	2683601
12	2511460.65	377141.05
13	1824661	3396118
14	698933	1201547
15	1941424	2970581
16	368772	939168
17	519854	764642
18	2385388	3056189
19	1662275.52	2699354
20	1446331	2370003
21	723309.40	1571382
22	3073178	4706090
Mean	1460814.70	2,172,988
Standard deviation	890601	1273662

**Table 7** Employment Figures

**NET INCOME PER EMPLOYEE (KSH)**

Company	Before Privatization	After Privatization
1	139334	211643
2	67128	88142
3	112679	132266
4	194622	248433
5	168830	266565
6	86998	120857
7	(22469)	42883
8	18424	46928
9	175606	226951
10	137007	183932
11	152037	207332
12	66188	84857
13	118536	214659
14	(114660)	67249
15	181953	215399
16	(13224)	68743
17	74307	10689
18	167298	249118
19	98354	160112
20	104656	157644
21	86211	133958
22	168218	223888
23	276185	318876
24	268247	326882
25	341191	422928
26	99188	120266
Mean	123955.53	179982.57
Standard deviation	90045.20	94106.3

**Table Employment Figures**

Company Code	Average Before divestiture	Average After Divestiture
1	370	385
2	67	52
3	128	133
4	490	600
5	166	140
6	69	117
7	37	30
8	320	120
9	25	30
10	160	110
11	600	350
12	910	650
13	1200	1300
14	140	155
15	78	49
16	1160	715
17	55	42
18	765	820
19	125-	1390
20	960	620
21	821	430
22	906	1100
23	300	475
24	1170	1266
25	3390	3960
26	205	291
Mean	606.4	589.6

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