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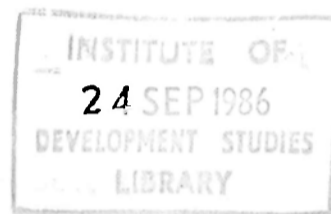
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RESERVE

IMPROVING PARASTATAL PERFORMANCE:  
AN ORGANIZATIONAL APPROACH  
A RESEARCH PROPOSAL

By

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ABSTRACT

Improved parastatal performance is increasingly crucial to the Kenyan economy because of its macro-economic effects and because of the key sectors controlled by parastatals. There is a consensus that the sector has performed poorly in Kenya, especially in terms of profitability and efficiency. In the literature review it is shown that no author has articulated a positive theory of how public firms respond to their environments. This lack of a theory of the firm has weakened policy analysis in Kenya and elsewhere. It is proposed that each firm should be thought of as a coalition between consumers, input suppliers, management and stock holders. The coalition together produces a surplus, with coalition members competing for shares thereof. The performance of a parastatal can thus be characterized by the way this surplus is allocated. A central assumption of this model is that management will behave strategically to appropriate its share of the surplus, rather than passively obeying the wishes of the stockholders. Analysis of a firm's performance then turns into an examination of the mechanisms by which a coalition member can increase its share in the surplus. Policy prescriptions revolve around strengthening or weakening those mechanisms, taking into account the likely responses of other actors in the coalition. There is sufficient richness of experience in the parastatal sector in Kenya that it should be possible, through a careful comparative study, to demonstrate the effectiveness or lack thereof, of various types of controls which have been proposed.

## I. Statement of Problem

In Kenya, as in most of sub-Saharan Africa, a major portion of investment is channelled through government owned corporations, called parastatals. The reasons given for government participation in directly productive activities are "to decolonize the economy, promote development and regional balance, increase citizen participation in the economy and ensure greater public control of the economy."<sup>1</sup> This participation by government has been effected through 147 statutory boards, 47 companies owned wholly by the government or the statutory boards, 36 companies in which the government owns a controlling interest and 93 companies in which the government has a minority shareholding position.<sup>2</sup> These enterprises are found in many sectors of the economy, including strategic and infrastructural industries such as banking and finance, transport, energy, communications and export commodities. It also includes investments in nonstrategic sectors such as textiles, shoes, sugar, tyres alcohol, canning, salt, paper, radios, fishing, beverages and food processing.<sup>3</sup> In 1976 parastatals contributed more than 10% of G.D.P. and accounted for a similar portion of capital formation.<sup>4</sup>

Because parastatals control so many key sectors it is important that they perform well. Some have functioned efficiently, producing goods and services in a technically efficient manner and earning profits. Most, however, have performed poorly, wasting resources and requiring large subsidies. The consequences of an inefficient parastatal sector are grave.

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1. Working Party on Government Expenditures, Report and Recommendations of the Working Party, July, 1982.

2. Ibid., p. 40.

3. For a complete list of Kenya's parastatals, see *ibid.*, pp. 93-8.

4. Hans G. Klaus, "Parastatals in Kenya: Analysis of Their condition and Methods for an Improved Performance," Institute for Development Studies Working Paper No. 370, University of Nairobi, June, 1979.

The importance of good performance in the parastatal sector has been recognized in Kenya. According to the recent Working Party on Government Expenditures, "Examples of unsound and poorly controlled investments can readily be found... The amounts involved are of such a magnitude that if they had been directed toward the development of essential rural infrastructure, several districts could have been radically transformed..."<sup>5</sup> According to the Ndegwa Committee "These shortcomings... constitute a serious threat to the economy and it is, therefore, a matter of extreme urgency that steps should be taken to overcome them. The economic and social costs of delay in taking action to remedy these serious problems are simply unacceptable."<sup>6</sup>

While the urgency of reform is acknowledged, Kenya's parastatals continue to be a heavy burden on the nation's finances. "By 1982 cumulative investments by Government, including guaranteed debt of parastatals, exceeded KSh 900 million. At a rate of return of 10 per cent, Government should be realizing KSh90 million per annum in dividends. Instead, in 1978/79 dividends paid to the Exchequer amounted to only KSh2.2 million and were paid by only six parastatals."<sup>7</sup> This poor record of returns reflects the poor way in which most parastatals are operated. The Ndegwa Committee found that "there is clear evidence of prolonged inefficiency, financial mismanagement, waste and malpractices in many parastatals."<sup>8</sup>

The Ndegwa Committee emphasized the confused chain of command experienced by parastatals. They noted that "because of the confusion which exists; it is becoming increasingly difficult to say where responsibility for waste or inefficiency lies and there is a growing tendency to attempt to shift blame to others when things go wrong. A confused situation of this sort can be exploited in

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5. Working Party, op. cit., p. 38.

6. Review of Statutory Boards: Report and Recommendations of the Committee Appointed by His Excellency the President, May 1979, p. 22 (Hereafter referred to as the "Ndegwa Committee Report")

7. Working Party, op. cit. p. 41.

8. Ndegwa Committee Report, op. cit., p. 3

many ways, e.g. to resist public accountability and to engage in corruption and nepotism."<sup>9</sup>

While the Ndegwa Committee perceived confusion and contradiction in policy toward parastatals, the Committee scarcely dealt with the source of these problems. The source of much of the confusion and contradiction in policy is the multiplicity of public enterprise goals.

Enterprises which have been assigned multiple objectives must make tradeoffs between them. Even if management were "efficient" so that the firm is on a production possibility frontier of its goals, the pursuit of some goals must mean a curtailment in pursuit of others. An evaluation of a firm using only one criterion, such as technical efficiency, when the firm has been pursuing other objectives, such as maximizing employment or self-sufficiency in basic commodities, will naturally show the firm as being inefficient in achieving the single goal.

It seems that in Kenya public enterprises have been pursuing a number of objectives which the Ndegwa Committee labels as "political" and hence assumes to be illegitimate. The very existence of the Ndegwa Committee and its follow-up by the Working Party on Expenditures suggest that the balance of power in Kenyan politics is now shifting to favor efficiency and profitability goals over other goals. The problem of reform of parastatals can be viewed as one of a search for mechanisms by which the group which favors efficiency and profitability can ensure that those goals are given precedence over others.

If reforms are to be successful, they must be based on a realistic theory of both the firm and the environment in which it operates. Many of the reforms which have been proposed involve new control mechanisms imposed on the firm by the state. Yet such controls may increase the politicization of some aspects of firm performance in ways which will actually lead to worse per-

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9. Ndegwa Committee Report, op. cit., p. 3.

formance. To discuss reforms intelligently, we need a comprehensive and consistent theory of what factors determine firm performance.

In the review of the literature on public enterprise, it will be shown that past studies have suffered because they did not have a realistic theory of firm behavior. They also lacked a systematic theory of what political pressures were likely to be applied to different firms and how performance would be affected.

Based on the literature review a theory of public enterprise will be proposed which explains firm performance as resulting from competition between pressure groups which attempt to appropriate as much as possible of the surplus generated by the firm. The performance of a firm can thus be characterized by the way the surplus is shared between consumers, input suppliers, management and stockholders. Policy analysis of a firm will focus on the mechanisms available to each of the pressure groups in its struggle to secure its share of the surplus.

## II. Review of Literature

In considering the problem of how parastatals in Africa can be made to function effectively one can tap literature in several different fields. In the literature review which follows the contributions of each field are described, with mention made of representative works and authors.

The economic literature on public enterprise can be divided into two categories, normative and positive. The former category is better developed.

The normative literature on public enterprise builds on basic welfare economics. One outstanding example of this literature is Baumol and Bradford's "Optimal Departures from Marginal Cost

Pricing"<sup>10</sup> which was developed primarily in reference to nationalized industry and only secondarily applied to regulation problems. This literature also includes treatments of the problem in a dynamic context. Perhaps the most elaborate example of this is the UNIDO Project Evaluation Guidelines.<sup>11</sup> This literature is relatively mature and well-developed. It is useful for the setting of policy goals.

The second category of literature on public enterprise is "positive rather than normative." Instead of asking "how should public enterprises behave so as to maximize social welfare?" it asks "how do public enterprises act under given conditions?" Thus, it attempts to provide a theory of the firm. Such a theory should predict how a public firm will behave when confronted by different environments. Part of the environment which must be considered is different constraints put on the public firm by the state. This literature is underdeveloped and largely unsatisfactory. It is to this area that the proposed research will contribute.

Evaluations of public enterprises have been weakened by the void which exists where a theory of the firm ought to be. For example, the World Bank recently published a study of state manufacturing firms in Turkey.<sup>12</sup> This study illustrates the methodological gap to be filled. Walstedt carefully evaluates the efficiency of state firms in several sectors. By comparing productivity of capital and labor with international data from the same industries he concludes that they have performed inefficiently. In arriving at this conclusion, Walstedt carefully corrects for distortions caused by wage, price and currency controls. He goes on to give recommendations for how to reorganize the state sector for greater

10. W. Baumol and D. Bradford, "Optimal Departures from Marginal Cost Pricing," American Economic Review, June 1970, pp. 265-283.

11. United Nations Industrial Development Organization, Guidelines for Project Evaluation, United Nations, 1972.

12. Bertil Walstedt, State Manufacturing Enterprise in a Mixed Economy: the Turkish Case, Johns Hopkins University Press, 1980.



While this might seem an obvious point, the problem has been difficult in practice because of the many seemingly nonquantifiable goals which parastatals are supposed to pursue. Jones shows that many of these goals are met by the existence of public enterprise and require no further deviations from profit maximizing behavior, though a lower rate of profit may be acceptable. However, market distortions make shadow pricing necessary in calculating public profit. But shadow pricing remains an inexact practice and it will be difficult to base managers' evaluations on it. Thus it seems likely that efforts to evaluate public enterprise will continue to be plagued by a multiplicity of non-commensurable goals, which weakens the ability of public monitors to serve as effective watchdogs of public firm behavior.

Aharoni has made a promising beginning at an attempt to model the public firm.<sup>15</sup> Yet, his paper still suffers from a basic confusion as to the nature and behavior of the firm.

Aharoni assumes that firms will seek to maximize "managerial discretion." He takes his definition of managerial discretion from Williamson.<sup>16</sup> Managerial discretion is the "ability of managers to choose and pursue objectives and strategies that differ from those of the owner." This is equivalent to saying that managers appropriate some of the firm's resources. Aharoni gives a list of factors which will contribute to managerial discretion in public firms. For example, firms which can finance new investment out of retained earnings will have more discretion than firms which have to submit their requests through the national budgetary procedure. Firms which fall under the jurisdiction of more than one ministry will experience greater discretion because they can exploit the resulting ambiguity in instructions.

Aharoni is on the right track here in that he views, public firm managers as behaving strategically to further their objectives, rather than assuming, as in orthodox economic models,

15. Yair Aharoni, "Managerial Discretion," in Raymond Vernon and Yair Aharoni, eds., State-Owned Enterprise in the Western Economies, St. Martin's Press, New York, 1981.

16. Oliver Williamson, The Economics of Discretionary Behavior: Managerial Objectives in a Theory of the Firm, Prentice Hall, Englewood Cliffs, N.J., 1964.

Oliver Williamson, The Economics of Discretionary Behavior,  
Managerial Objectives in a Firm, Prentice Hall,  
Englewood Cliffs, N.J., 1963.

that managers act as instruments of owners. But a curious ambivalence as to what managerial objectives are exists in Aharoni's paper.

According to Williamson, managerial discretion leads to thick carpets, fat expense accounts and over-large personal fiefdoms. Hence managerial discretion is a source of inefficiency.

In Aharoni's paper, the concept seems to have gotten flipped on its head. His examples of managerial discretion all seem to involve an enterprise resisting pressure to go along with some (assumed) ill-founded income redistribution policy. Such examples include building plants in unfavorable locations, or buying purchasing inputs from other parastatals which offer very good terms, etc. While it is never explicitly stated, it seems that public enterprise managers have now become champions of the public interest and enemies of corruption, cronyism and stop-gap measures designed to redistribute income.

How can such a remarkable transformation occur? How can managerial discretion look so different to Williamson in the private sector and to Aharoni in the public sector? The answer is simple if one starts from the assumption that public managers are like private managers. They can be expected to resist any measure which cuts into their discretionary realm. Additional tasks for their enterprise will reduce discretion. So, they can be expected to resist political interference. This is quite different from saying that they seek to maximize social welfare and operate efficiently. Aharoni and many other authors who argue in favor of public enterprise autonomy have by and large been fooled by a history of public firms' resisting political pressures into a naive view of how such firms will behave when given autonomy.

The studies of Kenya's parastatals which have been done in Kenya have also suffered from a confused implicit theory of the firm. Reports listing problems with parastatals typically contain problems at every different levels. For example, one list<sup>17</sup>

17. See Hans G. Klaus in his "Analysis and Survey of the Conference," in "The Role of Public Enterprises in Development in Eastern Africa: Proceedings of a Workshop Organised by the Institute for Development Studies," I.D.S. Occasional Paper No. 39. The conference took place 4-7 November, 1980.

pointed out that unqualified managers are appointed for political reasons. In the same list another problem cited was that maintenance plans and inventory lists were inadequate. Surely the latter problem is a result of the former and therefore belongs in a separate analytical category.

Some authors have written detailed descriptions of the accountability structures of public enterprise. Cassesse did this for France, Italy and England.<sup>18</sup> He concludes that in these countries public firms provide enough information for the type of performance evaluation which Jones proposed. However, the information seems to go virtually unused. Oyugi comes to the same conclusion for Kenya.<sup>19</sup> Anyane-Ntow confirmed the same phenomenon in Ghanaian public enterprise.<sup>20</sup> This suggests that the problem with public enterprises may not lie in that they respond poorly to incentives but rather that the political system is incapable of providing proper incentives. This is the conclusion reached by Oyugi:

"The problem facing the parastatals in Kenya can be analysed at two levels, namely, at the level of policymaking and also at the level of internal management. The policymaking function is one which the enterprise shares with many other interested parties. In the case of a public enterprise, the government, at least theoretically, is a critical actor. Where the government fails to play its part or neglects it altogether, a public enterprise is likely to go astray or even collapse.

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18. Sabino Cassesse, "Public Control and Corporate Efficiency," in Raymond Vernon and Yair Aharoni, eds., State-Owned Enterprise in the Western Economies, St. Martin's Press, New York, 1981.

19. W.O. Oyugi, "Government and Public Enterprises: Some Observations on Kenya." in Hans Klaus and S.E. Migot-Adholla, eds., The Role of Public Enterprises in Development in East Africa, Proceedings of a Workshop organized by the Institute for Development Studies, University of Nairobi, 4 - 7 November, 1980. Occasional Paper No. 39, 1982, p. 73.

20. Kwabena Anyane-Ntow, "The Use of Accounting Information in Structuring Decision Making and the Management of State Controlled Business Enterprises in Ghana: Accounting and Economic Development Revisited," unpublished doctoral dissertation, University of Georgia, 1982.

Lack of external stimuli in the form of policy guidelines leads to laxity in the organization and eventually to disintegration of the organizational system. The disintegration comes about as a result of the managers beginning to promote their own 'particularistic' interests, as opposed to the public interest in the absence of 'external' concern for the latter. In some cases the neglect may lead to goal displacement as the managers alter the original goals to suit their own perspectives or interests.... The practice is widespread in Kenya...." 21

This is an important fact which must be considered in any analysis which hopes to point the way to improved parastatal performance, as it suggests that we should focus our attention not on the firm itself but on the complex political interplay which is the source of the firm's signals and the incentive system under which management operates. While this is a much more daunting task, it may not be so impossible as Oyugi suggests:

"(The Ndegwa Committee Recommendations) .. are based on somewhat false premises-- that the problem is one of lack of effective management and that adjustments in this area could bring about the desired effect. My submission is that the problem is more intricate than it appears. It involves restructuring of the basic value orientation of the political-bureaucratic elites in the society. It involves the introduction and institutionalization of acceptable ethical standards in public and private life if practices such as corruption, nepotism, etc. have to be eradicated altogether."22

Indeed, the proposed research will attempt to show that there are some reforms more modest than "the introduction... of acceptable ethical standards" which can have some positive effect on parastatal performance.

The evidence suggests then that in order to explain the performance of different public enterprises one must examine what pressures are exerted on the firms, by whom, and by what means. Differential performance can then be understood as resulting from a different configuration of pressures at work on each firm.

21. Oyugi, *op. cit.*, p. 65.

22. *Ibid.*, p. 77.

Fortunately, the theoretical basis for such a model already exists. There is a large and growing literature on political economy models which attempt to model redistributive policies. These models have been used to explain the pattern of provision of public goods, the pattern of the tax burden and spending policies, patterns of tariff protection, and patterns of economic regulation.

The models all proceed by dropping the assumption, so conventional elsewhere in economics, that government acts as a benevolent social welfare maximizer seeking only to correct market failure and to secure Pareto optimality. Rather, the models assume that policies are made democratically by politicians seeking to maximize their welfare by responding to constituents who maximize their own welfare. When costs of information and voting are added to such a model, the way is open for redistributive policies which will not be Pareto optimal. Some of these models (for example, McCormick and Hollison and Landes and Posner) have focussed on institutional details such as bicameral legislatures and the independent judiciary. Others (like Peltzman) have proposed models virtually devoid of institutional detail.

Of course one wishes to go beyond the recognition that in a democratic system with transaction costs redistributive policies are possible. One would like to be able to predict what groups are likely to be powerful in diverting resources to themselves, and who will bear the costs. Fortunately, some other authors considering somewhat different questions have made contributions which can be used in conjunction with these political economy models to predict public firm behavior. They permit the formulation of hypotheses about what pressure groups will act on a particular firm and which groups are likely to succeed at having their demands met.

Mancur Olson writes about the problem of when a group will form to act in the members' collective interest and when it will not.<sup>23</sup>

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23. Mancur Olson, The Logic of Collective Action: Public Goods and the Theory of Groups, Harvard University Press, Cambridge, 1965

He identifies the size of the group and the concentration of benefits as key variables. If the group is large there will be a free rider problem and the collective action will collapse, as in the case of a competitive industry unable to sustain a price above marginal cost. If the group is small or if the benefits are concentrated in a few hands, the group will be able to coalesce, as in the case of a cartel or an industry with a dominant firm.

Olson further suggests that there are two possible ways in which large pressure groups can form. They can use coercion. Or, alternatively, they can use some non-collective good as an inducement to join. In this latter instance, the group must have some monopoly power in the provision of the non-collective good in order to use it to extract rent which can be devoted to lobbying for favorable regulation, or whatever the collective good is.

Pfeffer and Salancik<sup>24</sup> develop a general model of organizational behavior which they then apply to private firms. According to their model, a firm, like any other organization, is a coalition of actors, rather than a rational entity which maximizes some objective function. Naturally, different members of the coalition which make up the organization will have demands which may conflict. The outcome of such a coalition will depend on the complex interaction of competing demands. The result will depend on the ability of each member of the coalition to press its own claims. Pfeffer and Salancik list the factors which will increase the probability

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24. Jeffrey Pfeffer and Gerald Salancik, The External Control of Organizations: a Resource Dependence Perspective, Harper and Row, New York, 1978. See especially pp. 23-28.

that a pressure group's demands on an organization will be satisfied. These factors can be summarized by saying that a pressure group will be more powerful if it has control of some resource which is important to the firm, and if the firm doesn't have control over a resource important to the pressure group.

According to this view of the firm, efficiency or inefficiency will be merely a byproduct of the balancing of competing demands. Most of the actors making the demands will find efficiency to be of only minimal interest. Rather, customers will care only about price and quality, the Treasury about profits, suppliers about the price and quantity of inputs. Even when there are actors who care explicitly about efficiency, it will be experienced simply as one more competing demand.

The literature on corporate control will be useful in analyzing which pressure groups will be most successful in achieving desirable outcomes from the public firm. The feature which makes it so useful is that it drops the assumption made in more orthodox economic models that a firm acts as a monolithic individual maximizing some objective function. Instead it recognizes that a firm is an amalgamation of individuals, each with his or her own objectives. Particular emphasis is given to how owners control managers, which should be especially useful when analyzing how the government exercises its responsibility as stockholder in public firms.

Oliver Williamson has developed and tested models where management has the opportunity to pursue its own objectives in addition to that of profit for the stockholders.<sup>25</sup> He shows that this behavior develops when external pressure on the firm to behave efficiently are weak or absent. The situation of the parastatals would seem to epitomize the lack of external pressure for efficiency.

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25. The Economics of Discretionary Behavior: Managerial Objectives in a Theory of the Firm, Prentice Hall, Englewood Cliffs, New Jersey, 1964.

More recently,<sup>26</sup> Williamson has noted that large firms are actually bureaucracies; most activity is carried out by salaried staff with no direct stake in the outcome. These large firms have been able to overcome problems of internal control in order to grow large enough to take advantage of economies of scale. Williamson devotes several chapters to these problems of internal control and how they can be overcome. Much of this material can be applied equally well to public firms.

Alfred Chandler has also examined the effects of organizational form on productivity. He has written histories of U.S. firms in which he shows how they gradually learned how to solve the control problem as they grew larger and were forced to rely on salaried managers.<sup>27</sup> He pinpoints the organizational innovations which were important in allowing firms to grow to take advantage of economies of scale. He focuses especially on how managers were made accountable for their division's performance and on the evolution of a rational division of responsibility. Chandler provides many insights into how organization affected firms' performance.

#### Conclusion to Literature Review

Existing studies of public enterprise have suffered for lack of a model of how such enterprises can be expected to behave. There exist sufficient analytical tools to construct such a model. The literature on positive theories of regulation suggests that the problem should be conceptualized as a conflict between pressure groups lobbying for income redistribution in their favor. The organizational theory literature can be used to predict what interest groups will attempt to influence the behavior of the firm. The corporate control literature will be helpful in predicting how the firm will arbitrate these conflicting demands.

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26. Markets and Hierarchies, The Free Press, New York, 1975.

27. The Visible Hand, The Belknap Press, Cambridge, 1977.



### III. Model

Each public firm is the focus of a set of pressure groups which push for policies on the part of the firm which will be favorable to them. Firm behavior can be characterized as a vector of outcomes (output prices, input prices, efficiency, profitability, etc.) some of which are of interest to each of the pressure groups. The firm's behavior will depend on the relative strength of the different pressure groups.

The most important pressure groups which act on public firms are:

- 1) consumers, who press for low prices,
- 2) suppliers of inputs, who press for high input prices and procurement from themselves,
- 3) competitors, who press for high prices, and restrictions on services offered,
- 4) management, which acts to ensure that the firm generates a continuing stream of surplus from which it will attempt to appropriate a portion for its own consumption, and
- 5) stockholders, who press for the firm to earn profits.

This model of a public firm can be used to characterize the behavior of public firms. For any particular firm it can be noted to which, if any, of the outside pressure groups the firm seems to have been particularly responsive, that is whether to consumers, input suppliers, competitors or stock holders. One can then focus on cases where the firm is seen to be improperly responsive and examine the mechanism by which pressure is exerted, with a view to strengthening or weakening them accordingly.

This model will help to focus attention on a useful set of questions, and help to avoid a number of less useful ones. In particular, in analysis of public enterprise, there is a temptation for the analyst to get caught up in analyzing where the firm has

gone wrong. Before long, the analyst is either recommending the preparation of, or actually preparing, such things as operating and forward budgets, inventory lists, accounting procedures, etc. Thus the outside analyst is, in fact, attempting to perform management's role. This is unsuitable. If the management is competent, they can perform those tasks, and with greater familiarity with the firm's operations than an outsider can hope to gain. In such a case, the analyst should be focussing on what are the incentives and constraints within which management operates, and how can they be restructured to encourage managers to do their jobs. If management is not competent, then ad hoc interventions by outsiders cannot be expected to turn around a firm's operations.

The proposed model gives a different emphasis. It encourages questions such as the following: Who are the main actors that affect an enterprise? What are their goals? To what extent have they achieved them? What mechanisms have they used? What new arrangements might change management behavior which policy makers consider undesirable? How would these new arrangements change the reward structure within which management operates?

Success in reforming the parastatal sector depends on a realistic understanding of the firm and how it responds to its environment. Policies which ignore the motivations and behavior of managers may make things even worse. For example, imagine a firm which has been running relatively well in terms of efficiency and profits. It has been retaining and reinvesting most of its profits. Now suppose it is desired that the firm should continue its operations as before, with the exception that profits should be turned over to the Treasury. If one takes an instrumental view of managers, i.e. assumes that they behave passively as instructed, without attempting to promote their own interest, the case seems

simple. One simply takes the decision on disposition of paras-  
tatal surpluses out of the hands of the Board and lodges it instead  
with the Treasury.

However, a more sophisticated analysis quickly reveals  
that the proposed change in policy causes a drastic change in the  
reward system which applies to managers. Previously managers  
had an incentive to keep costs down and service quality high because  
the resulting profits could be used for expansion. Managers derive  
prestige and power as the size of their operation expands. If  
managers are suddenly deprived of their discretion over the sur-  
plus, they may lose the incentive to generate such a surplus.  
They may appropriate it in other ways allowing costs to rise and  
service quality to fall, if the resulting repercussions are of  
no consequence to managers. Viewed in this light, it may be better  
to institute profit sharing or managerial bonuses, or some other  
scheme for transferring profits to the Treasury without vitiating  
managerial initiative.

#### IV Directions for Future Work

The chief goal is to demonstrate, based on past performance, what policies can lead to increased profitability and efficiency in the parastatal sector. The performance in the parastatal sector has not been uniformly bad, as the impression is sometimes given. By studying the differences in performance and differences in the manner of operations, within the framework of the model presented, one should be able to learn a great deal about what factors contribute to efficient and profitable performance.

No one has ever compiled a data base which would permit a systematic comparative study of parastatal performance. Therefore, the first project will be to do so. Such a data base will draw heavily on annual reports for the 25 to 30 largest parastatals, from independence or their date of inception, whichever is later, to the most recent data available. From these reports one can compile data on trends in sales, prices, costs, operating profit, net profit, employment, assets, productivity of capital and labor, debt service, sources of finance, disposition of surplus, etc.

In addition to the afore mentioned time series, one can collect information on turnover among directors and senior management. One can gather a record of major events which affect firm performance, such as border closures, changes in ownership, diversification, capital restructuring, changes in divisionalization, or changes in the responsibilities assigned by the government. One can get a feel for certain aspects in the politico-economic environment of each firm. Which firms have had continued battles over price controls? Which have pushed for and been granted high levels of protection? Which have been propped up by receiving grants of monopoly status, and which have been denied such protection? The information from annual reports can be supplemented with other data, especially data on prices of internationally traded goods.

When all this information has been assembled, an interesting and thought provoking picture of the parastatal sector should emerge. One will be able to see, for example, which firms have never been allowed to charge prices which cover their costs, and which firms are protected so that they can charge prices high above the international price. Some firms have been able to finance their expansion out of retained earnings, allowing them substantial autonomy, while other firms have carried forward losses every year, making them dependent on special loans and subventions from their parent ministry. Some firms have been more responsive to

their input suppliers than others. Some have been more profitable than others. Some have been more efficient than others.

Using such a data base, one should be able to test a series of hypotheses on control of parastatals in Kenya. For example, a common proposal for reform is to require government approval for all new investment. In Kenya some parastatals have de facto had to acquire such approval, since they are dependent on outside finance, while others have had greater freedom. What does the record show about the efficacy of requiring such project review? Other reform proposals center around constraining the salaries paid by parastatals. Some firms have offered very attractive terms of employment while others have not. Can any lessons be learned by comparing their experiences?

The data base can also be used to spotlight cases where some behaviour which is considered undesirable has persisted. Then it can be used to suggest other firms with better records on that count, so that a more detailed enquiry can be made to find the reasons for the difference. For example, some firms, even though profitable, seldom or never declare dividends, while others remit dividends regularly. What accounts for the difference in behavior? What are the likely repercussions?

While the data base should be useful in showing trends and suggesting comparisons, to take full advantage of the richness of experience available, one must use more detailed case studies. Interviews with parastatal managers and ministry officials will be used to supplement the statistical information from the data base.

### Conclusion

Previous studies have been weakened by their lack of a consistent theory of how public firms behave and how they respond to their environment. The outlines for such a model have been presented. The proposed model has two essential features: 1) Managers act strategically to further their own interests, and 2) Management arbitrates between conflicting demands from other pressure groups, each of which controls resources essential to the firm. Using this framework, the analyst can focus on the particular mechanism available to each pressure group. At present the model is skeletal. It requires numerous case studies to flesh it out. Yet it provides a useful way of making sense of the wide variety of experience within the parastatal sector. This variation in performance has previously been largely ignored by most analysts. Careful analysis of the varied performance in the parastatal sector, within the framework suggested, can reveal a great deal about what results can be expected from proposed policy reforms.

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