THE EFFECTS OF PRIVATIZATION ON FINANCIAL PERFORMANCE OF PARASTATALS IN KENYA

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DECLARATION

STUDENT'S DECLARATION

I declare that this research project is my original work and has not been presented to any other university for the award of a degree.

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SUPERVISOR'S DECLARATION

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

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DEDICATION

To my family and friends who gave their all to encourage me even on the face of difficulties that almost made me abandon the project as well as my employer Kenya Revenue Authority Rift Valley region who understood me whenever I had to be absent from work even abruptly sometimes without prior arrangements. Thank you all most sincerely**.**

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ABSTRACT

The purpose of this paper is to explore and review privatization impact on firms' Performance in Kenya .The focus of this study will be on privatization of parastatals in Kenya and the effect that privatization has had on formerly state owned firms. The theoretical part of this study will provide few definitions for privatization, and it will clarify its common requirements and methods. The empirical part of this study was conducted by using a qualitative research method. The results were based on questionnaires administered to Senior Managers of Privatized Parastatals in Kenya. The aim of this Study was to find out whether indeed privatization improved financial performance of parastatals in general. The findings of this research showed a positive impact of privatization over firms' performance and at the same time the research clarified the major and the most important factors of privatization that affected financial performance the most.

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LIST OF ABBREVIATIONS

CCK	Communications Commission of Kenya
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
JV	Joint Venture
NSE	Nairobi Stock Exchange
OECD	Organisation for Economic Co-operation and Development
SOE	State-Owned Enterprises
SPSS	Statistical Package for Social Sciences
U.S	United States (of America)

CHAPTER ONE

INTRODUCTION

1.1 Background

In the last decades, countries around the world have embarked on major privatization programs, yet many remain reluctant to privatize while still more have had to halt ongoing processes of privatization. This is particularly true in developing countries like Kenya, where State-Owned Enterprises (SOE) still account for more than 10 percent of gross domestic product, 20 percent of investment and about five percent of formal employment (Kikeri, Nellis and Shirley, 1994). The aversion to privatization appears to be associated with public distrust of the privatization process. Unions and other traditional opponents of privatization have argued that it results in layoffs and poorer services.

Privatization has a large positive impact on telecommunications performance. Privatization in general contributed substantially to labor shedding, output growth, network expansion, and improvements in labor productivity as well as total factor productivity. But how countries privatized is important. Share issue privatization is found to facilitate the development of the mobile market segment. Granting a newly privatized operator a period of exclusive access to some market segments, on the other hand, tends to reduce the size of the gains from privatization but not entirely negate the gains. The presence of competitive pressure in the market is associated with more employment, higher output, faster network expansion, and higher labor and total factor productivity.

1.1.1 Concept of Privatization

Privatization refers to the transfer of activities and assets from the public to the private sector. Today, the pace of privatization exceeds that of nationalization. Such transfers can take several forms. Privatization can also refer to liquidation; which is government sale of a state owned enterprise to the private sector, subsidization: referring to government provision of grants to non profit organizations for public services, nation building; where government franchises a private company to exclusively provide a geographical area with a certain service; and contracting out: where government retains responsibility for providing a service, but hires a private contractor to deliver it (Taylor, 1991). Privatization is usually argued to improve corporate performance in all situations (Megginson and Netter 2001; Megginson, 2005), though the situation has been less clear cut in transition economies (see Djankov and Murrell, 2002), perhaps because the institutional framework was insufficiently developed. One way to explore the relationship between privatization and institutional development more deeply is to focus on the impact of private sector development on corporate performance in an economy where institutional development has been limited.

Before the decision to privatize is made, it is vital to define success, so as to measure the impact of privatization. According to Molt (1990) successful privatization strategy should result in at least the following: a level of service at least as good as, if not better than, that provided by government; and a lower cost of service than when the service was provided by government, with a discernible trend towards even lower costs. But is there demand in the marketplace for more property ownership including its attendant risks? For privatization actions to succeed, the answer to this critical question must be yes. Investment bankers and potential purchasers assess this question. Privatization can occur by direct purchase transaction or by an Initial Public Offering (IPO). There are mutual funds that manage savings for longer term gains that need more risk. Attendant to the risk profile is the prospect for larger future gains, especially capital gains. Preferred tax treatment of mutual funds is allowable only if a threshold proportion of a fund's investments.

Privatization only becomes a deal when a state corporation is worth less to its government owner than to a private sector purchaser (Taylor, 1991). Any effort to successfully privatize a government service will depend upon: establishing strong political leadership; assuring comprehensive advance planning, with clear criteria to weigh public benefits against public costs of choosing suitable candidates for privatization; involving business and organized labour in the process of privatization initiatives; encouraging employee ownership; including a method of objectively measuring the level and cost of service before and after privatization; and beginning with companies or services that will make the easiest transition to the private sector, so that the process will be constructive, rather than disillusioning (Keller, Dogan and Eroglu, 1994).

1.1.2 Firm Performance

Firm's performance is the measure of standard or prescribed indicators of effectiveness, efficiency, and environmental responsibility such as, cycle time, productivity, waste reduction, and regulatory compliance. Performance also refers to the metrics relating to how a particular request is handled, or the act of performing; of doing something successfully; using knowledge as distinguished from merely possessing it. It is the outcome of all of the organisation's operations and strategies (Venkatraman and Ramanujam, 2001). It is also the extent to which an individual meets the expectations regarding how he should function or behave in a particular context, situation, job or circumstance. Oakland (1999) is of the view that performance is what people do in relation to organizational roles.

Performance measurement systems provide the foundation to develop strategic plans, assess an organisation's completion of objectives, and remunerate mangers (Alderfer, 2003). Although assessment of performance in the marketing literature is still very important, it is also complicated (Andersen and Segars, 2001). While consensual measurement of performance promotes scholarly investigations and can clarify managerial decisions, marketers have not been able to find clear, current and reliable measures of performance on which marketing merit could be judged (Manogran, 2001). Two approaches have been adopted in the literature to measure financial performance.

Longer term performance has been chosen for two reasons: firstly because that is what the customers of "retail" products such as unit trusts might be expected to be looking at, particularly in view of the charging arrangements which make shorter term investment unwise. Secondly, one of the attractions of looking at "real" products rather than theoretical studies is the question of how administrative costs contribute to the results. In principle, such costs might appear in either front-end or regular annual management charges. Using five-year offer-to-bid figures should capture such effects regardless of the choices of individual firms as to how to split costs between the two types of charges.

1.1.3 Relationship between Privatization and Performance

The privatization of state-owned enterprises has been among the most controversial of market reforms. The benefits of the decision to privatize a particular public sector activity vary from case to case (Khan, 1999). Privatization has helped in the increase of the efficiency of organizations since a privatized concern becomes accountable to private shareholders. This increases the pressure on the organization to reduce costs and achieve higher profits. A further utilization of resources may come about due to increased competition in the capital and the product market.

It is argued that investors in the capital market will only buy shares of the companies which are capable of using the funds thus provided most profitably. It is therefore suggested that the capital market assessment of a firm's performance is superior to the government's non-market criteria of allocating investment funds to public corporations (Hardwick, 1999). Privatization also helps to less bureaucratic interference of an organization. Public corporations are sometimes used by the government to influence the level of demand in a country by bringing forward or postponing investment programs or by interfering with their pricing policies. Such interference may lead to less efficient resource allocation. A reduction in public sector deficit is another social benefit of privatization.

Newly-privatized firms cut employment, usually reducing the roll of white and blue-collar workers by nearly half. These numbers may actually underestimate the effects of privatization, since in the years before, most companies have already trimmed payrolls in order to prepare for divestiture. These findings suggest that transfers from workers to shareholders play a role in the success of privatization. The sale of public sector assets raises revenue for the government in the year of sale and so contributes to a reduction in public sector deficit for that year. In addition the sale of those corporations that tend to earn insufficient profits to finance their investment programs will help reduce the deficit in future years though on the other hand the sale of corporations that do earn sufficient profits will tend to lead to a decrease in the budget deficit in future years (Langmead, 1999). There is threat to public interest.

Public industries have the dual responsibility: to operate in the public interest and to seek to achieve profit as commercial undertakings. Making privatized organizations directly accountable to shareholders as privatized concerns may mean less concern to their public interests responsibility (Khan, 1999). Creation of private monopolies is another of the costs of privatization. Critics maintain that privatization means in many instances a replacement of public monopolies with private ones. It can be argued that this type of industry should remain subject to some government control even when privatized.

Kenya is one of the oldest capital markets in Africa, its origins dating back to 1954. Over the last two decades there has been a significant increase in the number of capital markets in Africa. This has been driven in part by the failure of the banking system to cope with the growing demand for long term funds required to finance long term development (Aker and Mbiti, 2010). Capital markets are intended to fill this gap. The establishment of a deep and vibrant capital markets is therefore key to the achievement of socio economic development goals. However, to function efficiently and play an effective role in harnessing and mobilizing domestic and foreign capital resources, our capital market needs a critical mass of products, securities, investors, issues, institutions and intermediaries.

In the 21st Century, the telecommunication industry has evolved to become the fastest growing, competitive and the most vibrant industry in Kenya. This is mainly after the introduction of the Mobile phone services in the year 2000. Safaricom and Airtel (then Kencell) were the first companies to venture into this business. The last decade has seen the birth of Essar's Yu and Orange companies in this industry. This has consequently increased the competition among these companies which has had a positive effect on the consumer. For instance, calling costs have decreased in comparison to five years ago. In addition, the companies have had to become more innovative in order to survive and be relevant in the market (CCK, 2010). This has seen the introduction of Mobile phone money transfer, mobile phone bill payments, mobile phone banking, and many other services that have revolutionized the way we carry out business in Kenya.

1.2 Statement of the Problem

Privatization is one of the most important elements of the continuing global phenomenon of the increasing use of markets to allocate resources (Megginson and Netter, 2001). The transfer from the public to the private sector (Vickers and Yarrow, 1988) necessarily implies a change in the relationships between those responsible for the firm's decisions and the beneficiaries of the profit flows. Until recently in most countries, telecommunications service providers were state-owned, state-operated, and often operated in protected monopolistic markets (Noll, 1999).Nevertheless, there is still little empirical knowledge about how well privatization has worked. The impact of privatization is felt on profitability ratios, operating efficiency ratios, labor indicators, and capital deepening indicators. Even though the ultimate effect of changes in management incentives depends on the competitive and regulatory environment in which a given firm operates, it is argued that the degree of market competition and the effectiveness of regulatory policy has more important effects on performance than does change of ownership (Vickers and Yarrow, 1988).

The last few years has seen privatization of many state owned corporations where agencies were established to monitor and promote competition in each sector. However, the effect of privatization on performance has remained controversial with some finding negative and others a negative effect. Wallsten (2000) considers the effects of exclusivity on revenue raised from privatization and on tele-density, while McNary (2001) and Fink et al (2002) examine the effects of competition. A firm under public ownership is often under direct bureaucratic control. Politicians who control the firm often choose not to maximize the firm's profit, which is owned by the public and controlled by the treasury. While a benevolent and selfless politician may maximize social welfare, most politicians will give weights in their objective function to patronage motives—redistribution preference to favored interest groups, subsidization of loss-making public enterprises, and excessive wage and employment in public sectors (Lopez-de-Silanes, Shleifer, and Vishny, 1997; Shleifer and Vishny, 1994, 1998; and Noll, 1999). On the other hand, Ernst, Edwards, Gregory, and Holt's (1999) examination of 6 Moroccan privatized firms revealed that privatization has a negative or no effect on financial performance while Bortolotti et al (2001) in their study of source of performance improvement in privatized telecommunication firms found that privatized firms are not found to perform better that state owned ones. The study therefore seeks to establish the status at parastatals in Kenya.

Locally Mutuku (2002) factors hindering the privatization program in Kenya. His study found that lack of strong incentives, product market competition, income levels, acquisition of technical skills within the labor force, labor mobility, ownership and economies of scale hinder the process of privatization among firms in Kenya. Ng'ang'a (2003) did a comparison of the financial performance of state-owned enterprises and privatized enterprises in Kenya and concluded that privatization improves corporate performance of the privatized firms, private ownership ensured superior corporate governance via the role of external owners in monitoring managerial performance and a single minded concentration on profitability as the objective of the firms, growth in sales, employment. Further, Mwanthi (2004) carried out a study on the financial impact of privatization on Kenya Airways. The study found that there was more change in the finance and provision of assets among privatized firms. Another study was carried out by Awino in 2006 on gradual vis a vis rapid privatization and financial performance of privatized companies quoted in NSE and concluded that the gradual privatization had a gradual increase in financial performance of the privatized NSE quoted companies, while the rapid privatization is usually affected by the unstable ownership process that affects employees performance hence financial performance. This study was based on the premise that the passage of time and the very numerous and significant changes in the business environment have led to totally different operating environment after privatization. As such this study would update the existing knowledge about privatization in the new environment because the political, legal, economic and trading environments have undergone numerous changes, ushering in new challenges for businesses. This study therefore sought to investigate the impact of privatization on financial performance of parastatals in Kenya.

1.3 Objective of the Study

The objective of this study was to determine the impact of privatization on financial performance of parastatals in Kenya

1.3.1 Specific objective

The specific objectives of the study was to examine how efficiency,labour productivity as well as the firm's competitiveness changed with privatization and what effect the changes had on the financial performance of the parastatals in Kenya.

1.4 Importance of the Study

The study was important not only to the parastatals managers but also other managers in other industries.

The government ministries and policy makers may also gain knowledge of the impact of privatization on financial performance of parastatals in Kenya. The government agencies may make use of this study, as it provides complementary knowledge on privatization and firm performance and use the knowledge to develop policies that enhance positive participation of such organizations. The study aimed to bridge the gap in knowledge of the impact of privatization on financial performance of parastatals in Kenya and private organizations.

Researchers and scholars may use this information to add to their understanding of privatization in Kenya. The study was to provide foundation and material for further related research. It also introduced new comparative knowledge useful in dealing with challenges posed by the effects of privatization; this may be in the areas of relationships between privatization and firm’s financial performance.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The specific areas covered here are privatization of state-owned assets, drivers of privatization, impacts of privatization on firm performance, privatization and profitability, privatization and competition, privatization and efficiency, labour productivity and empirical review

2.2 Theoretical Review

The link between privatization and economic growth relates most directly to the microeconomic theories used to justify privatization. At the heart of this debate are theoretical perspectives on the ownership issue drawn from patronage theory, modern economic theory, work growth theory and the theory of cognitive capitalism. The key theoretical elements underpinning the argument for a change in ownership from public to private relate firstly to the view that public ownership led to the pursuit of objectives that detracted from economic welfare maximisation (Boycko, Shleifer and Vishny, 1996). Secondly, an ownership change could improve economic performance by changing the mechanisms through which different institutional arrangements affect the incentives for managing enterprises (Vickers and Yarrow, 1988; Laffont and Tirole, 1991; Cook and Fabella, 2001).

2.2.1 Patronage Theory

Patronage theory asserts that politicians have an incentive to pressure state-owned telecommunications providers to subsidize basic services. As such, effect of a full privatization on employment should be significantly higher than that of a partial privatization. Privatization, which transfers both the control rights and the residual cash-flow rights to private owners, should in principle increase labor productivity and improve input allocation in the absence of government intervention. However, private firms do frequently face government intervention.

But it is likely that private firms will face less government intervention than public ones. Sappington and Stiglitz (1987) argue that privatization increases the transaction costs of government intervention in firm decision-making. While privatization does not imply that politicians will not increase employment beyond the profit-maximizing level or subsidize loss-making firms, excessive employment and subsidization are clearly easier under public ownership.

2.2.2 Modern Economic Theory

The change in ownership alone at the microeconomic level is not sufficient to guarantee greater enterprise efficiency, then other reforms, more directly related to enterprise development, may indeed play a crucial role. If the success of privatisation is linked to competition and the regulation of competition, then weaknesses in these fields may explain why privatisation is negatively related to economic growth in developing countries. Recent reviews of competition policy in developing countries indicate fundamental weaknesses in implementation (Gray, 1991; Cook, 2001). Similarly, regimes for regulating competition in developing countries have not developed uniformly and with the same degree of effectiveness across developing countries. The share of utilities in privatisation has increased significantly in the 1990s in developing countries resulting in the creation of numerous private sector monopolies, and the need for better regulation.

The modern economic theory suggests that income distribution, plays an important role in the determination of aggregate economic activity and economic growth. The credit market imperfection approach, developed by Galor and Zeira (1993), demonstrates that inequality in the presence of credit market imperfections has a long lasting detrimental effect on human capital formation and economic development. The political economy approach, developed by Alesina and Rodrik (1994) and Persson and Tabellini (1994), suggests that inequality is harmful for economic development because inequality generates a pressure to adopt redistributive policies that have an adverse effect on investment and economic growth.

2.2.3 Work Growth Theory

Concentration of ownership is important, with majority private ownership having mostly positive effects on the firm performance. The overall positive effect is again driven primarily by foreign owned firms. The effect of majority domestic private ownership tends to be positive but smaller in magnitude. Studies that distinguish between privatized SOEs and newly created private firms suggest that de novo firms are more productive than or at least as productive as SOEs privatized to domestic owners. The effect of employee (insider) ownership on performance is found to be mostly statistically insignificant or in one case actually positive. Estimates of the effects of privatization on growth suggest that in privatization had a positive effect on the rate of change of performance in the early transition period and that the effect disappears in the later stage.

The useful work growth theory, also called the Ayres-Warr model, addresses deficiencies in the neo-classical and endogenous growth models. It claims that physical and chemical work performed by energy, or more correctly exergy, has historically been a very important driver of economic growth. Key support for this theory is a mathematical model showing that the efficiency of electrical generation is a good proxy for the Solow residual, or technological progress, that is, the portion of economic growth that is not attributable to capital or labor. The useful work theory relates the slowing of economic growth to energy conversion efficiencies approaching thermodynamic limits, and cautions that declining resource quality could bring an end to economic growth in a few decades.

2.2.4 Theory of Cognitive Capitalism

The theory of "Cognitive capitalism" asserts that cognitive ability is the crucial factor which creates wealth in modern economies, and that the geographical factors which have been necessary in ancient societies are no longer so important. The average cognitive ability of a nation determines its wealth, each IQ point increase boosting a country's average GDP by $229. Of even more significance, the IQ of the brightest 5% of people in the nation (the cognitive elite) boosts GDP by $468 per IQ point. The cognitive elite support general efficiency, technological innovation, efficient administration, independent institutions, and economic freedom. Via these factors intelligence and knowledge stimulate growth leading to national wealth, which in turn may boost cognitive ability in a virtuous circle.

Privatization has been the global phenomenon of the twentieth century. Privatisation is the transfer of ownership and control from the public to the private sector with particular reference to asset sales (Walle, 1989). In the 1980s and 1990s a major, worldwide shift was witnessed from the public to the private sector, motivated by strong evidence to support the positive effect of privatization. D'Souza and Megginson (1999) stated that transfer of government ownership to private ownership was a significant determinant of SOE performance improvement. In addition, Sheshinski and Calva (2003) asserted that the objectives of privatization are to achieve higher allocation and productive efficiency, strengthen the role of the private sector in the economy, and to improve the public sector's financial health. Obirih-Opareh and Post (2002) noted that privatization has become the political creed of the 1990s. One can say, however, that from the literature on privatization, many countries are equipped to make the privatization of SOEs a success and that the overall result has tended to be positive, simply because those countries followed the correct process of privatization

Privatization of state enterprises is often viewed as a necessary condition for improved corporate performance. Boylaud and Nicoletti (2000), focusing on the subset of 23 OECD countries in the 1990s, find that privatization had little effect, while competition helped improve service quality. Petrazzini and Clark (1996) find that in a sample of 26 developing countries, deregulation and privatization increased tele-density. Bortolotti, D'Souza, Fantini, and Megginson (2001) look at 25 countries and focus on the impact of a specific type of privatization share issue privatization. Fink, Mattoo and Rathindran (2002) examine the sample of developing countries. More comparable in data to our analysis, McNary (2001) covers over 200 countries between 1987 and 1998 and considers the effects on network penetration from privatization and competition for both fixed and mobile phone segments.

Nationalized telephone companies typically employed far more workers than were necessary. Employment per unit of output was extremely high, even after adjusting for the lower productivity of workers in poor countries. One cause was the use of nationalized enterprise for patronage, but another cause was the perverse incentive structure that the budget process created for managers of nationalized entities. Whereas the budgetary process could starve capital investment funds without much short-term consequence, it could not starve operating funds to pay salaries without creating an immediate political backlash. Hence, the budget process gave managers an incentive to substitute labor for capital, which, in a capital-intensive industry like telecommunications, is extremely inefficient.

Privatization, especially when accompanied by complementary reforms, may have a positive effect on the level of aggregate output or economic growth. However, one of the most widely debated issues of transition (János Kornai, 2001), namely the effect on aggregate output and growth of rapid privatization (frequently accompanied by dispersed ownership) versus slower privatization (often with more concentrated ownership) remains unresolved.

2.2.5 Drivers of Privatization

It has been argued that when there are externalities and economies of scale and scope, privatization might worsen performance without proper regulation to internalize the externalities or increase productivity and profitability at the expense of neglecting non-profit objectives (such as universal service). But rapid technological innovations in the past three decades have significantly reduced economies of scale and scope in this sector, attenuating the economic rationale for state-owned natural monopoly in the telecommunications sector (Noll, 1999). In addition, externalities and universal services may be handled by regulation. For instance, the regulator can require private operators to fulfill certain universal service goals, which would likely be fulfilled since the more efficient private operators would have deeper pockets. Indeed Wallsten (2001b) finds evidence that private operators were better providers of universal services than public operators during the early last century. A potentially powerful pattern of privatization is developing in around the world. In part, this is because there is so much to privatize. Britain led the shift to privatization in the 1980s (Richardson, 1990). Other governments undertook privatization initiatives starting in the 1980s, ebbing by 1990 and then accelerating in the late 1990s (Hardin, 1989).

The body politic includes those that believe virtually all activities ought to be in the private sector, conceding perhaps defence, policing, and the courts. It is taken as self evident that superior wealth generation will include spinoffs that look after social needs to an acceptable level. Osborne and Gaebler (1992) caution that privatization is one answer, but not the entire answer". They note that business does some things better than government, and government does some things better than business. Ideology can be a powerful imperative towards privatization, usually seeking a substantial change in mix of economic activities.

This is the most difficult driver for privatization proponents. It is very hard to argue that private sector activity is more accountable to the public than government control. While public benevolence can be argued, it also must be recognized that shareholder interests must be the top priority; pragmatic considerations also should give higher priority to customers and employees. Accountability advantages of public ownership erode when there is political abuse such as patronage appointments to boards of governance. Whether valid or not, there is understandable anxiety about undue political influence in what should be commercial business decisions. The key point on accountability is for private sector corporations and business to earn the trust and credibility of the public (Taylor, 1991). A further strategy is to recognize that the accountability driver contains risks; this driver should not be allowed to be isolated, but rather to be bundled with winning drivers such as efficiency and financing (Richardson, 1990).

This is a winning driver for privatization over nationalization. Despite the best of intentions, for many reasons public sector decision making is slower and less certain to actually decide. Politically motivated intentions make it even worse at times. The advantage of private sector decision making is magnified when decisions must be larger, quicker and risk laden to keep up with changes in the modern global economy. A further efficiency advantage of privatization is that when government has fewer things to do, it has the opportunity to do each and all of them better (Richardson, 1990). Pursuing the strategy of bundling efficiency with accountability, a strong case can be made that society is better off when policy reality recognizes both considerations.

Financing is both a driver towards a policy of nationalization and a policy of privatization. Financing of projects or enterprises incorporates risk taking, and in the past some governments assisting with financing would choose outright ownership. Often the path to such nationalization would result from government having greater financial capacity than the private sector. Today government decision making is severely constrained by debts and deficits. Taylor (1991) is of the view that privatization can offer some relief from government financial pressures. There are three aspects to the financing driver. One is that the private sector may be in a stronger position to finance enterprises that should go forward in the larger interest of society. Another is that removal of contingent liabilities can improve credit rating and permit cheaper future financing.

The final aspect is that privatization, via whole or partial disposition of state owned assets can provide revenues to the cash strapped public sector.

2.3 Empirical Review

David (2000) defines firm performance as the total economic results of the activities undertaken by an organization. Primary dimensions of business performance could be grouped into the three categories of effectiveness, efficiency, and adaptability. But there is little agreement as to which measure is best. Thus, any comparison of business performance with only these three dimensions involve substantial trade-offs: good performance on one dimension often means sacrificing performance on another (Deane et al, 1991). Organizational performance is measured using an instrument developed by Gupta and Govindarajan (1984) and Govindarajan (1988), which measures organizational performance along multiple dimensions, rather than on any single dimension. Organizational performance can be achieved through four dimensions of customer satisfaction: competitive pricing, product variety, delivery service, and product quality. Empirical research has indicated that service companies, which satisfy their customers by focusing on the preceding four dimensions of customer satisfaction, actually enhance their level of overall business performance. These four dimensions have also been identified as important criteria in supplier selection. It is plausible that effectual selection and evaluation of suppliers and promoting their involvement in critical supplier chain activities will result in improved firm performance via enhanced customer satisfaction (Terziovski and Amrik, 2000).

Earlier surveys of firm-level studies examining the effects of privatization on firm performance range from ones that find a large variation of outcomes but no systematically significant effect of privatization on performance (Bevan, Estrin and Schaffer, 1999) to those cautiously concluding that privatization improves firm performance (Megginson and Netter, 2001), to ones that are fairly confident that privatization tends to improve performance (Mary Shirley and Patrick Walsh, 2001; and Djankov and Murrell, 2002). This variation in the interpretation of results is brought about in part by the fact that the early studies had access to different and often somewhat limited data on firm performance and ownership. For these reasons, many studies treat ownership as a relatively simple categorical concept and some are often unable to distinguish the exact extent of ownership by individual owners or even relatively homogeneous groups of owners.

2.3.1 Privatization and Profitability

The effect of privatization on performance has been estimated and shows a positive effect of owners on profitability levels in the early as well late transformation periods, together with an insignificant effect of privatization to owners on the rate of growth of profitability. The effect varies across types of ownership, and concentrated private ownership, managerial ownership, and to a lesser extent foreign ownership tend to have a positive effect on profitability, while state keeping a golden share or concentration of worker ownership appear to be unrelated to profitability. The studies of private ownership on profit of firms vary considerably in terms of methodology sample size and findings, with most indicating a positive and usually significant effect. The standard argument for privatization is that in most circumstances private ownership leads to the best possible economic performance of firms. Attempting to measure the contribution of an ownership change on economic growth is complicated by the fact that economic performance is likely to be affected by factors that affect the wider economic environment in which privatised enterprises operate.

Privatisation is often accompanied in developing countries by changes in economic policies that affect economic growth. If privatization was sufficiently extensive and had efficiency inducing effects then the contribution of improved performance could be detected at the macroeconomic level. Privatization would reduce crowding out and provide more credit to the private sector. There is threat to public interest. Public industries have the dual responsibility: to operate in the public interest and to seek to achieve profit as commercial undertakings. Making privatized organizations directly accountable to shareholders as privatized concerns may mean less concern to their public interests responsibility (Khan, 1999). Creation of private monopolies is another of the costs of privatization. Critics maintain that privatization means in many instances a replacement of public monopolies with private ones. It can be argued that this type of industry should remain subject to some government control even when privatized.

Privatization can also affect the monitoring of managerial efforts. Given politicians' lack of profit motives, it is not surprising that managers of public enterprises face less incentive to reduce costs since they cannot capture the cost savings directly. In general, politicians may lack strong incentives to monitor enterprise management, as Vickers and Yarrow (1991) argue, if their political fortunes are not very sensitive to the overall performance of state-owned enterprises. Under private ownership, managers may face stronger incentives to reduce costs and to innovate. Because of the higher incentives to innovate and to save costs, we expect the telecommunications sector to have higher total factor productivity after privatization.

2.3.2 Privatization and Competition

More important, privatization without a simultaneous introduction of competition will simply create private monopolies interested in extracting monopoly rents by restricting output. Most economists therefore argue that privatization works best where there is competition limiting the market power of the incumbent(s) (Yarrow (1986), Kay and Thompson (1986), and Vickers and Yarrow (1998)). Competition is thus seen as a complement to privatization.

Competition can be a force that affects—and most likely improves—performance in its own right. To begin with, market competition tends to weed out inefficient firms under the assumption that firms face hard budget constraints. The ex ante threat of bankruptcy may compel existing operators to be leaner and more efficient so as to minimize the probability of a corporate failure. Since state-owned firms rarely operate under hard budget constraints, the positive impact of market competition on performance is more likely to be present in privatized firms, further suggesting a complementarily between privatization and competition.

Competition also makes it possible for the principal of a telecommunications service provider and the regulator to compare the firm's performance against that of its competitors. With more information to infer managerial efforts, the principal can write a better incentive contract for the managers, and the regulator can design and implement regulations more efficiently and more transparently (Holmstrom, 1982b; Nalebuff and Stiglitz, 1983; Hart,1983). Performance is therefore expected to improve with competition. In addition, as market competition makes managerial efforts more observable, managers should face added incentives from the managerial labor market to improve firm performance so as to protect their reputation and human capital (Holmstrom, 1982a; Meyer and Vickers, 1995).

Not every model of competition, however, predicts productivity improvement. Schumpeter, for instance, suggests that firms with more market power face less uncertainty, have a larger cash flow, and can fund R&D and innovations more readily (also Levin, Cohen, and Mowery, 1985). But in countries that have developed and sophisticated financial markets, new entrants may be able to fund the development and the adoption of new technology. To the extent that new entrants are more likely to adopt new and cheaper technologies and the incumbent has ample stranded assets in old technology, competition is likely to change the composition of the sector in favor of new technology, and therefore leads to higher productivity.

2.3.3 Privatization and Efficiency

Historically SOEs were established to ensure political control of production, better provision of public goods, more effective ways of dealing with externalities, spearheading of economic development in the absence of "well functioning" markets, and guaranteeing full employment and equitable income distribution. The economic performance of many SOEs proved disappointing, however, and since the early 1980s privatization started to be advocated as a means of establishing clear property rights, providing economic incentives and stimulating superior economic performance of firms and economies at large (Bernardo Bortolloti and Domenico Siniscalio, 2004). One argument for privatization is that firms under central planning are inefficiently large and their divestitures, combined with privatization, constitute a desirable way to improve corporate performance (Jan Hanousek, Evžen Kočenda and Svejnar, 2008). Another argument for privatization stresses the fact that the objectives imposed by the state as owner in SOEs are not necessarily consistent with profit maximization (Saul Estrin and Virginie Perotin, 1991). The politicization of enterprise decision-making may also open firms up to lobbying and unproductive rent seeking (Shleifer and Vishny, 1994, 1997).

Even if the state as owner seeks to maximize the profits of its firms, problems of corporate governance may still lead to inferior performance. Outside owners – whether private or state – do not have full information about corporate performance, so firmspecific rents may be appropriated by the managers. However, private ownership may place more effective constraints on managers' discretionary behavior, via high-powered incentives for managers (Randall Morck, Shleifer and Vishny, 1989) or through the operation of the market for corporate control (Schleifer and Vishny, 1997), though if ownership is dispersed, owners may face a free rider problem in which the individual returns to monitoring by each owner are less than the costs (Shleifer and Vishny, 1997).

The weak monitoring of managers by the state and the absence of external constraints often enabled SOE managers to gain discretion and follow their own objectives (Estrin, 2002). In much of continental Europe, greater emphasis has traditionally been placed on bank debt than equity, with governance exercised via board membership of the controlling owners. This approach has also developed in a number of transition economies. However, in many developing economies as well as in some developed countries, family and business group ownership remains predominant, and though the ownership structures are typically highly concentrated, this ownership form is argued to impair company performance relative to outsider ownership structures (Morck, Daniel Wolfenzon and Bernard Yeung, 2005). This is relevant for transition economies because, privatization has led to the emergence of diversified business groups owned by individuals. Though preliminary evidence suggests that business groups may actually be more efficient that other privatized companies in Russia and Ukraine (Guriev and Andrei Rachinsky, 2005; Yuriy Gorodnichenko and Yegor Grygorenko, 2008).

Firms in transition economies also suffered the incentive problems caused by the softness of budget constraints (Kornai, 1990, Mathias Dewatripont, Eric Maskin and Roland, 2000; Kornai, Maskin and Roland, 2003), with poorly performing firms often being granted easier access to external investment funds than the better performing ones (Lubomír Lízal and Svejnar, 2002). This led analysts to stress that hardening of budget constraints should be a priority and could be achieved most effectively by breaking the link between firms and the state through privatization. The imposition of hard budget constraints on SOEs will not induce strategic restructuring because entrepreneurial incentives associated with outside investor will still be absent. This relates to the incomplete contracts ideas of Oliver Hart and John Moore (1988) that have been used to argue that state managers tend to make routine decisions whereas private owners would engage in non-routine decisions and stimulate entrepreneurship. In the presence of external shocks, privatized firms are hence thought to move more readily into new markets and product lines and hence be less likely to lay off workers than SOEs. This suggests that privatization might only be effective when control shifts to new owners, who are thereby able to change the managers. Delayed privatization can undermine the performance of the SOEs, since in this situation the incentives of managers become to seize assets or to tunnel them out, rather than to improve performance (Johnson, Rafael LaPorta, Florencio Lopez-de-Silanes, and Shleifer, 2000).

Perhaps the main caveat to the efficiency arguments in support of private ownership concerns the welfare dilemmas when private firms provide public goods and/or have natural monopoly power (Jean-Jacques Laffont and Jean Tirole, 1993). If firms have monopoly power, privatization can be harmful even if productive efficiency of a firm increases, unless there are adequate regulatory controls or sufficiently rapid entry (also Edward Glaeser and José Scheinkman, 1996). Monopoly power also creates a dilemma for the state as owner in a privatization process; firms that are privatized with monopoly power can be sold for higher prices than if the company is broken up to create a more competitive market structure. Similarly, if corporate governance provisions for private firms are lax, company assets may be stolen and misallocated.

2.3.4 Labour Productivity

Productivity can be measured in a number of ways. It is the level of output produced for a given level of inputs. Labour productivity is one of the most common ways of looking at productivity, analysing changes in output in terms of labour inputs. The definition of output itself can vary. There is a presumption that privatization and liberalisation will lead to an improvement in productivity growth. The change in ownership is assumed to provide new incentives to increase output and reduce costs as managers respond to the pressures imposed by the company's shareholders rather than what might be the broader social and political aims of the national or municipal governments that set priorities under public ownership. In that sense improved efficiency, cost reduction and profit maximisation become the focus of management activity and it goes almost without saying that privatization should lead to an increase in productivity if the organisation is no longer constrained to meet various social and political objectives. The debate then shifts to the value of those other objectives and the extent to which the change in ownership was a necessary cndition to achieve the change in focus.

Among a number of aims of the privatisation of public enterprises (Megginson et l., 1994; Villalonga, 2000; Megginson and Netter, 2001; Sheshinski and Lopez-Calva, 003 for the theory of privatisation) the most important is the presumption that privatization and liberalisation will lead to increased efficiency, or productivity. The change in ownership is assumed to provide new incentives to increase output and educe costs as managers respond to the pressures imposed by the company's shareholders rather than what might be the broader social and political aims of the ational or municipal governments that set priorities under public ownership. In that ense improved efficiency, cost reduction and profit maximisation become the focus of anagement activity and it goes almost without saying that privatisation should lead to n increase in productivity if the organisation is no longer constrained to meet various ocial and political objectives.

Privatisation strategy results in new laws, decisions and regulations to enable companies to more easily interact with foreign companies. This interaction generates an increase in the resources needed for economic growth. Manpower plays an important part in the application of these resources, and is becoming central for both developed and developing countries. In this context, there are numerous mechanisms through which manpower may be developed to use new technology in order to improve its capability some of these mechanisms are, joint venture (JV), foreign direct investment (FDI), trade in goods, licensing, and movement of people (Ofori, 1994; Kumar, 1999). Joint venture mechanism will be targeted as important vehicles of technology transfer, and the means by which can develop manpower capability in the house building industry. Ofori et al (2002) stated that there is scope for local and foreign firms to collaborate for the mutual benefit, for example through joint ventures which have been effective technology transfer vehicles.

2.4 Empirical Studies

The basic economic argument given for privatization states that governments have few incentives to ensure that the enterprises they own are well run. One problem is the lack of comparison in state monopolies. It is difficult to know if an enterprise is efficient or not without competitors to compare against. Another is that the central government administration, and the voters who elect them, have difficulty evaluating the efficiency of numerous and very different enterprises. A private owner, often specializing and gaining great knowledge about a certain industrial sector, can evaluate and then reward or punish the management in much fewer enterprises much more efficiently. Also, governments can raise money by taxation or simply printing money should revenues be insufficient, unlike a private owner.

Empirical studies on the impact of privatization on the financial performance and operating performance confirm that privatization can be beneficial. D'Souza and Megginson (1998), state in their paper that privatization works in almost every institution examined. In their study they found that out that there was a significant improvement in performance in both statistical and economic terms after privatization. Private ownership is more beneficial for an economy and society than public ownership (Bogdanovicius, 2000). This is because there is less incentive for government to aim for efficiency and public property for solving day-to-day political issues. Privatization contributes to treasury and most likely helps to kick start the economy by encouraging local participation in investments, property rights protection, promoting government policies relative improvement in credibility.

Kenya embraced privatization like most developing countries as a means of improving the performance of SOEs and a requirement by the World Bank and IMF. After Kenya's independence in 1963, the establishment of the parastatals was driven by a national desire to Accelerate economic social development and Redress regional economic imbalances, in addition to this the other motives for establishing parastatals was to Increase Kenyan Citizen's participation in the economy and Promote indigenous entrepreneurship and lastly to Promote foreign investments through joint ventures. This desire was expressed in the Sessional Paper No. 10 of 1965 on African Socialism and its application to planning in Kenya.

Weche (2005) performance is relative and needs to be viewed in a broader perspective decline in overall performance is possible even when the company is improving its ability to utilise its assets to generate sales. Therefore managers of privatised companies shouldn't be judged only by looking at overall financial performance but also at other indicators of performance. Gikanga (2008) All stakeholders in privatization process must have an extreme proclivity for acting as the privatization happens faster and deeper in organizations when people are persuaded by its meaning and feat passionate about success. That is for privatization to be effective all stakeholders have to positively work towards it.

Boit (2008) concluded that trading on the stock exchange is an instrument for privatization since the exchange has provided on an avenue of liberation of sectors previously dominated by the government and facilitated public divestiture of its shares in PE. Mwanthi (2004) says that privatization did provide a turning point in the performance of Kenya Airways, which prior to privatization was on the verge of collapse.

Mutuku (2002) carried out a study on factors hindering the privatization program in Kenya. His study found that lack of strong incentives, product market competition, income levels, acquisition of technical skills within the labor force, labor mobility, ownership and economies of scale hinder the process of privatization among firms in Kenya. Ng'ang'a (2003) did a comparison of the financial performance of state-owned enterprises and privatized enterprises in Kenya and concluded that privatization improves corporate performance of the privatized firms, private ownership ensured superior corporate governance via the role of external owners in monitoring managerial performance and a single minded concentration on profitability as the objective of the firms, growth in sales, employment.

Further, Mwanthi (2004) carried out a study on the financial impact of privatization on Kenya Airways. The study found that there was more change in the finance and provision of assets among privatized firms. Another study was carried out by Awino in 2006 on gradual vis a vis rapid privatization and financial performance of privatized companies quoted in NSE and concluded that the gradual privatization had a gradual increase in financial performance of the privatized NSE quoted companies, while the rapid privatization is usually affected by the unstable ownership process that affects employees performance hence financial performance. No study so far has investigated the effects of privatization on financial performance of parastatals in Kenya.

2.5 Summary

With the privatization of British Telecom and the introduction of competition in the U.S. long distance telephone services, the late 1980s and 1990s witnessed the most dramatic policy reforms the telecommunications world had ever seen. 2 National carriers were privatized, new competitors licensed, and new services allowed. More than 150 countries introduced new telecommunications legislation or modified existing regulations. In 1980, only two percent of telecommunications operators in 167 countries had private owners. The privatization trend was part of a global movement towards liberalization in this sector as countries introduced competition, especially in the mobile telecommunications segment. The monopoly-based system of service supply, which dominated the world's telecommunications markets for over three-quarters of the last century, gave way to competitive supply in many markets.

Though there has been much theoretical and empirical research on the effects of privatization on performance in general, relatively little empirical work has been done on how the privatization affects performance and how components of these privatizations interact with the outcomes of the various firm before and after the reform. The current study is based on the premise that no known local study has ever investigated the effects of privatization of parastatals in Kenya hence the expectations of their financial performance after privatization are worth documenting.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

This chapter sets out various stages and phases that were followed in completing the study. It involved a blueprint for the collection, measurement and analysis of data. This section is an overall scheme, plan or structure conceived to aid the study in answering the raised research question. In this section the research identifies the procedures and techniques that were used in the collection, processing and analysis of data. Specifically the following subsections are included; research design, target population, data collection instruments, data collection procedures and finally data analysis.

3.2 Research Design

Research design is the scheme, outline or plan that is used to generate answers to research problems. It is an overall plan for research undertaking. A descriptive cross-sectional design method was preferred for this study as it offered the researcher the methodology to investigate the relationship between privatization and financial performance using a multivariate based analysis from a surveyed data. The method is chosen since it is more precise and accurate since it involves description of events in a carefully planned way (Babbie, 2004). This research design also portrays the characteristics of a population fully (Chandran, 2004). The research design was both quantitative and qualitative with the aim of determining the relationship between the independent variables and dependent variable.

3.3 Target Population

Target population in statistics is the specific population about which information is desired. According to Ngechu (2004), a population is a well defined or set of people, services, elements, events, group of things or households that are being investigated. The target population composed of the 153 parastatals in Kenya. For purpose of this study the target population included the various privatized parastals spreading through the 12 sectors including Financial Services, Water Conservation, Education and education services, Energy, Transport and

Communication, Health and Welfare, Hotel and Tourism, Trade and investment, Agriculture, Dairy and fisheries, Development Authority and others. Mugenda and Mugenda (1999) explain that the target population should have some observable characteristics, to which the study intends to generalize the results of the study. This definition assumes that the population is not homogeneous.

Table 3.1: Target Population

Category	Population	Percentage
Financial Services	11	7
Water Conservation	13	8
Education and education services	19	12
Energy	9	6
Transport and Communication	15	10
Health and Welfare	15	10
Hotel and Tourism	13	8
Trade and investment	14	9
Agriculture	24	16
Dairy and fisheries	7	5
Development Authority	6	4
Other	7	5
Total	**153**	**100**

3.4 Sampling Procedure

Sampling techniques provide a range of methods that facilitate to reduce the amount of data need to collect by considering only data from a sub-group rather than all possible cases or elements. A population frame is a systematic list of subjects, elements, traits, firms or objects to be studied. From the population frame the required number of subjects, respondents, elements, firms are selected in order to make a sample. Sampling ensures that some elements of a population are selected as riding representative of the population this was according to Keya et al., (1989). Purposive sampling technique was used to select a sample of 35 parastatals (appendix III). Cooper and Schindler (2006) argue that if well chosen, samples of about 10% of a population can often give good reliability. The study collected data from the chief finance officers from the privatized parastatals since they are the ones conversant with the impact of privatization on financial performance of parastatals in Kenya. Owing to the big number of target population and given the time and resource constraints, the sampling of at least 30 elements is recommended by Mugenda and Mugenda (1999).

3.5 Data Collection

The main focus of this study was qualitative approach. The researcher used primary data. Primary data was collected using semi structured questionnaires.

For the purpose of this study, the researcher used a semi structured questionnaire as the primary data collection tool. The questionnaire was structured to include both closed, open-ended and matrix questions to allow variety. The structured questions are normally close ended with alternatives from which the respondent is expected to choose the most appropriate answer (Mugenda & Mugenda, 2003). Unstructured questions are open-ended and present the respondent with the opportunity to provide their own answers. These types of questions are easy to formulate and allow the respondent to present their feelings on the subject matter enabling a greater depth of response (Mugenda & Mugenda, 2003). Matrix questions were also utilized. This type of questions present the respondent with a range of questions against which they are expected to respond based on a predetermined rating scale. The most commonly used is the likert scale. These types of scales are used to measure perceptions, attitudes, values and behaviour (Cooper & Schinder, 2007). These types of questions are popular with the respondents and researchers as they are easy to fill in, economical and provide easy comparability. The questionnaire was administered to finance officers of the privatized parastatals using a drop and pick later method.

3.6 Data Analysis

Before processing the responses, the completed questionnaires were edited for completeness and consistency. Descriptive statistics were used to summarize the data. This included percentages and frequencies. All quantitative data on impact of privatization on financial performance of parastatals was measured in real values by normalizing. Descriptive statistics was used to measure the quantitative data which was analyzed using the SPSS. Tables and other graphical presentations as appropriate were used to present the data collected for ease of understanding and analysis. The researcher used the data with an aim of presenting the research findings in respect to impact of privatization on performance of parastatals. This generated quantitative reports through tabulations, percentages, and measure of central tendency. Cooper and Schindler (2003) notes that the use of percentages is important for two reasons; first they simplify data by reducing all the numbers to range between 0 and 100. Second, they translate the data into standard form with a base of 100 for relative comparisons.

In addition multiple regression was used to measure the quantitative data which was analyzed using the SPSS. Multiple regression is a flexible method of data analysis that may be appropriate whenever quantitative variables (the dependent) is to be examined in relationship to any other factors (expressed as independent or predictor variable). Relationships may be non-linear, independent variables may be quantitative or qualitative and one can examine the effects of a single variable or multiple variables with or without the effects of other variables taken into account (Coben, Cohen, West and Aiken, 2003).

For this study, the researcher was interested in measuring the impact of privatization on financial performance of parastatals in Kenya. The factors of performance of the parastatals are X(n) (independent variables) and dependent variable is Y.

The regression equation is:

$$Y= \beta_0+ \beta_1X_1+\beta_2X_2+ \beta_3X_3 +\alpha$$

Where Y is the dependent variable (financial performance), β_0 is the regression coefficient, β_1, β_2, and β_3 are the slopes of the regression equation, X_1 is the labour productivity independent variable, X_2 is the competition independent variable and X_3 is the efficiency independent variable, while α is an error term normally distributed about a mean of 0 and for purpose of computation, the α is assumed to be 0. The equation was solved by the use of statistical model where SPSS was applied.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Introduction

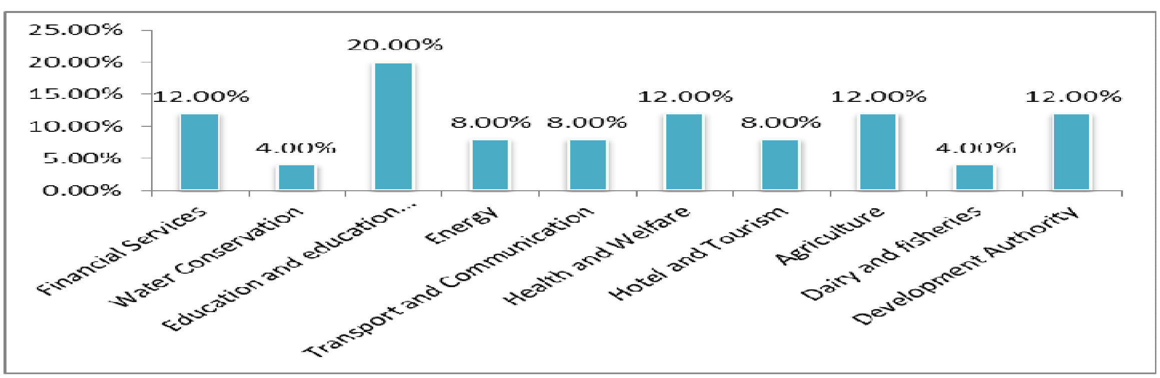
This chapter presents analysis and findings of the study as set out in the research methodology. The results were presented on the effects of privatization on financial performance of parastatals in Kenya. The study targeted 35 respondents out of which 31 respondents responded to the study contributing to the response rates of 88.6%. This response rates were sufficient and representative and conforms to Mugenda and Mugenda (2003) stipulation that a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent. This commendable response rate was due to extra efforts that were made via personal visits to request the respondents to participate in the study. The chapter covers the demographic information, and the findings are based on the objectives. The study made use of frequencies on single response questions. On multiple response questions, the study used Likert scale in collecting and analyzing the data whereby a scale of 5 points were used in computing the means and standard deviations. These were then presented in tables, graphs and charts as appropriate with explanations being given in prose.

4.2 Background information

Sector that the organization belong to

The study sought to establish the sector that the organization that the respondents worked belonged to.

Figure 4.1 Sector that the organization belong to

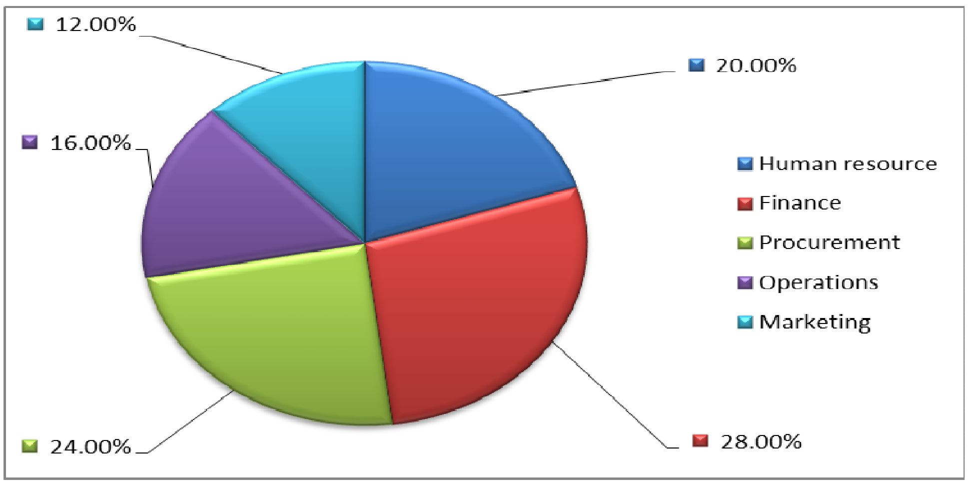


From the findings, the study established that 20% of the respondents were from education and education services, 12% from development authority, 12.0% from agriculture, 12.0% from health and welfare, 12.0% from financial services, 8.0% from energy, transport and communication or hotel and tourism. In addition 4.0% of the respondents were from dairy and fisheries or water conservation. This shows that there are most of the respondents worked in the parastatals based in education and education services, development authority, agriculture, health and welfare and financial services.

Department that the respondent worked in

The respondents were required by the study to indicate the department that they worked in.

Figure 4.2 Department that the respondent worked in

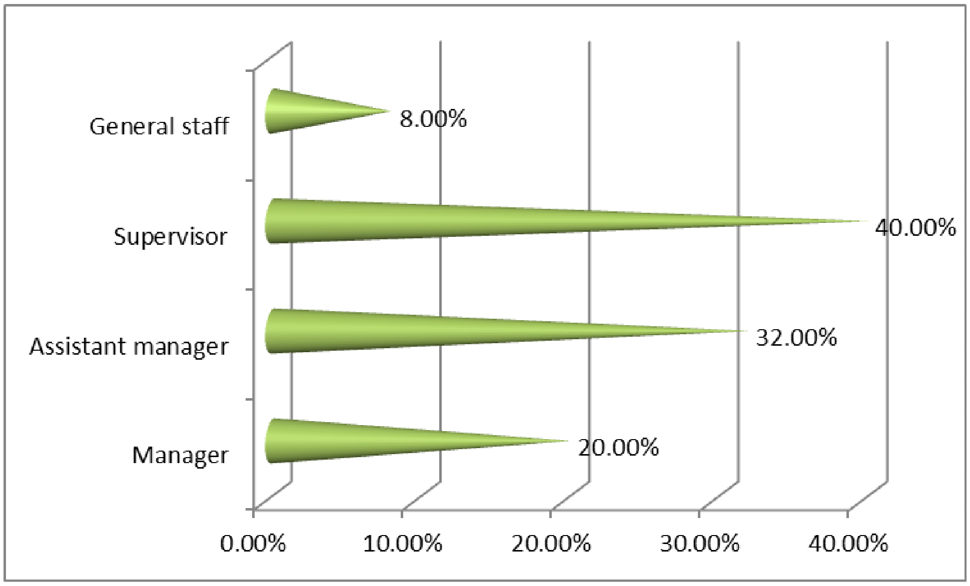


According to the findings, 28.0% of the respondents were from finance, 24.0% from procurement, 20.0% from human resource, 16.0% from operations while 12.0% were from marketing. This depicts that most of the respondents worked in the finance and procurement departments and thus they gave credible information on effects of privatization on financial performance.

Respondents' designation

The respondents were further requested to indicate their designation

Figure 4.3 Respondents' designation

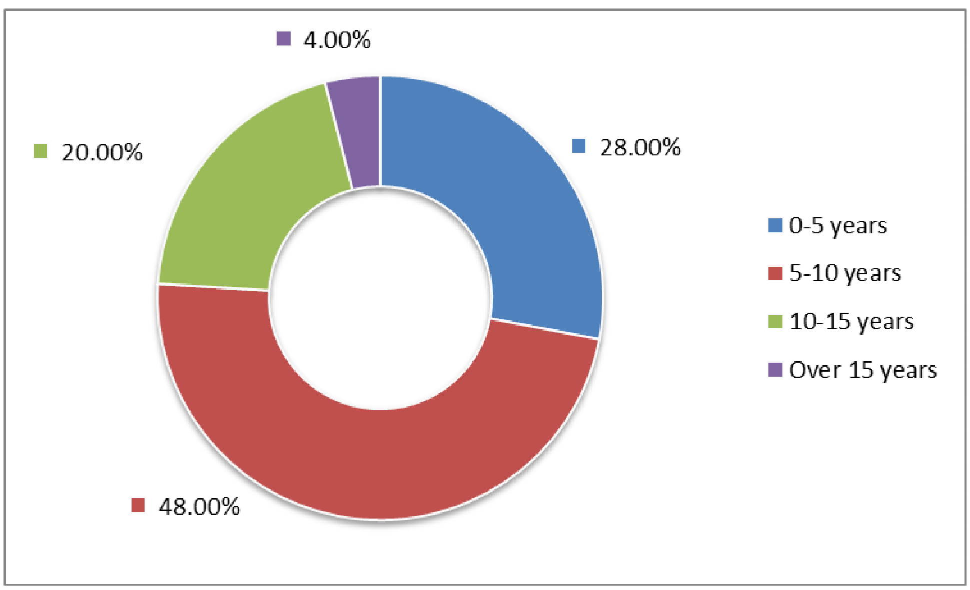


From the findings, 40.0% were supervisors, 32.0% were assistant manager, 20.0% were manager while 8.0% were general staffs. This depicts that the respondents were well trained in their worked as reflected by their designations in the company.

Duration of time the company has been privatized

The study sought to establish the the duration that the company has been privatized

Figure 4.4 Duration of time the company has been privatized



According to the findings, most of the companies (48.0%) had been privatized for 5-10 years, 28.0% for 0-5 years, 20.0% for 10-15 years while 4.0% had been privatized for over 15 years. This illustrates that parastatals had been privatized for a long period of time and were stable organizations.

4.3 Effects of privatization on financial performance

In order to further establish the effects of privatization on financial performance, the respondents were requested to rate the extent to which various aspects of privatization affects the profitability of the firm. The responses were rated on a five point Likert scale where: 1- No extent at all, 2- Little extent, 3- Moderate extent, 4- Great extent and 5-Very great extent. The mean and standard deviations were generated from SPSS and are as illustrated in table 4.3 below.

Table 4.2 Effects of privatization on financial performance

	Mean	**Std. Deviation**
Share of ownership	3.2400	1.33167
Managerial ownership	4.0400	.78951
Development policies	4.0000	1.25831
Concentration of worker ownership	3.8400	.89815
Monitoring of managerial efforts	3.6800	1.28193

From the study findings, the majority of the respondents agreed that the various aspects of privatization that affected the profitability of the firm to a great extent were managerial ownership (M=4.0400) development policies (M=4.0000), concentration of worker ownership (M=3.8400) and monitoring of managerial efforts (M=3.6800) respectively.

Effects of privatization on profitability of parastatals

The study sought to establish the effects of privatization on profitability of parastatals. The respondents were requested to indicate their level of agreement with various statements on the effects of privatization on profitability of parastatals. The responses were rated on a five point Likert scale where: 1= strongly disagree, 2-disagree, 3-moderately agree, 4-agree and 5=

strongly agree. The mean and standard deviations were generated from SPSS and are as illustrated in table 4.3 below.

Table 4.3 Effects of privatization on profitability of parastatals

	Mean	Std. Deviation
Privatization helped reduce worker crowding in the firm	3.1600	1.06771
Privatization reduced political interests in the firm	3.6000	1.32288
Under private ownership, managers face stronger incentives to reduce costs and to innovate.	3.7600	.72342
Because of the higher incentives to innovate and to save costs, the company now has higher profits	3.7200	1.24231

From the findings, the majority of the respondents agreed that under private ownership, managers face stronger incentives to reduce costs and to innovate (M=3.7600), because of the higher incentives to innovate and to save costs, the company now has higher profits (m=3.7200), and that privatization reduced political interests in the firm (m=3.6000) while they were neutral on the fact that privatization helped reduce worker crowding in the firm (M=3.1600) respectively.

4.4 Competition

In order to further establish the privatization and its effects on competition of the companies in Kenya, the respondents were requested to rate aspects of privatization and its effects on competition. The responses were rated on a five point Likert scale where: 1- Not at all, 2- Little extent, 3- Moderate extent, 4- Great extent and 5-Very great extent. The mean and standard deviations were generated from SPSS and are as illustrated in table 4.3 below.

Table 4.3 Statements about privatization and its effects on competition of the companies in Kenya

	Mean	Std. Deviation
Privatization ensured that there is competition limiting the market power of the incumbent	3.3600	1.25433
Market competition reduces the inefficient firm under budget constraints	3.6000	1.04083
Competition makes it possible for the principal of the Firm and the regulator to compare the firm's performance against its competitors	3.4400	.86987
Due to market competition, managers of the privatized firm face added incentives to improve firm performance so as to protect their reputation and human capital	4.0400	.84063
Competition led to change of the composition of the sector and adoption of new technology	3.8800	.92736

From the findings, the majority of the respondents agreed that due to market competition, managers of the privatized firm face added incentives to improve firm performance so as to protect their reputation and human capital (M=4.0400), Competition led to change of the composition of the sector and adoption of new technology (M=3.8800), Market competition reduces the inefficient firm under budget constraints (M=3.6000), Competition makes it possible for the principal of the Firm and the regulator to compare the firm's performance against its competitors (M=3.4400), Privatization ensured that there is competition limiting the market power of the incumbent (M=3.3600) respectively.

4.5 Efficiency

The study sought to establish extent to which organizational aspects affect the efficiency of the firm since its privatization. The respondents were requested to indicate their level of agreement with various organizational aspects affect the efficiency of the firm since its privatization. The responses were rated on a five point Likert scale where: 1- Not at all, 2- Little extent, 3- Moderate extent, 4- Great extent and 5-Very great extent. The mean and standard deviations were generated from SPSS and are as illustrated in table 4.3 below.

Table 4.5 Aspects that affect the efficiency of the firm since its privatization

	Mean	Std. Deviation
Provision and control of service delivery	3.4400	1.19304
Employment policies	3.5200	.91833
Income distribution	3.6400	.86023
Corporate governance	3.9600	.73485
Technological advancements	4.4000	.70711
Managerial competences	4.3600	.56862

From the findings, the majority of the respondents agreed that the organizational aspects that affect the efficiency to a great extent were technological advancements (M=4.4000), managerial competences (M=4.3600), corporate governance (M=3.9600), income distribution (M=3.6400), employment policies (M=3.5200) and provision and control of service delivery (M=3.4400) respectively.

4.6 Labour productivity

The study further sought to establish the effect of labour productivity of parastatals in Kenya. The respondents were requested to rate the various aspects of labour productivity in their company. The responses were rated on a five point Likert scale where: 1= strongly disagree, 2-disagree, 3-moderately agree, 4-agree and 5= strongly agree. The mean and standard deviations were generated from SPSS and are as illustrated in table 4.3 below.

Table 4.6 Labour productivity

	Mean	Std. Deviation
The change in ownership provide new incentives to increase output of the privatized firms	3.6400	1.11355
Privatization reduce costs as managers respond to the pressures imposed by the company's shareholders rather than the broader social and political aims of parastatals	3.6800	.94516
Privatization strategy resulted in new laws, decisions and regulations to enable companies to more easily interact with foreign companies	3.4800	1.26227
The interaction with foreign companies generated an increase in the resources needed for economic growth	3.9600	.61101
Competitive hiring in privatized firm results to new pool of creative and innovative ideas which increase productivity	4.3600	.70000

From the findings, the majority of the respondents agreed that competitive hiring in privatized firm results to new pool of creative and innovative ideas which increase productivity (M=4.3600), the interaction with foreign companies generated an increase in the resources needed for economic growth (M=3.9600), privatization reduce costs as managers respond to the pressures imposed by the company's shareholders rather than the broader social and political aims of parastatals (M=3.6800) and that the change in ownership provide new incentives to increase output of the privatized firms (M=3.6400) respectively. In addition, the majority of the respondents agreed to a moderate extent that privatization strategy resulted in new laws, decisions and regulations to enable companies to more easily interact with foreign companies (M=3.4800).

4.7 Regression Analysis

The researcher conducted a multiple regression analysis so as to test relationship among variables (independent) on the financial performance. The researcher applied the statistical package for social sciences (SPSS V 17.0) to code, enter and compute the measurements of the multiple regressions for the study.

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (financial performance of parastatals in Kenya) that is explained by all the three independent variables (competition, efficiency and labour productivity).

4.8 Summary and Interpretation of Findings

The study found that that the most significant effects of privatization on profitability of parastatals were that; under private ownership, managers face stronger incentives to reduce costs and to innovate, because of the higher incentives to innovate and to save costs, the company now has higher profits, and that privatization reduced political interests in the firm, and that privatization helped reduce worker crowding in the firm respectively.

The study deduced that due to market competition, managers of the privatized firm face added incentives to improve firm performance so as to protect their reputation and human capital, competition led to change of the composition of the sector and adoption of new technology, market competition reduces the inefficient firm under budget constraints, competition makes it possible for the principal of the Firm and the regulator to compare the firm's performance against its competitors, and that privatization ensured that there is competition limiting the market power of the incumbent respectively.

The study established that the organizational aspects that affect the efficiency to a great extent were technological advancements, managerial competences, corporate governance, income distribution, employment policies and provision and control of service delivery respectively.

The study deduced that competitive hiring in privatized firm results to new pool of creative and innovative ideas which increase productivity, the interaction with foreign companies generated an increase in the resources needed for economic growth, privatization reduce costs as managers respond to the pressures imposed by the company's shareholders rather than the broader social and political aims of parastatals and that the change in ownership provide new incentives to increase output of the privatized firms respectively.

The study established that competition contribute most to the financial performance followed by efficiency and labour productivity respectively.

4.8.1 Model Summary

The three independent variables that were studied, explain only 84.5% of the financial performance as represented by the R^2. This therefore means that other factors not studied in this research contribute 15.5% of the financial performance. Therefore, further research should be conducted to investigate the other factors (15.5%) that affect financial performance of parastatals in Kenya.

Table 4.7 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.919	0.845	0.789	0.6273

4.8.2 ANOVA Results

The significance value is 0.0179 which is less than 0.05 thus the model is statistically significance in predicting how competition, efficiency and labour productivity affect the financial performance of parastatals in Kenya. The F critical at 5% level of significance was 3.23. Since F calculated is greater than the F critical (value = 9.475), this shows that the overall model was significant.

Table 4.8 ANOVA

Model		**Sum of Squares**	**df**	**Mean Square**	**F**	**Sig.**
1	Regression	2.534	2	1.267	9.475	.0179[a]
	Residual	9.307	40	2.327		
	Total	**3.465**	**42**			

4.8.3 Coefficient of Determination

Multiple regression analysis was conducted as to determine the relationship between financial performance of parastatals in Kenya and the three variables. As per the SPSS generated table above, the equation

$Y= \beta_0+ \beta_1X_1+\beta_2X_2+ \beta_3X_3 +\alpha$ becomes:

$Y= 0.680+0.549X_1+0.385X_2+0.124X_3+\alpha$

According to the regression equation established, taking all factors into account (competition, efficiency and labour productivity) constant at zero financial performance will be 0.680. The data findings analyzed also shows that taking all other independent variables at zero, a unit increase in competition will lead to a 0.549 increase in financial performance, a unit increase in efficiency will lead to a 0.385 increase in financial performance while a unit increase in labour productivity will lead to a 0.124 increase in financial performance. This infers that competition contribute most to the financial performance followed by efficiency and labour productivity respectively. At 5% level of significance and 95% level of confidence competition had a 0.001 level of significance, efficiency showed a 0.106 level of significance while labour productivity showed a 0.504 level of significance. Hence the most significant factor is competition.

Table 4.9 Coefficient of determination

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	0.680	1.259		0.540	0.595
	Competition	0.549	0.143	.638	3.853	0.001
	Efficiency	0.385	0.228	.303	1.688	0.106
	Labour productivity	0.124	0.182	.120	0.680	0.504

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	0.680	1.259		0.540	0.595
	Competition	0.549	0.143	.638	3.853	0.001
	Efficiency	0.385	0.228	.303	1.688	0.106
	Labour productivity	0.124	0.182	.120	0.680	0.504
a. Dependent Variable: Under private ownership, managers face stronger incentives to reduce costs and to innovate.						

The major studies that were chosen as a reference for this paper showed that privatization has a general positive impact on firms' performance. In the study conducted by Megginson, Nash, and Randerborgh, Profitability and output increased significantly for the privatized firms in developing countries, and at the same time, Leverage declined significantly for firms operating in developing countries. However the increase in efficiency is insignificant for privatized firms operating in developing countries. In the other study conducted by Boubakri and Cosset, Profitability, output, employment, and dividends increased significantly for all newly privatized firms in developing countries. However the efficiency increased significantly for upper middle income developing countries only. In the third study led by D'Souza and Megginson, profitability, efficiency, output, and dividend increase significantly for privatized firms operating in developing countries, while capital investments increased insignificantly and leverage declined significantly. The surprising result of the last study is that employment rate declined after privatization. However the decline is insignificant, and this due the fact that one third of D'Souza, Megginson firms' sample are from regulated utilities (electricity and telecommunication firms).

The findings of this study appear to reinforce those of previous studies and therefore suggest that privatization though with its challenges has a strong positive impact on firm's performance in Kenya.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The study, the results of which this section summarizes, constituted a major phase of the research project, which was aimed at assessing the impact of privatization in public firms in Kenya. As part of this research, the study looked into the impact of these processes by examining three independent variables of competition, efficiency and labour productivity and how their change with privatization affected the profitability of the firm. The study analyzed the findings and concluded that the three independent variables changed differently affecting profitability differently.

However, the three independent variables that were studied, explained only 84.5% of the financial performance as represented by the R^2. This therefore means that other factors not studied in the research contributed 15.5% of the financial performance. Therefore, the study will recommend further research on the other factors (15.5%) that affect financial performance of parastatals in Kenya.

The study established that the organizational aspects that affect the efficiency to a great extent were technological advancements, managerial competences and corporate governance, income distribution. The study further deduced that competitive hiring in privatized firm results to new pool of creative and innovative ideas which increase productivity. The study finally concluded that competition contribute most to the financial performance followed by efficiency and labour productivity respectively.

This study revealed that the most significant aspects of privatization that affected the profitability of the firm were managerial ownership, development policies, and concentration of worker ownership and monitoring of managerial efforts respectively.

5.2 Conclusions

Few public policies have moved in and out of fashion in such pendulum-like manner as privatization. The cyclical process of privatization and nationalization has long been recognized

and even predicted: Private provision of utility services eventually leads to conflicts over prices and what is a "reasonable" return on investment. The government then responds with more

strenuous intervention and regulation, which eventually decrease returns—causing private operators to quit the market or governments to take over the service. What follows is populist

pricing, insufficient investment, and a failure to sustain reform short of ownership, leading to problems of both quantity and quality of service—and provoking once more the increasing involvement of the private sector, first as managers and financiers, and finally as owners. And the cycle begins anew.

This study concluded that privatization affected the profitability of the firm through managerial ownership, development policies, and concentration of worker ownership and monitoring of managerial efforts respectively. The study also deduced that under private ownership, managers face stronger incentives to reduce costs and to innovate and that privatization reduced political interests in the firm.

The study also concluded that due to market competition, managers of the privatized firm face added incentives to improve firm performance so as to protect their reputation and human capital, competition led to change of the composition of the sector and adoption of new technology and that privatization ensured that there is competition limiting the market power of the incumbent. The study established that the organizational aspects that affect the efficiency to a great extent were technological advancements, managerial competences and corporate governance, income distribution. The study further deduced that competitive hiring in privatized firm results to new pool of creative and innovative ideas which increase productivity. The study finally concluded that competition contribute most to the financial performance followed by efficiency and labour productivity respectively.

5.3 Policy Recommendations

The study recommends that management of parastatals should fully support the adoption of new technology which will help to streamline the privatization efforts and achieve a higher financial performance.

The study recommends that parastatals management should seek to increase managerial competences through continuous training of the management personnel for them to guide the privatization efforts successfully and achieve a higher financial performance.

The study recommends that parastatals management should seek to reduce the operational costs of the parastatals to gain a higher financial performance of the organizations.

The study also recommends that the Kenya Government should put more emphasis on monitoring the provision of public services and rigorously and without prejudice evaluate the impacts of liberalization and privatization. The knowledge and experience of consumer protection groups and organizations should be used to establish adequate institutions and processes. Both monitoring and evaluation should include independent experts from a variety of academic disciplines because impacts are not only economic. The output of monitoring and evaluation activities should feed in regulation policies and enable policy makers to make informed decisions about the future of public services in Kenya

Leaving the regulation of service provision to the forces of the market bears risks because, among other things, the liberalization process was only modestly successful with respect to enhancing competition. Instead of focusing on particular aspects of the supply chain, regulation should cover various aspects of service provision in order to make sure that services are easily accessible, affordable and of high quality and to ensure they will remain so for future generations (which requires an adequate amount of investments). Regulation should guarantee equal conditions for all, in terms of access, quality and price.

5.4 Limitations of the study

This study was conducted over privatized parastatals in Kenya in general, and the findings are quite general and may not be suitable for a particular parastatal or firm and due the fact that each parastatal has its own history and culture, suitable privatization conditions and practices may vary between firms.

Another point of restriction is that the international and local studies which have been used as empirical evidence in this study have been conducted between the years 1980-1999 and the information and data which have been used are relatively old.

The other limitation of the study was due to the dispersed nature of the respondents sampled, the researcher was not able to be present in person to administer the questionnaire to the respondents. A drop and pick later method was therefore adopted. Accordingly, it was not possible to establish whether the senior managers of the organization targeted were actually the ones who filled the questionnaires.

The researcher was faced by time and financial resource constrains that meant quantitative data for all privatized parastatals sampled before and after privatization could not be reviewed and analyzed to gain hindsight into the actual impact privatization had on the firms and to compare the same with the qualitative data obtained.

5.5 Suggestions for Further Research

Since this study explored the effects of privatization on financial performance of parastatals in Kenya, the study recommends that;

Further studies should be done on the role of management in privatization of parastatals in Kenya. Management play a very important role in providing information that assist policy makers in terms of the decision to privatize as well as the methods to adopt. This role should be studied to identify how it affects the process and thereafter the performance of the firm after privatization.

As much as privatization was largely found to improve financial performance, the study does recommend that methods of privatization and the policies adopted by the state in doing so be evaluated to find out whether this would affect the extent of impact the privatization would have on the firm.

A study should also be conducted on the challenges facing privatization of parastatals in Kenya. The challenges Identified could be included in the policy paper recommending privatization and this perhaps could be taken into account while undertaking privatization.

A basic question for both policy makers and the public is "why privatize?" Important answers, which must be evaluated, based on economic reasoning and the facts of the case are,

Does privatization raise revenue for the government? Does it improve competitiveness in the industry? And does it improve corporate governance? The researcher recommends that these areas be studied further.

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APPENDICES

Appendix I: Letter of Transmittal

I am an MBA student at the University of Nairobi and in my final year of study. As part of the requirement for the award of the degree of Master of Business Administration, I'm undertaking a research on **THE IMPACT OF PRIVATIZATION ON PERFORMANCE OF PARASTATALS IN KENYA.**

In this regard, I'm kindly requesting for your support in terms of time, and by responding to the attached questionnaire. Your accuracy and candid response will be critical in ensuring objective research.

It will not be necessary to write your name on this questionnaire and for your comfort and confidentiality, all information received will be treated in strict confidence. In addition, the findings of the study will surely be used for academic research purposes and to enhance knowledge in the field of privatization.

Thank you for your valuable time on this.

Yours faithfully

Ambrose Ageng'a.

MBA Student

University of Nairobi

Appendix II: Questionnaire for Management Staff

THE IMPACT OF PRIVATIZATION ON FINANCIAL PERFORMANCE OF PARASTATALS IN KENYA

Kindly answer all the questions to the best of your ability. Indicate with a tick or filling in the space(s) provided.

SECTION A: RESPONDENT DETAILS

1. In which sector does this organization belong to?

Financial Services	[ ]	Water Conservation	[ ]
Education and education services	[ ]	Energy	[ ]
Transport and Communication	[ ]	Health and Welfare	[ ]
Hotel and Tourism	[ ]	Trade and investment	[ ]
Agriculture	[ ]	Dairy and fisheries	[ ]
Development Authority	[ ]	Other	[ ]

2. Your department:

Human resource	[ ]	Finance	[ ]
Procurement	[ ]	Operations	[ ]
Marketing	[ ]	Other (Specify……………………)	[ ]

3. What is your designation?

Manager	[ ]	Assistant manager	[ ]
Supervisor	[ ]	General staff	[ ]
Other (Specify……………………)	[ ]		

4. How long has this Company been privatized?

0-5 yrs	[ ]	5-10 yrs	[ ]
10-15	[ ]	Over 15 yrs	[ ]

SECTION B: EFFECTS OF PRIVATIZATION ON FINANCIAL PERFORMANCE

5. To what extent do the following aspects of privatization affect the profitability of this firm? Rate on a scale of 1 to 5 where 1= no extent, 2= little extent, 3= moderate extent, 4= great extent and 5 is to a very great extent.

Aspects of privatization that affect the profitability	1	2	3	4	5
Share of ownership					
Managerial ownership					
Development policies					
Concentration of worker ownership					
Monitoring of managerial efforts					
Others (Specify……………………………………………..)					

6. What is your level of agreement with the following statements about the effects of privatization on profitability of parastatals? Use a scale of 1 to 5 where 1 is strongly disagree, 2 is disagree, 3 is neutral, 4 is agree and 5 is strongly agree.

Statements about the effects of privatization on profitability	1	2	3	4	5
Privatization helped reduce worker crowding in the firm					
Privatization reduced political interests in the firm					
Under private ownership, managers face stronger incentives to reduce costs and to innovate.					
Because of the higher incentives to innovate and to save costs, the telecommunication company now has higher profits					
Others (Specify……………………………………………..)					

COMPETITION

7. What is your level of agreement on the following statements about privatization and its effects on competition of the companies in Kenya? Use a scale of 1 to 5 where 1 is strongly disagree, 2 is disagree, 3 is neutral, 4 is agree and 5 is strongly agree.

Privatization and its effects on competition of the telecommunication companies	1	2	3	4	5
Privatization ensured that there is competition limiting the market power of the incumbent					
Market competition reduces the inefficient firm under budget constraints					
Competition makes it possible for the principal of the Firm and the regulator to compare the firm's performance against its competitors					

Due to market competition, managers of the privatized firm face added incentives to improve firm performance so as to protect their reputation and human capital					
Competition led to change of the composition of the sector and adoption of new technology					
Others (Specify……………………………………………..)					

EFFICIENCY

8. To what extent do the following organizational aspects affect the efficiency of the firm since its privatization? Use a scale of 1 to 5 where 1= no extent, 2= little extent, 3= moderate extent, 4= great extent and 5 is to a very great extent.

Organizational aspects that affect the efficiency of the firm	**1**	**2**	**3**	**4**	**5**
Provision and control of service delivery					
Employment policies					
Income distribution					
Corporate governance					
Technological advancements					
Managerial competences					
Others (Specify………………………………………………..)					

LABOUR PRODUCTIVITY

9. Privatization lead to increased level of output produced for a given level of inputs. In the light of this statement, what is your level of agreement with these statements about the effects of privatization on labour productivity in your firm? Use a scale of 1 to 5 where 1 is strongly disagree, 2 is disagree, 3 is neutral, 4 is agree and 5 is strongly agree.

Privatization and Labour Productivity	**1**	**2**	**3**	**4**	**5**
The change in ownership provide new incentives to increase output of the privatized firms					
Privatization reduce costs as managers respond to the pressures imposed by the company's shareholders rather than the broader social and political aims of parastatals					

Privatization strategy resulted in new laws, decisions and regulations to enable companies to more easily interact with foreign companies					
The interaction with foreign companies generated an increase in the resources needed for economic growth					
Competitive hiring in privatized firm results to new pool of creative and innovative ideas which increase productivity					
Other (Specify…………………………………………………………..)					

THANK YOU!

Appendix III: List of Privatized Parastatals in Kenya

1. Chemilil Sugar Company
2. Consolidated Bank of Kenya
3. East African Breweries (EABL)
4. East African Portland Cement Company Limited
5. Industrial & Commercial Dev. Corporation (ICDC)
6. Industrial Development Bank
7. KCB
8. Kenya College of Communications
9. Kenya Dairy Board
10. Kenya Electricity Generating Company (KenGen Ltd.)
11. Kenya Ferry Services ltd.
12. Kenya Film Commission
13. Kenya National Assurance (2001) Limited
14. Kenya Petroleum Refinery
15. Kenya Pipeline Company
16. Kenya Port Authority (KPA)
17. Kenya Post Office Savings Bank
18. Kenya Power & Lighting Company
19. Kenya Railways Corporation (KRC).
20. Kenya Re-Insurance Corp.
21. Kenya Utalii College
22. Kenyatta International Conference Centre Corporation
23. Mumias Sugar Company
24. National Sports Stadia Management Authority
25. National Bank of Kenya
26. National Cereals and Produce Board (NCPB).
27. New Kenya Co-operative Creameries Ltd
28. Numerical Machining Complex
29. Nzoia Sugar Company

30. Postal Corporation of Kenya
31. Telecommunications company (TELKOM) Kenya Ltd.
32. The Co-operative Bank
33. The East African Portland Cement Company (EAPCC)