THE EFFECT OF EXPANSION PROJECTS ON THE FINANCIAL PERFORMANCE OF AIRLINE COMPANIES

A CASE STUDY OF KENYA AIRWAYS

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November 2013
DECLARATION

This research project is my original work and has not been submitted to any other institution of learning for the award of any academic certificate.

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DEDICATION
I gratefully dedicate this research work to my dear wife, Elizabeth and my lovely sons Festus Somo and Kennedy Kena for their enormous support during my study. Special thanks to my parents, Mr. Malgis Nabosu and Mrs. Sadia Nabosu for their prayers and moral support.
ACKNOWLEDGEMENTS

I owe my sincere gratitude to all individuals who assisted and supported me during the time I worked on this research proposal. First I am grateful and proud of my dear parents, brothers and sisters for the unyielding encouragements, financial and moral support.

Secondly I am indebted to my advisor and supervisor Mr. Herick Ondigo and my research moderator Mr. Mirie Mwangi for their invaluable input, support, patience, encouragement and guidance in conducting, presenting and successfully completing my research work.

Finally I wish to offer my utmost thanks to God the Almighty for giving me the strength, health, sound mind and blessings. To all that I may not have specifically mentioned but who have contributed to making the successful, Thank you.
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<tr>
<td>EAA</td>
<td>East African Airways</td>
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<tr>
<td>ERP</td>
<td>Enterprise Resource Planning</td>
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<tr>
<td>IATA</td>
<td>International Air Transport Association</td>
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<td>KLM</td>
<td>Royal Aviation Company.</td>
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<td>KQ</td>
<td>Kenya Airways</td>
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<tr>
<td>NP</td>
<td>Net profit</td>
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<td>ROA</td>
<td>Return on Asset</td>
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<td>ROE</td>
<td>Return on Equity</td>
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<td>ROI</td>
<td>Return on Investment</td>
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ABSTRACT
The study sought to establish the effect of expansion projects such as thirty one numbers of fleets, cargo volumes, passenger growth, overhead costs, direct expenditures and operating leases on financial performance. The case study was adopted for Kenya Airways Company for the period of 10 years (2002 to 2011). Secondary data was collected for the purpose of this study and descriptive statistics were used to analyze the data by way of means, standard deviations, correlation analysis, multiple regression analysis, F and T tests. The study shows a negative relationship between direct expenditure, overhead costs, operating lease rental and the profit of Kenya Airways. This is to mean that, an increase in direct expenditure and overhead costs will lead to a decrease in profits and vice versa.

The study also found a positive and significant relationship between number of aircraft fleets, cargo volumes, passenger numbers and financial performance of Kenya Airways. This is to mean an increase in aircraft fleets, cargo volumes and passenger numbers would increase the company’s profitability and vice versa. These findings are in line with Homsombat, Fu, and Sumalee (2010) who examined changes in productivity and cost competitiveness of France carriers and through a regression analysis they identified key factors that led to such changes; they revealed that expansion enabled many carriers to improve productivity levels above the industry's average. The study concluded that there is need to create strong positive and negative correlation between the expansion project and financial performance in order to create profitability of the organization. The outcome of the study was beneficial to the Kenya Airways and provides managers with some perspective to see value of the expansion project. The study recommends policy decisions to shield external shocks that affect financial performance and further research on the impact of expansion project on other mode of transport in order to appreciate and relate to economic growth and development of the country.
CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

Airline industry has always been famous for its continuous struggle: cutting costs, managing fluctuating demand, keeping up with tight quality requirements while trying to maintain superior services and satisfy needs of various customer groups. Customer satisfaction has been on very low levels for decades, and e.g. According to American Customer Satisfaction Index, airline industry score slowest out of 47 other industries (CNN.com, Airlines score lowest in customer satisfaction, 2011). However, the demand for air transportation has been stable and despite current economic crisis and such events as September 11, the grow theched 7.8% in 2011 (Datamonitor, 2011).

In this struggling environment, airlines are forced to shift their focus towards customer oriented service quality through devising expansion projects (Chang & Yeh, 2002). It is extremely important for airline companies not only to understand the perception of passengers of their service offerings, but as well find out what customers expect from the services (Chen & Chang, 2005) and what kind of services customers consider most important. In the airline industry, services are composed of very complex mix of intangibles as the airlines sell not physical objects but performances and experiences (Gursoy et al., 2005). Thus, service quality is a key to attract and keep loyal customers (Liou & Tzang, 2007; Chang & Yeh, 2002).

1.1.1 Expansion Projects

Delivering superior service quality by understanding customer expectations by airline companies is a key for success and survival in very hectic and competitive environment of airline industry (Gilbert & Wong, 2003; Chen & Chang, 2005). High level of expansion in projects is vital to acquire and retain loyal customers (Chang & Yeh, 2002).

Airline industry is widely discussed and bad performance is often criticized publicly. The rate of mishandled baggage reached 6.5 per 1000 passengers in 2006 and on-time arrival rates dropped significantly (Tiernan et al., 2008/1) in US. In EU, several measures have
been taken to improve projects and more rights in case of delayed or cancelled flights to compensate for failure of an airline to deliver good service. Since then, the number of complaints has decreased as the customers have felt more power over their own flight experience (Tiernan et al., 2008).

Projects expansion in Europe in 1990s and in US in the end of 1970s has changed the view on service quality. Prior to it, service quality was seen as such managerial variable as flight frequency, load factors, and aircraft type (Tiernan et al., 2008). Nevertheless, in today’s liberalized industry, a focus of projects expansion has shifted towards customer satisfaction and loyalty, which leads to improved competitive advantage. As service quality is more visible, passengers may use it as a basis for judging the overall quality of an airline (Rhoades & Waguespack, 1999).

According to Carlzon (1987), the only true assets of the airlines are their customers. Carlzon former CEO of SAS, who led the company from near bankruptcy to profitable and successful customer-oriented carrier within just two years, speaks about the importance of customer orientation as a prerequisite for business development and profitability. Being successful in what Carlzon calls ‘moment of truth’ (i.e. a first contact of a customer with an airline, remote or personal, which forms customer impression of the airline) that defines customer experience as well as creates customer loyalty. Furthermore, he states that the quality of services depend on this first encounter greatly, and highlights the power of front line employees in creating and shaping customer experience and perception. Babbar & Koufteros (2008) agree with Carlzon, stating that the most visible service to the customers is the service that contact employees provide. As Zomerdijk & Vries (2007) definite it, customer contact is a direct encounter between a customer and a service provider that takes place at the same time, but not necessarily in the same place, and has an opportunity for interaction. In this study, service- and performance-related attributes will be addressed. Service quality is a cornerstone to efficiency and through efficiency to profitability (Carlzon, 1987). According to Parasumaran et al. (1991), continuously providing consistent, reliable and fair services is a key to achieve customer loyalty.
As Gliatis & Minis (2007) say, a service is a sequence of processes; and each of those processes generates a different value for a service in question. The value of each service process depends on service attributes (characteristics) as well as the way the process accounts for these attributes. Similarly, Chen & Chang (2005) define airline service experience as a chain of services, each service is made of a series of processes. Here, a service process is divided into ground and in-flight services (sub-processes), and whereas Chen and Chang (2005) suggest that both have to be evaluated separately (which they do in their article), a customer is not very likely to differentiate between them. Thus, in this study, a service process is a descriptive service process from a customer’s perspective, a process that converts inputs to outputs through service steps that each customer takes when using air transportation. Service process consists of sub-processes, each of sub-processes contributing towards a service in question.

Tickets purchasing happens mostly online or through travel agencies. However, call centers still exist, and often it is possible to purchase the ticket or at least ask questions there. For the purposes of this research, it can be assumed that the ticket purchase happens without direct contact with the airline and the first contact with a carrier happens at the check-in. Even a decade or two ago this was completely different. According to Carlzon (1987) the key aspect of service experience, called ‘moment of truth’ was the first encounter of the customer with the company’s front line employees (or, more precisely, first 15 seconds of it) – in case of ticket purchase, it was a phone call to make a booking. With the introduction of online booking process became much easier: information is available 24/7 and the customer is able to freely choose between a variety of offers with different prices, timings, etc. Thus, now it becomes harder for an airline to compete with the others when it is so easy to compare various offers.

Nowadays there are a number of services offered before the flight; however, they vary greatly by the airline. For example, email or text message reminder has become rather common to be sent a day before the flight or when the online check-in is open (usually 36 or 24 hours before the flight). In addition, in many cases airlines offer their clients the opportunity to bring their luggage a day in advance, e.g. Finnair (Taloussanomat.fi, 2012). Furthermore, such services as parking facilities are important. It should be easy for
a passenger to find parking lot and conveniently get to the airport from there. Ease of other transportation options is also valuable. A great example of convenient transportation services to/from the airport is ViennaInternationalAirport, where a passenger can get by two types of trains, buses to a number of locations in Vienna as well as extensive taxi services (ViennaAirport.com, 2012).

Check-in services have witnessed major makeovers over the last decade – from what has started as over-the-counter face-to-face interaction, now is almost fully is enabled by technology. Whilst in many places regular check-in is still available (smaller airports, leisure destinations), there are options to check-in online, via text message or via check-in machines at the airport. For example, Finnair has phased out traditional check-in completely on economy and leisure flights (HS.fi, February 2012), which may create complications for not-so-frequent flyers. However, such changes in infrastructure affect service quality perceptions as well as change expectations of service performance (Chang & Yang, 2008).

As Rendeiro & Cejas (2006) state, airport infrastructure affects customer perception of service quality. Airport services are services that occur after check-in and end at the boarding. Airport provides such services as security check, duty free shopping, meal services etc. There may or may not be airline lounge or only airport own lounges. Airport services may also include such services as tourist information, currency exchange kiosks, connections to nearby hotels, etc. Also, communication via such channels as email or Facebook to inform the customers about the delays or potential queues can be done by the airports.

Normally, passengers do not spend much time at the airport; however, in some cases such as on transit intercontinental flights, passengers may have to spend several hours at the airport. In such event, range of services needed by passengers is broader, and, in addition to such basic things as toilets, cafeterias and shops, travelers may need showers, places to take a nap, use their computer etc. Naturally, smaller local airports have much more limited services, compared to international airports with lots of traffic.
Services onboard have evolved recently, with introduction of in-flight shopping and developing technology that led to introduction of interactive audio and video entertainment system. For example, offering broad entertainment opportunities such as music, TV programs, language courses, books, games on its intercontinental flights (KLM.com, 2012/1). In short haul flights entertainment possibilities are usually limited and some airlines provide e.g. free newspapers, own magazines, online shopping etc. Another factor at arrival stage is post-arrival services such as lost luggage services, help upon arrival (Westwood et al., 2000), etc. The key component here is mishandled luggage (lost, broken, missing, or delayed) (Gilbert & Wong, 2003). The airline focuses on passenger growth, increasing fleet and expanding cargo business and internally controlling direct and overhead expenditures.

1.1.2 Financial Performance

There are many different ways to measure financial, but all measures should be taken in aggregation. Some of the indicators of financial performance are Return on Equity (ROE), Return on Asset (ROA), Return on Investment (ROI), leverage ratios and market value ratios along with their variability as measures of risk. The idea behind these measures is to evaluate managerial performance how well a firm’s management is using the assets to generate accounting returns per amount of investment, assets or sales.

Return on equity (ROE) is a frequently used variable in judging top management performance, and for making executive compensation decisions. ROE can be used as a measure to judge performance and calculate the average return on equity (AROE). ROE is defined as net income (income available to common stockholders) divided by stockholders equity. The coefficient of variation (CV) gives us the risk per unit of average return (Jonathan 1994).

Return on Asset (ROA) is the most frequently used performance measure in previous studies. It is define as net income (income available to stockholders), divided by the book value of total assets (Hendric and Elaine 2009). Market return (MKTRET), is another measure of performance. MKTRET is computed for a calendar year by taking the
difference between the current year’s ending stock price and previous year’s ending price, adding to it the dividends paid out for the year, then dividing the result by the previous year’s ending price (Brown and Marcus 2004). Net profit also referred to as bottom line, net income or net earnings is a measure of a profitability of a company after accounting for all costs.

1.1.3 Effect of Expansion Projects on Financial Performance

Any project begins with the planning decision. In general, measures of productivity are computed as the ratio of the change in output to the change in inputs used to produce them and thus evaluate an entity's production process. Diewert and Nakamura (2005) suggest envisioning the production process as a black box” that takes in inputs on one side and produces outputs that are sold on the other. Productivity measures how well the black box turns quantities of inputs into quantities of outputs. An increase in productivity occurs with a variety of output and input changes that include the increase in input quantities (e.g., in the case of airlines more aircraft) to increase output and the increase in the efficiency of inputs (e.g., larger and faster aircraft) to increase outputs.

Economic theory suggests that changes in productivity affect profits, prices, and compensation for an industry. Consequently, by achieving higher productivity, an entity produces more output with the same (or less) quantity of inputs, ceteris paribus, resulting in an increased difference in total revenues and total costs, and thus, higher profits. According to Kaci (2009), increases in airline productivity can benefit stakeholders through: Lower fares for customers; Increased tax revenues for government; Higher retained earnings for carriers; Increased dividends for investors; and Higher wages for employees.

However, as this thesis shows, improvements in productivity performance are not indicative of financial performance in the US airline industry, as sustained profits have eluded many carriers despite achieving increased productivity. The relationship between profits and productivity differs in how profits account for changes in prices and quantities and productivity accounts for quantity changes only. Productivity is one aspect of financial performance, among the ability to price above costs and reduce unit costs. As a
result, due to the tradeoff between various performance measures (i.e., productivity, input costs, and pricing ability), it is important not to confuse improvements in productivity as an indication of profitability. Thus, the inability to predict financial performance from changes in productivity serves as a limitation of gross measures of productivity.

Financial performance is reviewed based on the performance dimensions comprising: capital adequacy, asset quality, Net profit, Gross profit and liquidity. The business case for sustainability in terms of expansion projects performance can be made both for companies and for the financial institutions that support or service them. If the business case means that companies improve their economic performance because of investment in projects then this should translate into higher returns and/or lower risks for the financial institutions that support them. This implies however, that financial institutions are able to recognize good environmental and social performance and understand its financial implications. For this reason, it is important to examine the business case at a certain level: At the company level, asking how profitability or the accounting returns of companies are linked with their environmental and project performance (In practice many studies look both at accounting returns and at returns to shareholders). (Repetto & Austin 2000).

Planning is a process of determining the procurement needs of an entity and the timing of their acquisition and their funding such that the entities operations are met as required in an efficient way. Project must take a thoroughly professional view of its role in business as a whole and that must include planning (Bailey, Farmer, Jessop & Jones, 1998). Any such project begins with the planning decision to make the purchase and this will involve in the first place, deciding whether there is a need for the particular investment has the legal powers to undertake the transaction, obtaining any relevant approvals within the government hierarchy and arranging the necessary funding (Arrowsmith, Linarelli & Wallace, 2000). This process is identical to the private sector and additionally, checking for whether such requirements are provided for in the budget is key in the private sector. Where the required goods and services are not in the approved budget, then special approval ought to be sought before going through the ordinary project process.
1.1.4 Kenya Airways

Kenya Airways was established by the Kenyan government on 22 January 1977, following the break-up of the East African Community and the consequent demise of East African Airways (EAA). It started operations on 4 February 1977, with two Boeing 707–321s leased from British Midland Airways. The carrier also inherited two Douglas DC-9-32s and two Fokker F27-200s from EAA.

In 1986, Sessional Paper Number 1 was published by the Government of Kenya, outlining the country's need for economic development and growth. The document stressed the government opinion that the airline would be better off if owned by private interests, thus resulting in the first attempt to privatize the airline. In 1992, the Public Enterprise Reform paper was published, giving Kenya Airways priority among national companies in Kenya to be privatized.

In the fiscal year 1993 to 1994, the airline produced its first profit since the start of commercialization. Also, in 1994 the International Finance Corporation was appointed to provide assistance in the privatization process, which effectively began in 1995. KLM was eventually awarded the privatization of the company, which restructured its debts and made a master corporation agreement with the Dutch airline that bought 26% of the shares, becoming the largest single shareholder since then. The Government of Kenya kept a 23% stake in the company, and offered the remaining 51% to the public; however, non-Kenyan shareholders could at most have a participation of 49% into the airline. Shares were floated to the public in March 1996, and the airline started trading on the Nairobi Stock Exchange.

In June 2012 the company announced the issuance of rights worth KSh20 billion, aimed at increasing capital to support expansion plans. Following the allocation of shares, KLM increased their stake in the company from 26% to 26.73%, while the Kenyan government boosted their participation into the company from 23% to 29.8%, becoming the new major shareholder of the carrier. The first of five Embraer 190s ordered in 2010 was incorporated into the fleet in December 2010. An additional order for ten aircraft of the
same type was placed in August 2011; the carrier took delivery of the first and second of these fully owned aircraft in September 2012.

Kenya Airways has nine Boeing 787 Dreamliners on order, although the company considered cancelling the order after systematic delays with the delivery dates. The company announced in late February 2011 its intention of acquiring a freighter aircraft to boost cargo capacity on African operations. Until February 2012, when a joint freighter service with KLM was launched, the carrier’s cargo division has been using belly capacity on its operations; there are plans to buy and lease more freighter aircraft in order to boost capacity in the growing cargo market between Africa and Asia. Furthermore, the airline announced in October 2012 the conversion of some Boeing 737-300s into freighter aircraft to complement the Boeing 747-400F service, jointly operated with KLM and Martinair Cargo.

Kenya Airways operates scheduled passenger service and cargo services to 24 international destinations with 45 flights a week. Kenya Airways serves 7 destinations in Europe; 11 in sub-Saharan Africa; and 6 in North Africa, Asia, and the Middle East. Kenya Airways, as the national airline of Kenya, has rights under existing bilateral agreements to operate flights to a total of 58 countries. Kenya Airways is the leading operator on domestic routes. Kenya Airways operates 67 flights a week to four domestic destinations: Mombasa, Malindi, Kisumu, and Nairobi.

1.2 Research Problem

Airline industry was essential to global world as without airline transportation, such industries as leisure and tourism would suffer and international business activities would become much harder to conduct (Tiernan et al., 2008/1). It is one of the biggest industries in the world, reaching turnover of 501.2$ billion (Datamonitor, 2011) and 18$ billion in profits as of 2010 (IATA, 2011) and hence providing significant amount of work places as well as taxation revenues to governments. The industry is expected to grow up to 713.6$ billion within next few years. The market is divided between domestic (64% of all flights) and international (36%) (Datamonitor, 2011).
Currently two major issues affect profitability of airlines (Kostama & Toivonen, 2012): firstly, whereas demand has been stable for last decade, terrorism threat and financial crisis slowed down the industry growth (11.9% industry growth in 2010 and 7.8% in 2011 (Datamonitor, 2011). The expected recovery is slow, with growth projected to reach only 7.4% in 2015 (Datamonitor, 2011). Second, deregulation of airline industry in allowed low-cost carriers (LLCs) to enter the market with new, revolutionary business model, thus driving the customers away from regular full-service airlines. Deregulation as well enabled introduction of new services and more competition within the industry, as well as gave customers more power over their flight experience. In 2009, LLCs accounted for 32% of total seats in Europe. In addition to appearance of LLCs, airline industry experienced major makeovers during the last few years, such as elimination of paper tickets, introduction of self-service check-in kiosks etc. (IATA, 2011). Another challenge the airline industry is facing is a competition coming from other modes of transportation (Tiernan et al., 2008/1), such as high-speed trains. Thus, some routes have become unfeasible to carriers.

Several studies have been done in the field of financial performance, such as Shitakwa (2008), studied the relationship between projects implementation and financial performance of state owned corporations. Musyoki (2007) studied the relationship between quality improvement and financial performance for commercial banks. Rono (2010) studied on effects of globalization to Kenya airways. Diffu (2011) studied the relationship between foreign exchange risk and the financial performance of airline in Kenya. Kiptoo (2011) examined the challenges of competition on Kenya airways. Among all these studies conducted not one has addressed fleet expansion project on the financial performance in Kenya Airways.

The research entailed establishing the impact of fleet expansion project on the financial performance of the airline and whether the fleet expansion project has effect on profitability of Kenya Airways Company. The issue of airlines financial performance in developing countries has received little attention from the researchers. It is therefore evident that since no study was found on impact of fleet expansion on profitability. Given the gaps poised by the above empirical studies, this study posed the research question:
“What is the effect of the expansion projects on the financial performance of airlines in Kenya?”

1.3 Objective of the Study

To establish the effect of expansion projects on the financial performance of Kenya Airways.

1.4 Value of the Study

The outcome of the research was beneficial to the Kenya Airways and provided managers with some perspective to see the value of expansion projects. The study helped to visualize the impact of expansion projects on the financial performance of Airline Companies, decision making and using expansion information to decide whether to grow through acquisitions, grow through innovation, go global or develop new capabilities.

To the researchers, this study helped to understand the concepts of expansion projects on the financial performance and developed a deep insight on how to apply to their responsibility area and to get extensive approaches to the concept of expansion projects. It also made some statistical contribution to the previous studies or knowledge gaps.

The result of this study also revealed information about company’s expansion projects and financial outcomes, given the new competitive business environment in the industry through which the government had a better cooperation with Airline Companies, after they understand their expansion projects perspective. Other parties, such as the investors had extra evaluation information to make investment decision.
CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction
This chapter presents the review of the literature relevant to the purpose of the study. It starts with the economic growth theory, capital market imperfection theory, product and expansion projects and financial performance has been focused. In addition, the chapter presents information on literature regarding empirical review.

2.2 Theoretical Review
Economic growth theory entails mobilizing saving, managing risk, facilitating transactions or evaluating projects, technological and economic development is stimulated. Technological change is a process of constant replacement of old production methods and goods with better procedures, commodities, and services by invention and innovation.

2.2.1 Economic Growth Theory
In the last two decades, a rapidly growing research has investigated the relationship between corporate growth and financial structure. Considerable attention has been paid to the hypothesis that firms are constrained in their expansion process by the lack of appropriate financial resources. The “financial constraints hypothesis” proposed by Fazzari, Hubbard and Petersen (1988) states that there is a wedge between the cost of internal and external funds because of asymmetric information problems between the firm and her external financiers. Capital market failures may eventually lead to the financial rationing of firms and, therefore, to a reduction of their investment spending capacity.

The capital structure of firms is important in shaping managers’ incentives and affects the expansion patterns of firms. As argued by Jensen (1986), it should not be ignored that different forms of debts entail different governance effects, by providing different motivations to managers, and therefore influence real decisions of firms. Several
dimensions of firms’ financial structure have been thought to be importantly associated with firm value and growth by different strands of theoretical and empirical research.

A rich literature has tackled the issue of how the mix between internal and external funds is linked with firm real performance. According to the financial constraints and pecking order hypotheses, the availability of internal liquidity is a key determinant of firms’ ability to invest and accomplish the desired expansion plans (among the most recent contributions, see Almeida et al. 2004; Faulkender and Petesen 2006; Pàl and Ferrando 2006). A similar view is proposed by the trade-off theory put forward by Acharya et al. (2005), which stresses that, the dependence of investment on cash or debt largely depends on whether the firm is facing an income shortage or, conversely, a high-income state. The authors highlight that there is interplay between firms’ cash and debt policies as cash holdings have a significant effect on financing capacity and investment spending in low cash-flow states, while debt reductions are a particularly effective way of boosting investment in high cash-flow states.

A different approach to the issue of the relationship between firm financial policy and performance has been adopted by the corporate finance literature. In this view, external debt can be considered as an effective way to reduce the agency cost problems that may lead to the underperformance of firms (Jensen 1986). Especially when cash flow is high, indeed, conflicts of interests may cause managers to undertake unprofitable investment or waste internal liquidity on organizational inefficiencies. In these circumstances, resorting on external financiers may provide managers the right incentives to avoid cash wasting policies, and thus finally result in firm better performances.

The connection between financial development and economic growth is a long debated issue. Back in 1911, Joseph Schumpeter argued that financial development induces economic growth. His main point was that through the services that financial intermediaries bring about, like mobilizing saving, managing risk, facilitating transactions or evaluating projects, technological and economic development is stimulated. Technological change is the key in Schumpeter’s reasoning. His idea of “creative destruction” is a process of constant replacement of old production methods and
goods with better procedures, commodities, and services by invention and innovation. In addition, financial intermediaries enable this technological innovation (King, Levine, 1993).

Hicks (1969) also noticed that financial institutions might facilitate growth. However, he focused on capital formation. From this perspective capital formation can be influenced by financial institutions through altering the savings rate or by reallocating savings among different capital producing technologies. Liquidity is crucial here. The high-return projects involve a long-run commitment of capital and savers are generally reluctant to lose control of their savings for a long time. The task of financial institutions is to enhance the liquidity of long-term investments so that more investment is expected in the high-return projects. According to Hicks the industrial revolution in England was mainly caused by the capital market improvements that moderated liquidity risk (Levine, 1997).

The above general view was shared by scholars like Goldsmith (1969), McKinnon (1973) and Shaw (1973), who opted for the proactive function of financial services as well. Goldsmith (1969) assumed that the size of a financial system is linked with the supply and quality of financial intermediation and his analysis on 35 sample countries proved a positive correlation between the financial development and economic growth. MacKinnon (1973) and Shaw (1973) suggested that state involvement in the development of financial systems can be an obstacle for economic growth. Thus, financial development was perceived to positively affect growth.

The development of endogenous growth models gave a bigger scope for financial intermediation in influencing economic performance (Liu, Shu, 2002). Within these models Lucas (1988) and Romer (1986, 1990) enhanced the definition of investment to contain human capital and allow for externalities in investment. Given that, they suggested that returns to investment are slightly diminishing or even non-diminishing. Following this idea, it is financial institutions, when properly fulfilling their tasks that can generate externalities in investment and by this secure non-diminishing return to investment in the endogenous growth models.
Firms save money by not having to contact many potential lenders and simply going to one financial institution. Likewise, savers do not need to evaluate every borrower and just place money with financial institution. Allocation of savings is the second function. It is the financial system that decides who obtains loans. Due to the fact that financial institutions are specialists, they can determine the best investments, properly assess risks and make the decision about worthwhile borrowers cheaper than a typical small investor.

2.3 Productivity and Expansion Projects

Productivity is a broad performance concept that was widely studied in the airline industry even before deregulation. Since the early 1970s, productivity studies have evolved in the carriers studied, times analyzed and theoretical methodologies applied. Early studies aimed to differentiate sources that led to productivity changes that can be attributed to returns to scale (e.g., increase network size) and shifts in productive abilities (e.g., managerial and organizational changes), to name a few. The latter (i.e., shifts in production abilities), is what economists think of as productivity (Oum et al., 1992).

This theme of identifying specific sources of productivity has continued in much of the current literature. However, given that productivity measures computed are "residuals" that encompass a variety of sources, studies such as Baltagi et al. (1995) admit it is challenging to explain changes in productivity that may be credited to measures difficult to quantify, such as deregulation and technological progress.

The most common approaches used to measure airline productivity in the literature range from the basic accounting methodology framework to more econometric-based. Apostolides (2006) applied a basic accounting methodology to examine changes in growth for the US airline industry from 1990 to 2001. Although the basic accounting methodology is commonly used by government agencies to compute aggregate measures at the airline industry level, the majority of past studies measure TFP using parametric or non-parametric approaches (Oum et al., 1992).
The latter (i.e., non-parametric techniques), allow productivity measures to be constructed using data opposed to parametric techniques that require statistical estimation of a cost or production function. Specifically, the use of direct quantity indexes such as the trans-log multilateral index procedure proposed by Caves et al (1982). The trans-log multilateral index procedure is the most common methodology applied throughout past studies. For simplicity when referring to the Caves et al. (1982) methodology, this section refers to it as CCD’s methodology. The majority of the literature refers to TFP as the single most useful measure of productive efficiency (Windle (1991) and Caves et al. (1983).

The fact that reduced cost of capital is often cited as an argument for the business case for project expansion at company level suggests that companies do take account of these differences. The traditional economic approach to company project investment in environmental and financial performance focuses on the concept of externality. The costs involved in improving project performance are internal and hence represent an additional cost for the firm but the benefits of such measures are often external. If a company invests in pollution control treatment project to reduce its emissions, it is society as a whole that benefits rather than the company (Noronha, 2001).

Only if the benefits are internalized, for example if an airline company needs to use clean water as an input will there be an incentive. Proponents of the business case criticize this approach as being too static as it ignores the potential of companies to innovate (e.g. Porter and van der Linde 1995). There is also the view that many externalities owing to tightening regulation, the force of public opinion and consumer pressure are becoming increasingly internalized. A number of publications (e.g. WBCSD 1997; Sustain Ability 2001) set out the business case emphasizing the advantages from the cost side and from the market side of addressing project sustainability or making a commitment. Kenya airways expanded its route network by investing heavily on modern fleet by replacing its old aircrafts resulting to market growth. The airline has also invested in Electronic ticketing and Enterprise resource planning system (ERP) as cost reduction strategy.
2.4 Empirical Review

Baltagi et al. (1995) investigated the impact of projects expansion on financial performance using a sample of 24 US airlines from 1971 to 1986 to explore efficiency changes because of deregulation, technological progress, or a combination of both. This study admits it is difficult to compare the linkage between technologies, technological innovation. The results of this study indicate expansion significantly reduced union wage rates, led to faster output growth for non-trunk airlines, and had a pronounced effect on route structure (i.e., increase stage length and hubbing).

The authors claim productivity would have grown more slowly because of its enabling affects with improvements in capital stock (e.g., fuel-efficient aircraft), increased load factors, and development of hub operations. To compare carriers operating in both competitive and non-competitive environments, Windle (1991) extended the previous study done by Caves et al. (1983) by examining expansion/growth and unit cost differences among airlines. The non-US airlines were used as a control group to evaluate effects on US carriers operating in the newly competitive environment. In addition, this study decomposed a previous cost function analysis by Caves et al. (1987) to identify specific sources of productivity changes to determine what forms of expansion would have increased productivity for the non-US environment (as cited in Caves et al. (1983)). The results of this study indicate that although US carriers had higher productivity gains in the specified year (1983), these gains were offset by higher labor costs. Implications from this study focused on the need to increase traffic density (more passengers traveling on a particular route) through some form of deregulation that enabled increased demand, reduced fares, network re-configuration, and restructuring.

Using a different approach than the popular CCD’s methodology, Distexhe and Perelman (1994) applied Data Envelopment Analysis (DEA) to measure productivity growth using a panel set of 33 international airlines from 1977 to 1988. Although the DEA approach is not used in this study, this study identified some key conclusions worth noting. This study argued changes in route network density and load factors are the best indicators” of airlines' response to deregulation and the success of this response, respectively. The results of Distexhe and Perelman (1994) indicate carriers who operated worldwide (e.g.,
legacy carriers) witnessed a general improvement in technological efficiency in the 1980s. Consequently, carriers that operated on a lower scale were often condemned to merge or purchased by a larger airline.

Overall, early studies assessed the various policy regimes of the aviation markets. In general, most studies agreed that passenger airlines experienced the highest productivity gains with increased competition and route and pricing freedoms, prior to the liberalization of international aviation markets. That is, deregulation allowed carriers to achieve higher productivity than their international counterparts, despite the latter's lower labor costs. However, the productivity gap between US and non-US carriers closed significantly since liberalization of European aviation, which started in the late 1980s. Some studies show the availability of cheaper labor and substantial unit cost savings of international airlines enabled them to surpass US carriers in productivity levels. For instance, Windle (1991) concluded Singapore Airlines was number one in both productivity and unit costs at the time of the study, explained by cheaper labor prices, longer stage length, and the diminishing traffic density advantages in the US market. Oum and Yu (1995) found evidence of substantial productivity gains" for non-US carriers over the 1986 to 1993 time period since liberalization. After the mid-1990s, commercial aviation worldwide operated under a highly competitive environment with some form of deregulation or liberalization, and thus, past studies evolved from assessing policy regimes of international markets to decomposing productivity gains (or losses). That is, a recent theme of productivity studies aims to distinguish changes in productivity that can be attributed to changes in productive abilities (i.e., innovation) from other sources such as returns to scale (Oum et al., 1992).

Oum and Yu (1995) measured and compared performance of 23 of the world's major airlines from 1986 to 1993 to examine changes in cost and productivity performance. As previously mentioned, the authors reported that while carriers on average have higher productivity levels, the newly industrialized countries were achieving much higher growth rates thus diminishing the overall productivity gap. To identify projects that affected finance changes, regression models of growth rates were estimated and their results indicated the change in levels were explained by changes in output and stage
length. However, the authors admitted due to the positive correlation between stage length and load factor, the contribution of both variables may be overstated or vice versa. While the majority of past studies were conducted prior to the turn of the 21st century, there are a few recent studies worth noting that focused on measuring and comparing productivity performance among carriers and thus serve as a direct comparison to this thesis.

Oum, Fu, and Yu (2005) applied a methodology to measure and compare productivity performance among a sample of US carriers from 1990 to 2001 in order to capture the unforeseen events that transpired after 2000 such as the attacks on September 11th. The authors claimed carriers improved their productivity over the entire period despite rising input prices. Furthermore, this study reported evidence of declining productivity, yield, and unit costs because of the September 11 attacks.

Homsombat, Fu, and Sumalee (2010) examined changes in productivity and cost competitiveness of France carriers from 1990 to 2007 and applied regression analysis to identify key factors that led to such changes. The authors reported expansion enabled many carriers to improve productivity levels above the industry's average. While this study found significant productivity improvements from 1990 to 2007, they also noted how efficiency gains were largely offset by the increase in fuel prices. Similar to Oum and Yu (1995), this study also found negative correlation between productivity improvements and labor costs, which implies that as labor costs were reduced, productivity improved.

Local studies include Mokanya (2008) examines factors influencing high turnover of engineers at Kenya airways and concluded result as internal factors which include inadequate remuneration, a non responsive management, poor working condition, industry dynamic and competition. Sterling investment bank- member of Nairobi stock exchange (2009) carried Kenya airways company research update and concluded that the company is on an ambitious route expansion and creating more shareholders value in long run. Gichira (2010) examines challenges of globalization and their impact on Kenya airways limited and concluded that competition and rapid technological changes pose greatest challenge to airline.
2.5 Conclusion
Overall, past studies range from using measures of projects productivity to determine the effects of financial performance (Caves et al., 1983) to comparing productivity performance across airlines worldwide during periods of rapid change (Oum and Yu, 1995). Study periods serve as a major drawback of such studies and thus provide an opportunity to re-evaluate and compare changes in productivity between low-cost and legacy airlines. The most popular methodology used to measure productivity due to expansion projects is the trans-log multilateral procedure proposed by Caves et al. (1982). As it can be noted, the debate on the impact is not yet settled. Further most these studies were done in different environments which cannot be generalized to developing countries especially Kenya. The impact of expansion projects on financial performance of airlines is not widely researched. Hence, the present study seeks to bridge the gap.
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction
This chapter highlighted the methods and procedures used in carrying out the study to accomplish the objective. It included the following; section 3.2 research design; section 3.3 data collection; section 3.4 data analysis and analytical model.

3.2 Research Design
The study was a case study. It allowed a detailed examination of company, social unit, institution and upheld a deeper understanding of study (Kothari, 1990). The airline industry in Kenya is composed of many airlines. However it was difficult to collect data especially that which pertains to financial performance from airline companies that are not public listed companies. Only the national carrier Kenya Airways is listed on Nairobi stock exchange. As result of the aforementioned limitation the research was a case study.

3.3 Data Collection
There were two kinds of data: Primary and Secondary data. Secondary data refers to the data that has already been collected by someone else for different purpose. The data used in this study was from a secondary source which included financial statement, operational budget, internet resources, and publications. The period considered for the study was 10 years (2002-2011).

3.4 Data Analysis
Data analysis is the process of bringing order, structure and meaning to the mass of information collected. It involved examining what had been collected and making deductions and inferences Kombo and Tromp (2006). The research method adopted in this paper was the quantitative method since the research was more concerned with impact between variables and analysis of causal using numerical data and statistics. The quantitative method focused on the measurement and analysis of causal and effect relationship between variables. Comparison on performance before and after expansion
was carried to establish significant differences. The technique used was linear regression analysis using SPSS. The researcher used return on investment as performance indicator and cost then number of fleet as expansion project for ten years.

3.4.1 Analytical and Empirical Model

The study examined the impact of expansion projects on the financial performance based on the fleet expansion concept. The relationship among the variables was stated using a function;

\[ \text{NP (Y)} = f(X_1, X_2, \ldots) \]

Where, \( \text{NP (Y)} \) is a dependent variable and \( X_1, X_2, X_3, X_4, X_5, \) and \( X_6, \) are independent variables as passenger traffic growth, cargo tones, overhead cost, direct cost, operating lease rental, and fleet expansion respectively.

Regression model was used in the study. It offered the value of \( R^2, \) which was used to indicate how well the model was performed. In this study, the independent variable was evaluated in terms of its predictive power. The main goal of study was to establish if fleet expansion and passenger traffic growth had effect on the Kenya Airways’ financial performance. \( \alpha \) was the variable that contributed some effect to dependent variable without any influence caused by independent variables. KQ heavily invested in fleet and route expansion project. The study established the effect of the expansion projects on the company’s financial performance.

The equation was as follows:

\[ \text{NP (Y)} = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 \]

Where;

\[ \text{NP (Y)} = \text{Net Profit (Financial performance)} \]
\( \alpha = \text{Constant Term} \)

\( \beta_j = \text{coefficients of the independent variables} \)

Expansion projects were operationalised using six variables which were shown as: \( X_1 = \) passenger traffic growth, \( X_2 = \) cargo tones, \( X_3 = \) overhead cost, \( X_4 = \) direct cost, \( X_5 = \) operating lease rental, \( X_6 = \) number of aircrafts. Kenya Airways has heavily invested in expansion projects thus it is important to determine effects on financial performance.

\( \beta = \text{error variable which represented all the factors that affected the dependent variable but were not included in the model either because they were difficult to measure or not known.} \)

**Diagnostic tests**

F-test was tested for joint significance of all coefficients and t-test for significance of individual coefficients. Measures of central tendency (mean) and a measure of dispersion/variation (standard deviation) was also used to analyze the data.
CHAPTER FOUR
DATA ANALYSIS AND FINDINGS

4.1 Introduction

The study’s main objective was to evaluate the effect of expansion projects on the financial performance of Kenya Airways. In chapter four, secondary data for ten years on financial performance analyzed and findings discussed.

4.2 Findings

Table 4.1 shows secondary data for ten years period for profit as dependent variable and passenger numbers, cargo volume tones, number of aircraft fleet, overhead costs, direct costs and lease rental as independent variables. Further details on the specific performance of the variables have been analyzed in the chapter.

<table>
<thead>
<tr>
<th>Year</th>
<th>Profit for the year (After Tax) KShs Millions</th>
<th>Passenger in Numbers</th>
<th>Cargo Tones in a year</th>
<th>Overhead costs Kshs ‘000’</th>
<th>Direct Expenditure Kshs ‘000’</th>
<th>Operating Lease rental Kshs ‘000’</th>
<th>No. of Aircraft fleets in a year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>868</td>
<td>1,539,872</td>
<td>23,574</td>
<td>5,346</td>
<td>17,911</td>
<td>28,000</td>
<td>16</td>
</tr>
<tr>
<td>2003</td>
<td>345</td>
<td>1,621,429</td>
<td>28,497</td>
<td>5,800</td>
<td>20,561</td>
<td>28,000</td>
<td>17</td>
</tr>
<tr>
<td>2004</td>
<td>1,302</td>
<td>1,701,170</td>
<td>32,147</td>
<td>6,306</td>
<td>22,001</td>
<td>27,000</td>
<td>19</td>
</tr>
<tr>
<td>2005</td>
<td>3,882</td>
<td>2,041,487</td>
<td>44,405</td>
<td>6,580</td>
<td>29,065</td>
<td>26,000</td>
<td>20</td>
</tr>
<tr>
<td>2006</td>
<td>4,829</td>
<td>2,386,253</td>
<td>55,093</td>
<td>9,496</td>
<td>35,452</td>
<td>120,000</td>
<td>21</td>
</tr>
<tr>
<td>2007</td>
<td>4,098</td>
<td>2,601,350</td>
<td>60,932</td>
<td>9,818</td>
<td>41,335</td>
<td>117,000</td>
<td>23</td>
</tr>
<tr>
<td>2008</td>
<td>3,869</td>
<td>2,762,049</td>
<td>62,596</td>
<td>9,968</td>
<td>43,924</td>
<td>115,000</td>
<td>24</td>
</tr>
<tr>
<td>2009</td>
<td>(4,083)</td>
<td>2,824,709</td>
<td>55,606</td>
<td>12,001</td>
<td>55,786</td>
<td>1,161,000</td>
<td>28</td>
</tr>
<tr>
<td>2010</td>
<td>2,035</td>
<td>2,890,207</td>
<td>55,201</td>
<td>15,426</td>
<td>53,478</td>
<td>1,640,000</td>
<td>27</td>
</tr>
<tr>
<td>2011</td>
<td>3,588</td>
<td>3,136,789</td>
<td>56,401</td>
<td>16,980</td>
<td>63,041</td>
<td>1,684,000</td>
<td>31</td>
</tr>
</tbody>
</table>

Source: Researcher Findings
4.3 Profitability

The profit after tax reported as turnover less direct and overhead cost, these are used as dependent variable. The company financial profit grew for six years consistently but on year 2008 and 2009 reported declining trend as result of post election violence. The figure 4.1 indicates the trend of profitability for ten years period.

Figure 4.1: Financial Performance Trend for Ten Years Period

Source: Researcher Findings

4.4 Passenger Numbers

The passengers are made up of domestic and international arrival and departure. The company reported positive growth from 1,539,872 in year 2002 to 3,136,789 in the year 2011, these 51 Per cent growth. Figure 4.2 shows passenger growth trend for ten years period as graphically presented.
4.5 Cargo Tones

The cargo handling business contributes immensely to revenue of the airlines company. The cargo volume grew positively as evidenced from 23,574 tons in year 2011, these was 58 Per cent growth. The graphical presentation for ten years period as par figure 4.3.

Figure 4.3: Cargo Tones for Ten Years Period (2002 to 2011)

Source: Researcher Findings

4.6 Aircraft Fleets

The fleets were categorized on basis of wide body and narrow body. The capacity seats range from 72 for embraer to 322 for boeing 777-200. The number of fleet positively correlate with profitability. Kenya airways aircraft fleet grew from 16 fleet in year 2002
to 31 fleets by 2011 representing 48% growth. Figure 4.4 indicates the number of aircraft fleet for ten years period.

**Figure 4.4: Aircraft Fleet Number for Ten Years Period**

![Aircraft Fleet Number for Ten Years Period](image)

**Source: Researcher Findings**

4.7 Overhead Cost

The overhead costs that include the administrative and selling costs grew over the ten years. In year 2011 the overhead cost totaled to Kshs 5,346,000 and rose to Kshs 16,980,000 in year 2011, that translate to 68.2% growth. Figure 4.5 indicate that the growth of overhead costs over the last ten years.

**Figure 4.5: Overhead Cost for Ten Years Period**

![Overhead Cost for Ten Years Period](image)

**Source: Researcher Findings**
### 4.8 Direct Expenditure

Direct expenses include aircraft fuel, hire of aircraft, maintenance, crew route expenses, passenger services and others. In ten years analysis the direct expenditure grew from Kshs 17,911,000 to Kshs 63,041,000 for year 2002 and 2011 respectively, this translate to 71.6 per cent as shown in figure 4.6.

**Figure 4.6: Direct Cost trend for Ten Years Period.**

Source: Researcher Findings

### 4.9 Operating Lease Rental

Prepaid operating lease rentals relate to the cost incurred to acquire lease hold land. The cost is carried in the financial statement as long term prepayment and amortized to the income statement. There is upward trend for ten years period ranging from Kshs 28,000 to Kshs 1,684,000 for 2002 and 2011 respectively. Figure 4.7 indicates the operating lease rental for ten years period.
4.10 Regression Model

A multivariate regression model was applied to determine the relative importance of each of the six variables with respect to the after tax Profit for the year in the financial performance of Kenya Airways.

The regression model was as follows:

\[
\text{NP} (\bar{Y}) = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6
\]

Where:

NP (\(\bar{Y}\)) = profit for the year (after tax)

\(\alpha\) = Constant Term

\(\beta_j\) = Beta coefficients of the independent variable

\(X_1\) = Passenger

\(X_2\) = Cargo

\(X_3\) = Overhead costs

\(X_4\) = Direct expenditure
X₃ = Operating lease rental

X₆ = No. of Aircraft fleets

**Table 4.2: Model Summary**

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.775(a)</td>
<td>0.600</td>
<td>0.545</td>
<td>.31207</td>
</tr>
</tbody>
</table>

(a) Predictors: (Constant), Passenger in numbers, cargo, overhead costs, direct expenditure, operating lease rental, no. of aircraft fleets

The Adjusted R Square is called the coefficient of determination and tells us how the after tax profit of the year is related to the passenger numbers, cargo, overhead costs, direct expenditure, operating lease rental and number of aircraft fleets. From Table 4.2 above, the value of Adjusted $R^2$ is 0.545. This implies that, the independent variables explain 54.5% of dependent variable at a confidence level of 95%.

**Table 4.3: ANOVA**

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>Df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>4</td>
<td>1.059</td>
<td>10.871</td>
<td>.000(a)</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>29</td>
<td>.097</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>33</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a) Predictors: (Constant), Passenger in numbers, cargo overhead costs direct expenditure operating lease rental, no. of aircraft fleets

b) Dependent Variable: profit for the YEAR (after tax)

The study used ANOVA to establish the significance of the regression model from which an f-significance value of $p<0.001$ was established. This shows that the regression model has a less than 0.001 likelihood (probability) of giving a wrong prediction. Hence the regression model has a confidence level of above 95%.
Table 4.4: Coefficients Results

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>2.821</td>
<td>0.604</td>
<td>4.673</td>
<td>0.000</td>
</tr>
<tr>
<td>Passenger in numbers</td>
<td>0.157</td>
<td>0.110</td>
<td>1.424</td>
<td>0.015</td>
</tr>
<tr>
<td>Cargo</td>
<td>0.332</td>
<td>0.067</td>
<td>4.946</td>
<td>0.000</td>
</tr>
<tr>
<td>Overhead costs</td>
<td>-0.084</td>
<td>0.072</td>
<td>-1.162</td>
<td>0.025</td>
</tr>
<tr>
<td>Direct expenditure</td>
<td>-0.034</td>
<td>0.106</td>
<td>-0.322</td>
<td>0.038</td>
</tr>
<tr>
<td>Operating lease rental</td>
<td>-0.052</td>
<td>0.024</td>
<td>-2.115</td>
<td>0.549</td>
</tr>
<tr>
<td>No. of aircraft fleets</td>
<td>0.008</td>
<td>0.001</td>
<td>.505</td>
<td>7.097</td>
</tr>
</tbody>
</table>

(a) Dependent Variable: profit for the YEAR (after tax)

From the regression analysis, the following regression equation was established:

\[ Y = 2.821 + 0.157X_1 + 0.332X_2 - 0.084X_3 - 0.034X_4 - 0.052X_5 + 0.008X_6 \]

From the above regression model, holding passenger numbers, cargo, overhead costs, direct expenditure, operating lease rental and number of aircraft fleets constant, after tax annual profit would be at 2.821. It was established that a unit increase in passenger numbers would cause an increase in profit of the Company by a factor of 0.157, a unit increase in cargo and overhead costs would cause an increase and a decrease in the profit of the company by a factor of 0.332 and 0.084 respectively. A unit increase in direct expenditure would cause a decrease in yearly profit of the company by a factor of 0.034. Further, a unit increase in operating lease rental cost and the number of aircraft fleets would account for a decline and an increase in the profit of the company by a factor of 0.052 and 0.008 respectively. The study also established a significant relationship between the profit of the company and the factors; passenger numbers (p=0.065<0.05, cargo p=0.000<0.05, overhead costs (p = 0.025<0.05), direct expenditure(p= 0.038>0.05), and number of aircraft fleets and p=0.000<0.05. However, the study shows an insignificant relationship between operating lease rental; (p= 0.549>0.05) and the profit.
4.11 Interpretation of Findings

The study shows a negative relationship between direct expenditure, overhead costs, operating lease rental and the profit of Kenya Airways. This is to mean that, an increase in direct expenditure and overhead costs will lead to a decrease in profits and vice versa. These findings are similar to those of Oum and Yu (1995), whom in their study also found negative correlation between productivity improvements and labor costs, which implies that as labor costs were reduced, productivity improved.

The study also found a positive and significant relationship between number of aircraft fleets, cargo, growth of passenger numbers and financial performance of Kenya Airways. This is to mean an increase in aircraft fleets and cargo would increase the company’s profitability and vice versa. These findings are in line with Homsombat, Fu, and Sumalee (2010) who examined changes in productivity and cost competitiveness of France carriers and through a regression analysis they identified key factors that led to such changes; they revealed that expansion enabled many carriers to improve productivity levels above the industry's average.

Kenya Airways has expanded in the last 10 with an increase in passengers, cargo and number of aircraft fleet and this explains the steady increase in profits in the same duration. This shows that expansion has an impact on the productivity and general financial performance. This is in line with Windle (1991) who sought to identify specific sources of productivity changes to determine what forms of expansion would have increased productivity for the non-US environment and revealed that the carriers had higher productivity gains in the specified year which led to a focused strategy to increase traffic density (more passengers traveling on a particular route).
CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
This chapter presents the summary of the research findings, conclusions and recommendations. The conclusions were drawn from the findings of the study in line with the objective of effect of expansion projects on the financial performance.

5.2 Summary
The question whether expansion projects have effect on financial performance is considered vital by both academic and stakeholders. According to the study conducted the fleet expansion, passenger growth, cargo volumes, operating lease, direct expenditure and overhead cost are independent variable.

The study adopted in an effort to establish the effect of the expansion project on financial performance of Kenya Airways Company. Secondary data was collected for 10 years period (2002-2011) for the purpose of the study. Descriptive statistics were used to analyze the data by way of means, standard deviation, correlation, multiple regression, F and T tests.

The financial model aim was to ascertain functional relationship between expansion projects and financial performance. The study shows a negative relationship between direct expenditure, overhead costs, operating lease rentalanda positive and significant relationship between number of aircraft fleets, cargo, passenger numbers and financial performance of Kenya airways. From the analysis of the data collected it was proved that expansion of the projects has positive and negative correlation with financial performance. The ANOVA test analyzed on the effect of expansion project on financial performance result to positive and negative output, implying that there exist significant relationship between expansion projects and financial performance.

5.3 Conclusions
The objective of this study was to establish the effect of the expansion projects on financial performance of Kenya Airways Company. Considering the results analyzed from the study the following conclusion can deduced.
First the strong positive and negative correlation between the expansion projects and financial performance is reported, secondly the positive and negative regression model confirm that expansion projects (independent variables) if consistently applied contribute to increase or decrease in financial performance (dependent variable) depending on specific independent variable applied.

5.4 Recommendations

The study recommends key micro-economic policy factors that affect the performance of the airline company. The exchange rates, inflation rates, global recession and high cost of fuels have effect on financial performance.

Secondly the need for further policy decisions and actions to shield expansion projects from external forces that affect its implementation program negatively. Thirdly, the study will also help policy makers to develop best policies for expansion of projects.

For further research there is need to establish the extent of expansion projects on the value of the shareholders and broader appreciation of the effect of expansion projects on financial performance of airline companies.

5.5 Limitation of the Study

This study used a case study of expansion projects at Kenya Airways Company, ideally such study one would wish to conduct a survey of all airline sector expansion projects in Kenya but it was not possible owing to time, financial constrains and limitation of information.

Secondly, it was difficult to get studies carried locally on the effect of expansion project on the financial performance thus limiting reference to the research topic.

Finally, the expansions projects are internalized through the operations of the company, however there are other external factors that have effect on the financial performance and hence difficult to get adequate information in order draw conclusion and recommendation from the findings.
5.6 Suggestions for Further Study

The study dealt with effect of expansion project on the financial performance in Kenya Airways. The result of the study having been carried out in Kenya Airways cannot be fully conclusive to all airlines companies operating in Kenya. Further study on the same topic should be carried out in other airlines companies not listed in the stock exchange in order to get adequate information on the effect of expansion project on the financial performance.

Research should be done more on to what extent external factors such terrorism threat, financial crisis and competition have impact on financial performance of airline companies in Kenya.

Finally there is need for further research on impact of expansion on other mode of transport sector in order to appreciate and relate to economic growth and development of the country.
APPENDICES

Appendix 1: List of Airlines Companies in Kenya

1. KenyaAirways
2. Fly 540
3. Jet Link Express
4. 748 Air Services
5. African Express Airways
6. Aircraft Leasing Service (ALS)
7. Air Kenya Express.
8. Astral Aviation
9. Blue Bird Aviation (Kenya)
10. CMC Aviation
11. Delta Connection (Kenya)
12. East African Safari Air
13. Safari Link Aviation
14. Mombasa Air Safari
Appendix 2: Introduction Letter

University of Nairobi

School of Business,

P.O. Box 30197-00100

Nairobi.

Dear Respondent,

I am postgraduate student at the university of Nairobi, School of Business. I am conducting a case study on, “effect of expansion projects on financial performance at Kenya Airways.” This is in partial fulfillment of the requirements for the award of the degree of Master of Business Administration.

Kindly fill attached questionnaire to the best of your knowledge. The information received will be used purely for academic purposes and will be treated with strict confidence. A copy of the final report will be availed to you on request.

Your assistance will be highly appreciated. Thank you.

Yours faithfully,

Simon S. Nabosu

MBA student
Appendix 3: Research Questionnaire

I am conducting a research on “Effect of Expansion Projects on Financial Performance at the Kenya Airways” This study is being carried out in part fulfillment of the requirements for the award of a master of Business Administration Degree of the University of Nairobi, Kindly fill this questionnaire to the best of your knowledge.

Section A: Biographical Details

1. What is your job role?

- Project Manager [ ]
- Project Implementation Team [ ]
- Financial Controller [ ]
- Other: Specify …………………………………. [ ]

2. How long have you been involved in expansion projects?

- Below 2 years [ ]
- Between 2 and 5 years [ ]
- Over 5 years [ ]

Section B: Expansion Projects

Please indicate the list of expansion projects carried at the Kenya Airways

1. …………………………………………………

2. …………………………………………………

3. …………………………………………………

4. …………………………………………………

Thank you
### Appendix 4: Data Collection Sheet

<table>
<thead>
<tr>
<th>Year</th>
<th>Profit for the year (After Tax) KShs Millions</th>
<th>Passenger in Numbers</th>
<th>Cargo Tones in a year</th>
<th>Overhead costs Kshs ‘000’</th>
<th>Direct Expenditure Kshs ‘000’</th>
<th>Operating Lease rental Kshs ‘000’</th>
<th>No. of Aircraft fleets in a year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>868</td>
<td>1,539,872</td>
<td>23,574</td>
<td>5,346</td>
<td>17,911</td>
<td>28,000</td>
<td>16</td>
</tr>
<tr>
<td>2003</td>
<td>345</td>
<td>1,621,429</td>
<td>28,497</td>
<td>5,800</td>
<td>20,561</td>
<td>28,000</td>
<td>17</td>
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<tr>
<td>2004</td>
<td>1,302</td>
<td>1,701,170</td>
<td>32,147</td>
<td>6,306</td>
<td>22,001</td>
<td>27,000</td>
<td>19</td>
</tr>
<tr>
<td>2005</td>
<td>3,882</td>
<td>2,041,487</td>
<td>44,405</td>
<td>6,580</td>
<td>29,065</td>
<td>26,000</td>
<td>20</td>
</tr>
<tr>
<td>2006</td>
<td>4,829</td>
<td>2,386,253</td>
<td>55,093</td>
<td>9,496</td>
<td>35,452</td>
<td>120,000</td>
<td>21</td>
</tr>
<tr>
<td>2007</td>
<td>4,098</td>
<td>2,601,350</td>
<td>60,932</td>
<td>9,818</td>
<td>41,335</td>
<td>117,000</td>
<td>23</td>
</tr>
<tr>
<td>2008</td>
<td>3,869</td>
<td>2,762,049</td>
<td>62,596</td>
<td>9,968</td>
<td>43,924</td>
<td>115,000</td>
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</tr>
<tr>
<td>2009</td>
<td>(4,083)</td>
<td>2,824,709</td>
<td>55,606</td>
<td>12,001</td>
<td>55,786</td>
<td>1,161,000</td>
<td>28</td>
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<tr>
<td>2010</td>
<td>2,035</td>
<td>2,890,207</td>
<td>55,201</td>
<td>15,426</td>
<td>53,478</td>
<td>1,640,000</td>
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<tr>
<td>2011</td>
<td>3,588</td>
<td>3,136,789</td>
<td>56,401</td>
<td>16,980</td>
<td>63,041</td>
<td>1,684,000</td>
<td>31</td>
</tr>
</tbody>
</table>
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