THE FINANCIAL IMPACT OF PRIVATIZATION ON KENYA AIRWAYS

BY

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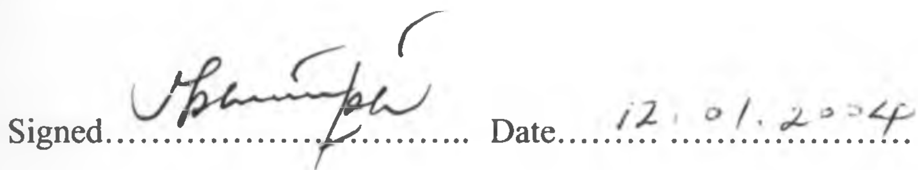
DECLARATION

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



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DEDICATION

This project is dedicated to my beloved wife Leah and my son Glen for their patience, understanding and support during my course of study.

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ABSTRACT

Privatization of State-Owned Enterprises (SOE's) has been quite a challenge to the Kenya Government over the years. Whereas there has been public outcry to privatize all SOE's due heavy taxation required to barely keep them afloat, the Government has, on the other hand, justified clinging to a majority in the name of strategic importance. There is; however, a limit to which the public patience could be stretched by paying for invincible services.

This study sought to establish the financial impact of privatization on Kenya Airways. It entailed examining financial data of Kenya Airways for five years before and after privatization and subsequently undertaking a thorough ratio analysis to compare trends in the two periods. Data for the pre-privatization period was obtained from the Prospectus issued at the time when the Public was invited to subscribe to the shares of Kenya Airways whereas post-privatization data was obtained from the Company's Published Financial Statements.

The analysis revealed that privatization did improve the financial position of Kenya Airways as portrayed by the following ratios among others: -

1. Profitability of the Airline significantly improved after privatization, with gross profit being recorded for the five years and even raising to a peak of 39.1% as compared to negative results during the entire pre-privatization period.

2. Positive Earnings per share (EPS) and Dividends were reported for four out of the five years after privatization whereas negative EPS and nil dividends were reported during pre-privatization period.
3. Return on assets was positive during post-privatization period but negative during the pre-privatization period.
4. Fixed interest cover was greater than one during the post-privatization period but negative for the entire pre-privatization period.
5. The acid test ratio was greater than one for the five-year post-privatization period whereas it was less than one during the pre-privatization period.

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CHAPTER ONE

INTRODUCTION

1.1 Background

Mention the word privatization and you will be surprised if not shocked by a wide group of people who will be attracted to the scene including academicians, politicians, financial advisers and the public in general. This interest arises from the impatience with which all these people have been forced to contend with, by routinely paying to the Government through state - owned enterprises for goods and services that are either of very poor quality or non-existent. Privatization in general refers to moving the provision of a service or an asset from the public to the private sector.

Boubakri (1999) defines privatization as the transfer of ownership from the government to the private sector. Privatization could be partial (divestiture) or complete (100% sale of ownership). Privatization is a worldwide phenomenon. From the former Socialist States of Eastern Europe to Latin America, from South Asian Countries to the African Continent, the world has for the last two decades been undergoing a profound fundamental shift in infrastructural development and provision of essential services. There has been a rush to privatize state-owned enterprises as the vehicle of choice for development. Most governments in developed and developing countries alike are retreating from owning and running business-like activities and are focusing more in providing a regulatory framework and enabling operating environment for the private sector development.

Most governments have similarly started seeing sense in opening their economies to outsiders. Mwaniki (1992) observes that, "in a majority of African countries, those opposed to privatization have come to grips with reality that there is a relationship between open markets and economic growth and that free markets need free men"*pp. 2.*

The Breton Wood Twins (i.e. The World Bank and International Monetary Fund) equally mounted pressure in most African countries to undertake privatization of state-owned enterprises as a precondition for financial aid and debt rescheduling. Mutahi (1989) notes that the World Bank did in fact curtail aid to countries opposed to privatization arguing that most African states were over-extended and that it was not practical for the state to sell potatoes to the people and at the same time engage in the thoroughly scientific exercise of economic planning, and do the two with a considerable level of efficacy. One might be tempted to question whether there is anything wrong with the Government owning and in fact running businesses. Simba (1986) notes that the Government is not best suited to do business in a competitive environment, where customer tastes and preferences change overnight. He draws a comparison between both Public and Private Enterprises in terms of Personnel, Investment and management policies as follows: -

- In terms of management policies, Boards decisions in Public corporations are only recommendations to the government, whereas in private sector enterprises, the Board is the highest authority and makes all policy decisions.
- Whereas investments are done in backward areas on national strategy considerations in the case of public corporations, private sector investments are based on viability and market analysis.
- In as far as workers are concerned, unproductive and inefficient employees are maintained in public corporations whereas they are laid off in private sector enterprises.

These practices indicate that the Government is not best placed to do business and ought to free itself and concentrate on the activities it knows how to do best such as maintaining law and order, providing social services and creating an atmosphere where business innovation and entrepreneurship can thrive.

According to the Policy Paper on Public Enterprise Reform and Privatization (July 1992), there are 240 commercially oriented public enterprises in Kenya, with direct or indirect Government ownership out of which, 33 are considered strategic, 207 non-strategic. Strategic enterprises are so defined if they either provide essential services or play a key role from the viewpoint of national security, health and environment protection. Simba (1986) defines a Public Enterprise as an organization or company: -

(i) That is created by an Act of Parliament, with specific policy guidelines, objectives and goals;

(ii) In which the Government holds a controlling equity share capital either directly or through a government Ministry or agency;

(iii) In which the Government appoints the Board of Directors and the Chief Executive.

This study will attempt to establish the financial impact of privatization on Kenya Airways.

1.2 Statement of problem

The privatization process in developing countries such as Kenya has been at a snails pace. Despite ambitious privatization programs in policy documents, the reality has been quite different. Out of the aforementioned 240 state-owned enterprises, only half have been privatized over a period of twelve years (since 1992). Mutahi (1989) notes that the reluctance to speed up the privatization process is attributed to the fact that the public sector has been used by many African Governments as an entry point for school leavers for whom something sensible must be found. Equally, the sector provides goods and services at subsidized prices for the social good of the people. It has also been used for political patronage, which is critical to the legitimacy of most African Governments.

Mwaniki (1992) observes that one of the hurdles of privatization is that the chief Executives of state -owned enterprises have self-interests and will not easily give up their perquisites. Such people need their jobs and the comfort that comes with them, and will put up spirited fights to frustrate any privatization programs as long as they can. Though privatization might bring about loss of employment, it should be noted that financial losses resulting from inefficient management, antiquated technologies and bloated workforces of these enterprises often pose a major burden to the already hard-pressed public budgets. Privatizing these enterprises will thus decrease their financial demands on the strained Government budget and improve the country's economic and social development. Sheshinski (2000) notes that privatization is the only way forward and is a key component of structural reform programs in both developed and developing economies. The aim of such programs is to achieve higher micro-economic efficiency and foster economic growth as well as reducing public sector borrowing requirements through the elimination of unnecessary subsidies. Kinandu (1995) further notes that Privatization of parastatals is one the major elements in the economic reform program being undertaken by African governments. He cites the objectives of privatization as: -

- Raising revenues from sale of state-owned assets,
- Deepening of financial markets,
- Dispersing widely the ownership of assets previously held by the government,
- Reducing the financial and administrative burdens that these enterprises impose on the government.

In Kenya, no study has been done to assess the financial impact of privatization on state-owned enterprises. This study will therefore fill the gap by collecting and collating evidence on the financial impact of privatization on Kenya Airways and act as a guide to future efforts in privatizing other enterprises such Kenya Reinsurance Corporation, Telecom, among others. The choice of Kenya Airways for a detailed study has been justified on grounds that this Airline was almost on the verge of collapse prior to privatization due to its accumulated losses and high indebtedness, which stood at Ksh 3.89 billion and 866 million respectively as per the 1996 Prospectus. It will therefore be interesting to undertake an analytical study to establish whether the financial position of this airline did improve after privatization. Equally, the study is expected to establish why Kenya Airways share prices have remained below the issue price.

1.3 Objective of the study

The objective of this study is to assess and compare financial performance and position of Kenya Airways before and after privatization.

1.4 Importance of the Study

This study is important to the following -

1. The Government

This study is intended to act as a guide to the Government for future privatization of state-owned enterprises.

2. To Organizations

The study is expected to show how capital market discipline, increased public scrutiny, competition and other demands on a privatized firm contribute to its overall performance improvement.

3. Potential Investors

Those investors who are contemplating to purchase state-owned enterprises could use this study in understanding how change in ownership can turn round these cash-drain enterprises into highly competitive and profit making companies

4. Shareholders

This study would be useful to shareholders who might be interested to know why the share price of this airline has, for a long time, remained below the issue price thereby making them not to realize capital gains.

5. Scholars and Academicians

Scholars and academicians can use this study to undertake further research in this field of privatization.

CHPTER TWO

LITERATURE REVIEW

2.1 KENYA AIRWAYS-BACKGROUND

Kenya Airways was until 1995 a State-Owned Enterprise. According to 1996 prospectus that invited the public to subscribe for its shares, its history dates back to 1946 when the East African Airways Corporation (EAAC) was formed. With the formation of the East African Community, EAAC passed into joint ownership of the governments of Kenya, Tanzania and Uganda. After the collapse of the East African Community in 1976, EAAC was placed into liquidation. Kenya Airways was thereafter (i.e. in January 1977) incorporated as company wholly -owned by the government to be the national flag carrier, thereby acquiring some of the assets and staff of EAAC. Flamingo Airlines, which is its wholly owned subsidiary, operates daily domestic flights to Mombassa, Malindi, Lamu, Eldoret, Kisumu and Lokichoggio. Brian (1999) observes that Kenya Airways was privatized in 1996 through a public offering of shares when it was noted that the real problem behind its dismal performance was the ownership structure. Brian (1999) further notes that the goal of privatizing Kenya Airways was to remove this under-performing airline from the Governments books, attract a credible international airline partner and retain a majority ownership in the hands of Kenya investors.

Prior to privatization, this airline experienced a gradual deterioration in financial and operating performance, making the government to shoulder a heavy burden of keeping it afloat and to seriously consider privatization as the way forward. According to the aforementioned Prospectus, this airline had reported consecutive losses for the five years prior to privatization as follows:

Year ended	30th June 1991 Ksh'000'	30th June 1992 Ksh'000'	31st March 1993 Ksh'000'	31st March 1994 Ksh'000'	31st March 1995 Ksh'000'
Profit/(loss) before tax	[669,502]	[414,605]	[512,664]	[43,434]	[1,539,730]

This means that, for the five years prior to privatization, Kenya Airways had accumulated losses to the tune of Sh3.18 billion, putting itself into a very high gearing position. Similarly, the financial statements show that the Airline neither paid taxes nor dividends for the same period. Over the same period, Kenya Airways was heavily indebted with its long-term loans rising to a peak of Ksh3.9 billion as follows: -

	Ksh Million **1991**	Ksh Million **1992**	Ksh Million **1993**	Ksh Million **1994**	Ksh Million **1995**
Loans guaranteed by the government	2,558	2,778	2,680	2,295	1,105
Government loans	966	1.131	1.134	1.134	-
Total loans	**3,524**	**3,909**	**3,814**	**3,429**	**1,105**

The above position was frightening given the fact it had reported operating losses before tax, meaning that it could not cover interest on these loans from operations.

2.2 THE ROLE OF ITS STRATEGIC PARTNER- KLM

Brian (1999) observes that KLM- Royal Dutch Airline, which is Kenya Airways strategic partner owns 26% of its shares whereas the public holds 52%, leaving a minority shareholding of 22% to the Kenya Government. KLM, which has been flying to Kenya since 1969 is one of the worlds's leading airlines. Brian (1999) further gives the history of KLM as dating back to 1919 when two entrepreneurs namely Dr. Albert Plesman and Anthony Fokker seized a golden opportunity of the then, new means of transport (the aeroplane) to launch KLM.

In addition to its 26% stake in Kenya Airways, the 1996 Prospectus empowers KLM to:

- Appoint two Directors to the Board of Kenya Airways,
- Nominate future candidates for the positions of Managing and Finance Directors for board approval,
- Nullify any major strategic decisions, such as acquisition of new aircraft's and material changes to Kenya Airways route network sanctioned without prior approval of KLM-appointed Directors.

According to the 1996 Prospectus, the role of KLM is to: -

- Make Kenya Airways the pivot of KLM's network in sub-Sahara Africa, thereby introducing Kenya Airways to KLM's global alliance,
- Increase each airline's scope for offering profitable air transportation services between Africa, Europe, North America, the Middle East and Asia,

- Provide economies of scale by sharing resources such as sales and marketing, station and ground facilities, flight equipment, maintenance and purchasing (including insurance, fuel and aircraft).
- Provide technology and know-how in computerized bookings and reservations
- Integration of routes and systems, and development of closer management relations,
- Free training and technical assistance up to a value of US$3 million.

All these roles are geared towards providing Kenya Airways passengers with a seamless service and improving the overall profitability of the airline.

2.3 DERERMINANTS OF PERFORMANCE IMPROVEMENTS IN PRIVATIZED FIRMS

Privatization subjects managers to pressure of the financial markets and to monitoring and discipline of profit-oriented investors. The change in ownership equally redefines the firm's objectives and the manager's incentives.

Boycko et al (1996) notes that, state-owned enterprises suffer from embracing multiple objectives, many of which are imposed on them by political masters who reap the benefits of politicized decision-making.

Boycko et al (1996) further notes that releasing a firm from Government control, provides greater entrepreneurial opportunities and that freeing SOE's from the financial constraints imposed by the government's public sector borrowing requirements, opens attractive financing options, such as bonds and other trading instruments from international markets.

2.3.1 Capital Market Discipline

Dewenter et al (1997) observes that state-owned firms are less efficient because they are immune from capital market scrutiny. This implies that managerial performance is not monitored. He further notes that, the public trading of shares establishes the possibility of takeover by outsiders, introduces the discipline of managerial labor market and provides the ability to link compensation to performance. As a result, when shares trade in public equity markets, owners have the enhanced capacity to spur greater managerial effort and accountability. According to Boubakri et al (1998), a well-developed and active capital market may contribute to an economic and regulatory environment conducive to post-privatization performance improvements. He contends that such a market allows the newly privatized firms a greater access to capital, frequently required for further restructuring and equipment modernization.

2.3.2 Incentive effects of Changes in Ownership of SOE's

Privatization redefines the firm's objectives and goals. Whereas state-owned firms typically pursue multiple and often conflicting objectives, privatized firms focus on profit-maximization. Since SOE's pursue objectives that frequently conflict with profit-maximization, the level of post privatization ownership retained by the state usually affect the firm's efficiency improvements. Claessens et al (1977) contends that, if the state maintains majority ownership, it is likely to delay restructuring. This view is shared by Boycko et al (1996), who maintains that efficiency gains from privatization can only be realized if ownership control rights pass from the Government to private investors. The presence of foreign investors also does affect the degree of post-privatization performance. A study of Czech privatization by Makhija et al (1997) on 41 firms with direct foreign investment and 947 firms with no foreign investment established that profitability measured either by return on equity or revenue per employee is significantly higher for firms with foreign investors. Similarly, Wellenius (1992) notes encouraging results in the privatization of state telecommunication enterprises in Latin America, in terms of attracting expert mangers (labor), specialized management tools, access to latest technologies and willingness by international markets to provide large amounts of capital to privatized companies in countries with sound microeconomic and regulatory frameworks.

2.3.3 Changes in CEO and the Board of Directors

Changes in the privatized firms upper management who are often political appointees usually leads to performance improvements. Lopez-de-Silanes et al (1999) notes that the existing SOE management may lack the appropriate human capital to effectively guide the privatized firm in the new, competitive market. He also finds a positive relationship between a change in Chief Executive Officer (CEO) and the market value of the privatized firm.

Megginson (1994) also examines how executive change affects the operating performance of newly privatized firms and reports improved performance for firms with larger changes in top management. In a study of post-privatization change of the CEO, Boycko et al (1996) notes that high managerial turnover immediately after transfer of ownership indicate that new private owners actively search for managers with human capital that corresponds to the needs of their firms.

2.3.4 Exposure to Competition

Privatization equally exposes the firm to discipline of product market competition. Having to compete with other firms for customers and market share may provide the pressure required to stimulate greater efficiency and profitability. Vickers et al (1992) identifies competition as a major determinant of post-privatization performance improvements. On the other hand, Boardman et al (1996) contends that firms such as utilities, which are not subject to the discipline of competitive pressure, are less likely to benefit from privatization.

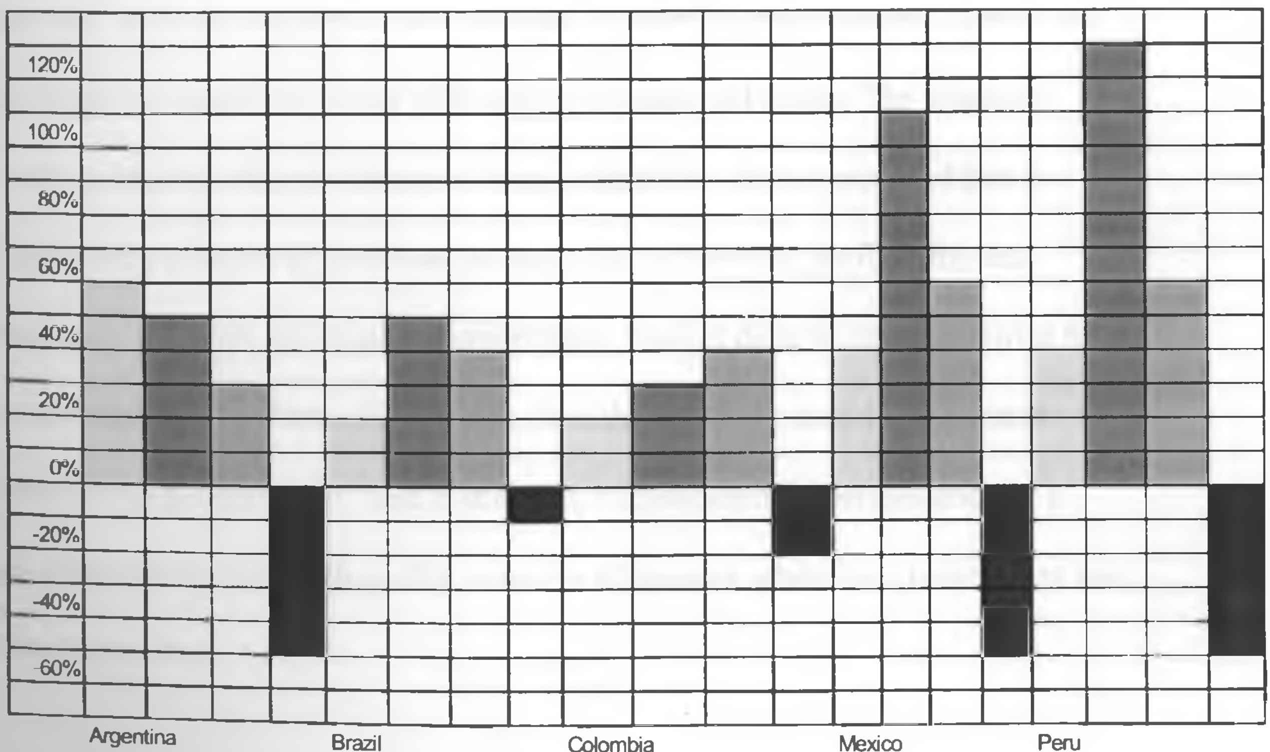
2.4 BENEFITS OF, COSTS AND CONSTRAINTS TO PRIVATIZATION

2.4.1 Benefits of Privatization

To an organization that has undergone privatization, some of the benefits include; improvement in performance in terms of profits, increased productivity and enhanced operating efficiency. These benefits arise from change in ownership and the resultant deployment of both modern technologies and professionalism from highly qualified personnel, who are attracted to a well-managed firm.

Privatization equally opens the doors to international investors who may have initially shunned investing in bureaucratic managed firms. In a study of Brazilian firms, Chong et al (2003) finds positive results for productivity, operational efficiency and production but negative results for labor in a firm five years following privatization as per **table 1** below.

Table 1- Firms Performance five years after Privatization



KEY

Profitability
Operational Efficiency
Production
Labor

Megginson (1994) compares pre-and post-privatization financial and operating performance of 61 companies from 18 countries and notes that after being privatized, firms increase real sales, become more profitable, increase their capital spending and improve their operating performance.

Macedo (2000), Pinheiro (1996) and Gambiagi & Pinheiro (1997) analyzed the performance of 50 former state-owned enterprises in Brazil, one to four years before and after privatization. Their studies covered eight variables (i.e. net sales, net profit, net assets, investment, fixed investment, number of employees, debt and index of liquidity). From these variables six were derived to measure efficiency: sales and profit by employee, rate of return in form of profit to sales, sales to net assets and propensity to invest with respect to sales and assets. The obtained results confirmed that privatization brings significant improvement of firm's performance in terms of increased productivity, efficiency, profitability and propensity to invest but reduces employment. Studies done in other countries have proven this fact. La Porta (1999) notes from the Mexico's world largest case privatization program that there is dramatic improvement in performance of a newly privatized firm with profits rising by 40 percent where the Government had minority interest.

To ensure that this profitability was not resulting from reduced costs such as employee's lay-off, a study of 218 privatized firms examined changes in profitability, efficiency, employment, wages, investment, output, prices, and taxes paid. Empirical analysis showed that profitability of the firms increased significantly after privatization according to the following ratios: -

- Operating income to sales,
- Net income to sales
- Operating income to fixed assets,
- Net income to fixed assets.

Interestingly, this study showed that layoffs and wage cuts were not the driving force behind increased profitability, but rather the change in ownership and expertise from additional professionals employed thereafter.

The analysis rather showed that in fact wages increased substantially after privatization, rising from a mean N$14,925 to N$26,348. The overall position of changes in performance of privatized firms in Mexico is as follows: -

Indicator	**Average change (Per-cent age)**
Profitability	+40
Cost per unit	-18
Output	+42
Employment	-20
Wages Blue collar (unskilled)	+120
White collar (skilled)	+78

Note *+ Refers to increase*

- Refers to decrease

2.4.2 Costs and Constrains to Privatization

Not all about privatization is benefits. La Porta (1999) notes that the observed higher profitability of privatized companies comes at the expense of the rest of the society. He cites Increased prices of goods and services, as firms capitalize on the market power as well as layoffs and lower wages as firms seek to roll back generous labor contracts. Using data from 218 privatized firms in Mexico that took place between 1983 and 1991, he found that whereas privatization is followed by a 24 percent (24%) increase in the ratio of operating income to sales, these gains could be decomposed as ;

- Ten percent (10%) increase as being due to higher product prices,
- Thirty-three percent (33%) increase being due to savings from laid-off workers
- Fifty-seven (57%) due to productivity gains.

Scheshinski et al (2000) notes the following constraints may affect the privatization process if not properly addressed: -

1. Ownership

A variety of issues surround the question of ownership of assets, which may be divested. These are hardly discussed between the government and the public, hence could often raise contentious and emotive debate. Such issues include;

(a) Concentration

A divestiture of a public enterprise assets in a manner which results in control going to a particular investor or investor group can be of great concern. Such concern may stem from equality and fair play or concentration of economic power in the hands of a few investors.

(b) Indigenisation

There are concerns regarding maintaining a certain portion of state-owned assets (and even control) in the hands of indigenous people. These concerns are founded on the premise that, in the wake of globalization and liberalization of world economies, most investors who can afford to buy shares in privatized companies are usually foreigners.

(c) Foreign Control

Most countries often have a fear of foreign control over means of production. This concern must be balanced with the frequent need to attract both investment capital and technical know-how, while considering strategic sectors such as communication and security.

(d) Role of Government as shareholder

The eventual role of the government needs to be addressed before privatization takes place. This is often done on an industry by industry basis. In the case of strategic and infrastructural enterprises, the government may delay privatization and even prefer to retain some involvement, either through shareholding or regulation.

(e) Social Welfare

Labor is most likely affected by public enterprise reform and divestiture. While the World Bank evidence suggests that privatization typically results in an increase in employment and remuneration as enterprises begin to earn profits and grow, most workers, in the early days of restructuring, will be made redundant.

(f) Transparency

A successful privatization program must be transparent. The general public and other observers must be comfortable that no vested interests are being promoted and that no principal actors have conflicts of interest.

Thus, the Government could, among other things, make use of independent consultants, open tender system and maintain regular and accurate communication with all parties to enhance transparency.

2. Valuation

Valuation is another critical issue, which might need to be addressed properly for successful privatization. Here in Kenya, there was a public outcry when Kenya Reinsurance Corporation was under-priced so much so that the sale had to be called off. The Government must balance between valuing assets too low or at unrealistically high prices, which could prevent sales. Issues of valuation apply mostly to: -

- Commercial value of land
- Valuation of capital assets
- Valuation of intangibles
- Debt position

3. Non-viability of many enterprises

Many public enterprises are simply non-viable. These must be liquidated in an orderly manner, with full awareness of the impact such liquidations will have on the community. Careful attention must be paid to the manner and timing of liquidation. Competitors may be adversely affected if machinery and equipment of the liquidated enterprises is dumped into the market at prices that will disadvantage existing commercial enterprises.

4. Levels of Indebtedness

It is likely that most existing public enterprises have extremely high levels of indebtedness. In many cases, this will have produced a massive debt burden on the respective organizations. Equally, the capital structures of many public enterprises usually have negative equity due to high-accumulated losses.

Some solution must be agreed to deal with this level of indebtedness. The Government assumption of debt or conversion of debt into equity will be necessary in the case of such enterprises. A case by case approach to indebtedness and debt restructuring is therefore necessary before privatization takes place.

Scheshinski et al (2000) observes that all these issues require judicious handling to ensure a smooth transition from pre-to post-privatization period.

2.5 RESULTS FROM OTHER PRIVATIZED AIRLINES

Though there are no other licensed commercial airlines in Kenya, the review of literature will examine privatization of Airlines in other countries.

The review will attempt to establish whether these airlines shared similar characteristics with the Kenya Airways of incurring perennial losses during the pre-privatization period and whether privatization did improve their performance. Thorsett (1993) notes that up till 1989, the Australian airline (Qantas) enjoyed the benefits of a state-owned carrier, which included; a heavily regulated operating environment and unlimited access to government resources among others and was thus shielded from failure. This airline; however, continued to make losses rising to a peak of US$100 million during the 1989-90 fiscal year. Within the same year, its total debt rose to US$1.15 billion recording a debt-equity ratio of 78:22.

Thorsett (1993) further notes that following removal of these benefits, the airline quickly merged with Qantas and sought for a strategic partner, the British Airways. By selling 22% shares to the British Airways for US$665 million, the airline managed to raise the badly needed capital to improve its debt-equity ratio. This was the exact situation with Kenya Airways, which remained on a life-support machine by being heavily funded and even guaranteed for additional foreign loans by the Government, yet it continued incurring huge losses year after year. Kenya Airways equally sought for a strategic partner KLM, who acquired 26% of the share capital, for Ksh 1.4 billion according to the 1996 Prospectus. Chomicka (1997) notes that, prior to privatization in 1991, the Polish national carrier (PLL LOT SA) made losses of approximately US$13 million, making the Board of Directors to seriously consider privatization as the way forward. Just like the Kenya Airways, there were no better results during the pre-privatization period other than consecutive operating losses, with the year ended 31st March 1994 recording the highest accumulated losses amounting to Ksh 3.1 million. Chomicka (1997) observes that the Polish Airline is currently an emerging force to reckon with in terms of turning round from loss to profit making, alongside its improved fleet of modern Boeing series, having discarded its Russian–built aircrafts. The Czechoslovak national carrier (CSA) was up to 1991 a major cash drain to the Government. Blom (1993) notes that when the Government discontinued subsidizing this airline, it went wild looking for a partner.

In 1992, CSA was privatized, with Air France entering into a strategic partnership and acquiring 51% of its shares, whereas the Czech Government retained 49%. With the funds raised from sale of shares, this airline acquired a modern fleet of airplanes and is now a viable and prosperous company.

The Turkish airline, which was founded in 1933, was until 1989 operating under the armpit of the Ministry of Transportation under the name, "State airlines administration". In 1990, it was privatized and renamed, *Turkish airlines Inc.* Ertuna (1998) observes that the main objective of privatizing this airline among other enterprises, was to confine the role of the state in the economy to such areas as health, basic education, social security, national defense, infrastructure investments and structural environment for free enterprises to operate. The other objective was to save the airline from collapse due to perennial losses since its inauguration. These objectives are not different from the Kenyan situation, whereby the privatization of Kenya Airways was aimed at removing the government from business and confining it to the activities it knows how to do best such as maintaining law and order, provision of basic education, national defense, among others. Blom (1993) observes that the Turkish Airline started reporting profits immediately after privatization.

2.6 JUSTIFICATION FOR USE OF RATIOS AS MEASURES OF PERFORMANCE

The financial impact of privatization on Kenya airways would best be captured through ratio analysis. Edwards et al (1946) defines a ratio as a mathematical expression of the relationship between two variables. The justification for use of ratios is founded on the premise that, they disclose significant relationships and trends that are not evident from the mere examination of a company's financial statements. Atrill et al (1991) notes that, financial ratios help to assess the performance and position of a business. Such an assessment is useful in determining whether or not those entrusted with the management of the business have utilized the resources efficiently and effectively. The usefulness of ratios cannot be overemphasized. Glautier et al (2001) notes that several empirical studies have been undertaken to determine the extent to which financial ratios may be used to predict business failure. This predictive ability of ratios is very crucial since an early warning signal of probable failure would enable both the management and investors take preventive measures. Altman (1968) used multiple discriminant analysis to predict corporate failure. He used twenty-two financial ratios based on data obtained two year before failure and selected five ratios, which when combined could most likely predict failure.

Altman examined financial characteristics of two samples of failed and no-failed United States companies to determine which ratios were most important in discriminating between the two groups. His model commonly referred to as the Z–Score was formulated as follows: -

$Z = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5$, where

X_1 = Working Capital /Total Assets

X_2 = Retained Earnings/Total Assets

X_3 = Earnings before Interest and Tax (EBIT)/Total Assets:

X_4 = Market Value of Equity/Book Value of debt

X_5 = Sales/Total Assets: Assets.

Altman (1968) found that companies with Z-scores of below 1.81 always went bankrupt, whereas those with a Z score of 2.99 and above were healthy, non-failed firms. This model could classify companies as failed or non-failed with 72% accuracy two years before failure. The significance of accounting ratios is enhanced by comparison with some yardstick of corporate performance. Atrill et al (1991) further observes that there are three standards of performance; namely, past periods, planned performance and other similar businesses or industrial average figures. In the case of Kenya Airways, comparison with other similar businesses or industrial average would not be possible due to the fact that there are no other licensed commercial airlines in Kenya. Besides this, it may not be possible to obtain financial data from other regional airlines.

Even if this were possible, such comparison could be distorted by different use of accounting policies, different legal requirements (legislation) and other business practices in those countries that are not similar to Kenya.

As far as past periods are concerned, Glautier (2001) notes that, though useful trends could be detected that might help predict future performance, economic conditions between any two periods may differ significantly and this could hinder proper evaluation of current performance and position. He further observes that the usefulness of the planned performance standard will depend on the validity of the assumptions made during the formulations of those plans. The usefulness or strengths or ratios are that;

- ❖ They reveal some trends from which one can easily infer some logical relationships and conclusions about a company's performance,
- ❖ They can be used to determine the credit-worthiness of a potential credit customer,
- ❖ They can be used in prediction of corporate failure, such as the use of the Z-score by Edward Altman,
- ❖ They can be used in assessing corporate excellence,
- ❖ They can be used in valuation of equity shares, such as the price-earnings ratio.

Ratios; however have some limitations that might require careful considerations before one jumps to conclusions about some given data. Among others are: -

- ❖ Some useful information such as; changes in management, technology and government regulations are not subject to ratio analysis yet their importance in the success or failure of the firm is crucial,

- Some figures such as depreciation and stock valuations are based on estimates,
- The fact that different companies, though similar in many aspects, might adopt different accounting policies,
- Manipulation of accounting data through window-dressing for various purposes,
- The fact that ratios are based on historical values, which might not be a good guide for the future.
- Inclusion of extra-ordinary activities in one period but exclusion in the other.

Atrill et al (1991) observes that, whilst the computation of ratios is fairly a straightforward process, their interpretation is often more complex. The analyst must therefore exercise skill and judgement in deciding whether or not the changes in financial ratios are significant and what the underlying cause(s) might be. He further notes that, by calculating ratios, which reflect key relationships, it is possible to reduce the complexity of the profit and loss account and the Balance sheet figures to a small number of key performance indicators.

2.7 ECONOMIC IMPORTANCE OF PRIVATIZATION

There are quite a number of economic benefits that accrue to the Government following privatization. Some of these include;

2.7.1 Cash proceeds from sale of State-Owned Enterprises

The sale of state-owned enterprises could earn the government substantial amount of money. Scheshninski (2000) for instance notes that, in terms of the proceeds obtained from privatization during the period 1990 to 1998 from a group of selected countries, Brazil was leading with US$ 53 billion, with Kenya having the least amount of US$387 million. These proceeds could go along way in supplementing the Government's budget in its endeavors to rendering the much-needed social services in health –care especially in the fight against HIV/AIDS and security among others.

2.7.2 Less Reliance by the Government on Foreign Aid

The pumping of millions of shillings to keep SOE's afloat has to a certain degree contributed to the government reliance on foreign aid to supplement its revenue sources. This aid; however, is usually accompanied by unpleasant conditional ties and reform measures that have often been viewed as questioning the Governments legitimacy and compromising of state sovereignty. Mutahi (1989) observes that, since the government, according to the donors is the problem due to its inefficiency in the management of SOE's, it is not possible for the same government to implement the required structural reforms. By privatizing these enterprises, there would be less reliance on or begging for donor aid.

2.7.3 Revenues to the Government in form of Corporate Taxes

Taxes normally form the largest component of the government's revenue source. It is for this reason that the Government should not hesitate in privatizing all loss-making state-owned enterprises in the hope that they would make profits and pay back taxes. This might provide a turning point in the Government's budgets, which are always in deficit.

2.7.4 Dividends from Divested Companies

In cases where the Government has retained some minority equity holding and sold the rest of ownership to private investors, it can still receive dividends as a shareholder once the company so divested declares and pays dividends.

2.7.5 Savings to the Exchequer

Privatizing loss-making enterprises could result in savings of millions of shillings in terms of financial and administrative burdens to the exchequer spent in the management of these state-owned enterprises.

As afore-mentioned, the Government, due to its non-profit national development strategy, is not best suited to run businesses; hence privatization of SOE's would provide savings of wasted resources in their management.

2.7.6 Reduction in Government Borrowing

Privatization reduces Government borrowing often required to sustain loss making SOE's. The Government has in the past years been competing for lonable funds with Commercial banks, thereby making availability of credit to other borrowers minimal. With such minimal credit, investments are reduced thereby causing a slump in the country's economic growth.

Other economic benefits include the multiplier effects likely to arise from stable employment following privatization such as; payment of personal taxes on income by employees, indirect taxes on consumption of goods and services, individual savings and investments. All these benefits would translate into the overall growth to the country's economy.

2.8 METHODS OF UNDERTAKING PRIVATIZATION

There are quite a number of methods for undertaking privatization.

2.8.1 The Kenyan Experience

The Kenyan Policy Paper on Public Enterprise Reform and Privatization (July 1992) issued by the Ministry of Finance, lists the following methods for undertaking privatization: -

1) **Public offering of shares on the Nairobi Stock Exchange**.

   This involves floating of shares at the exchange, thereby giving a chance to every member of the public to participate in share ownership.

2) **Sale of shares by private sector placement**

This method involves the issuing of shares selectively to individuals or institutions, which are known to or have expressed their interest in shares of a particular company.

3) **Sale of enterprise assets (including liquidation)**

This is mostly applied to those institutions that have ceased from going concern but whose assets can fetch some residual value.

4) **Employee/management buy-outs**

This method is applied to small and medium firms with the intention of retaining insiders (employees and management) who are already familiar with the running of the enterprise to provide continuity. The method involves forwarding of their proposal to the privatization committee, which, if accepted, gives them the legal ownership status.

5) **Leasing or reward of management contract**

This is where lease-purchase contracts are made between the treasury and the willing parties.

2.8.2 The Polish Experience

The law of Privatization of State Enterprises (1990) in Poland provides for four methods of undertaking privatization namely,

1) **Mass Privatization Through Voucher Distribution**

Pannier (1996) notes that this method occurs when a substantial portion of an economy's public assets is referred to a large group of private buyers.

It involves distribution of shares to citizens, either for free or for a minimum charge. The distribution is carried out by giving vouchers to the population that can be exchanged for stock in a bidding process. The main advantage of this method is that it assures political acceptability by giving ownership to the public. The drawbacks on the other hand are that it not only reduces the privatization proceeds to the government but also undermines corporate governance in the post-privatization period by offering advantages to the insiders, unions and former public managers to retain control and expropriate rents from small investors.

2) Direct Sales to Strategic Investors

According to Milgrom (1989), this method involves transfer of ownership and control to private investors whose expertise ought to guarantee successful performance of the firm in a competitive environment. This transfer is done through a competitive bidding process. The advantages of this method are that:-

- It enhances political acceptability,
- It maximizes revenues to the government from privatization proceeds,
- It assigns the company to the most efficient investor.

3) Public Offering

A public offering of shares entails sale of the company to the general public in the stock exchange or any other organized market.

In terms of share price determination, a discounted cash flow calculation is done as an initial parameter, followed by book building process. This book building process involves pricing of initial public offerings (IPO's) by constructing a book of orders from institutional investors based on the different issue prices. The advantages of public offerings are that: -

- It is transparent,
- It enhances the development of Capital Markets,
- It creates broad ownership, and
- If successful might help the government build a reputation for future privatization deals.

The disadvantage is that it is costly in the sense that IPO's are usually issued at a discounted price, technically known as under-pricing. Mauer et al (1992) notes that under-pricing of initial offering is an empirically established fact for public offering. Moreover, the process requires marketing and technical assistance, which increases transaction costs.

4) Mixed Sale

Meryll (1998) notes that this method has commonly been used in developing countries such as; Argentina, Peru and Mexico. It involves the direct sale of control to a strategic investor, either through a negotiation or competitive bidding, accompanied by a public offering as a second stage.

The public offering usually takes place within six months to one year, after transfer of the controlling shares. The advantages of this method are that: -

- It results in a positive impact on the domestic capital markets,
- It ensures that control goes to investors with potential to make the firm profitable under a market environment.

2.8.3 The Romania Experience

In an article titled, "Authority for privatization and management of state ownership", the Government of Romania in its article 13 of Law 44/1998 provides for the following privatization methods: -

1) Public offering

This method involves; advertisement for selection of underwriting company, presentation of applicants to the Local stock exchange, selection of the company, underwriting contract negotiation, issuing of the offer prospectus and performance of the public offering.

2) Negotiation

This method involves; advertisement regarding the company profile, letter of intent submitted by the prospected investors, drawing up of valuation report, document verification, opening and evaluation of the bids, sale-purchase contract negotiations and selection of bidders.

3) Outcry or sealed envelope auction

On top of the Negotiation method outlined above, this method entails submission of required documents, performing the outcry auction in English and Dutch languages, advertising the winning bidder and the signing of the sale-purchase contract within 10 working days.

These methods are intended to ensure transparency in the privatization process, equal treatment to all buyers as well as ensuring that the sale is performed at the determined market price on the demand-offer ratio.

CHPATER THREE

RESEARCH METHODOLOGY

3.0 Data Collection

This study relied on secondary data of published financial statements of Kenya Airways for five years before privatization (i.e.1991 to 1995) and five years after privatization (from 1997 to 2001). Data for the pre-privatization period was obtained from the Prospectus issued at the time when members of the public were invited to subscribe for the shares of Kenya Airways. Post privatization data was sourced from Kenya Airways offices. Data for 1996 was not included in this study since this was the year of transition and the results were distorted by extra-ordinary activities such as receipt of Ksh 5.6 million from issue of shares and floatation expenses among others.

3.2 Data Analysis

In order to establish the financial impact of privatization on Kenya Airways, data for five years before and after privatization was analyzed for indicators of increased profitability, efficiency and improved overall financial position. The use of ratios was justified on the grounds that the mere examination of a company's financial statements does not convey any significant meaning unless such statements are subjected to some form of comparison. This was achieved by comparing ratios for 1991-1995 to those of 1997-2001.

The analysis took into account the possibility of ratio analysis limitations as aforementioned under literature review.

Certain ratios under the category 3.2.2 (growth ratios) such as earnings and dividends yields, and under category 3.2.5 (operating performance ratios) such as price earnings ratio were excluded from computation.

This was because computation of these ratios required knowledge of market price per share, which could not be obtained especially for the pre-privatization period. Similarly, it was not possible to compute individual expense ratios under category 3.2.1 (profitability ratios) because detailed profit and loss account statements were not available, due to the minimum disclosure requirements, which make their reporting not mandatory.

CHAPTER FOUR

DATA RESULTS AND INTERPRETATION

4.1 Profitability Ratios

These ratios measure the operating effectiveness of the firm in generating returns from sales and investment.

They include;

- Gross profit margin, computed as; = Gross profit % / Sales
- Net profit margin, computed as; = Net profit % / Sales
- Return on capital employed = Profit before interest and taxes % / Total assets

Table 2 - Computation of Profitability Ratios

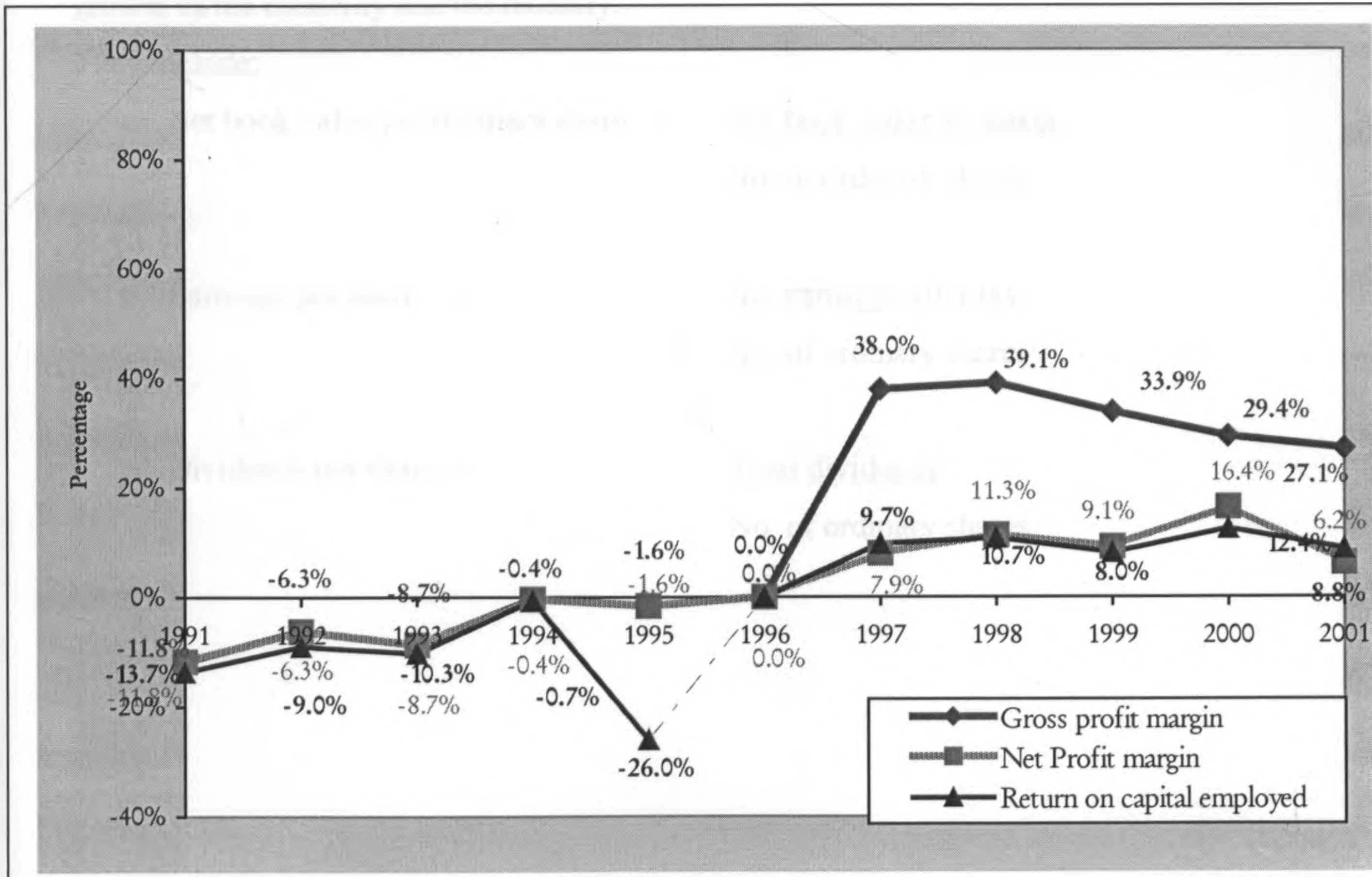
Pre-Privatization period

		1991	1992	1993	1994	1995
Gross profit margin	Gross profit x 100	-669	-414	-512	-43	-1539
	Sales	5688	6602	5862	11141	96078
		-11.8%	-6.3%	-8.7%	-0.4%	-1.6%
Net profit Margin	Net profit x 100	-669	-414	-512	-43	-1539
	Sales	5688	6602	5862	11141	96078
		-11.76%	-6.27%	-8.73%	-0.39%	-1.60%
Return on capital Employed	Profit before interest & taxes	-669	-414	-512	-43	1539
	Total assets	4873	4587	4984	6166	5915
		-13.73%	-9.03%	-10.27%	-0.70%	26.02%

Post-Privatization Period

		1997	1998	1999	2000	2001
Gross Profit Margin	Gross profit x 100	4068	4557	4350	5238	6107
	Sales	10712	11648	12834	17840	22525
		37.98%	**39.12%**	**33.89%**	**29.36%**	**27.11%**
Net Profit Margin	Net profit x 100	851	1314	1207	2922	1357
	Sales	10712	11648	13225	17840	21727
		7.94%	**11.28%**	**9.13%**	**16.38%**	**6.25%**
Return on capital Employed	Profit before interest & taxes x100	1090	1436	1425	2853	2044
	Total assets	11211	13392	17711	22940	23267
		9.72%	**10.72%**	**8.05%**	**12.44%**	**8.78%**

Figure 1- Graphical Representation of Profitability Ratios



According to the above computations and the graphical representation, the profitability ratios for the two periods (i.e. pre-and-post privatization) give a contrasting relationship. Whereas both the gross and net profit margins for the pre-privatization period are negative with as low as –26%, the position improves significantly in the post privatization period with the gross and net profit margins raising to 39.15 and 16.4 % in years 1998 and 2001 respectively. Similarly, return on capital employed depicts the same trend.

4.2 Growth Ratios

These ratios measure the firm's ability to maintain its economic position in the growth of the economy and the industry.

They include;

- Net book value per ordinary share = $\dfrac{\text{Net book value of assets}}{\text{No. of ordinary shares}}$

- Earnings per share = $\dfrac{\text{Net earnings after tax}}{\text{No. of ordinary shares}}$

- Dividends per share = $\dfrac{\text{Total dividends}}{\text{No. of ordinary shares}}$

Table 3 - Computation of Growth Ratios

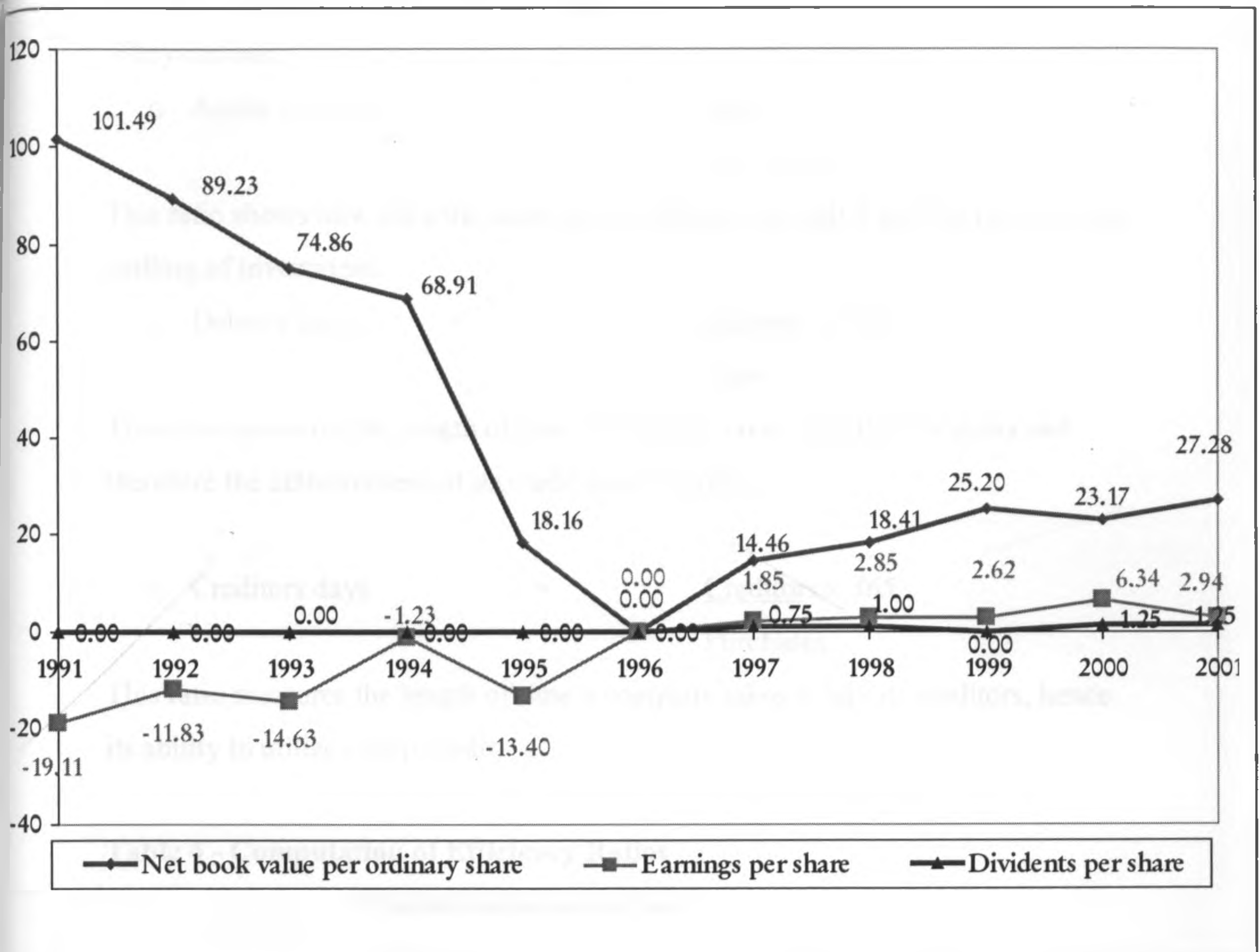
Pre-privatization period

		1991	1992	1993	1994	1995
Net book value per Ordinary Share	Net book value of assets	3552	3123	2620	2412	2088
	No of ordinary shares	35	35	35	35	115
		101.5	89.2	74.9	68.9	18.2
Earnings per share	Net earnings after tax	-669	-414	-512	-43	-1539
	No of ordinary shares	35	35	35	35	115
		-19.1	-11.8	-14.6	-1.2	-13.4
Dividends per share	Total dividends	0	0	0	0	0
	No of ordinary shares	35	35	35	35	115
		-	-	-	-	-

Post-Privatization period

		1997	1998	1999	2000	2001
Net book value Per Ordinary Share	Net book value of assets	6665	8488	11615	10682	12576
	No of ordinary shares	461	461	461	461	461
		14.5	18.4	25.2	23.2	27.3
Earnings per share	Net earnings after tax	851	1314	1207	2922	1357
	No of ordinary shares	461	461	461	461	461
		1.8	2.9	2.6	6.3	2.9
Dividends per share	Total dividends	346	461	-	577	577
	No of ordinary shares	461	461	-	461	461
		0.75	1.00	-	1.25	1.25

Figure 2 - Graphical Representation of Growth Ratios



The earnings per share were negative for the entire pre-privatization period whereas no dividends were declared or paid within the same period. This implies that the investor got no returns for having invested in this company. On the other hand, the position slightly improved during the post privatization period whereby some minimal dividends were declared as shown above.

4.3 Efficiency Ratios

Efficiency ratios also known as activity ratios evaluate the efficiency with which the firm's management has utilized its assets.

They include:

- Assets turnover = $\frac{\text{Sales}}{\text{Net Assets}}$

This ratio shows how fully the company is utilizing its capital and the turnover per shilling of investment.

- Debtors days, = $\frac{\text{Debtors}}{\text{Sales}} \times 365$

This ratio measures the length of time a company takes to collect its debts and therefore the effectiveness of its credit control policy.

- Creditors days = $\frac{\text{Creditors}}{\text{Purchases}} \times 365$

This ratio measures the length of time a company takes to pay its creditors, hence its ability to utilize cheap credit.

Table 4 - Computation of Efficiency Ratios

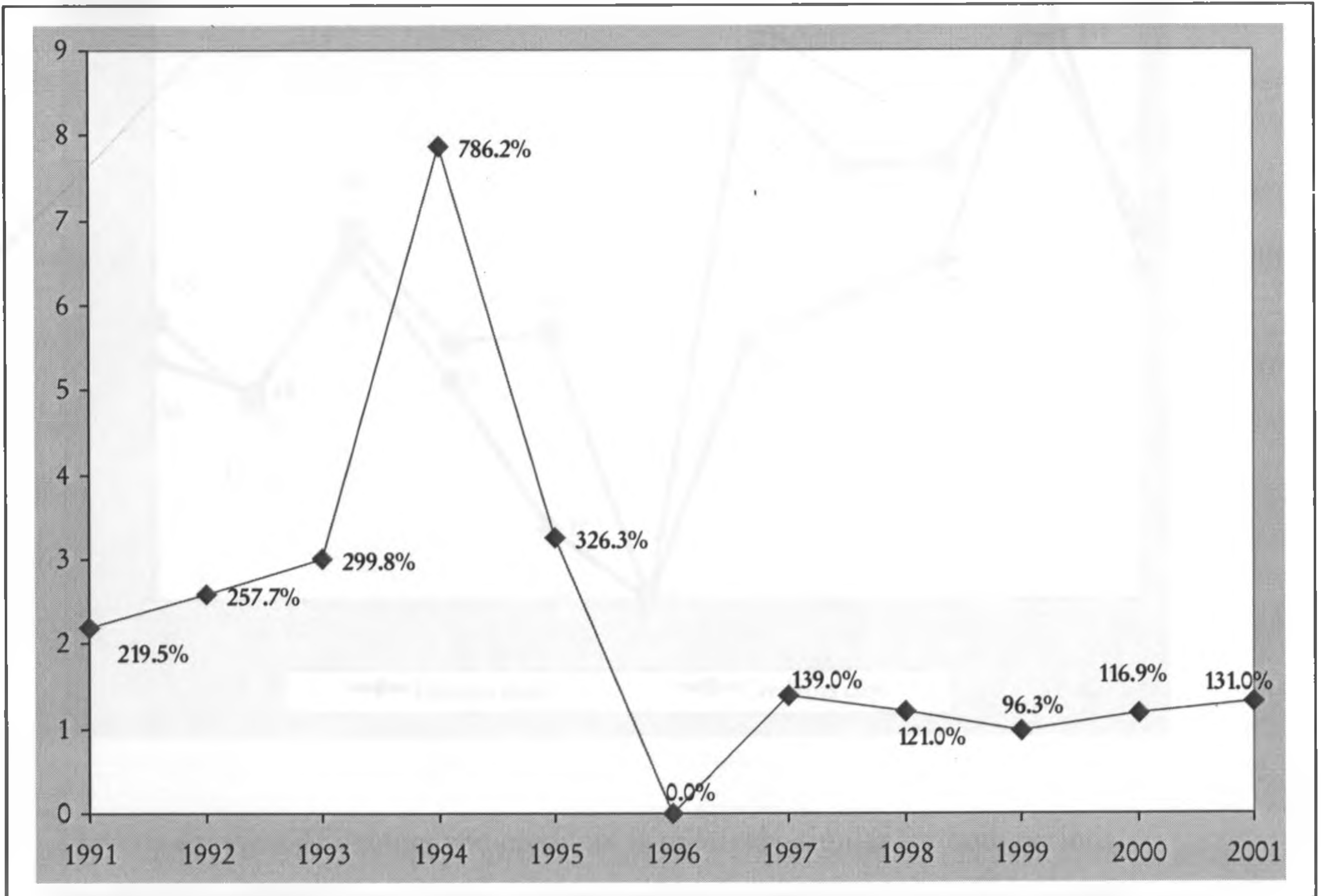
Pre-privatization period

		1991	1992	1993	1994	1995
Assets Turnover	Sales	5688	6602	5862	11141	9078
	Net Assets	2591	2562	1955	1417	2782
		219.53%	257.69%	299.85%	786.24%	326.31%
Debtors days	Debtors x 365 days	316820	319740	471945	571225	150015
	Sales	5688	6602	5862	11141	9078
		56	48	81	51	17
Creditors days	Creditors x 365 days	414275	325580	463185	669410	660285
	Purchases	6357	7016	5394	11184	10617
		65	46	86	60	62

Post-privatization period

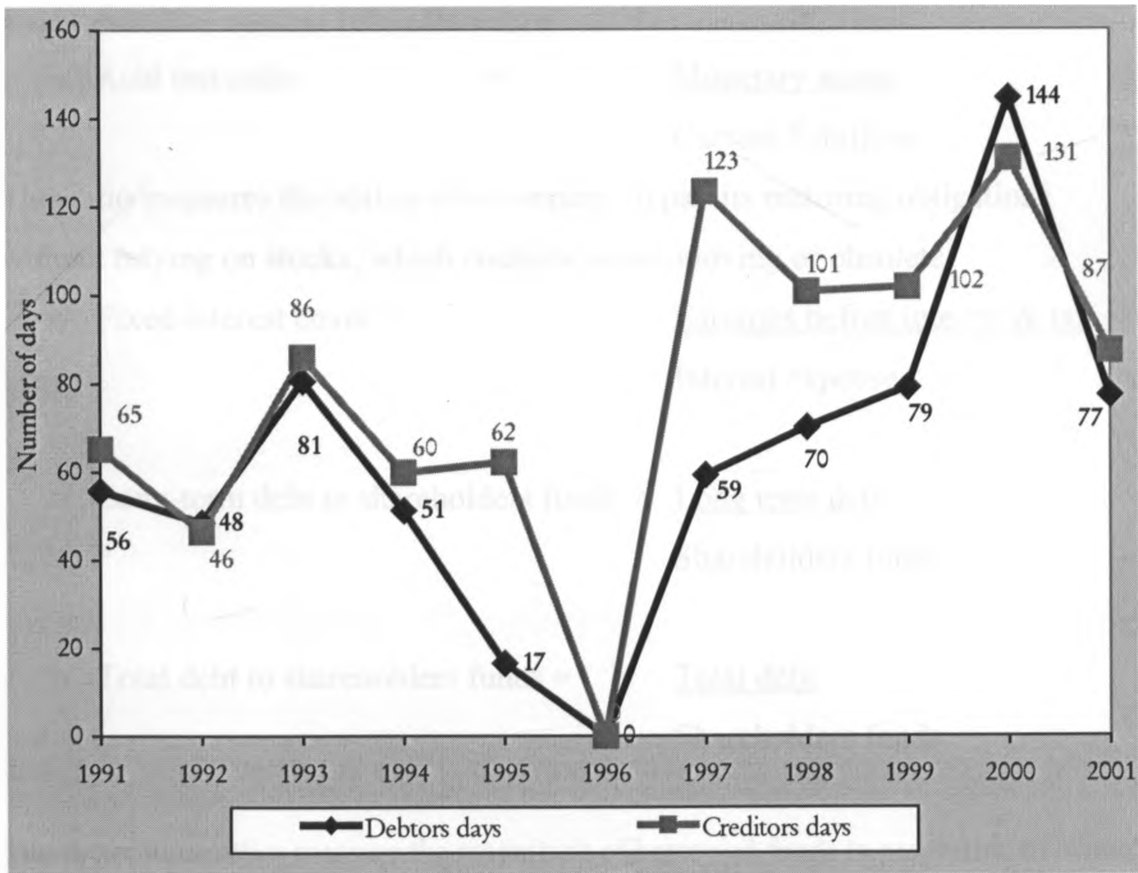
		1997	1998	1999	2000	2001
Assets Turnover	Sales	10712	11648	13225	17840	21727
	Net Assets	7709	9629	13737	15267	16589
		138.95%	120.97%	96.27%	116.85%	130.97%
Debtors days	Debtors x 365 days	634005	816140	1045360	2577630	1679000
	Sales	10712	11648	13225	17840	21727
		59	70	79	144	77
Creditors days	Creditors x 365 days	818695	713575	880380	2114445	1395395
	Purchases	6643	7091	8654	16157	15981
		123	101	102	131	87

Figure 4 0- Graphical Representation of Efficiency Ratios (Assets Turnover)



Assets turnover ratio is used to measure how well the assets are utilized to generate sales. From both the computations and the graph above, it is apparent that though assets appear to have been utilized well during the pre-privatization period, the results for the post-privatization period are distorted by a modern fleet of Boeing aircrafts acquired after privatization. According to 1999 annual report, these were 767-300 ER and 737-700.

Figure 5 - Graphical Representation of Efficiency Ratios (Debtors & Creditors)



The management of debtors and creditors is relatively similar for both periods, though the creditor's days during the post-privatization period are much higher indicating use of cheap credit and hence better management of creditors.

4.5 Solvency and Liquidity Ratios

These ratios measure the firm's ability to meet its maturing short-term obligations. Included here are gearing (leverage) ratios, which measure the extent to which the firm is financed by debt capital or the relative claims of outside financiers against the firms assets. They include;

- Current ratio = $\frac{\text{Current assets}}{\text{Current liabilities}}$

This ratio indicates the ability of a company to pay its short-term liabilities from its resources of current assets without resulting to its long- term fixed assets.

- Acid test ratio = $\frac{\text{Monetary assets}}{\text{Current liabilities}}$

This ratio measures the ability of a company to pay its maturing obligations without relying on stocks, which could be slow- moving or obsolete.

- Fixed interest cover = $\frac{\text{Earnings before interest \& tax}}{\text{Interest expense}}$

- Long-term debt to shareholders funds = $\frac{\text{Long term debt}}{\text{Shareholders funds}}$

- Total debt to shareholders funds = $\frac{\text{Total debt}}{\text{Shareholders funds}}$

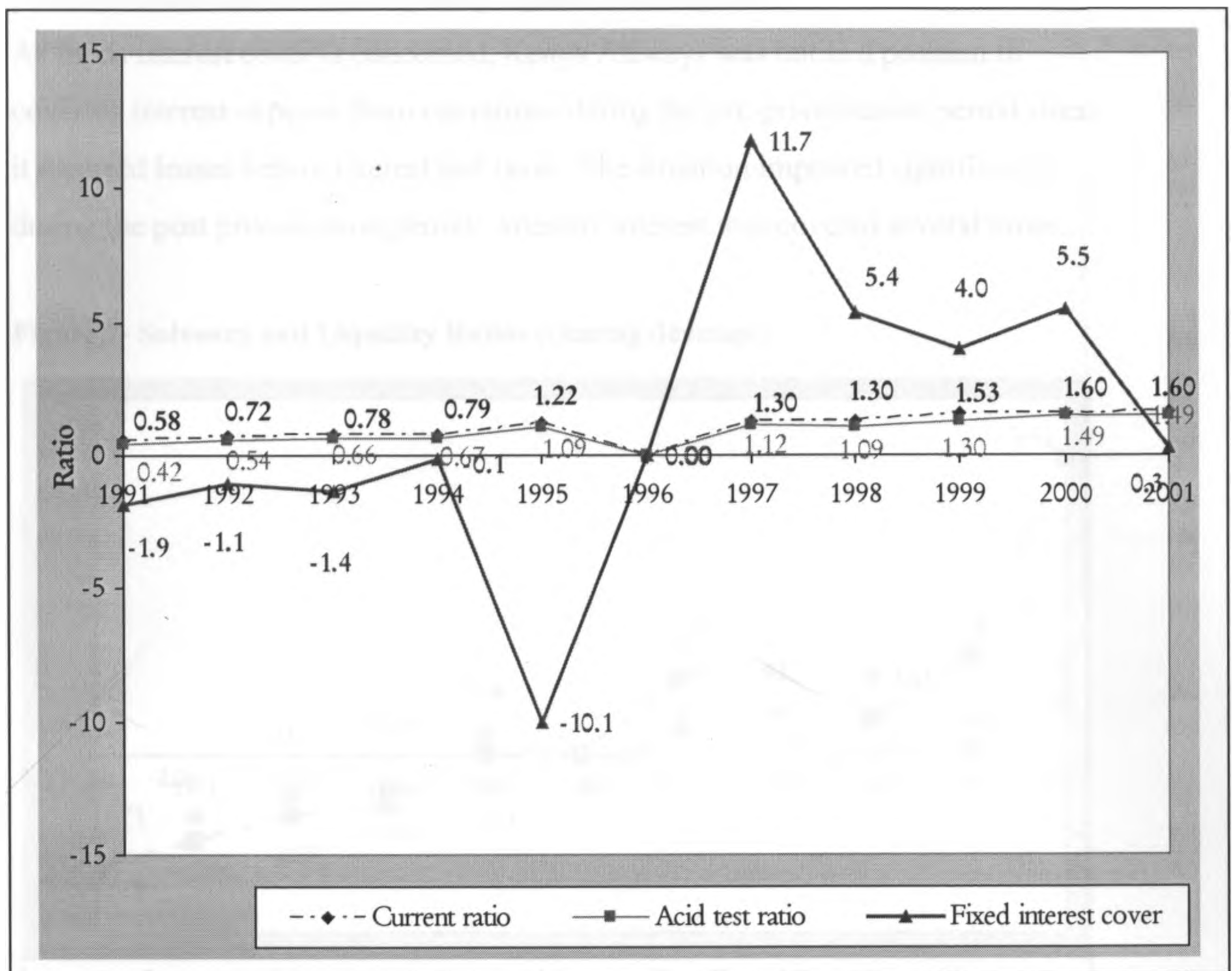
The above three ratios measure the magnitude of borrowed funds in proportion to owner's capital. A highly geared company has greater vulnerability if there is a sudden drop in profits since interest on debt must be paid irrespective of the company's performance.

Table 5- Computation of Solvency and Liquidity Ratios

		1991	1992	1993	1994	1995
Current ratio	Current assets	1321	1464	2364	3754	3827
	Currrent liabilites	2282	2025	3029	4748	3133
		0.58	**0.72**	**0.78**	**0.79**	**1.22**
Acid test ratio	Monetary assets	952	1095	1985	3188	3416
	Current liabilties	2282	2025	3029	4748	3133
		0.42	**0.54**	**0.66**	**0.67**	**1.09**
Fixed interest Cover	Earnings before interest and tax	-669	-414	-512	-43	-1559
	Interest expense	358	389	375	321	155
		-1.87	**-1.06**	**-1.37**	**-0.13**	**-10.06**
Long term debt to Shareholders funds	Long term debt	2557	2778	2680	2295	1105
	Shareholders funds	-932	-1346	-1859	-2012	1676
		-2.74	**-2.06**	**-1.44**	**-1.14**	**0.66**
Total debt to Shareholders funds	Total debt	3523	3909	3814	3429	11.05
	Shareholders funds	-932	-1346	-1859	-2012	1676
		-3.78	**-2.90**	**-2.05**	**-1.70**	**0.01**

		1997	1998	1999	2000	200[illegible]
Current ratio	Current assets	4526	4904	6096	12258	106[illegible]
	Currrent liabilites	3482	3763	3974	7673	667
		1.30	1.30	1.53	1.60	1.[illegible]
Acid test ratio	Monetary assets	3900	4089	5165	11418	998
	Current liabilties	3482	3763	3974	7673	667
		1.12	1.09	1.30	1.49	1.4[illegible]
Fixed interest cover	Earnings before interest and tax	1090	1436	1425	2853	204
	Interest expense	93	268	360	523	663
		11.72	5.36	3.96	5.46	0.[illegible]
Long term debt to Shareholders funds	Long term debt	1788	3122	6048	628	663
	Shareholders funds	2308	2308	2308	2308	230
		0.77	1.35	2.62	0.27	2.[illegible]
Total debt to Shareholders funds	Total debt	5921	6507	2864	7781	229[illegible]
	Shareholders funds	2308	2308	2308	2308	230
		2.57	2.82	1.24	3.37	9.9[illegible]

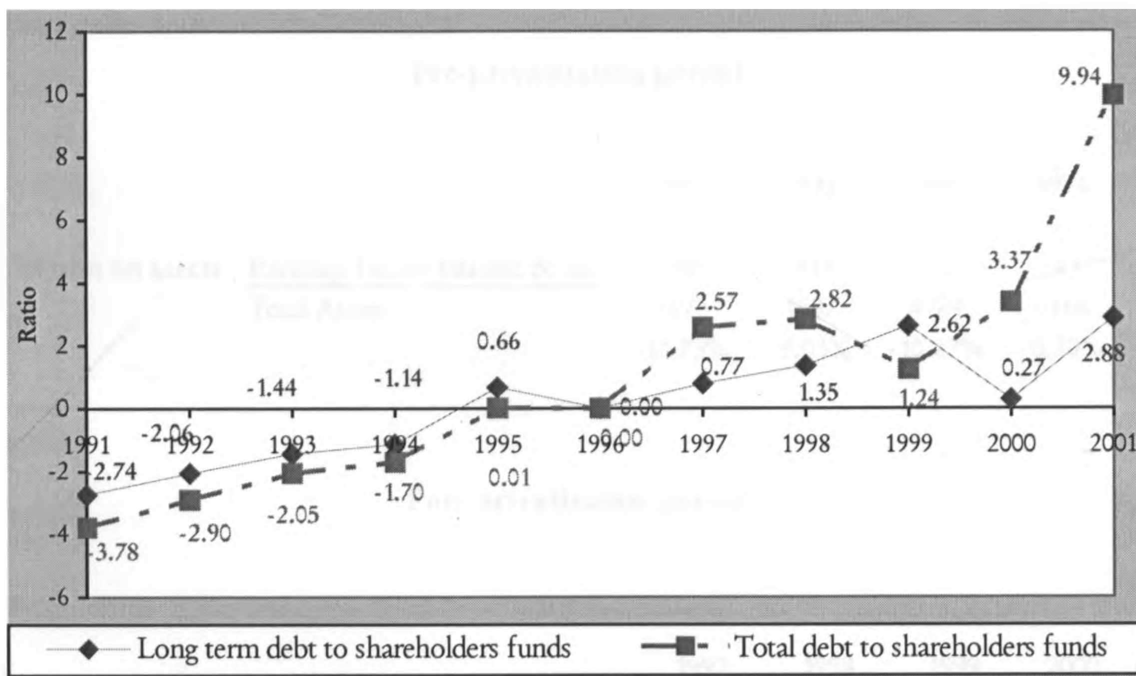
Figure 6: Graphical Presentation of Solvency and Liquidity Ratios



The current ratio measures the extent to which a firm is able to meet its short-term maturing obligations. A ratio of 2:1 is usually recommended if this objective is to be met. Though there is a slight improvement of this ratio during the post privatization period, the ratio is in both periods less than 2:1, questioning the ability of the firm to settle its maturing debt obligations. Equally, the acid test ratio measures the extent to which a firm is able to meet its maturing short-term obligations from monetary assets (without having to sell stocks).

A ratio of 1:1 is recommended. This ratio is satisfactory for the post privatization period but less than one during the pre-privatization period.
As far as interest cover is concerned, Kenya Airways was not in a position to cover its interest expense from operations during the pre-privatization period since it incurred losses before interest and taxes. The situation improved significantly during the post privatization period, whereby interest was covered several times.

Figure 7- Solvency and Liquidity Ratios (Gearing /leverage)



This airline was highly geared during the pre-privatization period, as the equity position was negative! This position did not improve much in the post-privatization period, as the ratio was more than 100.0 in each case. Such a highly-geared company could easily attract hostile takeover bids.

4.6 Operating performance ratios

These ratios examine how well the Directors are using the resources at their disposal.

- Return on assets = $\frac{\text{Earnings before interest \& tax \%}}{\text{Total assets}}$

Table 6 - Computation of Operating Performance Ratios

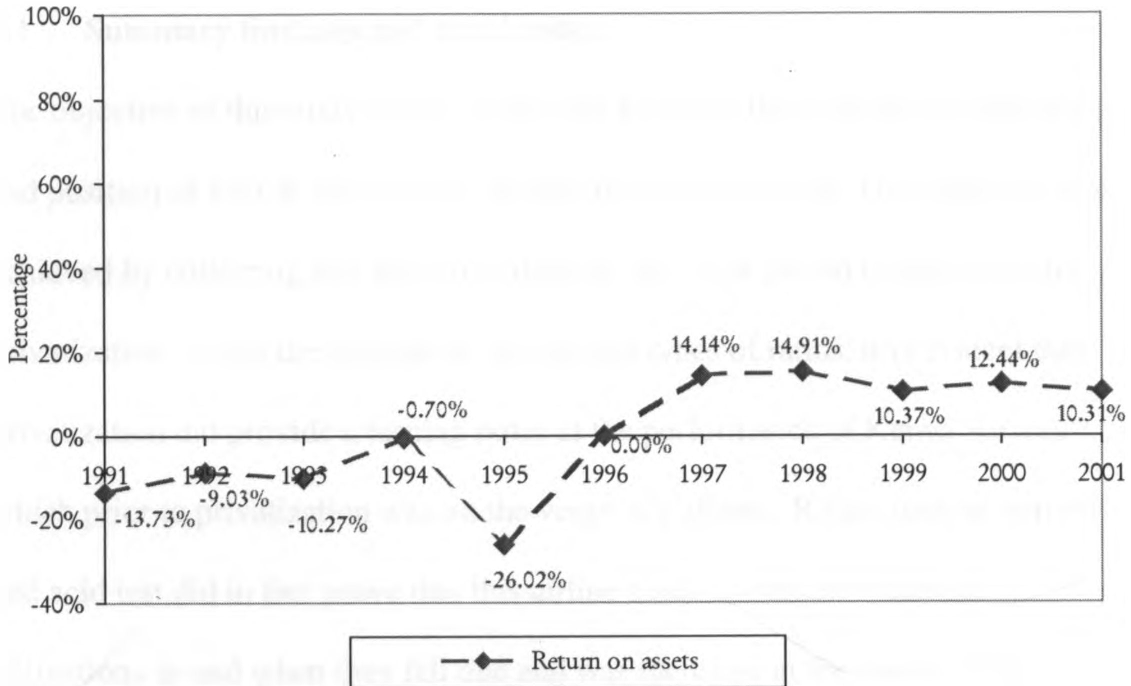
Pre-privatization period

		1991	1992	1993	1994	1995
Return on assets	Earnings before interest & tax	-669	-414	-512	-43	-1539
	Total Assets	4873	4587	4984	6166	5915
		-13.73%	-9.03%	-10.27%	-0.70%	-26.02%

Post-privatization period

		1997	1998	1999	2000	2001
Return on assets	Earnings before interest & tax	1090	1436	1425	2853	2366
	Total Assets	7709	9629	13737	22940	22946
		14.14%	14.91%	10.37%	12.44%	10.31%

Figure 7- Graphical Presentation of Operating Performance Ratio



This ratio, which measures the return relative to assets employed, indicate a negative position during the pre-privatization period, meaning that assets were not generating any returns. The situation improved markedly during the post-privation period with relatively stable positive return on assets.

CHAPTER FIVE

SUMMARY AND CONCLUSIONS

5.1 Summary findings and conclusions

The objective of this study was to assess and compare the financial performance and position of Kenya Airways before and after privatization. This objective was achieved by collecting and analyzing data for five-year period before and after privatization. From the analysis of the various types of ratios, it is evident that privatization did provide a turning point in the performance of Kenya Airways, which prior to privatization was on the verge of collapse. Ratios such as current and acid test did in fact prove that this airline could not meet its current obligations as and when they fell due and was therefore at the mercy of the government. Furthermore, the growth and profitability ratios for the pre-privatization period gave either zero or negative results meaning that there was virtually no return for the investors. Following privatization; however, the situation did improve tremendously with the company recording gross profit margins as high as 39.1% and even paying some dividends for four out of the five years after privatization.

In terms of operational efficiency, Kenya Airways did win the following awards as per its annual reports during the post-privatization period: -

1997-1999 - The best Regional Airline, *by Travel News*

1999- The Best African Airline, *by the Official Airline Guide*

1999- African Airline of the Year, *by African Aviation Magazine*

The 2001 annual report indicates that this airline is currently operating both passenger and cargo flight services to over 30 international destinations, covering over 1,350 cities in Europe, Sub-Sahara Africa, North Africa, Asia an the Middle East. This compares with 24 international destinations in 58 countries during the pre-privatization period. In terms of proceeds from privatization, the Kenya Government received Ksh 5.6 billion, according to the 1997 annual report. At the same time, the Government received a total of Ksh. 181 million in form of dividends for years 2000 and 2001.

Kenya Airways price per share; however, which is an indicator of performance, has been quite low, averaging Ksh 5.00 to 7.00 for a long time. This is almost half of the original issue price of Ksh 11.25 at the time of privatization. According to the Capital Market Authority, there are three authorized methods for valuing initial public offerings (IPO's). These are: -

- Net book value of assets for the year preceding privatization
- Average earnings for the last five years prior to privatization,
- Valuation based on the shares of a company in the same industry and operating at the same level.

Methods two and three could not have been used since the airline incurred losses for the five years prior to privatization, whereas it was not possible to get a similar business in the industry operating at the same level.

This price of Ksh 11.25 was arrived at by dividing the net book value of assets totaling 2,648,518,830 with the intended share offer of 235,423,896. This issue price suddenly dropped thereafter to 5.19 per share. This could be attributed to the fact that the book values did not represent actual market prices. This could be one of the problems with the book value method of valuing IPO's. In fact, according to the 1996 Prospectus, the last time these assets were revalued was in 1989. Similarly, the post-privatization profits are not sustainable at the same level but depict a fluctuating trend for the five years as per table 2 on page 43.

Thus, other that the market price of Kenya Airways shares remaining depressed, ratio analysis as computed above does prove that there was some improvement in the financial position of this airline following privatization.

5.2 Recommendations

In light of the findings above, this study recommends the following: -

- ❖ That the Government undertakes to privatize all other remaining cash-drain state-owned enterprises.
- ❖ That a time frame for this undertaking be pre-determined and strictly adhered to.

Kenya has experimented with state corporations for the last 40 years with negative results and cannot afford to continue treading on this dangerous path. It has been very costly and painful to the taxpayer.

5.3 Limitations of the study

This study was hampered by inability to compute very important ratios such price earnings ratio, earnings yield, dividend yield and individual expense ratios. Some important comparisons and analysis could therefore not be made.

The inability was occasioned by the fact that: -

- It was not possible to obtain the market price per share for the pre-privatization period since this company was not quoted at the Nairobi Stock Exchange.
- There are no other licensed commercial airlines in the country, meaning that no industrial average performance data could be obtained for further comparison.
- The minimum disclosure requirements stipulated by the International Accounting Standard number one (IAS 1) do not require a company to provide a detailed profit and loss account, hence individual expense figures were not available for computation of expense ratios.

5.4 Suggestions for Further Research

Scholars and Academicians who are interested in undertaking further research into this topic of privatization would be encouraged to investigate into: -

5.4.1 The impact of privatization at industry level,

5.4.2 The role of the regulatory agencies that are likely to have sprouted up following the receding role of the state as an entrepreneur.

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