A STUDY ON THE RELATIONSHIP BETWEEN PERFORMANCE CONTRACTING AND PERFORMANCE OF STATE OWNED ENTERPRISES: THE CASE OF AGRICULTURAL FINANCE CORPORATION (AFC)

BY
MILLICENT SHITAKHA
D61/P/8349/05

SUPERVISOR: MR. LISHENGA

A MANAGEMENT PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

AUGUST 2008

DECLARATION

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

Candidate: Shitakha M.M

SIGNATURE ....SMh................... **DATE** 17th November 2008

This project proposal has been submitted for examination with my approval as the university supervisor.

Supervisor: Mr.Lishenga

SIGNATURE .... **DATE** 17-11-08

LECTURER, UNIVERSITY OF NAIROBI

DEDICATION

This paper is dedicated to my sister; Laetia Mbaya who has been fully supportive of my endeavors.

ACKNOWLEDGEMENT

I acknowledge the support of the Agricultural Finance Corporation (AFC) which offered the platform during collection and analysis of my research data. I am grateful to the University of Nairobi (UON) for the resilient guidance and support in review of material that culminated in generating ideas for developing a proposal for this research.

Sincere gratitude goes to Mr Lisiola Lishengu, Lecturer, Faculty of Commerce, School of Business, University of Nairobi for his continued guidance, support, encouragement and scripture criticism as well as suggestions throughout the project.

I would also like to thank my family and friends for the support they have offered over the period I have undertaken the MBA programme. Thank you for your understanding and patience.

ACKNOWLEDGEMENT

I acknowledge the support of the Agricultural Finance Corporation (AFC) which offered the platform during collection and analysis of my research data. I am grateful to the University of Nairobi (UON) for the resilient guidance and support in review of material that culminated in generating ideas for developing a proposal for this research.

Sincere gratitude goes to Mr Lisiola Lishenga, Lecturer, Faculty of Commerce, School of Business, University of Nairobi for his continued guidance, support, encouragement and scripture criticism as well as suggestions throughout the project

I would also like to thank my family and friends for the support they have offered over the period I have undertaken the MBA programme. Thank you for your understanding and patience.

ABTRACT

This study set out to determine the relationship between performance contracting and the performance of the Agricultural Finance Corporation

The study involved analyzing financial and non financial performance indicators for the period 2000/01 up to 2006/07 and performing a trend analysis as well as a comparative analysis to determine the impact of performance contracting on the performance of AFC.

An overall analysis showed that performance contracting has not worked for the Corporation. Equally, the analysis showed that AFC does not totally conform to the conventions of a business concern In this regard, the performance of the corporation is affected by many other factors including political influence and government imposed policies which the Corporation can not easily negotiate

TABLE OF CONTENTS

TABLE OF CONTENTS

CHAPTER ONE

1.0 INTRODUCTION

A Performance Contract is a management tool that encompasses many things (OECD,1994).It is used for measuring performance that establishes operational and management autonomy between Government and public agencies; reduces quantity controls and enhances the quality of service; privatizes the style of public sector management by focusing on results and not processes and, measures performance and enables recognition and rewards of good performance and sanctions bad performance

It is a freely negotiated performance agreement between the Government, acting as the owner of a government agency, and the agency itself (Kenya, Sensitization Training Manual,2004) The mutual performance obligations, intentions and responsibilities between the two parties are clearly specified.

A performance contract outlines the tasks an agency has to discharge for the achievement of desired results. Tasks are defined so that management can perform them systematically and with reasonable probability of accomplishment. It helps determine what should be done and how to go about it.

Performance contracts are widely used to reform state owned enterprises. The World Bank (1995) found that there were, as of June 1994, 565 such contracts in 32 developing countries, where they are principally used for large utilities and other monopolies. Performance Contracts are a variant of pay for performance or incentive contracts, which have been often used to motivate private managers, and suggested as a way to improve central government agencies (Mookerjee 1997).

The rationale for incentive contracts such as performance contracts is largely based on the principal – agent theory (Ross 1991; Stiglitz 1974; Sappington 1991). The principal (in the case of state enterprises, the government) can not measure accurately the effort expended by the agent (the state owned enterprises' managers)or distinguish the effects of effort from other factors affecting performance (Laffont and Tirole 1986, 1993). A negotiated incentive contract is viewed as a device to reveal information and motivate managers to exert effort. In the case of state owned enterprises, performance contracts are also touted as a way to clarify the objectives of the multiple principals who govern state owned firms (different ministries, the legislature), and hence make it easier to set goals and evaluate achievements. Proponents argue that the contract can translate into multiple objectives into targets measured by specified criteria and given weights to reflect priorities (Ramamurti and Vernon 1991). Moreover, targets can be set to take into account circumstances where state owned enterprise' managers have less control over their firms than comparable managers in the private sector. By specifying targets and evaluating results ex post, the performance contract is seen by its advocates as a way to encourage governments to reduce ex ante controls, giving managers more freedom and motivation to improve operating efficiency.

Introduction of performance contracts in Kenya emanates from the realization that public agencies have not been clear about their goals as they have several functions with multiple objectives to fulfill their mandates The lack of clarity of goals may lead to the agency achieving objectives not related to its core mandate. A performance contract therefore addresses the imbalance in assessing performance by agreeing on the objectives against which performance will be measured

In addition, the poor performance of the public sector has hindered the realization of sustainable economic growth. Some of the factors for the poor performance include excessive regulations and controls, frequent political interference, poor management, outright mismanagement and bloated staff establishments.

To improve performance, the Kenyan Government undertook a number of reform measures. However, these measures did not adequately address management systems that are decentralized. They did not provide a framework for guiding behavior towards attainment of results nor ensure accountability in the use of public resources and efficiency in service delivery. The initiative lacked the following key elements of performance improvement systems: Performance information system, comprehensive performance evaluation system and incentive system.

Until the advent of performance contracts, public service management had emphasized inputs and conformity to laws, regulations and procedures rather than outputs, efficiency and cost-effectiveness (DPM,2005). Performance Contracts were adopted in Kenya in order to create a management system that focuses on the attainment of desired results at the highest levels in the government and state owned enterprises. The top level officials are expected to, in turn; hold those below them accountable for results

1.1 PERFORMANCE MEASURES FOR STATE OWNED ENTERPRISES

According to the http://www.en.wikipedia.org/wiki/government-owned ,a state owned enterprise is defined as a legal entity created by government to exercise some powers of the government. Some state owned enterprises may resemble a not for profit corporation as they have no need or goal of satisfying the shareholders with return on their investment through price increase or dividends, while other state owned corporations are established as for profit businesses, for example Telkom

According to Beiman and Sun(2003),state owned enterprises utilize the Balance Score Card methodology for measuring performance. This process involves determining the organization's mission, vision and strategic focus. The Balance Score Card is a set of four measures directly linked to a company's strategy: financial performance, customer knowledge, internal business processes, and learning and growth(Kaplan and Norton,1996).

Beiman and Sun(2003) identify the strategic performance criteria for state owned enterprises as follows:

Financial performance involves balancing revenue growth with increase in productivity, efficiency and costs.

Customer knowledge involves balancing the focus on different target markets that might have different value propositions.

Identifying which core business processes are critical for effective delivery of the enterprise's value proposition to target market.

Learning and growth involves balancing the enterprise's focus on competency development, improving access to information, and improving the enterprise culture in key areas that are important for successful strategy execution.

1.2. PROBLEM STATEMENT

Even though performance contracts are widespread, there have been few empirical assessments of their effectiveness; and those that exist (Song 1989; Trevedi 1990, World Bank 1995; Shirley and Xu 1997) reach different conclusions. Song (1989) and Trevedi (1990) suggest positive outcomes based on country case studies in Korea and India respectively. Trevedi(1990) finds that India's memorandum of understanding improves the dialogue between state owned enterprises' management and government, but does not rigorously analyze the impact of the performance contracts on the firm performance. Song(1989) finds improvement in performance in Korea. Nellis (1989) finds the effects of performance contracts in Africa were ambiguous, in part because at the time of the study, the experience was still recent.

The Agricultural Finance Corporation (AFC), a government owned development finance institution was established in 1963. The mandate of AFC is to assist in the development of agriculture and agricultural industries by providing loans, managerial

Beiman and Sun(2003) identify the strategic performance criteria for state owned enterprises as follows:

Financial performance involves balancing revenue growth with increase in productivity, efficiency and costs.

Customer knowledge involves balancing the focus on different target markets that might have different value propositions.

Identifying which core business processes are critical for effective delivery of the enterprise's value proposition to target market.

Learning and growth involves balancing the enterprise's focus on competency development, improving access to information, and improving the enterprise culture in key areas that are important for successful strategy execution.

1.2. PROBLEM STATEMENT

Even though performance contracts are widespread, there have been few empirical assessments of their effectiveness; and those that exist (Song 1989; Trevedi 1990, World Bank 1995; Shirley and Xu 1997) reach different conclusions. Song (1989) and Trevedi (1990) suggest positive outcomes based on country case studies in Korea and India respectively. Trevedi(1990) finds that India's memorandum of understanding improves the dialogue between state owned enterprises' management and government, but does not rigorously analyze the impact of the performance contracts on the firm performance. Song(1989) finds improvement in performance in Korea. Nellis (1989) finds the effects of performance contracts in Africa were ambiguous, in part because at the time of the study, the experience was still recent.

The Agricultural Finance Corporation (AFC), a government owned development finance institution was established in 1963. The mandate of AFC is to assist in the development of agriculture and agricultural industries by providing loans, managerial and technical assistance to the loan beneficiaries. AFC initially performed well, especially in the first two decades of its existence. The performance of AFC however experienced a downward trend during the 1990s, when lending declined from Kshs. 762 million in the 1993/94 financial year to Kshs. 4 million in the 2001/02 financial year. According to the AFC strategic plan, the poor performance is attributed to a number of factors; key among them the heavy build up of non performing loans arising from imprudent lending and poor loan recovery methods. Other factors included the poor performance of the economy, particularly the agricultural sector, the collapse of related supporting institutions especially the marketing agents, lack of budgetary support by the Government and discontinued donor support

In 2003, the ministry of Agriculture developed a sector specific recovery strategy known as Strategy for Revitalization of Agriculture Embedded within the strategy was the requirement that AFC management sign a performance contract with the government with a view to improving performance in service delivery. This paper seeks to find out the impact performance contracting has had on the performance of AFC since its introduction.

1.3. OBJECTIVE

To assess the impact of performance contracting on the performance of the Agricultural Finance Corporation.

1.4. SIGNIFICANCE OF THE STUDY

1.4.1 The study was significant to various groups of people as listed below:

1.4.1.1 AFC Management

The study may inspire AFC management to review aspects of the performance contract to be signed in the next financial year so that it may be relevant and consistent with changes in the Kenyan financial and agricultural sectors. The study should enable a review of performance indicators used.

1.4.1.2 The Government

The Government has a great stake in the Corporation which is used as a channel for agricultural development. The study will highlight the Corporation's returns as well as hindrances to good performance. This will enable the Government to identify appropriate means to support the Corporation with a view to good performance.

1.4.1.3 Partners

The Corporation partners with other institutions such as National Cereals and Produce Board, Kenya Seed and New KCC among others. The study will highlight issues that may affect the direction of investment by such partners.

1.4.1.4 Academicians

The study imparted knowledge to other academicians who may use it as literature in conducting extensive research in other similar areas.

CHAPTER TWO

2.0. LITERATURE REVIEW

Objectives of performance contracting include improving service delivery by ensuring top level managers are accountable for results, institutionalizing performance oriented culture, measuring and evaluating performance and linking reward to measurable performance. (AAPAM,2005)

By adopting the performance contract, the Kenyan Government has joined a worldwide practice and there is no going back on it. Whether it has worked in the public service is still debatable.However, there are broad indications that service delivery has improved in some government departments. (Aduda,2008)

2.1 CRITICAL SUCCESS FACTORS FOR STATE OWNED ENTERPRISES (SOE's)

Rockart (1979) defines critical success factors as "the limited numbers of areas in which results, if they are satisfactory, will ensure competitive performance for the organization" He used critical success factors to design information systems and this definition is rooted in the private sector.

Botherton and Shaw (1996) define critical success factors as the essential things that must be achieved by the company or which areas will produce the greatest "competitive leverage" They emphasize that critical success factors are not objectives, but are the actions and processes that can be controlled/affected by management to achieve the organization's goals They also state that critical success factors are not static, but depend on a combination of where the organization is and where it wants to be This definition again comes from the private (service) sector and is more a way of managing rather than an assessment of a project's success Both definitions emphasize gaining a competitive edge, which is not a feature of public sector organizations.

Boynton and Zmud (1984) defined critical success factors as "those few things that must go well to ensure success". This is a more universal definition which is equally applicable to both public and private sectors. The critical success factors for continuous improvement in state owned organizations are discussed below:

2.1.1 Management Commitment

A study by (Martin, 1994) indicates that for any SOE to be successful, its management has to be committed. Commitment is seen in management's ability to create a culture of participation by providing a compelling mission, a structure that emphasizes flexibility and autonomy, rewards for participation and a lack of punishment for risk taking, as well as ongoing involvement in programs and support for the integration of employees' work and family lives. Management commitment is also seen in the ability of management to foster good leadership and maximize and protect investments (UNDP, 2006).

2.1.2 Employee Empowerment

Vogt and Murrell, 1990 define empowerment as an act of building, developing and increasing power by working with others, which he terms "interactive empowerment", and of having the ability to influence one's own behavior. In an empowered organization, employees are able to fully participate as partners, they take initiative, work on teams as well as individuals, and have authority to make strategic decision.

Macy, Thompson, and Farias (1995) identify the major components of high performing state owned organizations. These include activities such as multi-skilling, cross training, self directed work teams, and horizontal design, human resource systems such as learning and development, job enrichment/enlargement, peer review, and innovative compensation plans, and total quality management that involves line employees such as statistical process control techniques, and formalized supplier/vendor partnerships.

2.1.3 Customer Management

Consumers demand quality services at reasonable prices and are increasingly offered more choices as to how they purchase public services. For any SOE to be successful there should be a good customer relationship management system in place (Forrester, 2002). It is important to have a customer information system which provides billing and provisioning capabilities as well as customer support and account management functionality. This provides a truly superior customer experience by focusing on customer insight, cost effective customer service, improved employee productivity and precision marketing (Terry, 2002), all geared to the success of the SOE.

2.1.4 Monitoring and Assessment

The UNDP, capacity Assessment Practice Note, New York, 2006 has highlighted the importance of monitoring and assessment for the success of the public sectors. It emphasizes that an effective state performance monitoring mechanism should strive at setting clearly spelt, measurable and realistic government objectives.

The UNDP discusses the following issues as being core to serve as the primary drivers of a capacity assessment:

2.1.4.1 Leadership

The relationship between capacity development and leadership is fundamental one: fostering good leadership maximizes and protects investments in capacities with enabling environment, as well as the organizational and individual levels. Among capacities assessed in this category are abilities to foster ownership; manage relationships with key external stakeholders, including the ability to negotiate; develop, communicate and give direction on vision, mission and values; develop and implement a system for overall management; and create an environment that motivates and supports individuals

2.1.4.2 Mutual accountability mechanisms

An efficient, responsive transparent and accountable public administration is of paramount importance. It is also the basic means through which government strategies to achieve development goals can be implemented. Assessing capacities to manage and support an accountable public administration and ensure the reforms required, often on long term and sustained basis is essential to effective governance. This category pertains to the capacity to ensure accountability through prevention and enforcement; strengthen national integrity institutions; increase public participation and build coalitions; and work with the international community.

2.1.4.3 Financial Resources

The capacity to manage financial resources is fundamental to the success within an enabling environment and at the organizations level; this applies to the management of both internal and external resources. Among capacities assessed in this category are capacities to negotiate, manage, utilize and monitor Direct Budget Support.

2.1.4.4 Physical Resources

Physical resources consist primarily of material resources and infrastructure. In the context of assessment, the capacity to build, maintain and manage these resources is the focus.

2.2 CHALLENGES FACING STATE OWNED ENTERPRISES

State owned enterprises lack the institutional capacities to perform well. (Behn, 2003). The issue of institutional capacity should be understood in the context of an organization's ability to train and utilize (as well as retain) their human resource Presently, most SOE human resources remain grossly underutilized and unutilized (Verheijen,2000). There exists an uncoordinated and fragmented approaches to human resources development, lack of data on training needs, uncoordinated training programmes, lack of sectoral and organizational training guidelines/policies, inadequate linkages between training output and the labour market requirements, inadequate support for training by end users; wastage and misplacement of personnel, and lack of monitoring mechanisms to determine the capacity and productivity of the trained personnel to contribute meaningfully to organizational development

The need to develop a strong institutional framework in SOEs cannot be overstressed since, in most of these organizations, institutional arrangements and processes are weak

2.1.4.3 Financial Resources

The capacity to manage financial resources is fundamental to the success within an enabling environment and at the organizations level; this applies to the management of both internal and external resources. Among capacities assessed in this category are capacities to negotiate, manage, utilize and monitor Direct Budget Support.

2.1.4.4 Physical Resources

Physical resources consist primarily of material resources and infrastructure. In the context of assessment, the capacity to build, maintain and manage these resources is the focus.

2.2 CHALLENGES FACING STATE OWNED ENTERPRISES

State owned enterprises lack the institutional capacities to perform well. (Behn, 2003) The issue of institutional capacity should be understood in the context of an organization's ability to train and utilize (as well as retain) their human resource. Presently, most SOE human resources remain grossly underutilized and unutilized (Verheijen,2000). There exists an uncoordinated and fragmented approaches to human resources development, lack of data on training needs, uncoordinated training programmes, lack of sectoral and organizational training guidelines/policies, inadequate linkages between training output and the labour market requirements, inadequate support for training by end users; wastage and misplacement of personnel; and lack of monitoring mechanisms to determine the capacity and productivity of the trained personnel to contribute meaningfully to organizational development.

The need to develop a strong institutional framework in SOEs cannot be overstressed since, in most of these organizations, institutional arrangements and processes are weak

and systems are generally not fully geared to the new challenges of development. The institutional frameworks are characterized by duplication of functions and overlapping jurisdiction, dilatory and outdated procedures and loopholes in administrative procedures leading to difficulty in maintaining objectivity, accountability and transparency in decision making.

Another challenge faced by SOEs is the 'requirement to balance political and economic interests bearing on it (Gomez 2007). This is such that if public enterprises fail to pursue commercial objectives, it is because there are few powerful interests pressing them to do so. In developing countries, public enterprises often constitute unusually large aggregations of resources that make them targets for interest groups.

In addition to the challenges discussed above, the principal – agent problem and the free rider problem are other challenges facing SOEs (Boorsma and Halachmi, 1998). An SOE is, by definition, run by managers who do not own the firm. Given the self seeking nature of humans, the argument goes; no SOE manager will run the firm as efficiently as an owner-manager would run his own firm.

This problem would not exist if the citizens, who are the owners (principals) of SOEs, can perfectly monitor the SOE managers (their agents). However, because it is inherently difficult to verify (although managers know) whether poor enterprise performance is due to shirking by the managers or circumstances beyond their control, monitoring by principals will always remain imperfect, resulting in inefficient management. (Alchain and Demsetz, 1974). This is called the principal - agent problem.

Moreover, individual citizens do not have the incentives and means to monitor the SOE managers. Instead, the costs that an individual owner (citizen) incurs in monitoring SOE managers are solely his or hers, while the benefits of improved management accrues to all owners. (World Bank, 1995). Thus individually, the citizens have no incentive to

and systems are generally not fully geared to the new challenges of development. The institutional frameworks are characterized by duplication of functions and overlapping jurisdiction, dilatory and outdated procedures and loopholes in administrative procedures leading to difficulty in maintaining objectivity, accountability and transparency in decision making.

Another challenge faced by SOEs is the 'requirement to balance political and economic interests bearing on it (Gomez 2007). This is such that if public enterprises fail to pursue commercial objectives, it is because there are few powerful interests pressing them to do so. In developing countries, public enterprises often constitute unusually large aggregations of resources that make them targets for interest groups.

In addition to the challenges discussed above, the principal – agent problem and the free rider problem are other challenges facing SOEs (Boorsma and Halachmi, 1998). An SOE is, by definition, run by managers who do not own the firm. Given the self seeking nature of humans, the argument goes; no SOE manager will run the firm as efficiently as an owner-manager would run his own firm.

This problem would not exist if the citizens, who are the owners (principals) of SOEs, can perfectly monitor the SOE managers (their agents). However, because it is inherently difficult to verify (although managers know) whether poor enterprise performance is due to shirking by the managers or circumstances beyond their control, monitoring by principals will always remain imperfect, resulting in inefficient management. (Alchain and Demsetz, 1974) This is called the principal - agent problem.

Moreover, individual citizens do not have the incentives and means to monitor the SOE managers. Instead, the costs that an individual owner (citizen) incurs in monitoring SOE managers are solely his or hers, while the benefits of improved management accrues to all owners. (World Bank, 1995). Thus individually, the citizens have no incentive to

and systems are generally not fully geared to the new challenges of development. The institutional frameworks are characterized by duplication of functions and overlapping jurisdiction, dilatory and outdated procedures and loopholes in administrative procedures leading to difficulty in maintaining objectivity, accountability and transparency in decision making.

Another challenge faced by SOEs is the 'requirement to balance political and economic interests bearing on it (Gomez 2007). This is such that if public enterprises fail to pursue commercial objectives, it is because there are few powerful interests pressing them to do so. In developing countries, public enterprises often constitute unusually large aggregations of resources that make them targets for interest groups.

In addition to the challenges discussed above, the principal – agent problem and the free rider problem are other challenges facing SOEs (Boorsma and Halachmi, 1998). An SOE is, by definition, run by managers who do not own the firm. Given the self seeking nature of humans, the argument goes; no SOE manager will run the firm as efficiently as an owner-manager would run his own firm.

This problem would not exist if the citizens, who are the owners (principals) of SOEs, can perfectly monitor the SOE managers (their agents). However, because it is inherently difficult to verify (although managers know) whether poor enterprise performance is due to shirking by the managers or circumstances beyond their control, monitoring by principals will always remain imperfect, resulting in inefficient management (Alchain and Demsetz, 1974). This is called the principal - agent problem.

Moreover, individual citizens do not have the incentives and means to monitor the SOE managers. Instead, the costs that an individual owner (citizen) incurs in monitoring SOE managers are solely his or hers, while the benefits of improved management accrues to all owners (World Bank, 1995). Thus individually, the citizens have no incentive to monitor the SOE managers, which means in the end, no one monitors them. This is called the free rider problem

2.3 SOLUTIONS TO PROBLEMS FACED BY STATE OWNED ENTERPRISES

Despite popular perception, encouraged by the business media and contemporary conventional wisdom and rhetoric, state owned enterprises can be efficient and well run. State owned enterprises could be reformed to operate in a more 'business like'manner,emphasizing commercial goals rather than what are called non commercial, social or political goals(McFetridge,1985) It is in this view that some proposed solutions to problems facing State Owned Enterprises are discussed below.

2.3.1 Privatization

Despite the absence of any peculiar barriers to good SOEs Performance, it is the case that SOEs have under performed private enterprises in many countries. For this reason, privatization has been touted as a means of squeezing better performance out of SOEs. Unfortunately, such a solution presents a conundrum. At root, it appears that if a government has the capacity and capability to conduct a good privatization, it probably also has the capacity and capability to operate goods SOEs, whereas if a government does not have the capacity to operate good SOEs, it likely also lacks the capacity to conduct a good privatization.

Government should focus on privatizing unprofitable SOEs (Stiglitz, 2003). Unfortunately, the private sector is not very interested in buying unprofitable SOEs. Therefore, in order to generate private sector interest in a poorly performing SOE, the government often has to invest heavily in it and /or restructure it

The very process of privatization involves financial expenditure, which can be a significant problem for cash strapped developing country government (Radon,2005). The valuation of an SOE and the floatation of its shares on the stock market are costly exercise, especially if they have to be managed by expensive international accounting firms and investment banks.

Privatization can put excessive burden on the regulatory capabilities of the government, especially if done on large scale. When the SOEs concerned are natural monopolies, privatization without appropriate regulatory capability can make things worse, as it may replace inefficient, but restrained public monopoly with inefficient and unrestrained private monopoly. The problem of regulatory capabilities is particularly serious with local governments. In the name of political decentralization and of "bringing service providers closer to the people," the World Bank and donor governments have recently pushed for breaking up SOEs into smaller units on a geographical basis, and leaving the regulatory capabilities of local governments, it has in effect, often resulted in regulatory vacuums (Kessler and Alexander, 2003)

2.3.2 Organizational Reforms

According to Chang and Singh (1993), organizational reforms should follow a number of steps: First, the goals of SOEs should be critically reviewed. Very often, SOEs are charged with serving too many goals for example meeting social goals, employment generation, industrialization, and provision of basic needs. Serving multiple goals can adversely affect enterprise performance, if the goals and the relative priority among them are left unclear. Therefore, each SOE should have clear goals, with explicit weights to each goal. It would also be helpful to minimize the number of goals and provide guidelines for reconciling potentially contradictory goals.

The second important element of organizational reform involves improving the quality of information regarding SOE performance and enhancing the ability of the monitoring agency to process and act on that information. It is vital that basic information be generated and clear lines and schedules of reporting be specified, adhered to, and meaningfully used to monitor improved performance without the government engaging in external micro management. At the same time, the supervisory authorities' ability to obtain, process and effectively use information should be improved.

Third, the incentive systems for those who work for SOEs need to be improved. (Chang 2003). A system of clear and effective incentives should be designed to reward the managers and employees in efficiency, productivity and consumer satisfaction. However, "incentives" here should not necessarily be narrowly interpreted as meaning individual materialistic incentives. They should include various types of non materialistic and non individualistic motives.

Fourth, establishment of a single, competently-staffed agency dedicated to SOE supervision could also improve monitoring. Consolidation of monitoring responsibilities into a single agency could increase monitoring efficiency by liberating managers from excessive inspection. However, in consolidating the monitoring responsibilities, it is necessary to ensure that there are adequate checks and balances on such all powerful agency.

2.3.3 Increasing Competition

Beyond organizational reforms, increasing competition can be important in improving SOE performance (Radon, 2000) SOEs are often in activities where there is natural monopoly, and increasing competition is either impossible or socially unproductive. However, there are cases when competitive pressure can be increased with positive results. In theory, it is possible to "stimulate" competition by artificially dividing up a natural monopoly industry into regional units and reward/punish them according to their relative performances.

2.3.4 Political and Administrative Reforms

In some countries, SOEs are used as a mechanism to address problems that could have been better addressed by other means, because the "first best" solutions are politically difficult to implement. In such cases, it may be desirable, although certainly not easy, to make it possible to go for the "first best" policies through political and institutional reform (Chang, 2000). For example, SOEs may be instructed to retain unnecessary workers despite making losses, because the government does not have an unemployment insurance program nor can it create more "productive" jobs through public works programs. In this case, a better solution would be to create a political environment where the government does not worry about generating "fictitious" employment because it has good unemployment insurance and public works programs. Setting up these programs, however, may need political reforms, because they require a political consensus for higher taxes and government deficit spending

The effective, political reforms must be accompanied by administrative reforms. Unless the bureaucrats monitoring the SOEs are competent in doing their job, creating the political space for them is not going to produce results.

Administrative reforms require a number of different elements. Improving the relative pay of civil servants will allow the government to recruit better people and also reduce corruption.

2.4 PERFORMANCE CONTRACTING

The primary development goal for any country is to achieve broad based, sustainable improvement in the standards of the quality of life for its citizens. The public service and in particular, the civil service plays an indispensable role in the effective delivery of services that are key to the functioning of a state economy. When the delivery of services is constrained or becomes ineffective, it affects the quality of life of the people and the nation's development process.

Public services in many African countries are confronted with many challenges, which constrain their delivery capacity (Lienert, 2003). They include the Human Resources factor relating to shortages of the manpower in terms of numbers and key competencies, lack of appropriate mindsets, and socio-psychological dispositions. There is also a perennial problem of the shortage of financial and material logistics that are necessary to support effective service delivery. On the other hand, the gradual erosion of the ethics and accountability has continued to bedevil the public sector in delivering public services to the people effectively. Public sector reforms meant to address these challenges have achieved minimal results (AAPAM, 2005).

The Kenyan Government responded to public service delivery challenges by formulating and implementing Public Sector Reforms (PRS) way back in 1993. The program implementation was in three phases. The first phase focused on cost containment, which entailed staff rightsizing initiatives and rationalization of government functions and structures. The second phase of the reform program focused on rationalization of government ministries/departments to determine appropriate structures and optimal size for effective performance of the government's core functions within budgetary limits. Both phases of the reform coupled with the embargo on recruitment reduced the civil servants size from 272,000 in 1992 to 191,670 in 2003 (GOK, 2004). While there was a reduction in the size of the core civil service of about 30%, it was noted that productivity and performance in the public service was not as expected (Opiyo, 2006). Further, reform initiatives targeting performance improvement and management in the public service were required, thus introducing the third phase of the public sector reforms guided by Economic Recovery policy direction (DPM, 2004).

In the Economic Recovery Strategy for wealth and Employment Creation (ERS) 2003 2007 policy documents, the government accords high priority to economic recovery and improving the performance of public service to deliver results to the people upto this point, the goal of public sector reform was the restoration so as to equip it well in order to play a pivotal role in national development. This called for fundamental changes in the way the sector operates in institutional organization and relationships, and in individual and collective behavior of those serving in the sector. The aim is to enhance efficiency and effectiveness together with probity and integrity In effort to achieve the objectives and targets of ERS and to manage challenges in public service, the Government adopted Performance Contracting in public service as a strategy for improving service delivery to Kenyans. The Performance Contract is one element of the boarder public sector reforms aimed at improving efficiency and effectiveness, while reducing total costs.

According to Ramarmuti and Venon(1991),a negotiated performance contract is viewed as a device to reveal information and motivate managers to exert effort. In the case of SOEs, performance contracts are also touted as a way to clarify the objectives of the multiple principals who govern state owned firms (different ministries, the president, the legislature), and hence make it easier to set goals and evaluate achievements. Proponents argue that the contract can translate multiple objectives into targets measured by specified criteria and given weights to reflect priorities (Ramarmuti and Vernon 1991)

2.5 INTERNATIONAL EXPERIENCES WITH IMPLEMENTATION OF PERFORMANCE CONTRACTS

According to the OECD 1999,the results of performance contracts have been mixed. In some countries there have been a general and sustained improvement in Public Enterprise improvement, while in other countries some public enterprises have note responded or have been prevented by government policies from responding For instance, in a little more than a decade, Ghana has transformed the structure and strategy of its rural water supply sector. By year 2000, district assemblies and communities played a significant

In the Economic Recovery Strategy for wealth and Employment Creation (ERS) 2003 2007 policy documents, the government accords high priority to economic recovery and improving the performance of public service to deliver results to the people upto this point, the goal of public sector reform was the restoration so as to equip it well in order to play a pivotal role in national development. This called for fundamental changes in the way the sector operates in institutional organization and relationships, and in individual and collective behavior of those serving in the sector. The aim is to enhance efficiency and effectiveness together with probity and integrity In effort to achieve the objectives and targets of ERS and to manage challenges in public service, the Government adopted Performance Contracting in public service as a strategy for improving service delivery to Kenyans. The Performance Contract is one element of the boarder public sector reforms aimed at improving efficiency and effectiveness, while reducing total costs.

According to Ramarmuti and Venon(1991),a negotiated performance contract is viewed as a device to reveal information and motivate managers to exert effort. In the case of SOEs. performance contracts are also touted as a way to clarify the objectives of the multiple principals who govern state owned firms (different ministries, the president, the legislature), and hence make it easier to set goals and evaluate achievements. Proponents argue that the contract can translate multiple objectives into targets measured by specified criteria and given weights to reflect priorities (Ramarmuti and Vernon 1991)

2.5 INTERNATIONAL EXPERIENCES WITH IMPLEMENTATION OF PERFORMANCE CONTRACTS

According to the OECD 1999,the results of performance contracts have been mixed. In some countries there have been a general and sustained improvement in Public Enterprise improvement, while in other countries some public enterprises have note responded or have been prevented by government policies from responding For instance, in a little more than a decade, Ghana has transformed the structure and strategy of its rural water supply sector. By year 2000, district assemblies and communities played a significant role in planning supplies. The new policy structure attracted extra funds and accelerated work. This reform process started with an extended dialogue with major shareholders in the sector, out of which a new rural water and sanitation policy was developed. The policy was then implemented in several large pilot projects, supported by a number of external agencies, and finally the lessons from those projects were incorporated into the national performance contract program itself. The success of this approach was due to the fact that national and international NGO's were contracted to build the capacity of local level NGO's.(World Bank,2002)

The evolution of contract plans in Swaziland can be traced back to the early 1990's period that witnessed the promulgation of the Public Enterprise (Control and Monitoring) Act of 1989.The latter sought to establish viable control mechanisms for Swaziland's parastatal sector amid a national outcry that public enterprises were continuing, unabated, to be a financial as well as an administrative burden on the government (Musa,2001). However, the performance agreement of the early 1990's failed to achieve its stated objective i.e. to improve performance of the public enterprises. This was as a result of widespread use of consultants in the formulation of contract plans, including determination of mechanisms for the monitoring and evaluation; public enterprise management did not develop the necessary sense of ownership and commitment to the success of enterprise contracts.

2.6 PERFORMANCE CRITERIA FOR BANKS AND NON BANKING FINANCIAL INSTUTIONS (NBFI's)

The Technical Guide of Performance Indicators by Inter-American Development Bank (Washington D.C, 2001) presents four main categories: portfolio quality, efficiency and productivity, financial management and profitability. While there exists other performance measures, emphasis is placed on the four criteria as the most important.These four criteria are as discussed below.

role in planning supplies. The new policy structure attracted extra funds and accelerated work. This reform process started with an extended dialogue with major shareholders in the sector, out of which a new rural water and sanitation policy was developed. The policy was then implemented in several large pilot projects, supported by a number of external agencies, and finally the lessons from those projects were incorporated into the national performance contract program itself. The success of this approach was due to the fact that national and international NGO's were contructed to build the capacity of local level NGO's.(World Bank,2002).

The evolution of contract plans in Swaziland can be traced back to the early 1990's period that witnessed the promulgation of the Public Enterprise (Control and Monitoring) Act of 1989.The latter sought to establish viable control mechanisms for Swaziland's parastatal sector amid a national outcry that public enterprises were continuing, unabated, to be a financial as well as an administrative burden on the government (Musa,2001). However, the performance agreement of the early 1990's failed to achieve its stated objective i.e. to improve performance of the public enterprises. This was as a result of widespread use of consultants in the formulation of contract plans, including determination of mechanisms for the monitoring and evaluation, public enterprise management did not develop the necessary sense of ownership and commitment to the success of enterprise contracts.

2.6 PERFORMANCE CRITERIA FOR BANKS AND NON BANKING FINANCIAL INSTUTIONS (NBFI's)

The Technical Guide of Performance Indicators by Inter-American Development Bank (Washington D.C, 2001) presents four main categories: portfolio quality, efficiency and productivity, financial management and profitability While there exists other performance measures, emphasis is placed on the four criteria as the most important.These four criteria are as discussed below.

2.6.1 Portfolio Quality

The largest source of risk for any financial institution resides in its loan portfolio. The loan portfolio is by far a financial institution's largest asset. In addition, the quality of that asset, and therefore, the risk it poses for the institution can be quite difficult to measure. The most widely used measure of portfolio quality in the finance industry is portfolio at Risk (PaR) which measures the portion of the loan portfolio "contaminated" by arrears as a percentage of the total portfolio. Although various other measures are regularly used, PaR has emerged as the indicator of choice. It is easily understandable, does not understate risk, and is comparable across institutions. In addition to the Portfolio at Risk Indicator, other indicators related to portfolio quality and associated risks are Write-Off Ratio, Provision Expense Ratio and Risk Coverage Ratio.

2.6.2 Financial Management

Financial management assures that there is enough liquidity to meet a financial lending institution's obligations to disburse loans to its borrowers and to repay loans to its creditors. Even though financial management is a back office function, decisions in this area can directly affect the bottom line of the institution. The importance of adequate liquidity and hence of financial management, grows further if the lending institution is mobilizing savings from depositors. Financial management can also have decisive impact on profitability through the skill with which liquid funds are invested. Finally, managing foreign exchange risk and matching the maturities of assets and liabilities involve financial management. Both are areas of great potential risk and underline the importance of competent financial management. The Technical Guide of performance indicators gauges financial management by using indicators which include finding expense ratio, cost of funds ratio and Debt/Equity

2.6.3 Efficiency and Productivity

Efficiency and productivity are performance measures that show how well the institution is streamlining its operations. Productivity Indicators reflect the amount of output per unit of input while efficiency indicators also take into account the cost of inputs and/or the price of outputs. Since these indicators are not easily manipulated by management decisions, they are more readily comparable across institutions than, say, profitability indicators such as return on equity and assets. On the other hand, productivity and efficiency measures are less comprehensive indicators than those of profitability.

Productivity and efficiency can be measured by operating expense ratio, cost per borrower ratio, personnel productivity and loan officer productivity.

2.6.4 Profitability

Profitability measures such as return on equity and return on assets tend to summarize performance in all areas of the Company. If portfolio quality is poor or efficiency is low, this will be reflected in profitability. Because they are an aggregate of so many factors, profitability indicators can be difficult to interpret. The fact that for instance a micro-finance institution has a high return on equity says little about why that is so. All performance indicators tend to be of limited use (in fact, they can be outright misleading) if looked at in isolation and this is particularly the case for profitability indicators. To understand how an institution achieves its profits (or losses), the analysis also has to take into account other indicators that illuminate the operational performance of the institution, such as operational efficiency and portfolio quality. Profitability can thus be measured by Return on Equity, Return on Assets and Portfolio yield.

unit of input while efficiency indicators also take into account the cost of inputs and/or the price of outputs. Since these indicators are not easily manipulated by management decisions, they are more readily comparable across institutions than, say, profitability indicators such as return on equity and assets. On the other hand, productivity and efficiency measures are less comprehensive indicators than those of profitability.

Productivity and efficiency can be measured by operating expense ratio, cost per borrower ratio, personnel productivity and loan officer productivity.

2.6.4 Profitability

Profitability measures such as return on equity and return on assets tend to summarize performance in all areas of the Company. If portfolio quality is poor or efficiency is low, this will be reflected in profitability. Because they are an aggregate of so many factors, profitability indicators can be difficult to interpret. The fact that for instance a micro-finance institution has a high return on equity says little about why that is so. All performance indicators tend to be of limited use (in fact, they can be outright misleading) if looked at in isolation and this is particularly the case for profitability indicators. To understand how an institution achieves its profits (or losses), the analysis also has to take into account other indicators that illuminate the operational performance of the institution, such as operational efficiency and portfolio quality. Profitability can thus be measured by Return on Equity, Return on Assets and Portfolio yield

CHAPTER THREE

3.0. RESEARCH DESIGN AND METHODOLOGY

3.1 RESEARCH DESIGN

This project is a case study of the effectiveness of performance contracting in improving the performance of the Agricultural Finance Corporation. Estimating the effect of incentives on performance is never straight forward. According to Chiappori and Salanie, 2003 the extent to which the performance contract will be effective in the corporation will be determined by various factors including the existence of a solid legal framework, which sets out the basic premises and status of the contract, availability and stability of resources, existence of control tools such as a quality service charter and regulations concerning transparency and accountability, and a performance oriented change in the management culture.

This paper will highlight the impact of the contract on the Corporation's performance by comparing its performance pre 2003 and after 2003 when the contract was signed between the Government and the Corporation's management.

3.2 DATA SOURCES

The study will mainly make use of secondary data including the corporation's annual financial statements, periodicals and strategic plan. The study will also make use of primary sources, namely interviews.

CHAPTER THREE

3.0. RESEARCH DESIGN AND METHODOLOGY

3.1 RESEARCH DESIGN

This project is a case study of the effectiveness of performance contracting in improving the performance of the Agricultural Finance Corporation. Estimating the effect of incentives on performance is never straight forward According to Chiappori and Salanie, 2003 the extent to which the performance contract will be effective in the corporation will be determined by various factors including the existence of a solid legal framework, which sets out the basic premises and status of the contract, availability and stability of resources, existence of control tools such as a quality service charter and regulations concerning transparency and accountability, and a performance oriented change in the management culture.

This paper will highlight the impact of the contract on the Corporation's performance by comparing its performance pre 2003 and after 2003 when the contract was signed between the Government and the Corporation's management.

3.2 DATA SOURCES

The study will mainly make use of secondary data including the corporation's annual financial statements, periodicals and strategic plan. The study will also make use of primary sources, namely interviews.

3.3 PERFORMANCE INDICATORS

The study will employ both financial and non financial indicators to gauge the impact of performance contracting on AFC performance The respective indicators are discussed below.

3.3.1 Financial Indicators

3.3.1.1 Pretax Profit

This is derived by deducting total expenses from total operating income. Operating income is derived by deducting interest expense from interest income while total expenses is the summation of board members allowances, staff costs, administration costs, depreciation and doubtful debts. As a performance indicator, it is expected that pretax profit should increase over time.

3.3.1.2 Return On Investment (ROI)

This is a performance measure used to evaluate the efficiency of an investment. To calculate return on investment, the Corporation uses the following formula:

$$\text{ROI} = \frac{\text{Pretax Profit}}{\text{Capital employment}}$$

As a performance criterion, any investment with a positive ROI should be undertaken The higher the ROI, the better.

3.3.1.3 Development Index

This is a ratio of development expenditure over recurrent expenditure.

$$\text{Development Index} = \frac{\text{Development Expenditure}}{\text{Recurrent Expenditure}}$$

Development expenditure is expenditure that results in the acquisition or creation of fixed assets. Recurrent expenditure on the other hand does not result in the acquisition or creation of fixed assets but mainly consists of expenditure on wages, salaries, purchases of goods and services and consumption of fixed capital (depreciation). As a performance measure, development index should increase over time.

3.3.2. Non-Financial Indicators

The Corporation set up a strategic plan whose elements is reviewed every five years. As performance criteria, the Corporation has to comply fully with those aspects of the plan which are discussed below:

3.3.2.1 Develop and offer innovative and market driven products.

The aim is to develop products that are responsive to market needs. In addition, the Corporation is expected to develop products for special interests groups in line with national development agenda. AFC is expected to work with other relevant Government bodies to develop environment friendly products such as agro-forestry and organic farming. Actionable strategies here include creating a research and development function, segmenting the agricultural credit retail market and developing a wholesale agricultural credit market. This aspect was measured by the number of new products introduced in each financial year. These products should also have a significant contribution towards the Corporation's interest income.

3.3.2.2 Re-engineer the business processes

The aim is to create an efficient organization that delivers quality services to customers through reduction of loan turn around time. Turn around time should be reduced to a maximum of fourteen days for loan approval and five working days for loan disbursements.

3.3.2.3 Achieve a sustainable financial base

The aim is to ensure a financially sound organization capable of meeting the needs of increased clientele with adequate funds for loan capital, institutional sustainability and growth. Actionable strategies here include cost rationalization and improvement of cash flows to attain return on investment of 15%, develop an appropriate risks management policy to maintain a delinquency level of no more than 15%, develop and implement appropriate investment policies to maintain a ratio of 3:1 interest income to non interest income.

3.3.2.4 Strengthen the Corporation's Human Resource base.

The aim is to strengthen and optimize the Corporation's human resource base to focus on new business priorities. This was measurable by evaluating the relevant skills and expertise developed in every financial year

3.3.2.5 Develop a positive corporate image

The aim is to foster understanding and appreciation of the Corporation and encourage maximum utilization of AFC products. This was measured by the ability of the Corporation to attract new customers and retain old customers.

3.4 DATA ANALYSIS

Analysis of data in the study was done under the two categories of financial and non financial indicators. The data was analyzed through trend analysis as well as descriptive analysis.

Pretax profit, Return on investment and Development index figures were calculated for the pre contracting period and post contracting period and comparison made to see whether these have been increasing over time. Graphs and charts were used for easier interpretations and drawing of conclusions and formulation of appropriate recommendations.

In the case of non financial indicators, questionnaires were prepared and distributed to AFC departmental heads and branch managers who have been employees of the Corporation in both the pre-contracting period and post contracting period. The derived data from the questionnaires was analyzed using Microsoft excel package. While analyzing the questionnaires, the questions were defined into variables for clarity; uniformity and adequacy in representing the research objective. A total of four variables were generated representing the questions the researcher wanted information on. Pie charts representing the percentage of various measures were generated from the data collected and descriptive reports generated.

CHAPTER FOUR-RESEARCH FINDINGS

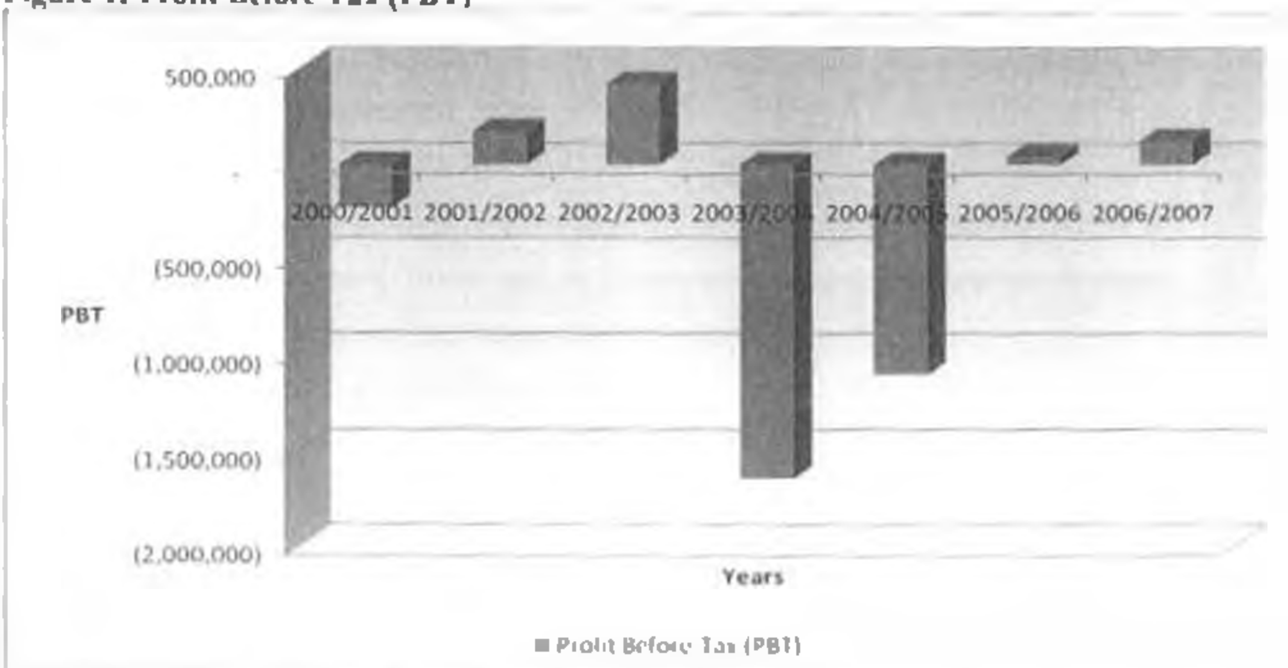
4.1 Introduction

The study involved getting secondary data from the AFC's financial statements, reports and periodicals. Specifically getting actual and budgeted figures for profit before tax, development expenditure, and recurrent expenditure and calculating the return on investment for the period 2000/01 up to 2006/07 It also involved calculating development index figures and performing a trend analysis as well as a comparative analysis of the figures

Further, the study included a representative sample of respondents chosen from AFC. Out of 35 questionnaires distributed, 30 were responded to. The five non respondents cited busy schedules and lack of time to participate in the research. This response rate is indeed considered adequate to form the basis for analysis. Findings were represented in the form of graphs and charts and interpretations thereof made

4.2 Financial indicators

Figure 1: Profit Before Tax (PBT)



Source: AFC annual financial reports for financial year 2000/2001 up to 2006/2007

CHAPTER FOUR-RESEARCH FINDINGS

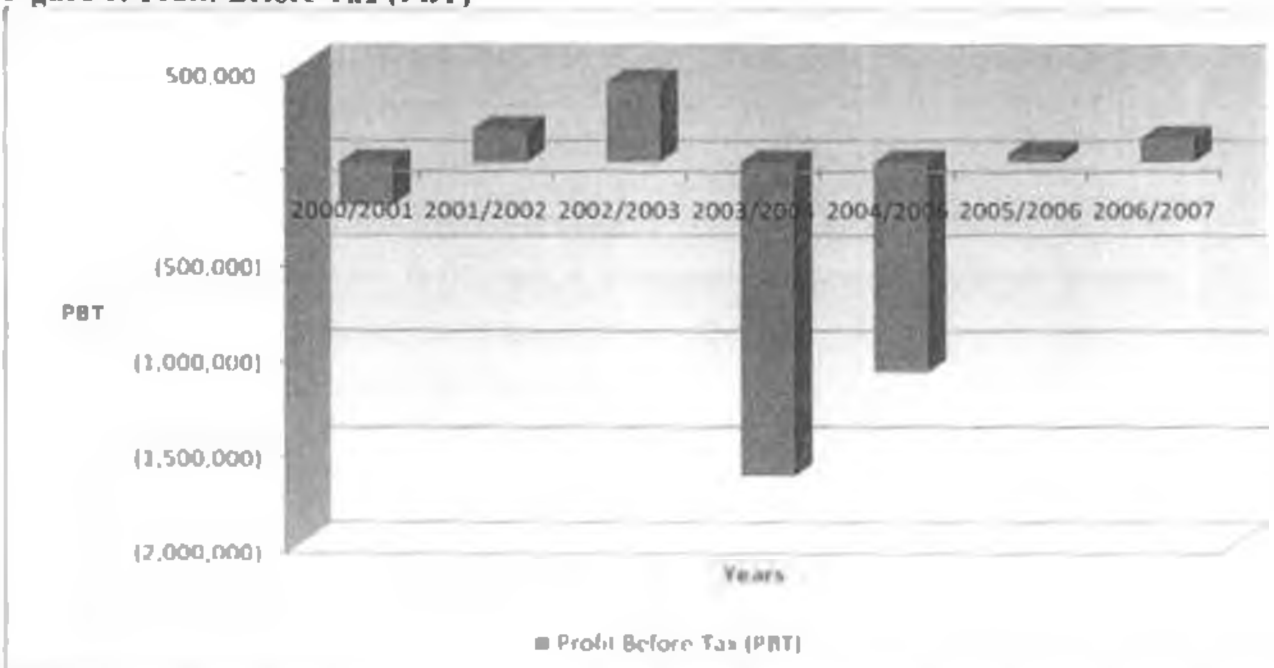
4.1 Introduction

The study involved getting secondary data from the AFC's financial statements, reports and periodicals. Specifically getting actual and budgeted figures for profit before tax, development expenditure, and recurrent expenditure and calculating the return on investment for the period 2000/01 up to 2006/07 It also involved calculating development index figures and performing a trend analysis as well as a comparative analysis of the figures

Further, the study included a representative sample of respondents chosen from AFC. Out of 35 questionnaires distributed, 30 were responded to. The five non respondents cited busy schedules and lack of time to participate in the research. This response rate is indeed considered adequate to form the basis for analysis. Findings were represented in the form of graphs and charts and interpretations thereof made

4.2 Financial indicators

Figure 1: Profit Before Tax (PBT)



Source AFC annual financial reports for financial year 2000/2001 up to 2006/2007

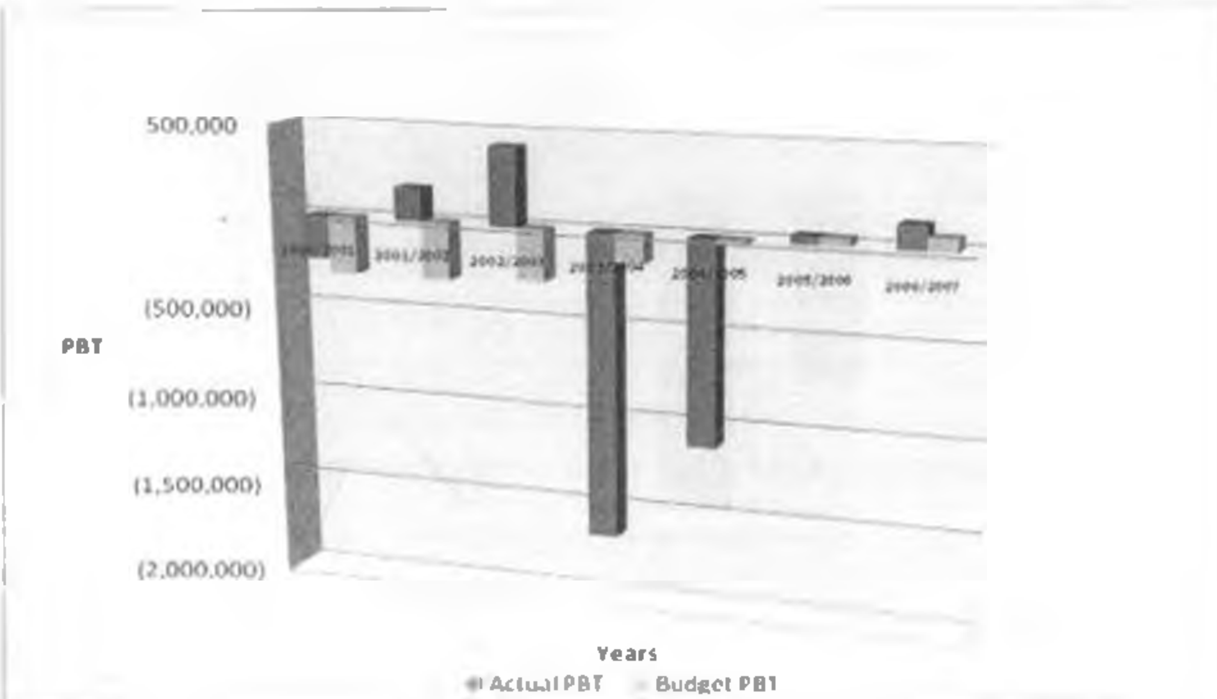
Figure 1 above shows the trend in profit before tax since the financial year 2000/01 up to 2006/07 Profit before tax increased from year 2000/01 to 2002/03 increased by 140% and also increased by 200% in 2006/2007 as compared in 2005/2006 There was a drastic drop in profit before tax in 2003/04 by Ksh 2 068 billion with 2002/03 having a loss of Ksh 0 4 billion, this is the year that the Corporation adopted the performance contract The loss however reduced in 2004/05 by 33% from negative Ksh 1 64 billion

The loss in the period 2004/05 and 2005/06 was as a result of the sale of non core and idle assets by the corporation The accounts now displayed the true profitability of AFC In addition, during this period, the Corporation implemented an interest concession write off amounting to Ksh 1 billion under the instructions of the Government

After signing the performance contract in 2003/04, the impact was initially of a drop in profit before tax up to the financial years 2005/06 and 2006/07 when there was a slight increase in profits This is an indication that the performance contract did not have a positive impact on the profitability of the Corporations The findings indicate that other factors including the implementation of interest concession write offs, also impacted on the profitability of the Corporation

The performance contract profit before tax targets were based on the budgeted figures as approved by the Government In this case, it is imperative to have a comparison between the actual profit before tax and the budgeted profit before tax
This comparison is clearly illustrated in Figure 2

Figure 2: Actual Versus Budget Profit Before Tax



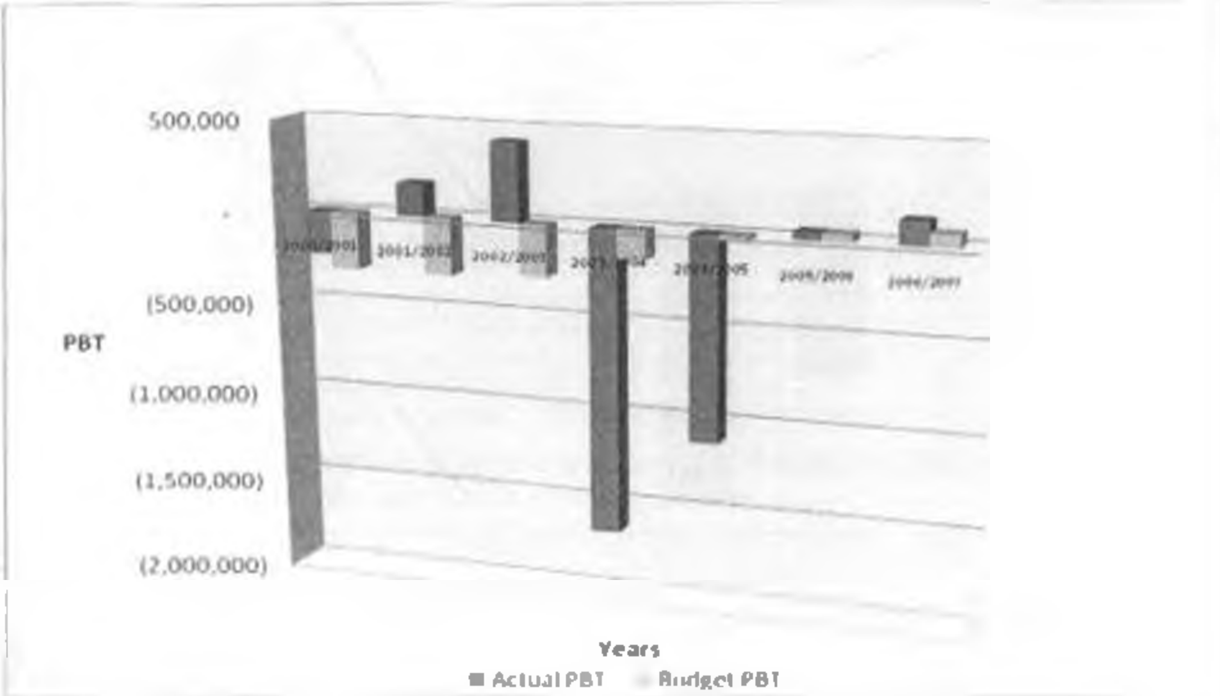
Source AFC annual financial reports for financial year 2000/01 up to 2006/07

Figure 2 above shows the relationship between the actual profit before tax and budgeted profit before tax for the period through 2000/01 to 2006/07

In 2000/2001, there was a slight variance of Ksh 77,374 million between actual and budgeted profit respectively. In the two subsequent years however, this variance was significant at Ksh 1.49 billion and Ksh. 1.08 million in 2003/04 and 2004/05 respectively. This variance could be attributed to the sale of the Corporation's idle assets, specifically the training complex. Further, the Corporation was not well knowledgeable on the required performance areas. This was however improved in the subsequent years as evident by the leveled variance

Similarly, the performance contracting did not impact positively due to government intervention where the Corporation was required to sale off idle assets and teething problems experienced at the initial stage of implementing the contract

Figure 2: Actual Versus Budget Profit Before Tax



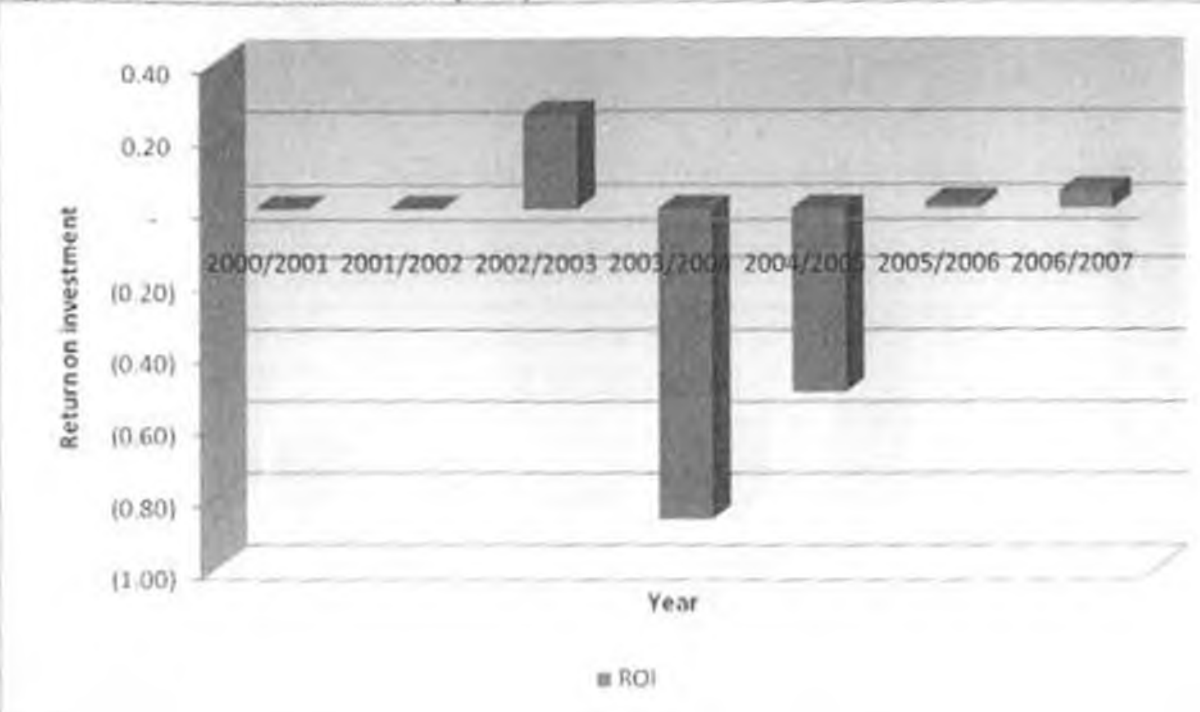
Source: AFC annual financial reports for financial year 2000/01 up to 2006/07

Figure 2 above shows the relationship between the actual profit before tax and budgeted profit before tax for the period through 2000/01 to 2006/07

In 2000/2001, there was a slight variance of Ksh 77,374 million between actual and budgeted profit respectively. In the two subsequent years however, this variance was significant at Ksh 1.49 billion and Ksh 1.08 million in 2003/04 and 2004/05 respectively. This variance could be attributed to the sale of the Corporation's idle assets, specifically the training complex. Further, the Corporation was not well knowledgeable on the required performance areas. This was however improved in the subsequent years as evident by the leveled variance.

Similarly, the performance contracting did not impact positively due to government intervention where the Corporation was required to sale off idle assets and teething problems experienced at the initial stage of implementing the contract.

Figure 3: Return On Investment (ROI)

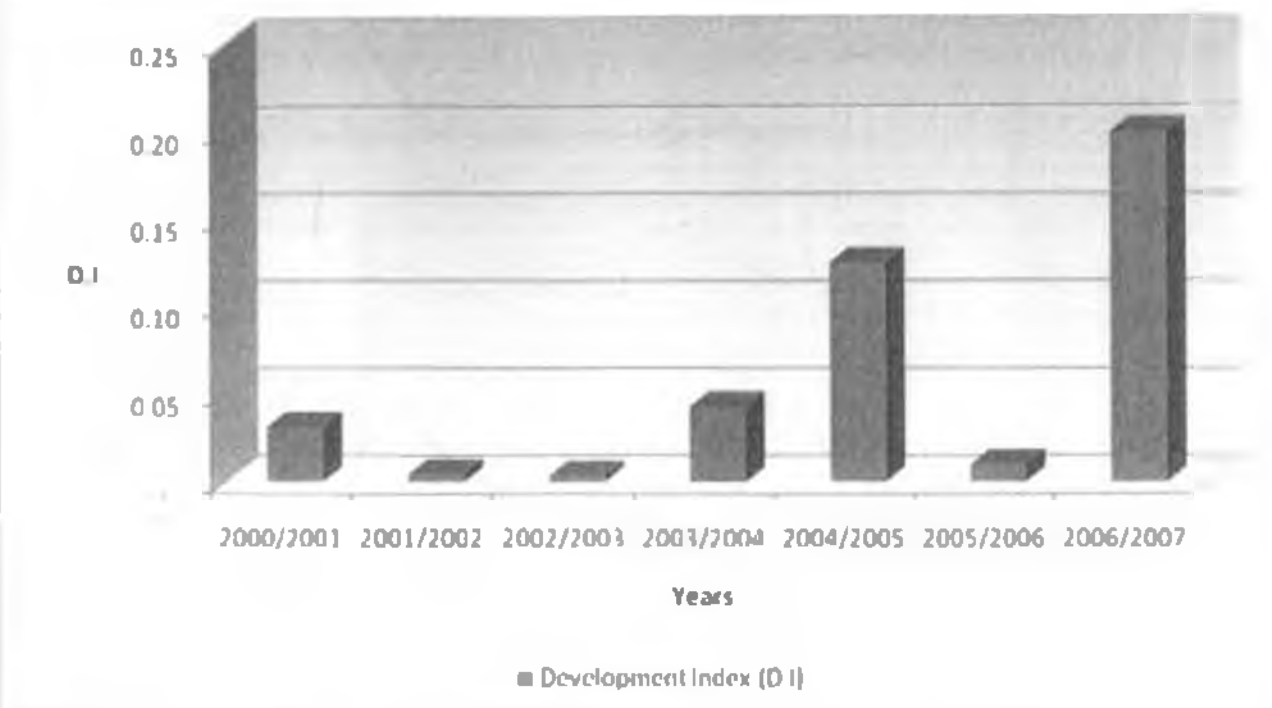


Source AFC annual financial reports for financial year 2000/2001 up to 2006/2007

Figure 3 above shows that there was an increase in return on investment from year 2000/01 up to 2002/03 with the latter having a ratio of 26 This however reduced significantly in the subsequent two years, the Corporation had a negative return on investment of negative 86 and negative 51 in 2003/04 and 2004/05 respectively. the significant drop could be attributed to the losses made in the years and increased equity injection by the Government

The performance contract in this case again did not initially have a positive impact on the return on investment of the Corporation The other factors that influenced profitability such as implementation of the interest concession write offs also impacted on the return on investment of the Corporation

Figure 4: Development Index (D.I)



Source AFC annual financial reports for financial year 2000/2001 up to 2006/2007

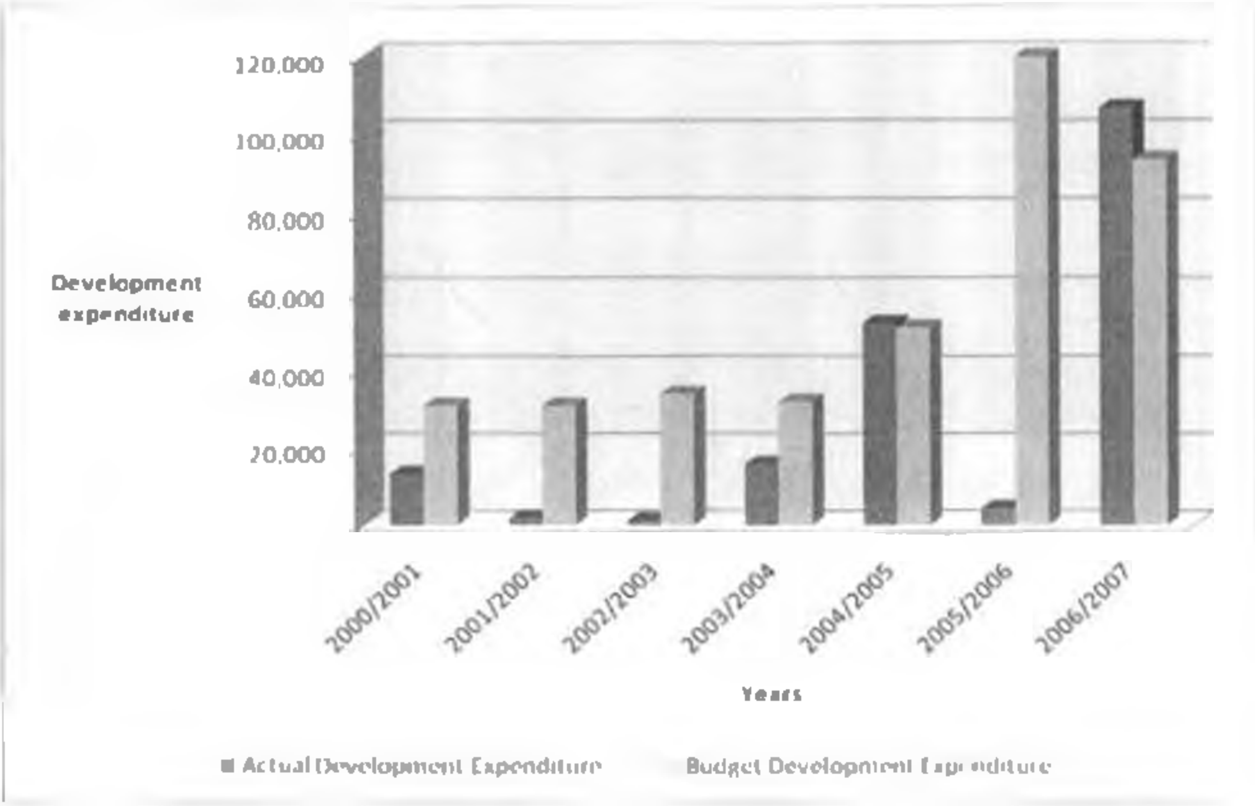
There was been a general increasing trend in development expenditure from 2003/04 to 2006/07 This could be attributed to Treasury allocation of equity by the Government of Ksh 260 million per year as from 2002/04 This enabled the Corporation to incur capital expenditure for development purposes

The Corporation invested in new motor vehicles and a computerization project in 2003/2004 and 2004/2005 There was an increased expenditure on renovation of branch offices as well as purchase of additional motor vehicles

The performance contract in this case had a positive impact on the performance of the Corporation since the development index increased gradually since the first year of implementing the contract However, in the year 2005/06,the performance contract had a negative impact since the development index reduced

It is also important to compare the actual expenditure against the budgeted expenditure on whose basis the performance contract was signed This is well illustrated in Figure 5 and 6

Figure 5: Actual Versus Budget Development expenditure

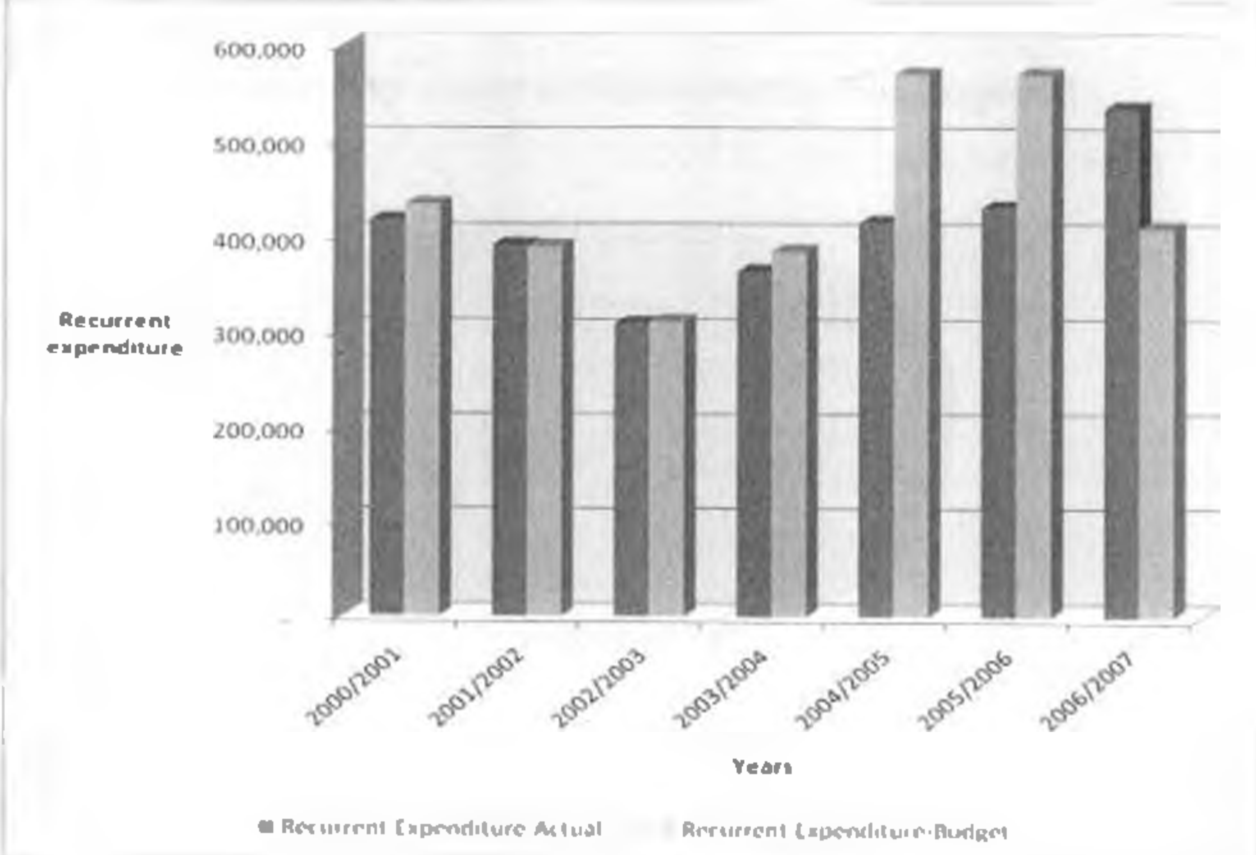


Source AFC annual financial reports for financial year 2000/2001 up to 2006/2007

The period prior 2004/05, the budgeted allocations to development expenditure were not actualized with the year 2002/03 having a variance of Ksh 32, 797 million The year 2005/06 had the highest variance between budgeted and actual development expenditure of Ksh 115,637 million

The increased variances over the period of study could be attributed to over allocation of the budgeted funds

Figure 6: Actual Versus Budget Recurrent expenditure

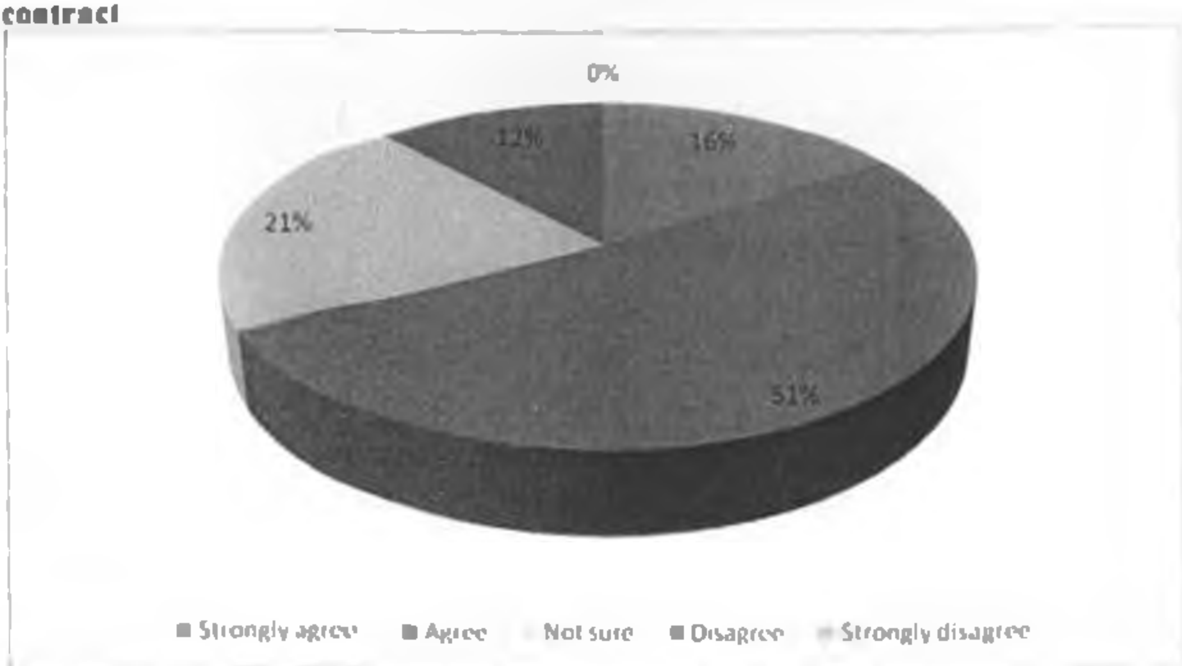


Source AFC annual financial reports for financial year 2000/2001 up to 2006/2007

The actual and budgeted recurrent expenditure reflected a decreasing from 2000/01 to 2002/03 but gradually increased from 2003/04 to 2006/07, indicating the high commitment towards meeting recurrent expenditure as opposed to development expenditure

4.3 Non Financial Indicators

Chart 1: Improvement of the product development function since inception of contract



Source Research data

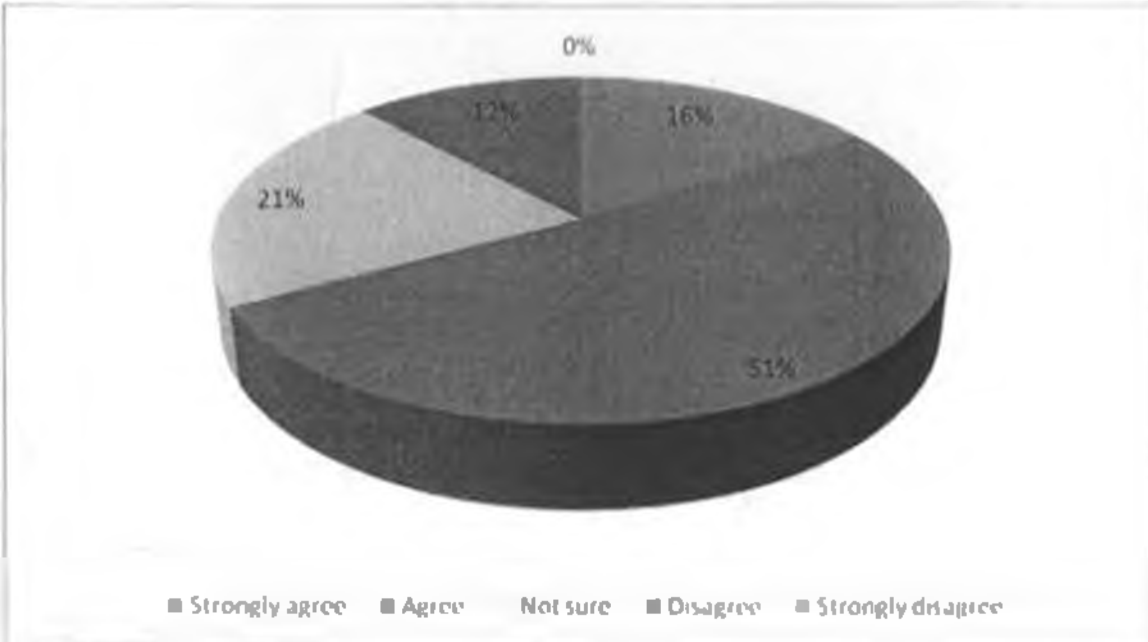
Of the responses received 51% agree that the product development function had improved since adoption of the contract while 12% disagreed. This is illustrated in the chart 1 above

This is evident in the corporation's new structure which encompasses a product development function. In the post contracting period, the corporation recruited competent officers for this function and work on product development as well as development of strategic partnerships is currently on course

In this case, the performance contract had a positive impact which is evident in the improvement and development of the product development function

4.3 Non Financial Indicators

Chart 1: Improvement of the product development function since inception of contract



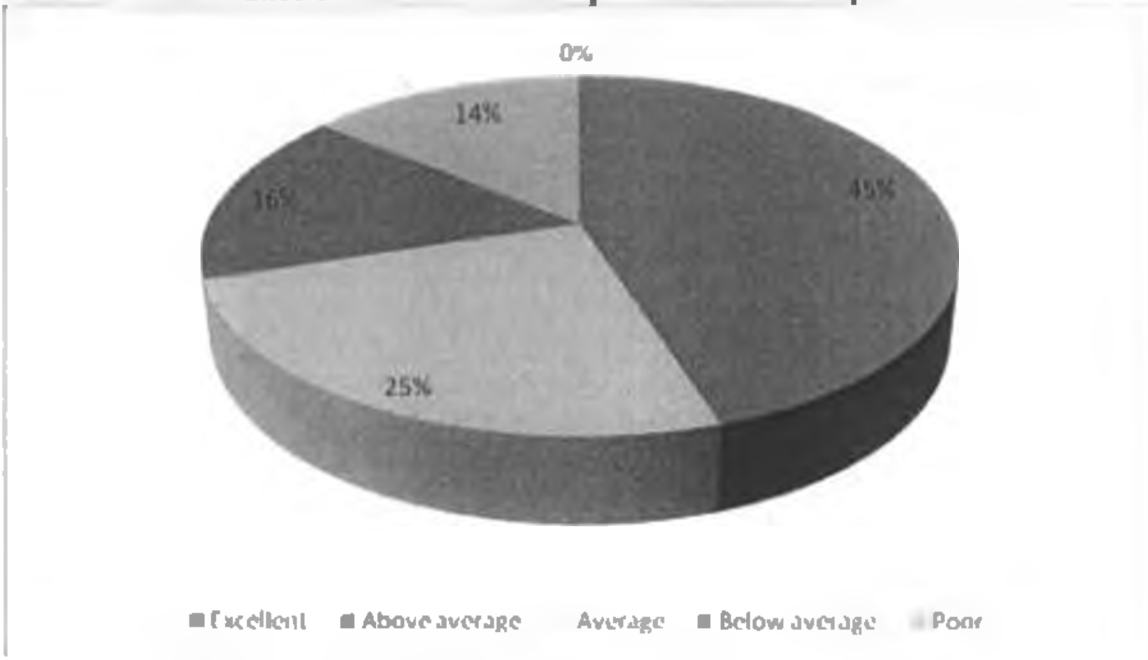
Source: Research data

Of the responses received 51% agree that the product development function had improved since adoption of the contract while 12% disagreed. This is illustrated in the chart 1 above

This is evident in the corporation's new structure which encompasses a product development function. In the post contracting period, the corporation recruited competent officers for this function and work on product development as well as development of strategic partnerships is currently on course

In this case, the performance contract had a positive impact which is evident in the improvement and development of the product development function

Chart 2: Performance of internal business processes after adoption of contract



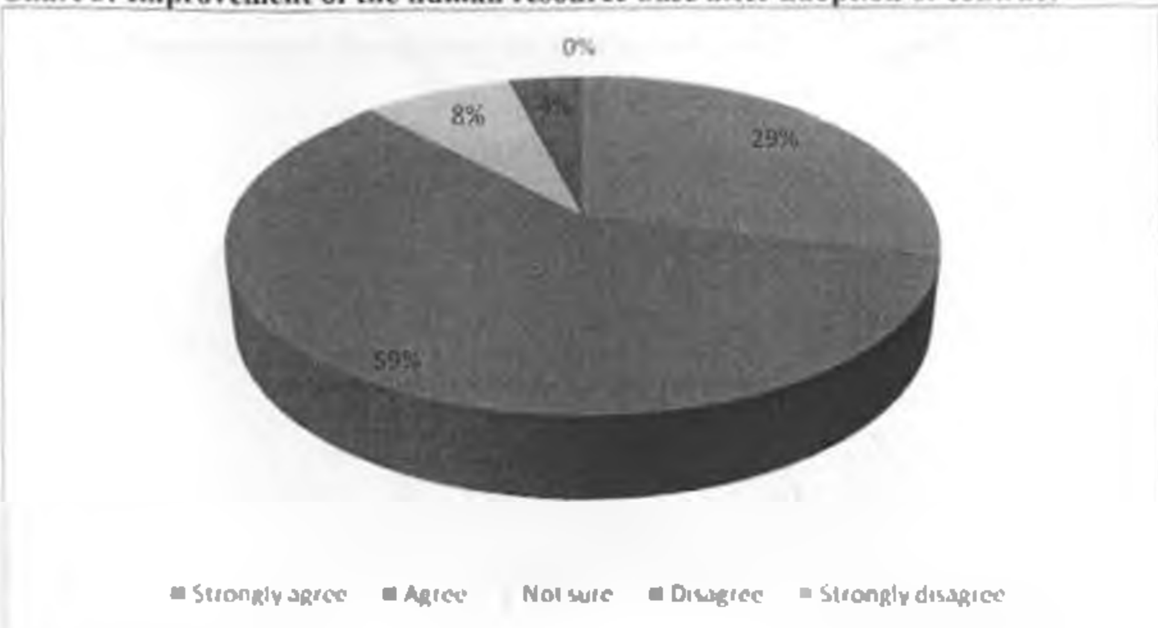
Source Research Data

Further, 45% of the respondents opined that since the adoption of the contracts internal business processes were above average while 16% opined that the business processes were below average This is illustrated in chart 2 above

Improvement of internal business processes is evident in the change of systems being used to provide services It has been greatly facilitated by the computerization programme undertaken by the Corporation in the post contracting period

It is therefore evident that the performance contracting had a positive impact on the performance of the Corporation in terms of improving internal business processes

Chart 3: Improvement of the human resource base after adoption of contract

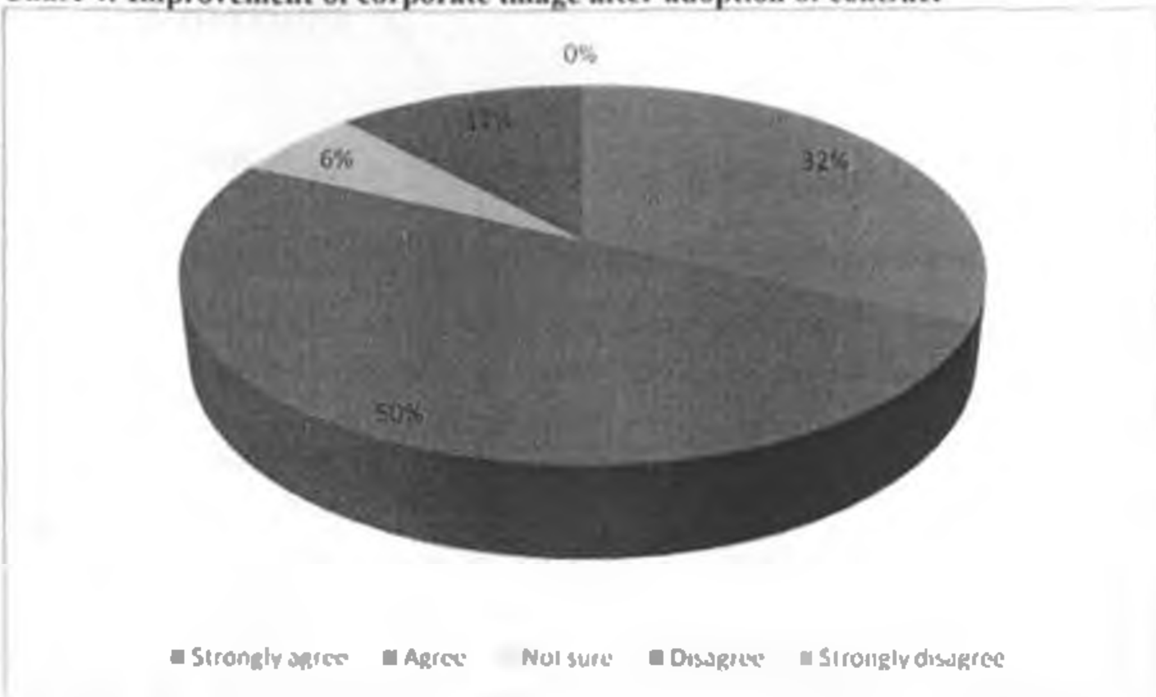


Source Research Data

Majority of the respondents 59% agreed that the human resource base had been strengthened since the adoption of the contract, while 4% disagreed to this. These responses are well depicted in chart 3 above

The strengthening of the human resource base is evident in the adoption and emphasis of training programmes especially in the post contracting period. In addition, the Corporation has also been seen to facilitate staff training by for instance giving study leaves and paying for professional courses for their staff. Thus, in this case, the performance contracting had a positive impact

Chart 4: Improvement of corporate image after adoption of contract



Source Research Data

50% of the respondents agreed that the Corporation had created a positive corporate image since the adoption of the contracts while 12% disagreed The responses are depicted in chart 4 above

From the above graph, half of the respondents agreed that the adoption of performance contract improved the Corporation's image This is evident in the new number of client achieved in the post contract period as well as the retention of previous clients In addition, there have been new strategic partnerships created on the strength of the Corporation's image Similarly, performance contracting impacted positively on the Corporation

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the summary of study findings, conclusions and limitations of the study. The chapter concludes with recommendations arising.

5.2 Summary of findings

The objective of the study was to assess the impact of performance contracting on the performance of the Agricultural Finance Corporation.

In doing so, a trend analysis and comparative analysis of performance indicators was done in a period of seven years covering the pre-contracting period (2000/01 up to 2002/03) and the post contracting period (2003/04 up to 2006/07). The main performance indicators surveyed were profit before tax, return on investment, development index, the product development function, the human resource base and the corporate image.

The findings indicate that in the post contracting period there was a decrease in profit before tax followed by a small increase in profit before tax. This trend was also observed in the case of return on investment and development index. The profitability status was negatively affected by the disposal of non-core assets and idle land in possession

However, in the case of non financial indicators, the observation was that there was a general improvement in the product development function, internal business processes and corporate image in the post contracting period.

The findings clearly indicate that AFC does not totally conform to the conventions of a business concern. In this regard, the performance of the corporation is affected by many other factors including political influence and government imposed policies which the Corporation can not easily negotiate.

5.3 Conclusion

In conclusion, it is evident that performance contracting has not worked for the Corporation. The findings indicate that the performance contracting has not been well conceptualized by the Corporation such that there is more emphasis on competition than efficiency. This has had an impact of poor target setting. The Corporation in some cases set low targets and was seen to be performing well in the end result, while this was not the true picture.

In addition, targets set were not well matched with the resources available to the Corporation. There was a basic assumption that the Government would continually inject equity funds on an incremental basis yet this was not the case.

Finally, the impact of Government interventions in the operations of the Corporation also pose a major challenge to the performance of the contract as agreed upon at the beginning of each financial year.
It is for the above discussed reasons that performance contracting has not worked for the Corporation.

5.4 Limitations of the study

The study was a case study of the Agricultural Finance Corporation where questionnaires were used with head of departments and branch managers who had served the corporation in both the pre contracting period and post contracting period. These respondents were considered representative; however they varied in terms of experience. In addition, due to the fact that the respondents have benefitted from AFC as an employer and this has as a result created a feeling of loyalty towards the organization, the opinions derived from the study were more subjective than they were objective.

Another limitation was that of the study period covered. The case study has covered a period of seven years from 2001 to 2007.The performance contract was signed in the year 2003/04.Therefore an assessment on the impact of contracting was done for only four years. This period is not enough to show a conclusive impact of contracting.

Thirdly, the study used information from financial statements that is prone to manipulation by the management to distort the financial position of the Corporation.

Finally, the study was conducted within the constraints of time and limited resources and the inherent problems associated with these limitations. Despite all these limitations, the main objective of the study was addressed.

5.5 Recommendations

Due to the limitation of time covered under the study, the researcher feels that more research is needed in this area to cover longer periods after the implementation of the contract so as to be able to conclusively deduce the impact of performance contracting on the performance of AFC.

Further research should also be done to encompass a more comprehensive coverage of all units of AFC. This will give a more detailed indication of the performance of the units and their contribution to the performance of the Corporation as a whole

References

AAPAM. 2005.The Enabling state and the role of the public service in Wealth creation Problems and strategies for Development in Africa. The Report of the 26th Roundtable conference of the African Association for Public Administration and Management Mombasa, Kenya.

Aduda, D.2008.Explain Performance Contract Concept to Teachers.The Daily Nation.

Agricultural Finance Corporation Audited Financial Reports,2001-2007

Agricultural Finance Corporation Strategic Plan,2005-2010

Alchain, A. A, and Demsetz ,H. 1974 "Production, Information costs, and Economic Organisation" (Reprint of the Original Article Form the American Economic Review 62 – December 1972, Pp 777 – 795). In, the Economics of Property Rights, ed. Eirik Furubotn and Svetozar Pejovich. Massachusetts: Cambridge.

Beiman, I and Sun,Y.2003. "Balanced Scorecard:Applications in China."Beijing:China Machine Press.

Behn, R D. 2003 "Why Measure Performance? Different purposes require Different Measures" Public Administration Review 63 (5): 586 606.

Boorsma, P.B., and Halachmi,A. 1998 " Inter and intra Government Arrangements for Productivity: An Agency Approach." Boston: Kluwer Academic Publishers.

Boynton, A – and Zmud, R. 1984 "An Assessment of Critical Success Factors." Sloan Management Review, Vol. 25 No. 4 Pp 17 – 27

Brotherton, B and Shaw, J. 1996 "Towards an Identification and Classification of Critical Success Factors in UK Hotels plc" International Journal of Hospitality Management, Vol.15 No. 2, Pp 113 – 135

Chang,H.J and Singh,A.1993 "Public Enterprise in Developing Countries and Economic Efficiency."UNCTAD Review no.4

Chang, H.J.2000 "State Owned Enterprises Reform" University of Cambridge.Cambridge.

Chiappori,P and Salanie,B.2003. Testing Contract Theory:A survey of some recent work,in Dewatripont,M ,Hansen,I and Turnovsky,P.(eds)Advances in Economics and Econometrics-Theory and Applications,Eighth World Congres,Econometric Society Monographs.Cambridge:Cambridge University Press,pp.115-149.

DPM 2004. Targeted Voluntary Early Retirement Scheme

DPM.2005.Information booklet on Performance Contracts in the Public Service.

GOK, 2004. "A strategy for Performance Improvement in the Public Service." Nairobi Government Printer

Gomez -Ibanez. J. A. 2005c "Singapore's Public Enterprises" Kennedy School of Government, Hravard University case Program, case No. 1817.

Kaplan,R.S and Norton,D.P.1996"Strategy Maps".Havard Business School Publishing Corporation.

Kessler, T and Alexander,N. 2003 "Assessing the Risks in the Private Provision of Essential Services." Geneva, Switzerland. http://www.unctad.org/en/docs/gdsmdpbg 2420047en.pdf.

Laffont, J, and Tirrole,J. 1993. " A Theory of Incentives in Procurement and Regulation."MIT press: Cambridge, NA.

Lienert, I. 2003. " Civil service Reform in African: Mixed Results After 10 years" International Monetary Fund. Finance and Development, Vol. 35 no. 2 (June)

Macy,B.A,Thompson,R.C.,Farias,G.F.1995, " Describing and assessing current high performance work practices in innovative organizations:A benchmarking study of 82 North America Organizations."A paper presented at Vancouver,British Columbia:National Academy of Management Meetings.Organizational Development.

Martin, L.A.C. 1994. " The Patterns of Empowerment: An Examination of Conditions Affecting Employee – Empowerment Effort." University of Knoxville, Knoxville, TN

McFetridge,D.G.1985.Commercial and Political Efficiency:A Comparison of Government,Mixed and Private Enterprises.In Canadian Industrial Policy Action edited by Donald G.McFetridge,pp.195-230.Toronto:University of Toronto Press.

Mookerjee, D. 1997 "Incentive Reforms in Developing Country Bureacracies: Lessons From Tax Administration." Forthcoming in Annual World Bank Conference on Development Economics: Proceedings.

Musa P.Dlamini.2001"Contract Plans and Public Enterprise Performance". Tangier,Morocco, Kessler, T and Alexander,N. 2003. "Assessing the Risks in the Private Provision of Essential Services." Geneva, Switzerland. http://www.unctad.org/en/docs/gdsmdpbg 2420047en.pdf.

Laffont, J, and Tirrole,J. 1993. " A Theory of Incentives in Procurement and Regulation."MIT press: Cambridge, NA.

Lienert, I. 2003. " Civil service Reform in African: Mixed Results After 10 years." International Monetary Fund. Finance and Development, Vol. 35 no. 2 (June)

Macy,B.A,Thompson,R.C.,Farias,G.F.1995, " Describing and assessing current high performance work practices in innovative organizations:A benchmarking study of 82 North America Organizations."A paper presented at Vancouver,British Columbia:National Academy of Management Meetings.Organizational Development.

Martin, L.A.C. 1994. " The Patterns of Empowerment: An Examination of Conditions Affecting Employee – Empowerment Effort." University of Knoxville. Knoxville, TN

McFetridge,D.G.1985.Commercial and Political Efficiency:A Comparison of Government,Mixed and Private Enterprises In Canadian Industrial Policy Action edited by Donald G.McFetridge,pp.195-230.Toronto:University of Toronto Press.

Mookerjee, D. 1997 "Incentive Reforms in Developing Country Bureacracies: Lessons From Tax Administration." Forthcoming in Annual World Bank Conference on Development Economics: Proceedings.

Musa P.Dlamini 2001"Contract Plans and Public Enterprise Performance". Tangier,Morocco.

Kessler, I and Alexander.N. 2003. "Assessing the Risks in the Private Provision of Essential Services." Geneva, Switzerland. http://www.unctad.org/en/docs/gdsmdpbg 2420047en.pdf.

Laffont, J, and Tirole.J. 1993. " A Theory of Incentives in Procurement and Regulation."MIT press: Cambridge, NA

Lienert, I. 2003. " Civil service Reform in African: Mixed Results After 10 years." International Monetary Fund. Finance and Development, Vol. 35 no. 2 (June)

Macy,B.A.Thompson,R.C.,Farias,G.F.1995. " Describing and assessing current high performance work practices in innovative organizations:A benchmarking study of 82 North America Organizations."A paper presented at Vancouver,British Columbia:National Academy of Management Meetings,Organizational Development.

Martin, L.A.C. 1994. " The Patterns of Empowerment: An Examination of Conditions Affecting Employee Empowerment Effort." University of Knoxville, Knoxville, TN

McFetridge,D.G.1985.Commercial and Political Efficiency:A Comparison of Government,Mixed and Private Enterprises.In Canadian Industrial Policy Action edited by Donald G.McFetridge,pp.195-230.Toronto:University of Toronto Press.

Mookerjee, D. 1997. "Incentive Reforms in Developing Country Bureacracies: Lessons From Tax Administration." Forthcoming in Annual World Bank Conference on Development Economics: Proceedings

Musa P.Dlamini.2001"Contract Plans and Public Enterprise Performance".Tangier,Morocco, Nellis, J. 1989 "Contract Plans and Public Enterprise Performance " Policy, Planning and Research Working Paper 118 World Bank, Washington, D.C.

Opiyo, H 2006. Civil Service Reform Policy in Kenya: A Review of the Retirement Strategy: Discussion Paper Series Institute of Policy Analysis and Research

OECD.1999"In Search of Results"Performance Management Practice Paris,France.

Performance Contracts Steering Committee,Kenya.2004.Sensitization/Training Manual on Performance Contracts in the Public Service.

RBM Guide, Kenya. 2005. Results Based Management Training Manual. Kenya

Radon, J. 2005. "The ABCs of Oil Agreements." In Covering Oil A Reporter's Guide to Energy and Development, Anya Schiffrin and Svetlana Tsalik, eds. New York: Open Society Institute.

Ramamuti,R. and Vernon,W 1991. "Performance Evaluation for State Owned Enterprises," New Delhi: International Management Publishers.

Rockart, J.F. 1979 "Chief Executives Define their Data Needs" Harvard Business Review, Vol. 57, Pp 81-93

Sapington, D. E. 1991 "Incentives in Principal – Agent Relationships." Journal of Economic Perspectives 5(2):45-66 ley, M, and Xu,L,C 1997. "Information, Incentives and Commitment: An Emprical ontracts between Government and state Enterprises " Policy Research working paper. Number. The World Bank.

g. D. H 1998. "Korea Public Enterprise Performance Evaluation system". Asian nomic Journal, 106 – 138.

litz, J. E. 1994. " Wither socialism?"Cambridge,Mass:The MIT Press.

y, R 2002. " Turning Down the Heat on the utility call center."Meta Group earch.

edi, P. 1990. "The Theory and Practice of the Contracting Approach: Lesson for s" In Memorandum of Understanding: An Approach to improving public erprises Performance, edited by Prajapati Trivedi, Pp 1- 30. New Delhi: International nagement Publishers.

DP 2002. Capacity for Development New Solutions to Old Problems.

DP. 2002 Manilla. 2002 Capacity Development Advisory Mission Report: New k.

heijen A.J.G,2000 "Administrative Capacity Development A race against time?" Hague.

t, J.F., Murrell, K.L. 1990. " Empowerment in Organizations. How to spark eptional Performance." University Associates, San Diego.

World Bank. 1995. "Bureaucrats in Business: The Economics and Politics of Government Ownership." Washington. D.C. Oxford University Press.

www.en.wikipedia.org/wiki/government-owned

World Bank. 1995. "Bureaucrats in Business: The Economics and Politics of Government Ownership." Washington. D.C Oxford University Press.

www.en.wikipedia.org/wiki/government-owned

APPENDIX B-QUESTIONNAIRE

THIS IS AN INTERVIEW THAT THE RESEARCHER WILL CONDUCT PERSONALLY WITH THE BRANCH MANAGERS AND DEPARTMENTAL HEADS AT AFC

AN INVESTIGATION ON THE CHANGE IN PERFORMANCE OF AGRICULTURAL FINANCE CORPORATION AFTER ADOPTION OF PERFORMANCE CONTRACTING

1. Position...

2. How long have you worked for the Corporation?

....

Please tick as appropriate.

3. Terms of service

Contract ☐

Permanent ☐

4. The Corporation has better identified the Agricultural credit retail and wholesale markets since the adoption of the performance contracting in 2004.

Strongly Agree ☐

Agree ☐

Not sure ☐

Disagree ☐

Strongly Disagree ☐

5. Since the adoption of performance contracting, the Corporation has developed and offers demand driven products

Strongly Agree □

Agree □

Not sure □

Disagree □

Strongly Disagree □

6. How would you rate the turnaround time for each of the following processes after the adoption of performance contracts in 2004.

(i) Loan processing

Excellent □

Above average □

Average □

Below Average □

Poor □

(ii) Loan Disbursements

Excellent □

Above average □

Average □

Below Average □

Poor ☐

(iii) Preparation of discharge of charge documents

Excellent ☐

Above average ☐

Average ☐

Below Average ☐

Poor ☐

(iv) Release of security documents

Excellent ☐

Above average ☐

Average ☐

Below average ☐

Poor ☐

(v) Preparation and dispatch of customer statements

Excellent ☐

Above average ☐

Average ☐

Below average ☐

Poor ☐

7. The Corporation financial systems and procedures have substantially improved after 2004

Strongly Agree ☐

Agree ☐

Not sure ☐

Disagree ☐

Strongly Disagree ☐

8. There has been an improvement in job analysis and description after 2004.

Strongly Agree ☐

Agree ☐

Not sure ☐

Disagree ☐

Strongly Disagree ☐

9. Since the adoption of performance contracting human resources development policies have been developed and are being implemented

Strongly Agree ☐

Agree ☐

Not sure ☐

Disagree ☐

Strongly Disagree ☐

10. Since 2004, the AFC marketing function has been well developed and products are appropriately marketed

Strongly Agree ☐

Agree ☐

Not sure ☐

Disagree ☐

Strongly Disagree ☐

11. Staff is better equipped with appropriate skills in communication and customer relations as compared to period prior to year 2004.

Strongly Agree

Agree ☐

Not sure ☐

Disagree ☐

Strongly Disagree ☐

12. Since year 2004,the Corporation has established strategic alliances important in fostering a positive Corporate image.

Strongly Agree ☐

Agree ☐

Not sure ☐

Disagree ☐

Strongly Disagree ☐

13. Staff have a more result oriented culture as compared to the pre-contracting period prior to year 2004.

Strongly Agree ☐

Agree ☐

Not sure ☐

Disagree ☐

Strongly Disagree ☐

APPENDIX C-RESEARCH FINDINGS

An investigation on the change in performance of The Agricultural Finance Corporation

S/No	Strongly agree	Agree	Not sure	Disagree	Strongly disagree
Product development					
4	7	8	11	4	0
5	4	19	0	7	0
6	3	19	8	0	0
	14	46	19	11	0
	16%	51%	21%	12%	0%
Business Processes					
S/No	Excellent	Above average	Average	Below average	Poor
7(i)	0	19	11	0	0
7(ii)	0	19	8	3	0
7(iii)	0	4	11	15	0
7(iv)	0	12	15	3	0
7(v)	0	0	0	4	26
7(vi)	0	26	0	4	0
	0	80	45	29	26
	0%	45%	25%	16%	14%
Strengthening of human resource base					
	Strongly agree	Agree	Not sure	Disagree	Strongly disagree
8	7	19	0	4	0
9	11	15	4	0	0
10	8	19	3	0	0
	26	53	7	4	0
	29%	59%	8%	4%	0%
Developing a positive Corporate image					
11	8	15	4	3	0
12	11	15	0	4	0
	19	30	4	7	0
	32%	50%	6%	12%	0%

APPENDIX D (I)-AFC FINANCIAL STATEMENTS

APPENDIX D (1)-AFC FINANCIAL STATEMENTS

APPENDIX D (II)-AFC FINANCIAL STATEMENTS

AGRICULTURAL FINANCE CORPORATION

INCOME STATEMENT FOR THE YEAR ENDED 30 JUNE [illegible]

	NOTES	[illegible] Kshs'000	2004 Kshs'000
INCOME:			
INTEREST INCOME:			
LARGE SCALE	[illegible]	[illegible]	[illegible]
SMALL SCALE	[illegible]	[illegible]	40,573
SEASONAL CROP	[illegible]	71,[illegible]	[illegible]
TOTAL INTEREST INCOME		[illegible]	654,484
LESS INTEREST EXPENSES			
REDEEMABLE LOANS	13(b)	[illegible]	40,939
REBATES INTEREST	13(c)	333	423
		[illegible]	41,362
NET INTEREST INCOME		[illegible]	[illegible]
OTHER OPERATING INCOME	[illegible]	[illegible]	213,[illegible]
TOTAL OPERATING INCOME		[illegible]	[illegible]
CHARGE FOR DOUBTFUL DEBTS	19	(1,754,369)	[illegible]
OTHER OPERATING EXPENSES	17	(414,731)	([illegible])
PROFIT/(LOSS) BEFORE TAXATION		(1,100,100)	(1,042,941)
TAXATION	12	-	
PROFIT/(LOSS) AFTER TAXATION		(1,100,100)	(1,042,941)

AGRICULTURAL FINANCE CORPORATION

BALANCE SHEET AS AT 30 JUNE [illegible]

APPENDIX D (III)-AFC FINANCIAL STATEMENTS

AGRICULTURAL FINANCE CORPORATION
PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30TH JUNE 2004

	NOTES	2004 Kshs'000	2003 Kshs'000
INCOME:			
INTEREST INCOME:			
LARGE SCALE	2.2	554,481	[illegible]
SMALL SCALE	4.3	49,873	[illegible]
SEASONAL CROP	5.5	30,328	[illegible]
TOTAL INTEREST INCOME		634,484	[illegible]
LESS INTEREST EXPENSE:			
[illegible]		36,147	[illegible]
[illegible] INTEREST		437	[illegible]
[illegible] LOAN (PROS)		4,792	[illegible]
		[illegible]	[illegible]
NET INTEREST INCOME		[illegible]	[illegible]
OTHER INCOME:			
[illegible]		[illegible]	[illegible]
INTEREST ON [illegible]	7(a)	[illegible]	[illegible]
[illegible]	7(b)	[illegible]	[illegible]
PROFIT ON [illegible] ASSETS		[illegible]	[illegible]
[illegible]	17(a)	[illegible]	[illegible]
[illegible] COMMISSION		[illegible]	[illegible]
[illegible]		7,961	[illegible]
		[illegible]	[illegible]
TOTAL OPERATING INCOME		[illegible]	[illegible]
OTHER EXPENSES:			
BOARD MEMBERS' ALLOWANCES		[illegible]	[illegible]
STAFF COSTS	18	[illegible]	[illegible]
ADMINISTRATION	19	[illegible]	[illegible]
DEPRECIATION	[illegible]	[illegible]	[illegible]
		[illegible]	[illegible]
PROFIT BEFORE PROV. D. DEBTS & TAX		[illegible]	[illegible]
DOUBTFUL DEBTS	[illegible]	[illegible]	[illegible]
PROFIT/(LOSS) BEFORE TAXATION		[illegible]	[illegible]

AGRICULTURAL FINANCE CORPORATION
BALANCE SHEET AS AT 30TH JUNE,2004

ASSETS:	NOTES		2004 Kshs.'000		2003 Kshs.'000
Non current assets					
Property and equipment	10		[illegible]		[illegible]
Repossessed farm properties	7		[illegible]		[illegible]
Deferred tax asset	12(a)		[illegible]		[illegible]
Loan to farmers	3.4, 4.4 &5.4		[illegible]		[illegible]
Staff loans	8	[illegible]		[illegible]	
Prov. For doubtful debts	9	[illegible]	[illegible]	[illegible]	[illegible]
			[illegible]		[illegible]
Current assets					
Cash and bank balances	3(a)		[illegible]		[illegible]
Short term deposits	3(b)		[illegible]		[illegible]
Debtors	3(c)		[illegible]		[illegible]
Consumable stores	3(d)		[illegible]		[illegible]
Loan to farmers	3.5, 4.5 &5.5	[illegible]		[illegible]	
Prov. For doubtful debts	4	[illegible]	[illegible]	[illegible]	[illegible]
			[illegible]		[illegible]
Total assets			[illegible]		[illegible]
CAPITAL AND LIABILITIES					
Capital and reserves					
Grants	14		[illegible]		[illegible]
Government equity capital	21		[illegible]		[illegible]
General reserve	[illegible]		[illegible]		[illegible]
Revaluation reserve	[illegible]		[illegible]		[illegible]
			[illegible]		[illegible]
Non current liabilities					
Redeemable loans	13		[illegible]		[illegible]
Current liabilities					
Trade creditors	11(a)		[illegible]		[illegible]
Other creditors	11(b)		[illegible]		[illegible]
			284,449		[illegible]
[illegible]			[illegible]		[illegible]

The accounts on pages 1 to 16 were approved by the Board of Directors on 28/10/2005 and were signed on its behalf by:

ROBERT K[illegible]GUNDA
CHAIRMAN

OM[illegible] IYADI
MANAGING DIRECTOR

APPENDIX D (IV)-AFC FINANCIAL STATEMENTS

AGRICULTURAL FINANCE CORPORATION

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30TH JUNE 2002

	NOTES	2002 Kshs '000	2001 Kshs '000
INCOME:			
INTEREST INCOME:			
LARGE SCALE	4	651,917	467,[illegible]
SMALL SCALE	5	130,079	[illegible]
SEASONAL CROP	6	268,305	[illegible]
OTHERS	21	17,004	21,[illegible]
TOTAL INTEREST INCOME		1,067,[illegible]	927,883
LESS:INTEREST EXPENSE:			
IRREDEEMABLE LOANS		[illegible]	8,218
REDEEMABLE LOANS		[illegible]	86,[illegible]
AFC SCC LOANS		50,170	50,120
REBATE INTEREST		[illegible]	3,045
ADB LOAN (FIDS)		[illegible]	8,459
CEREALS & SUGAR LOAN		[illegible]	46,300
BANK LOAN		[illegible]	0
		[illegible]	204,226
NET INTEREST INCOME		[illegible]	723,[illegible]
OTHER INCOMES:			
AGENCY COMMISSION		[illegible]	41,974
APP. LEGAL & INSP. FEES		2,[illegible]	[illegible]
PROFIT ON SALE OF ASSETS		[illegible]	[illegible]
RENT		[illegible]	[illegible]
SUNDRIES		[illegible]	[illegible]
		107,877	88,[illegible]
TOTAL OPERATING INCOME		[illegible]	809,[illegible]
OTHER EXPENSES:			
BOARD MEMBERS' ALLOWANCES		[illegible]	875
STAFF COSTS	22	[illegible]	[illegible]
ADMINISTRATION	23	[illegible]	[illegible]
DEPRECIATION	11	[illegible]	[illegible]
		[illegible]	[illegible]
		[illegible]	[illegible]
DOUBTFUL DEBTS	24	[illegible]	[illegible]
PROFIT/(LOSS)BEFORE TAXATION		[illegible]	[illegible]
TAXATION	13	[illegible]	0
PROFIT AFTER TAXATION	19	[illegible]	[illegible]
TO REVOLVING FUND	19	[illegible]	[illegible]
TO GENERAL RESERVE	19	[illegible]	[illegible]

AGRICULTURAL FINANCE CORPORATION

BALANCE SHEET AS AT 30TH JUNE 2002

	NOTES		2002 Kshs '000		2001 Kshs '000
ASSETS:					
CURRENT ASSETS:					
CASH & BANK BALANCES			[illegible]		[illegible]
SHORT TERM DEPOSITS			100,458		110,[illegible]
DEBTORS	8		79,946		[illegible]
CONSUMABLE STORES			2,004		2,[illegible]
LOANS TO FARMERS	4, 5 & 6	5,291,390		4,428,231	
PROV FOR DOUBT DEBTS	7	(2,078,238)	3,213,152	(1,726,142)	[illegible]
TOTAL CURRENT ASSETS			3,400,403		[illegible]
LESS: CURRENT LIABILITIES					
TRADE CREDITORS	12(a)		2,397,743		[illegible]
OTHER CREDITORS	12(b)		44,436		[illegible]
PROVISION FOR TAX	13		72,763		10,714
DUE TO AGENCY	14		477,921		[illegible]
CEREALS & SUGAR LOAN			300,000		[illegible]
AFC SCC LOANS	15		458,000		150,000
REDEEMABLE LOANS	16		277,670		[illegible]
TOTAL CURRENT LIABILITIES			4,028,439		[illegible]
WORKING CAPITAL			(628,036)		[illegible]
LONG TERM ASSETS:					
LOANS TO FARMERS	4, 5 & 6		489,971		[illegible]
STAFF LOANS	9	119,223		135,160	
PROV. FOR DOUBT DEBTS	10	(3,069)	116,154	(1,514)	133,646
REVERSIONARY PROPERTIES	8		61,750		[illegible]
FIXED ASSETS	11		901,911		[illegible]
TOTAL LONG TERM ASSETS			[illegible]		[illegible]
TOTAL ASSETS			[illegible]		[illegible]
LESS: REDEEMABLE LOANS	16		[illegible]		[illegible]
NETWORTH			[illegible]		[illegible]
FINANCED BY:					
IRREDEEMABLE LOANS	17		283,498		[illegible]
GRANTS	20		130,771		[illegible]
REVALUATION RESERVE		[illegible]		[illegible]	
GENERAL RESERVE	18	[illegible]		[illegible]	
REVOLVING FUND	19	1,784	[illegible]	[illegible]	[illegible]
			[illegible]		[illegible]

The accounts on pages 10 to 25 were approved by the Board of Directors on [illegible] and were signed on its behalf by:

[illegible] CHAIRMAN

[illegible] MANAGING DIRECTOR

APPENDIX E-FINANCIAL INDICATORS

ANNEX E-FINANCIAL INDICATORS Ksh'000

	2000/2001	2001/2002	2002/2003	2003/2004	2004/2005	2005/2006	2006/2007
Actual pretax profit	(227,830)	176,797	424,831	(1,642,941)	(1,100,100)	42,583	127,603
Budget pretax profit	(305,204)	(305,304)	(276,044)	(152,199)	(22,803)	40,803	70,319
Equity	-		1,647,766	1,907,766	2,167,766	2,427,766	2,687,766

	2000/2001	2001/2002	2002/2003	2003/2004	2004/2005	2005/2006	2006/2007
ROI(Actual pretax profit/Equity)			0.26	(0.86)	(0.51)	0.02	0.05

	2000/2001	2001/2002	2002/2003	2003/2004	2004/2005	2005/2006	2006/2007
Actual Development Expenditure	13,242	1,827	1,203	15,832	52,125	4,363	106,805
Budget Development Expenditure	31,000	31,000	34,000	32,000	51,000	120,000	53,550
Actual Recurrent Expenditure	417,215	391,162	309,029	364,134	414,711	430,280	531,823
Budget Recurrent Expenditure	433,458	390,558	311,359	385,419	569,000	568,278	409,822

	2000/2001	2001/2002	2002/2003	2003/2004	2004/2005	2005/2006	2006/2007
Development Index (D.I)	0.03	0.00	0.00	0.04	0.13	0.01	0.20