THE IMPACT OF PERFORMANCE CONTRACTING ON THE PERFORMANCE OF COMPANIES IN THE ENERGY SECTOR

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DECLARATION

This management research paper is my original work and to the best of my knowledge has not been presented for the award of any degree in any University.

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TABLE OF CONTENTS

ABSTRACT

Following the evolution of business environment over the past four decades, organization and management styles have had to change accordingly. Performance contracting has been used as part of the broader business reforms aimed at improving efficiency and effectiveness in the management of the private companies. In recent times, different governments have borrowed performance contracting ideology to improve performance of public sector institutions.

Several countries, including United States of America, China, United Kingdom, India, Korea and Morocco had earlier implemented performance contracts in their public institutions. Though found to have obtained varied results, most countries reported improved performance compared with period before contracts. Kenya borrowed the concept in 2003 to mitigate against poor public governance, wastage and misuse of public resources in the public institutions. There was need to examine the extent to which these contracts have enabled improved performance in Kenya.

Measuring organizational success is a continuous challenge for both managers and researchers. While financial measures were in wide use for many years, new frameworks have emerged in recent years that extend organizational perspectives beyond traditional financial measures. Among them the Balanced Scorecard is one of the most popular new frameworks. Balanced scorecard is a set of measures that consider both financial and non-financial perspectives in determining the overall performance of an institution. None of the earlier studies of performance contracting have used balance score card.

This study was dedicated to assessing the impact of performance contracts in parastatals in the Kenyan Energy sector using BSC. Despite the limitations of BSC, the results of the study support improved performance. Additional studies are however needed to assess other sectors using BSC.

CHAPTER ONE

1.0 INTRODUCTION

1.1 BACKGROUND

The business environment has evolved dramatically over the past four decades, which has caused almost every aspect of organization and management to change accordingly. Atkinson and Brown (2001), Corrigan (1998), Lockamy (1998) and Neely (1998) have discussed changes to business, which have caused and indeed contributed to the changes in the management styles. They include the changing nature of work, changing internal and external demands (stakeholders), national and international quality awards, increased competition, specific improvement initiatives, accelerated technological changes and the acceleration of globalization. The changes brought with them a new ownership – control issue known as corporate governance. This was intended to define the manner by which organizations are directed and controlled and thus solve the agency problem. Agency problems also arose in publicly held organizations (Jensen and Meckling, 1976). Agency theory specifies mechanisms which reduce agency theory. It proposes measures such as executive compensation, corporate takeovers and board structure aimed at reducing the agency problem.

One of the significant management reforms in the public service in recent times aimed at addressing the agency problem has been the introduction of performance contracts. Performance Contracting is part of broader public sector reforms aimed at improving efficiency and effectiveness in the management of the Public Service. Governments all over the world are increasingly faced with the challenge to improve delivery of service to the public. Performance Contracts (PCs) have their origins in the general perception that the performance of the public sector in general and government agencies in particular has consistently fallen below the expectations of the public.

The problems that have inhibited the performance of government agencies are largely common and have been identified as excessive controls, multiplicity of principals, frequent political interference, poor management and outright mismanagement. Different approaches to public sector management have been employed to address these challenges. Among these measures is performance contracting. It includes using relevant expertise such as financial, legal and probity; making provisions for appropriate access to records and premises by agency (the particular organization) and the Auditor-General to allow them have sufficient access to fulfill respective accountability requirements. It is also intended to establish clear mechanisms for assessing and monitoring performance under the contract, including consideration of the use of sanctions and incentives to achieve the contracted results (Hood, 1991). The Financial Management and Accountability Act, 1997, Section 44 states clearly that chief executives must manage the affairs of an Agency in a way that promotes proper use, that is, efficient, effective and ethical use of public resources for which the executives are responsible. Though being an agency cost, the importance of performance contracts has been debated by academicians and policy makers in both developed and developing nations.

A Performance Contract is a freely negotiated performance agreement between Government, acting as the owner of a government agency, and the agency itself. It is an agreement between two parties that clearly specifies their mutual performance obligations, intentions and responsibilities.

A Performance Contract addresses economic, social or other tasks that an agency has to discharge for economic performance or for other desired results. It organizes and defines tasks so that management can perform them systematically, purposefully, and with reasonable probability of accomplishment. It also assists in developing points of view, concepts and approaches for determining what should be done and how to go about it. A performance contract comprises two major components:-

(i) Determination of mutually agreed performance targets

(ii) Review and evaluation of periodic and terminal performance

Governments have been faced with an emerging public conviction that public sectors are too large and inefficient (Capling et al, 1998). In response to such pressure and faced with a more complex operating environment, public sector has been reformed by adopting managerial principles grouped under the rubric of New Public Management, NPM (Hood, 1991). These principles are aimed at changing the public sector in three areas as summarized by Maor (1999) as first, a change from hierarchical to economically-based structures, second, from regulative to economically-based processes and third, from legally based to economically based values. Many of these practices first emerged in private sector with the result that public sector has moved increasingly to resemble its private sector counterparts. Di Maggio and Powell (1983) described this trend as a process of engaging in isomorphic behaviour.

Performance Contracts were first introduced in France and were known as 'Programme de Contracts'. A Committee convened by the French Prime Minister and headed by Simon Nora was asked to investigate relations between public enterprise and Ministers and thereafter recommend new guidelines in this area. The Committee produced a report in 1967, known as the Nora Report, which among other things, proposed that Program Contracts be drawn to increase the operational autonomy of public enterprises and restrict the role of the state fixing the rules of the game. The state was now required to decide what goals an enterprise ought to pursue, what are the legal boundaries for its operations and then, leave the public enterprise free to achieve these goals without further meddling. The first Performance Contract signed in a developing country was in Senegal with the National Railway in 1980. A number of countries have since introduced performance contracts in their respective state owned corporations.

The concept of performance contract however varies from country to country (Robert and Peter, 1988). The extent to which performance contracting has been adopted has significantly varied between not only public sectors of various countries, but institutions within those countries.

1.1.1 THE CONCEPT OF PERFORMANCE CONTRACTING AND PERFORMANCE

Performance contracts or agreements specify standards for performance or quantifiable targets which a government requires public officials or the management of public agencies or ministries to meet over a stated period of time (Hope 2002). As part of the performance orientation in government, the common purposes of performance contracting are to clarify the objectives of service organizations, (for example Kenya Power and Lighting Company (KPLC), KenGen, or Kenya Pipeline) and their relationship with government. This facilitates evaluation based on results like financial performance instead of conformity with bureaucratic rules and regulations.

The setting of specific performance targets in a format that can be monitored is intended to provide a basis for evaluating performance and improving accountability in the public sector. Thus, the concept is inseparable with accountability and financial performance. In line with the new institutionalist perspective in public service management, as reflected in public choice theories and in the policy prescriptions based on them, the idea of performance contracting between the Kenyan government and public enterprises like KPLC, Kengen and KPL is increasingly being applied as an instrument for restructuring. However, performance evaluation results of these public enterprises have not been made public in order to evaluate the impact of such contracts and performance.

The impact of performance contracting therefore cannot be evaluated in isolation of performance measurement, (PM). Basically, performance measurement is the process of quantifying past actions (Nell, 1998).

The adage "if you do not know where you want to go, any path will take you there" is more relevant in performance measurement (Therkildsen, 2001). New Public Management has inspired refocusing on the public sector functions through staff reduction and changes in budgetary allocation. It also focuses on decentralization, delinking or 'hiving off' central government functions to local governments, marketization and introduction of competition in service provision; explicit standards and measures of performance, greater transparency, pay return and emphasis on outputs (Therkildsen, 2001).

Improved accountability in the conduct of public affairs is another reform objective. It may be observed that even in more economically stable states in Africa there are major deficits in accountability (Olowu, 1999; Therkilsden, 2001). The problems have arisen because governments ignore or transgress social ethics and constitutional and legal provisions in conducting public affairs; tasks to be performed are so complex or unspecified that implementation is very difficult if not impossible. In addition, corrupt practices are widespread, activities are hidden, political and personal loyalties are rewarded more than merit. Public participation in running public affairs is low (Olowu, 1999; Therkilsden, 2001).

Two of the early protagonists of an integrated approach Performance Measurement were Kaplan and Norton, who propounded the concept of BSC (Kaplan and Norton, 1992, 1993, 1996), which is essentially a multi-dimensional performance measurement framework. The Balanced Score Card approach of Kaplan and Norton broke new ground by juxtaposing both the financial and non-financial perspectives for measuring business performance namely, financial, customer, internal business processes and learning and growth. The premise of the concept was to construct a single approach that could provide an operational as well as a strategic insight into an organization's business, as well as serving as a management reporting tool (Sharif, 2002). Though a few critics have questioned the effectiveness of this approach in measuring business performance, the BSC has brought the concept of business performance measurement to prominence. This is evidenced by the fact that the most cited literature sources in the 1990s Performance Management Association (PMA) conferences so far were all publications of Kaplan and Norton. Therefore, it can be safely said that the BSC approach has been, in the last decade, and continues to be the most influential concept in the field of performance management (de Waal, 2003).

Organizations measure performance for a variety of reasons that include, among other things, identifying success, meeting customer requirements, understanding their processes, identifying problem bottlenecks, improvement opportunities and ensuring that decisions are based on facts (Parker, 2000). Owing to diverse inputs from various disciplines, recent business performance approaches, have seen a meteoric rise with the result that organizations have started to view it as a panacea for their sustenance and growth. It was not as though companies did not focus on their performance before. Towards the late 1980s there was a great interest in new measures of corporate performance, but most of them had shortcomings as they focused on isolated initiatives. But in the early 1990s, a fundamental shift took place in the way organisations measured their performance. Instead of targeting isolated measures, management experts started to talk about developing integrated, rather than piecemeal measurement systems (Neely and Bourne, 2000).

Organizations therefore might have adopted certain systems, policies and procedures to demonstrate conformity with institutionalized rules, thereby gaining legitimization to gain society's continued support (Meyer and Rowan, 1977; Meyer and Scott, 1992; Di Maggio and

Powell, 1983; Scott, 1995). This is the theoretical framework of performance contracting and financial performance in the energy sector lying in legitimization and rationalization purposes.

1.1.2 THE KENYAN ENERGY SECTOR

Some of the milestones in the history of the Kenyan Energy Sector include/fall: In 1875 when Seyyied Bargash, the Sultan of Zanzibar, acquired a generator to light his palace and nearby streets: In 1908 when Harrali Esmailjee Jeevanjee, a wealthy merchant in Mombasa, acquired the generator and transferred it to the Mombasa Electric Power & Lighting Company: 1908 Around the same time, an engineer, Mr Clement Hertzel, was granted the exclusive right to supply electricity to the then district and town of Nairobi. This led to the formation of the Nairobi Power & Lighting Syndicate: In 1922 when two utilities in Nairobi and Mombasa were merged under a new company incorporated as the East African Power & Lighting Company (EAP&L): In 1932 when EAP&L acquired a controlling interest in the Tanganyika Electricity Supply Company Ltd. (TANESCO): In 1936 when EAP&L obtained generating and distribution licenses for Uganda, thereby entrenching its presence in the East African region: In 1948 when the Uganda Electricity Board (UEB) was established by the Ugandan Government to take over distribution of electricity in the country: In 1954 when the Kenya Power Company (KPC) was created - to be managed by EAP&L - for the purpose of transmitting power from Uganda through the Tororo-Juja line: In 1964 when the EAP&L sold its majority stockholding in TANESCO to the Government of Tanzania: In 1983 with its operations confined only to Kenya, EAP&L was renamed KPLC Ltd. : In 1997 when the functions of generation were split from transmission and distribution. The Kenya Power Company, which has been under the management of KPLC since 1954, became a separate entity responsible for public-funded power generation projects: Lastly in 1998 The Kenya Power Company was re-launched as the KenGen (www.kplc.go.ke).

The Ministry of Energy is charged with the responsibility of Energy Policy and Development, Hydro-Power, Geothermal Exploration and Development, Thermal Power Development, Petroleum Products, Import/ Export/Marketing Policy, Renewable Energy Development, Energy Regulation, Security and Conservation, Fossil Fuels Exploration and Development, Kenya Power & Lighting Company Ltd, Kenya Petroleum Refineries Ltd., KENGEN, National Oil Corporation, Electricity Regulatory Board and Kenya Pipeline Company. The Ministry also formulates policy on the energy sector, in addition to administering the Rural Electrification Scheme (http://www.energy.go.ke/index.php).

The restructuring of the sector brought five key players in the sector. They are: KPLC, which owns all transmission and distribution assets, buys electricity in bulk from generating companies for transmission, distribution and retail to customers; The Kenya Electricity Generating Company (KenGen), which manages and develops all public electricity power generating facilities and sells electricity in bulk to KPLC. The company generates about 80% of the total country power output; Independent Power Producers (IPPs) that build, own and operate power stations and sell the power in bulk to KPLC, These are private investors who generate power. Currently, four IPPs are operational namely Iberafrica Power (K), Westmont Power (K), Orpower 4 and Tsavo Power Company Ltd. Electricity Regulatory Board (ERB) that reviews electricity tariffs and enforces safety and environmental regulations in the power sector as well as safeguarding the interests of electricity consumers. (www.kplc.go.ke).

Before 1997, The Kenya Power and Lighting Company Limited was charged with generation, transmission and distribution of electricity in Kenya. The Electric Power Act put in place in 1997 saw the separation of generation from transmission and distribution functions.

Kenya Electricity Generating Company Limited, KenGen is the leading electric power generation company in Kenya, producing about 80 percent of electricity consumed in the country. The company utilises various sources to generate electricity ranging from hydro, geothermal, thermal and wind. Hydro is the leading source, with an installed capacity of 677.3MW, which is 72.3 per cent of the company's installed capacity. KenGen is in direct competition with four Independent Power Producers who between them produce about 18 percent of the country's electric power. KenGen has a workforce of 1,500 staff located at different power plants in the country. With its wealth of experience, established corporate base and a clear vision, the company intends to maintain leadership in the liberalised electric energy sub-sector in Kenya and the Eastern Africa Region. KenGen Headquarters are located at Parklands, Nairobi (http://www.kengen.co.ke/content.asp).

The Kenya Pipeline Company (KPC) was incorporated on 6th September 1973 under the companies act (Cap 486) and started commercial operations in 1978. The Company is a State Corporation under the Ministry of Energy with 100% government shareholding. The company operations are also governed by relevant legislations and regulations such as; the Finance Act, The Public Procurement Regulations, amongst others. Kenya Pipeline Company operates a pipeline system for transportation of refined petroleum products from Mombasa to Nairobi and western Kenya towns of Nakuru, Kisumu and Eldoret. In collaboration with the Government, KPC facilitates the implementation of Government policies and Acts as a Government agent in specific projects as directed through the Ministry of Energy. To this end, the Company works with the Government in the implementation of key projects such as the extension of the Oil Pipeline to Uganda and the LPG import handling and storage facilities; Assists in the fight against fuel adulteration and dumping; Ensures efficient operation of petroleum sub-sector (http://www.kpc.co.ke/perfomance.php).

Unlike some State Corporations, KPC does not depend on government subsidies, but is a source of revenue to the Government in terms of dividends and taxes. The overall objective of setting up the Company was to provide the economy with the most efficient, reliable, safe and least costly means of transporting petroleum products from Mombasa to the hinterland (http://www.kpc.co.ke/perfomance.php).

1.1.3 PERFORMANCE CONTRACTING IN KENYA

The Economic Recovery Strategy for Wealth and Employment Creation Session Paper 2003-2007 highlighted governance of public sector enterprises as the government's main concern. The underlying concern noted was the realization that poor public governance had led to wastage and misuse of public resources. Management of the Kenyan State Corporations was previously dogged by political interference. Issues of political, tribal, ethnic and political patronage were rampant in ensuring appointments to the running of state corporations. The resultant performance of these corporations deteriorated. In deed, the Training Manual on performance contract in the public sector, February 2005, summarizes performance of 70 state corporations for the year ended 30th June 2002 as *"Total revenue, KShs 92.4 billion against total expenditure of KShs 99 billion,* *resulting to total losses of KShs 6.6 billion, total grants, KShs 9.5 Billion against dividends received of KShs 72.7 million and huge non performing loans".*

Donor agencies and World Bank were also increasingly demanding good corporate governance as a condition for aid, citing adoption of the same in a number of African countries including Nigeria and Ghana. There was therefore a need to shift focus to good corporate governance practices in state corporations. The Economic Recovery for Wealth and Employment Creation strategy paper therefore recommended introduction and implementation of performance contracts for CEO's and departmental heads to improve performance of state corporations.

State corporations are established by different laws with different provisions, some of which may be inconsistent with requirement to implement Performance Contracts (PC). H. E the President signed Legal Notice No. 93, a subsidiary legislation to the State Corporations Act, Cap 446, on 10th August 2004. The purpose of the legal notice was to provide a legal basis for the implementation of performance contracts in State Corporations and to set out the obligations, duties and responsibilities of the parties to the PC. These parties are Board of Directors, Parent Ministry, The Treasury, Inspector-General (Corporations) and State Corporations Advisory Committee. It also provides for the removal of an executive of a state corporation whose performance is unsatisfactory after evaluation. Minister for Finance developed guidelines on incentives and sanctions for, respectively, achievement and non-achievement of agreed performance targets.

The contracts became effective from 1st July 2004. The contracts defined the relationship between the Government and the parastatals and articulate agreed targets against which the performance will be evaluated. The Government developed performance incentives for boards of state corporations which meet the agreed targets, while, as a shareholder, it will have the right to call for removal of nonperforming director(s) by the shareholders (www.kplc.go.ke).

There have been several sensitization seminars and workshops organized by the government and professional bodies like Institute of Certified Public Accountants of Kenya (ICPAK). These have acted as a follow up to the performance contracting steering committee initiatives.

In all the countries analysed, it is evident that the success of performance contracting is premised on the existence of performance information, performance evaluation and incentive systems. Will the Government act on the basis of whether or not one has achieved the performance targets? Are the parastatal chiefs and departmental heads insulated from political interference so that they can be soberly judged? The reason for raising these questions is that we have seen in recent cases top performing parastatal chiefs being sent home, while some non-performers with political connections, being kept on. The examples of Kenya Broadcasting Corporation and the National Housing Corporation, where the chief executives turned around the organisations only to be shunted aside due to alleged political considerations do illustrate possible double standards being applied (Daily Nation, 27th July 2006). Another example is the story in *The People Daily* of 19th June 2006, page 5, where two assistant ministers claimed they would '*oppose moves by Regional Development minister to impose another managing director on Kerio Valley Development Authority (KVDA) at the expense of people from the region'*. They said it was unfair for the minister to shop for somebody from the North Eastern Province (where the minister comes from) to take over as CEO.

1.1.4 PERFORMANCE CONTRACTING IN KENYAN ENERGY SECTOR

The Kenyan government adopted performance contracting in the energy sector in July 2004 with two main objectives: to promote a culture of performance and to make the public sector more responsive to the needs of Government by increasing the organizations' accountability, promoting efficiency and effectiveness, introducing participative decision making and adopting a customer focus. The responsibilities and commitment of the three parastatals' board of directors under the performance contracts included: First, achieving maximum performance consistent with the business plan and in any event to meet the performance targets. Secondly, to monitor and evaluate periodical results against performance targets. Thirdly, maintain in place such systems and procedures to reasonably facilitate objective assessment of its performance by GOK. Lastly, adopt and implement good corporate governance practices in the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account the interest of the shareholders (Adopted from the Performance contracts of KPLC, KenGen, & KPLC, 2004/2005; 2005/2006).

In general, some of the target measures that were instituted in the PCs in 2004 to return the parastatals to center stage and steering them to profitability included restructuring their balance sheet, reviewing and rationalization of processes with other suppliers and reduction of system losses. It also included enhancement of customer base and financial restructuring, staff right-sizing, net work reinforcement and improvement of quality supply, which are now being re-defined and being focused on areas that can deliver rapid results. This was done through performance contracting to top organs composed of the Chief executive Officers (CEOs) and Departmental heads. The intention was to turn around of the performance of the parastatals (http://www.energy.go.ke/index.php).

The specimen performance contracts posted in the Directorate of Performance Management (DPM) website indicate the Boards of both KPLC and Kengen having committed themselves to:

- achieve maximum performance consistent with its Business Plan and in any event to meet the Performance Targets.
- monitor and evaluate periodical results against Performance Targets.
- maintain in place such system and procedures to reasonably facilitate objective assessment of its performance by GOK.
- adopt and implement good corporate governance practices in the Companies towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long term value while taking into account the interest of other stakeholders.

They also state that for purposes of assessing the overall performance of both companies, the weights assigned to the performance targets will be consolidated in order to give the aggregate weight factor.

The Strategic Objectives contained in the performance contract signed with KPC were;

- To maintain pipeline integrity;
- Enhance financial performance;
- Enhance the pipeline capacity;
- Utilize emerging technology to enhance performance;
- Maintain high operating standards;

- Develop and retain motivated, skilled and competent staff;
- Business diversification;
- Strengthen and maintain high safety standards;
- Develop and maintain an effective Business and Disaster Recovery Plan.

The specific quantified performance targets were provided as annexure to the performance contracts and were not attached to the contracts in the DPM website. These will be reviewed while undertaking the study.

The first Government-KPLC, KenGen and KPL performance contracts will expire in June 2007. The Directorate of Personnel Management is currently carrying out annual performance rating of the parastatals. This is intended to keep the performances of these parastatals congruent with the targets documented in Ministry of Energy Sessional Paper (2003), for the years 2004-2007.

1.2 STATEMENT OF THE PROBLEM

Management of the Kenyan State Corporations was previously dogged by political interference. Issues of political, tribal, ethnic and political patronage were rampant in ensuring appointments to the running of state corporations. This resulted in poor public governance, wastage and misuse of public resources. The performance of these corporations also deteriorated. Donor agencies and World Bank were also increasingly demanding good corporate governance as a condition for aid. This necessitated introduction of performance contracting in the Kenya state corporations. The Performance Contracts Steering Committee in Kenya undertook study tours to several countries implementing the concept. The countries visited were Morocco, United Kingdom, United States of America, India, Korea and China. The countries implementing the process were found to have obtained varied results, most being improved performance compared with period before contracts. The concept has also been refined by the implementing nations to suit their specific needs, thus producing hybrid models. There is need to examine the extent to which these contracts are able to achieve improved performance in Kenya.

On preliminary analysis of the financial statements of the parastatals, there appears to be improved performance. For example Kengen's revenue increased by KShs 2 billion (from KShs 9 billion to KShs 11 billion) in the year 2005, while KPLC's operating profits increased by KShs 3.6 billion (from loss of KShs 2.7 billion loss to KShs 900 million profit). There is need to examine whether the improved performance can be statistically attributed to performance contracting.

The Economic Recovery Strategy for Wealth and Employment Creation, 2003-2007 highlights adoption of performance contracts in Kenya as one of the ingredients to turn around state corporations. There is need to review the level of implementation of the contracts and their impacts on the organizations performance.

In addition, in all the countries analysed, it is evident that the success of performance contracting is premised on the existence of performance information, performance evaluation and incentive systems. There is need to examine whether there exists such systems in Kenya.

It must be emphasized that optimal performance contractual form is country and cultural specific, depending on factors such as trust, type of transaction, objectives, legal and administrative limitations, risk management and institutional history (Ahorani, 1986). There is need therefore to assess whether performance contracting in Kenya is unique in light of the mentioned factors.

Lippert and Moore, 1995 found that not all firms experience the same level of internal and external monitoring by the government. Board members and management exercise more power when firms are facing external threats like high level regulatory supervision (Lorsch and Maclver, 1989). There is need therefore to review whether the companies the firms experience the same level of internal and external monitoring by the government.

Most of the empirical literature on performance contracting is based on developed economies with a limited on emerging economies. Although a number of studies have been done in the area of performance contracting and performance, none has focused on the Kenyan parastatals.

It is against the backdrop of the above research gaps that this study on the Kenya Energy Sector is proposed.

1.3 OBJECTIVES OF THE STUDY

This study will aim to achieve the following objectives;

1. To evaluate the impact of performance contracting on the performance of parastatals in the energy sector.
2. To establish the extent to which managers were involved in the design of Performance contract.
3. To establish the extent to which performance contracting has allowed autonomy in decision making.
4. To establish the challenges facing these parastatals in the adoption and implementation of the performance contracts.

1.4 SIGNIFICANCE OF THE STUDY

It is anticipated that this study will be useful to the following groups;

a) Academicians

Findings from this research will assist researchers in broadening their syllabus with respect to performance contracting and financial performance.

b) The Energy Sector

The parastatals and other energy sector key players will have a chance to re-evaluate their present performance measurement with respect to performance contracting and in line with the New Performance Management (NPM).

c) Government

The government can use the findings to assist in policy formulation and development of a framework governing the energy sector.

CHAPTER TWO

2.0 LITERATURE REVIEW

Corporate governance issues in the public sector have previously been affected by political and regulatory environment (Jensen and Meckling, 1993). Political and regulatory forces have contributed largely to control measures in modern times. Jensen elaborated mechanisms that are available to mitigate the agency problem and to align the interest of managers of the agency and the principal (government). One of the measures advocated for is performance contracting.

According to Atkinson and Brown (2001), public sector reforms throughout the world have produced a new model of public governance incorporating a more modest role of the state as direct public service provider and a strong role of performance measurement. Performance contracting is part of the broader public sector reforms aimed at improving efficiency and effectiveness in the management of public sector.

The problems that have inhibited the performance of government agencies are largely common and have been identified as excessive controls, multiplicity of principals, frequent political interference, poor management and outright mismanagement (Hood, 1991). Different approaches to public sector management have been employed to address these challenges. Among these measures is performance contracting. It includes using relevant expertise such as financial, legal and probity; making provisions for appropriate access to records and premises by agency (the particular organization) and the Auditor-General to allow them have sufficient access to fulfill respective accountability requirements. It is also intended to establish clear mechanisms for assessing and monitoring performance under the contract, including consideration of the use of sanctions and incentives to achieve the contracted results (Hood, 1991). Di Maggio and Powell (1983) noted that many of these practices first emerged in the private sector with the result that the public sector has moved increasingly to resemble its private sector counterparts. They called this trend as a process of engaging in isomorphic behaviour.

Managing and measuring performance has been one of the key drivers in the reform of the public sector in recent years. It is one of the central planks of the “reinventing government” movement

(Gianakis, 2002). Performance measurement is an important tool for increasing accountability. Performance measurement may provide data on how effectively and efficiently public services are delivered. Within the public sector, performance measurement has fostered a move towards a contract culture on various levels. Performance contracts are seen as an instrument for steering the interactions between various organizational levels and contract partners. Along with the separation of steering and rowing or, to put it otherwise, the separation of the political and the managerial level, performance contracts have emerged in many countries.

Performance Contracts (PCs) have their origins in the general perception that the performance of the public sector in general and government agencies in particular has consistently fallen below the expectations of the public (Ahorani, 1986). The problems that have inhibited the performance of government agencies are largely common and have been identified as excessive controls, multiplicity of principals, frequent political interference, poor management and outright mismanagement.

According to Ahorani, 1986, different approaches to public sector management have been employed to address these challenges. These approaches include: -

1. new institutional structures and arrangements for managing and delivering programs and services (privatization, commercialization, contracting out and decentralization to local government)
2. systematic reforms (market type mechanisms, new budgeting and planning systems, administrative modernization, decentralization of management authorities); and
3. new methods of service delivery (case management and one-stop shops).

While these new methods are seen as addressing weaknesses in the more traditional centralized and compliance based public management systems, they bring their own set of problems. Most notably, management systems that are disaggregated, decentralized and devolved need a new framework to guide behaviour. These changes do not rely on uniform rules for the management relationship nor for ensuring accountability in the use of public resources and delivery of public services. In view of the shortcomings evident in the systems, countries have adopted the system of performance contracting as a management tool. The fundamental principle of performance contracting is the devolved management style where emphasis is management by outcome rather than management by processes. It therefore provides a framework for changing behaviours in the context of devolved management structures. Governments view performance contracting as a useful vehicle for articulating clearer definitions of objectives and supporting new management monitoring and control methods, while at the same time leaving day-to-day management to the managers themselves. Performance Contracts include a range of management instruments used within the public sector to define responsibilities and expectations between parties to achieve mutually agreed results (Performance Contracting Steering Committee Sensitization Manual on Performance Contracts in the Public Service, Feb 2005).

Performance Contracts were first introduced in France and were known as 'Programme de Contracts'. A Committee convened by the French Prime Minister and headed by Simon Nora was asked to investigate relations between public enterprise and Ministers and thereafter recommend new guidelines in this area. The Committee produced a report in 1967, known as the Nora Report, which among other things, proposed that Program Contracts be drawn to increase the operational autonomy of public enterprises and restrict the role of the state fixing the rules of the game. The state was now required to decide what goals an enterprise ought to pursue, what are the legal boundaries for its operations and then, leave the public enterprise free to achieve these goals without further meddling. The first Performance Contract signed in a developing country was in Senegal with the National Railway in 1980 (Performance Contracts Steering Committee, Sensitization/Training Manual on Performance Contracts in the Public service, Feb 2005).

2.1 Intended Purposes of Performance Contracting

The widely accepted rationale for performance contracting is that public agencies have multiple objectives and multiple principals. These fuzzy objectives lead to poor financial performance in most cases. One view is that because public agencies are required to carry several functions they are unable to do any one of them very well. The other is that while a government agency may have done very well in achieving many of its objectives, its performance may be judged with reference to one objective to which it has not done well. A performance contract is a tool of remedying the situation of multiple objectives by agreeing the preferred objectives, which the owner would like, achieved. It addresses the multiplicity of principals by requiring one agency to sign on behalf of all of them (Performance Contracts Steering Committee, Sensitization/Training Manual on Performance Contracts in the Public Service, Feb 2005). The multiple principals that government agencies must deal with in fulfilling their mandates emanate from:-

1. Parliament
2. Ministry of Finance
3. Ministry of Planning and National Development
4. Parent Ministry
5. Office of the President

Performance Contracts also prevent confusion due to multiplicity of objectives. Several government agencies may have to pursue certain social goals and such pursuit may affect the financial results of the operations of the agency. Therefore, a prior understanding of the extent to which financial results can be traded off against social objectives to be achieved by the agency through a performance contract helps to clarify the objectives of the agency (Jensen and Meckling, (1976).

Several government agencies, on the basis of current operations, could be recording losses but such results alone would not indicate the effort put in place and the success achieved by management of the agency in improving their operations. If a performance target by an agency for the year is to reduce loss from the level of previous years, the achievement of such a target would win public support, boost the morale of the current management and spur the agency on to better performance (Petri Uusikyla and Petri Virtanen, OECD, 1999).

The objective of the performance contracting policy is to simultaneously increase autonomy along with transparency and accountability. Unlike conventional privatization where public assets are transferred from public ownership to private ownership, the performance contract seeks to privatize the public sector style of management through what may be regarded as a movement away from control by procedures to control by results. Government surveillance mechanisms accordingly focus on the outcome of management processes and not on the processes themselves (Economic Recovery Strategy for Wealth and Employment Creation, 2003-2007). The positive impact of Performance Contracts is now widely recognized for it is based on the following premise:-

1. What gets measured gets done
2. If you do not measure results, you cannot tell success from failure
3. If you cannot see success, you cannot reward it
4. If you cannot reward success, you are probably rewarding failure
5. If you cannot see success, you cannot learn from it
6. If you cannot recognize failure, you cannot correct it
7. If you can demonstrate results, you can win public support

According to Economic Recovery Strategy for Wealth and Employment Creation, 2003-2007, a performance contract is therefore a management tool that ensures the following:

1. correlation between planning and implementation
2. coordination between various government agencies
3. an enabling public policy environment for other downstream reforms
4. a fair and accurate impression about public enterprise performance

2.2 Country Experiences with Implementation of Performance Contracting

The performance of the public sector has been a matter of public concern in both developed and developing countries. It has therefore been placed at the top of policy makers agenda (Ahorani, 1986). The main concern has been whether government agencies have delivered what was expected of them. This has resulted in concerted efforts to reduce the quantity of government while increasing the quality of government.

An analysis of countries that have successfully implemented performance contracting in public sector agencies reveals a commonality of issues that led to the adoption of the concept (Ahorani, 1986). These are as follows: -

1. Need to improve performance
2. Need for greater transparency and accountability
3. Need to improve productivity
4. Need to reduce, or eliminate reliance on the Exchequer
5. Need to give autonomy to government agencies

The concept of performance contracting however varies from country to country (Robert and Peter, 1988). It must be emphasized that optimal contractual form is country and culture specific, depending on factors such as trust, type of transaction, objectives, legal and administrative limitations, risk management and institutional history.

2.2.1 The French Experience

The concept of Performance Contracts was first introduced in France in 1967. It was known as 'Programme de Contrats'. The initial contracts were drawn between the government and the French Railways (SNCF) and Electricite de France (EDF) in 1969 and 1970 respectively (Gilles Grapinet, OECD, 1999).

France went through four phases of the contract system in less than two decades. Some of the reasons cited for the break down of the contracts were unexpected change in macro-economic conditions and political interference whenever it appeared to be convenient.

The French system has nevertheless continued to exist inspite of the above problems due to three main reasons:-

(i) the high quality of upper level public servants,

(ii) the similarity of background of the enterprise managers and the state controlling agents who attended the same schools and whose career paths show a remarkable similarity and interchangeability,

(iii) the existence of the evaluating body which though? it does not possess any specific legal sanctions, its reports are however so respected that the publications of an adverse report against an enterprise is strong enough to undertake change.

2.2.2 Denmark Experience

In Denmark contract management was introduced in 1992 as a response to framework budgeting which was solely an input-oriented system but not connected to the services that agencies provide. Since barriers to improved efficiency were found to be agency-specific a decision was made to negotiate customised contracts with individual agencies. The selection of pilot agencies was based on existing action plans that could be used as a starting point for contract negotiations. As a result, all major tasks of an agency could be included in the performance criteria so that the problem of goal displacement was avoided. After the first pilots the Ministry of Finance has been withdrawing from negotiations and now negotiations are solely between an agency and the agency's department. Changes currently considered or already introduced concern the implementation of budget guarantees in the performance contracts and the use of contract management as a means of strategic control by departments. As the experience with contract management in the Danish National Board of Industrial Injuries shows performance contracts are a powerful tool that motivate managers and employees to live up to the contract requirements due to its nature as a commitment with another party (Peter K. Pedersen *et al*, OECD, 1999). Overall, the problems identified pointed to the need for:

1. increased freedom of action in the performance of tasks;
2. budget guarantees based on multi-year agreements;
3. establishment of clearer target- and result-related requirements.

In many cases, agency performance was found to be better than the contract specifications. Secondly, the findings showed that provision of information to the public and users was strengthened. In addition, the reporting provided improved documentation of agency activities, something that in turn improved the quality of communication. At the same time, better integration of programme management and financial management was achieved, something that was very largely lacking in the normal one-year budget negotiations (Peter K. Pedersen *et al*, OECD, 1999).

In Denmark, contract agencies operate on organizational performance agreements linked to chief executive performance agreements and employment contracts. An evaluation done of the system by the Danish National Audit Office found that development of efficiency gains for contract agencies outpaced gains for government institutions that did not use contracts.

2.2.3 Finland Experience

Performance contracts were introduced in 1995 in the Finnish public sector. They can be characterized as quasi-contracts. This means that contracts between Ministries and executive agencies are not statutory and the word contract refers more to a mutually negotiated agreement than to a contract in the strict legal sense. The informal nature of the contracts made the implementation much easier than this would have been the case with a legal model. The idea behind the reform was to emphasize outputs and results instead of inputs and rules and to improve target-setting and follow-up. In this process, performance contracts have played an important role (Petri Uusikyla and Petri Virtanen, OECD, 1999).

However, it also caused some difficulties in ensuring the compliance of the actors and making contracting parties accountable for their actions. The performance contracting process of the Ministry of Social Affairs and Health shows performance contracting increased the co-operation between Ministries and agencies as well as among agencies. It also strengthened the strategic thinking in central government agencies and made the agencies more cost-conscious and results-oriented. There are still weaknesses with the performance indicators and the ex-post evaluation of the financial management (Petri Uusikyla and Petri Virtanen, OECD, 1999).

Finland also reported evidence that performance contracting has a positive effect on performance management, efficiency and quality of services (Petri Uusikyla and Petri Virtanen, OECD, 1999).

2.2.4 The New Zealand Experience

The separation of policy advice from policy implementation in New Zealand has provided chief executives with broad authority to run their organisations since the late 1980s (Sonja E. Smith, OECD, 1999). With this freedom to manage, performance contracts became an important tool to ensure that managers were accountable for these responsibilities. Performance contracting in various forms is applied throughout the Public Service to a variety of different relationships. Key relationships are between the State Services Commissioner and the chief executive, between the

Minister and the chief executive, within a department, between a department and its environment and between Government departments. The case of the Ministry of Justice (policy role) and the Department for Courts (service delivery role) show that some areas lend themselves to more standard and formal agreements than others. For areas where the principal-agent role is less clear, the ability to influence performance without monitoring or assessment components is limited.

New Zealand also reported evidence that performance contracting has a positive effect on performance management, efficiency and quality of services (Sonja E. Smith, OECD, 1999).

2.2.5 Norway Experience

The development of performance contracts in the Norwegian government administration has been encouraged by new financial regulations. There are two main contractual arrangements which encapsulate and formalise the ministries' control of executive agencies: Letters of allocation define the resource allocation, performance targets and reporting requirements for the more than 300 subordinate agencies'. The documents are the result and the basis for a management dialogue between the Ministries' and executive agencies about roles and responsibilities. At the individual level, a top management contract scheme was introduced in order to deal with wage competition from the private sector. The scheme embraces both a pay-level and a performance-related element. Even though both types of performance contracts are linked Norway still faces the challenge to co-ordinate these performance management tools (Public Management Department of Norway, OECD, 1999).

2.2.6 The Korea, India and United States of America Experiences

The Government of Korea enacted the Framework Act on the Management of Government Invested Institutions in 1983 with the main objective being to promote the rationalization of operations of Government invested institutions and efficient administration of Government investment therein by preserving fundamental matters concerning an autonomous and responsible system of such invested institutions (Performance Contracts Steering Committee, Sensitization/Training Manual on Performance Contracts in the Public service, Feb 2005).

The experience from Korea indicates that an elaborate system of negotiating, reviewing and evaluation of performance targets exists together with a strong incentive system to reward/sanctions good/bad performance. It was also demonstrated that autonomy under performance contracts increased transparency and accountability and that performance of public enterprises greatly improved

The Government of India introduced Performance Contracts (referred to as Memorandum of Understanding (MOUs) in 1987/88 financial year, to measure performance of public enterprises (Performance Contracts Steering Committee, Sensitization/Training Manual on Performance Contracts in the Public service, Feb 2005). The results of the introduction of performance contracting in India are as follows:-

1. achievement of targets has been enhanced
2. autonomy of public enterprises has been enhanced
3. the contribution of public enterprises to the Government in terms of dividends and surpluses has increased significantly

In the United States of America, performance management contracts exist for both the federal (government) agencies and the public enterprises (Performance Contracts Steering Committee, Sensitization/Training Manual on Performance Contracts in the Public service, Feb 2005). The experience of the federal agencies following the introduction of Performance Agreements was as follows:-

1. There is a greater focus on results within the organizations;
2. There is a firm merit system that recognizes and rewards excellent performance; and
3. Greater focus on customer satisfaction through improvement of service delivery

2.2.7 The Africa Experience

The first country in Africa to adopt performance contracts was Senegal. The initiative for adopting the system came from the Prime Ministers office. The idea was supported by the public enterprise managers who regarded it as a tool meant to compensate them for non-commercial objectives imposed on them. It afforded them the opportunity of increased autonomy and decreased outside interference. The parent Ministries and the Ministry of Finance on the other hand saw the introduction of Performance Contracts as a reduction in their powers over public enterprises. The Senegal Government adopted the French system whose weaknesses have been highlighted above (Performance Contracts Steering Committee, Sensitization/Training Manual on Performance Contracts in the Public service, Feb 2005).

The results of the introduction of Performance Contracts in Senegal were varied. Though the financial performance of the public enterprises did not reflect any improvement, the system did provide the Government with an opportunity to systematically compare the cost of social objectives and investment proposals with their benefits. Secondly, public enterprises were now obliged to undertake strategic planning which was not the case before and thirdly in a few cases, some aspects of the public enterprise performance have improved measurably

Morocco enacted a legal framework Law No.69-00 in November 2003 to give it the enabling legislation to introduce and implement program contracts. The program contracts are prepared through a process of negotiation of the terms of the contract by all the parties involved and agreement on all areas of performance measurement before implementation. This process abides by the three sub systems in the performance contracting process of performance information system, performance evaluation and performance incentive system (Performance Contracts Steering Committee, Sensitization/Training Manual on Performance Contracts in the Public service, Feb 2005). The public enterprises reported improvement in service delivery, cost reduction and greater autonomy for management.

The Kenya Government undertook to implement performance contracting in the management of government agencies in 2003. A committee was constituted to spearhead the introduction of the concept and as part of the preparation; the committee undertook study tours to several countries implementing the concept. The countries visited were Morocco, United Kingdom, United States of America, India, Korea and China, whose experiences are highlighted above (Performance Contracts Steering Committee, Sensitization/Training Manual on Performance Contracts in the Public service, Feb 2005).

2.3 Performance Contracting and the challenge of assessing performance

Performance Measurement (PM) can be described as a process of assessing progress towards achieving pre-determined goals, including information on the efficiency with which resources are transformed into goods and services, the quality of those outputs and outcomes, and the effectiveness of organisational operations in terms of their specific contributions to organisational objectives especially through performance contracting (Neely (1998).

Business and business unit performance needs to be measured in relation to the objectives identified in the planning process (Neely (1998). Attention to PM in the context of modern business has been focused on by the admission that financial information that had traditionally been provided to organizations for control and management purposes was no longer adequate for fully effective PM to be achieved.

2.4 Criticism of Traditional Financial Performance Measures

Not all non-financial criteria are created equal, according to the study carried out by Ernst & Young (1998). Measures of strategy execution, management credibility, innovation and market position, for example, proved to be far more useful than measures of customer complaints, employee training programmes or environmental and social policies (Table I). Developing a comprehensive PM system incorporating non-financial measures has frustrated many managers.

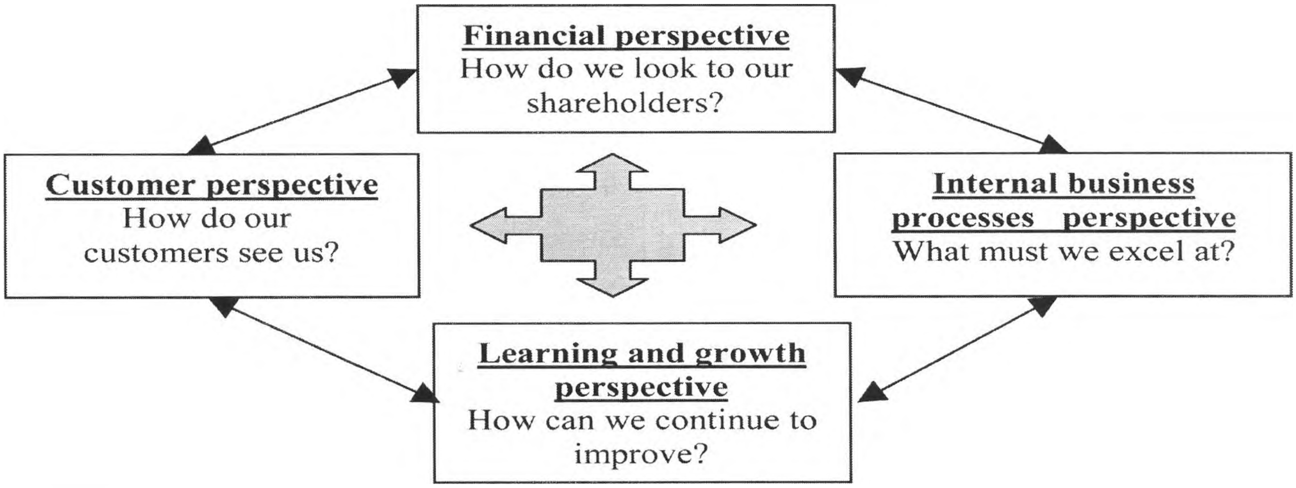
There is need for a range of performance measures. Many authors have emphasized the importance of PM in an organization. Oakland (1993) suggests that measurement plays an important role in quality and productivity improvement to (cited in Sinclair and Zairi, 1995): ensure customer requirements have been met; provide standards for establishing comparisons; provide visibility and provide a "score-board" for people to monitor their own performance levels; highlight quality problems and determine which areas require priority attention; give an indication of the costs of poor quality; justify the use of resources; and provide feedback for driving the improvement effort.

In response to the dissatisfaction with traditional PM systems, a number of PM models have been developed in the recent past (Cross and Lynch, 1989; Fisher, 1992; Maskell, 1991; Eccles, 1991;

Hronec, 1993; Sink and Tuttle; 1989, Kaydos; 1991). Although several approaches to designing and implementing a system to provide non-financial control have been proposed in the literature, the problem of integrating non-financial measures with financial measures effectively still remains an open question. This paper addresses this issue by means of the balanced scorecard (BSC) (Kaplan and Norton, 1996a).

The Balance Score Card (BSC), developed by Kaplan and Norton (1996), is a leader in PM and performance management in an attempt to identify an assessment methodology for organisational processes. A measurement model that identifies critical success factors for improving organisational processes, and develops performance measures within some perspectives: financial, customer, internal business processes and learning and growth (See Figure I). Some indicators are maintained to measure the organization's progress towards achieving its vision; other indicators are maintained to measure the long-term drivers of success, thus acting as a performance management system. Through the BSC, the organization monitors both its current performance, and its efforts to improve processes, motivate and educate employees, and enhance information systems – that is its ability to learn and improve.

Figure 1: The balanced scorecard



Source: Kaplan and Norton (1996a)

The original perspectives noted above were increased in what was called Holistic Score Card (HSC). In a nutshell the six perspectives proposed here address the different goals of any organization as shown in Figure II. The present HSC approach advocates the need for addressing the needs of all the stakeholders instead of targeting only those stakeholders who have direct bearing on the organization's financial prospects in either a direct or indirect fashion. Thus all the stakeholders, namely, shareholders (financial perspective), customers (customer perspective), suppliers (business process perspective), employees (employee perspective and intellectual capital perspective), and the society (social perspective) are included in the framework of HSC (Kaplan and Norton, 1996).

2.5 Why a BSC in Performance Contracting

Balance – a word that indicates the essence of a healthy organisation. Balance is necessary for efficient and effective movement, for the achievement of a rich sound, and for assisting in maximizing potential. In the same way, PM systems must achieve a balance, which supports progress against predetermined objectives, without sub-optimization (Kaplan and Norton, 1996). Over the recent past, organizations have tried various methods to create an organisation that is healthy and sound. By requiring strategic planning and a linking of program activities/performance goals to an organisation's budget, decision-making and confidence in the organisational performance is expected to improve. Major changes are taking place in the way the businesses are managed. Resources are diminishing, regulations are being cut, and the traditional role of overseer redefined into a more positive role. This uncertainty, coupled with a continually changing environment, has forced managers to pursue new ways to meet future demands of the organizations. The answers need to be found to how to balance a world of fewer regulations with effective risk management, how this can be accomplished with fewer and fewer resources and what tools can help to meet future challenges while enabling positive cultural change (Kaplan and Norton, 1996).

The BSC is a management framework that measures the economic and operating performance of an organisation. "Short-termism" of traditional accounting principles can be counter productive; thus, the scorecard's emphasis on non-financial measures is a welcome development. The BSC makes a compelling case for the inclusion of non-financial measures in an organisation's overall measurement system. The power of the framework comes from a second "balance" that goes beyond an *ad hoc* collection of financial and non-financial measures. The scorecard has to tell the story of the organisation's strategy, and that story is told by means of a cause-and-effect model that ultimately links all the measures to shareholder value. Non-financial measures, such as customer retention, employee turnover, and number of new products developed, belong to the scorecard only to the extent that they reflect activities an organisation performs in order to execute its strategy, and thus, these measures serve as predictors of future financial performance (Kaplan and Norton, 1996).

2.6 Performance Contracting in Kenyan Energy Sector

The Kenyan government adopted performance contracting in the energy sector in July 2004 with two main objectives: to promote a culture of performance and to make the public sector more responsive to the needs of Government by increasing the organizations' accountability, promoting efficiency and effectiveness, introducing participative decision making and adopting a customer focus. The responsibilities and commitment of the three parastatals' board of directors under the performance contracts included: First, achieving maximum performance consistent with the business plan and in any event to meet the performance targets. Secondly, to monitor and evaluate periodical results against performance targets. Thirdly, maintain in place such systems and procedures to reasonably facilitate objective assessment of its performance by GOK. Lastly, adopt and implement good corporate governance practices in the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long-term value while taking into account the interest of the shareholders (Adopted from the Performance contracts of KPLC, KenGen, & KPLC, 2004/2005; 2005/2006).

In general, some of the target measures that were instituted in the PCs in 2004 to return the parastatals to center stage and steering them to profitability included restructuring their balance sheet, reviewing and rationalization of processes with other suppliers and reduction of system losses. It also included enhancement of customer base and financial restructuring, staff right-sizing, net work reinforcement and improvement of quality supply, which are now being re-defined and being focused on areas that can deliver rapid results. This was done through performance contracting to top organs composed of the Chief executive Officers (CEOs) and

Departmental heads. The intention was to turn around of the performance of the parastatals (http://www.energy.go.ke/index.php).

The specimen performance contracts posted in the Directorate of Performance Management (DPM) website indicate the Boards of both KPLC and Kengen having committed themselves to:

1. achieve maximum performance consistent with its Business Plan and in any event to meet the Performance Targets.
2. monitor and evaluate periodical results against Performance Targets.
3. maintain in place such system and procedures to reasonably facilitate objective assessment of its performance by GOK.
4. adopt and implement good corporate governance practices in the Companies towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long term value while taking into account the interest of other stakeholders.

They also state that for purposes of assessing the overall performance of both companies, the weights assigned to the performance targets will be consolidated in order to give the aggregate weight factor.

The Strategic Objectives contained in the performance contract signed with KPC were;

1. To maintain pipeline integrity;
2. Enhance financial performance;
3. Enhance the pipeline capacity;
4. Utilize emerging technology to enhance performance;
5. Maintain high operating standards;
6. Develop and retain motivated, skilled and competent staff;
7. Business diversification;
8. Strengthen and maintain high safety standards;
9. Develop and maintain an effective Business and Disaster Recovery Plan.

The specific quantified performance targets were provided as annexure to the performance contracts and were not attached to the contracts in the DPM website. These will be reviewed while undertaking the study.

The first Government-KPLC, KenGen and KPC performance contracts will expire in June 2007. The Directorate of Personnel Management is currently carrying out annual performance rating of the parastatals. This is intended to keep the performances of these parastatals congruent with the targets documented in Ministry of Energy Sessional Paper (2003), for the years 2004-2007.

2.7 Summary and Gap to be Filled

Many scholars have advocated for the need for introduction of performance contracts in state corporations in different countries. Excessive controls, multiple objectives, multiple principals, frequent political interference, poor management and excessive reliance on the exchequer have been noted as the main reasons for the need for performance contracts. They also noted the need for measuring performances of the corporations and ensuring a more modest role of the state. All the scholars mentioned are in agreement that performance contracts are important public sector reform tools aimed at increasing accountability, efficiency and effectiveness in public service delivery. They all agree that unlike conventional privatization where public assets are transferred from public ownership to private ownership, the performance contract seeks to privatize the public sector style of management through what may be regarded as a movement away from control by procedures to control by results.

Studies done in a number of countries mentioned have shown improved performance of corporations with performance contracts as compared with prior performances and with other corporations. The studies also show increased autonomy is a necessary prerequisite to increased transparency and accountability. For performance contracts to succeed however there should be performance information, evaluation and incentive systems. This study seeks to establish the impact of these performance contracts in Kenya, the extent to which they have enabled increased autonomy in decision making of these parastatals and the challenges facing their implementation.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Research Design

The research approach was a case study on the impact of performance contracting on the performance of companies in the energy sector, specifically the key Kenyan parastatals. The study was limited to parastatals only and did not include other companies in the energy sector. This research therefore undertook an in-depth understanding and information about the impact of performance contracting on the performance of parastatals in the energy sector. It also sought to understand the autonomy granted to managers in decision making and the extent to which they were involved in the design of these contracts. Finally, it also documented the challenges facing these parastatals in the adoption and implementation of the performance contracts.

3.2 Population and Sampling

The target population of the study was all the CEOs and Departmental heads of the five (5) parastatals in the Kenyan energy sector. The study was initially designed to examine performance of all the parastatals in the Kenyan Energy sector. However, from preliminary study, it proved difficult to get information on two (2) of the parastatals; National Oil Corporation of Kenya (NOCK) and Electricity Regulatory Board (ERB). The study therefore concentrated on KENGEN, KPLC and KPC. The preliminary study showed that KENGEN had 11 respondents composed of the MD, Deputy MD and 9 departmental heads, KPLC had 8 respondents composed of the MD and 7 departmental heads while KPC had 8 respondents composed of the MD and 7 departmental heads. The sample size was therefore expected to be 27 respondents. Bearing in mind the size of the sample, the researcher was required to contact all respondents, in order to achieve sufficiently robust data. This was possible because the respondents were within Nairobi in the three parastatals. This entailed distribution of questionnaires to the 27 respondents in the top management of the 3 parastatals.

3.3 Data Collection

Data for research was drawn from both primary and secondary sources. A structured questionnaire was used to collect information relating to the impact of performance contracting on the performance of companies in the energy sector and to solicit answers on the second, third and fourth objectives. All the respondents were expected to answer all questions in the three parts. A total of 27 questionnaires were initially designated for distribution. However, during distribution, the researcher was informed that:

1. One respondent from KENGEN had gone on forced leave, while one was out of the country for 8 weeks.
2. One position in KPLC had been scrapped.
3. All performance contracting queries in KPC were handled by one department.

Out of the original 27 questionnaires intended for distribution, the researcher was able to distribute 18 questionnaires. The drop and pick method, offering short sessions for clarification, was used. Telephone and physical follow-ups were used where necessary.

Annual financial statements for the sampled companies were obtained and were used as secondary source of performance data based on the performance perspectives propounded by Kaplan and Norton, (1992). To proxy financial performance; operating profit and return on assets were obtained from the parastatals' published financial statements. To proxy customer satisfaction and social perspective; sales and social responsibility expenses were also obtained from the financial statements. To proxy internal business processes perspective; operating costs and provision for bad debts were obtained from the financial statements. To proxy employee and intellectual capital perspective; staff training costs and staff costs information was obtained from the annual financial statements. The levels of these perspectives were noted two (2) years prior and 2 years after performance contracting.

3.4 Data Specification

Operating profit (OPP) and return on assets (ROA) were used to proxy financial perspectives. This is because OPP is the profit earned from a company's normal core business operations, excluding any profit earned from the firm's investments, interest and taxes. It is therefore a good measure of how profitable the company's core business is. ROA on the other hand is a percentage showing how profitable a company's assets are in generating revenue, that is, how many shillings of earnings a company derives from each shilling of assets it controls. It is a useful number for comparing companies in the same industry.

To proxy customer satisfaction and social perspective, sales and social responsibility expenses were used. A sale is an act of completion of a commercial activity. It means the customer has consented to the proposed product or service, mostly by being satisfied. Corporate Social Responsibility (CSR) is a measure of the company's standing as a good corporate citizen. Positive CSR is therefore a measure of the company's proactive stance in responsibility to the society.

Operating costs and provision for bad debts were used to proxy internal business processes perspective. This is because operating costs are the recurring expenses which are related to the operation of a business and which the management has control. On the other hand, provision for bad debts is an effort to expect feasible losses because of the bad debts extended by management, and to sustain an estimated amount out of the profit record to compensate for the loss calculated in the next years.

Finally, to proxy employee and intellectual capital perspective, staff training costs and staff costs were used. Staff training costs, whether to acquire new skills or to keep up to date with new technology, are the time and cost commitments by a company for employee skills development. Staff costs on the other hand comprise any salary and/or remuneration paid to persons employed by the company for working regularly or recurrently for the company. They include costs, other than salary costs, arising from conditions of employment of the staff.

3.5 Data Analysis

The process of data analysis involved several stages. For primary data, completed questionnaires were edited for completeness and consistency. The data was then coded and checked for any errors and omissions (Kaewsonth & Harding, 1992). The data was analyzed using procedures within Statistical Package for Social Sciences (SPSS) PC version 10. Responses from questions were aggregated. Mean responses were then computed per objective. Where the mean responses exceeded the median, this was interpreted to confirm whether autonomy was granted to managers in decision making, the extent to which they were involved in the design of these contracts and the challenges facing these parastatals in the adoption and implementation of the performance contracts.

For secondary data sources, analysis concentrated on determining the averages of the proxies for performance indicators noted above two (2) years before and two (2) years after performance contracting. Using the year of introduction of performance contracts, 2004, as the base year, such that;

x = average of performance proxy before performance contracts, and

y = average of performance proxy after performance contracts,

Descriptive statistics were applied and paired t-test performed. The descriptive statistics describe data on variables with single numbers. Analysis of variance (ANOVA) was used to test for significant differences between mean values of variables before and after performance contracting.

3.5.1 Paired t-test

Performance was classified in terms of financial, customer, employee and internal processes perspectives as represented by the proxies mentioned above. These were measured two years before and two years after performance contracting, establishing an average and used to test for significant statistical difference. The Paired t-test was used to compare the means, standard deviations and p-values of the proxy averages before and after contracting ($d = y - x$).

T statistics were used to test the null hypothesis that the true mean difference is zero with *n-1* degrees of freedom. This was compared with tables for t distribution to get the p-value for the paired test. A low p-value (less than 0.05) would indicate a significant difference between variables. This was used to conclude that performance contracting has had a significant impact on financial, customer, employee or social performance as indicated by the p-value.

CHAPTER FOUR

4.0 DATA ANALYSIS AND INTERPRETATION OF RESULTS

4.1 Introduction

This chapter presents data analysis and presentation of the research study on the impact of performance contracting on companies in the energy sector.

The objectives of this study were:

1. To evaluate the impact of performance contracting on the performance of parastatals in the energy sector.
2. To establish the extent to which managers were involved in the design of performance contracts.
3. To establish the extent to which performance contracting has allowed autonomy in decision making.
4. To establish the challenges facing these parastatals in the adoption and implementation of the performance contracts.

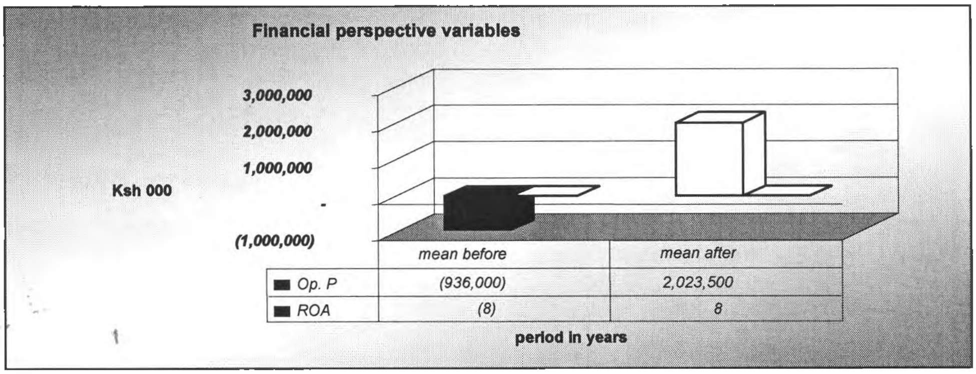
The analysis used the balanced scorecard model to address each of the objectives. Developed by Robert Kaplan and David Norton in 1992, the balanced scorecard methodology is a comprehensive approach that analyzes an organization's overall performance in four perspectives. These perspectives are financial analysis, the most traditionally used performance indicator, customer analysis looking at customer satisfaction, internal analysis looking at production and innovation, and finally, learning and growth analysis exploring the effectiveness of management in terms of measures of employee satisfaction and retention.

4.2 First Objective

The first objective was to look at the impact of performance contracting on the performance of parastatals in the energy sector. The objective here was to assess how the introduction of performance contracting had impacted on the financial performance of the companies.

(i) Financial Perspectives

KPLC (graph 4a)



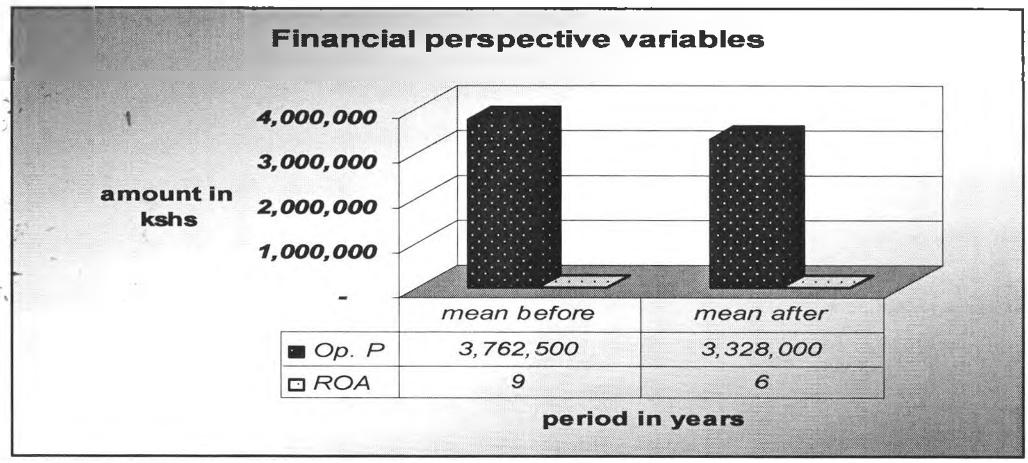
The above graph (4a) shows the financial performance of KPLC for the two year period before performance contracting was introduced and the period after the introduction of performance contracts. The amounts are in Kenya Shillings (KShs). As shown the period before the contracts had mean operating loss of KShs 936,000 as well as negative return on assets (ROA) of 8%. This indicates poor performance. The period after performance contracts had mean operating profits (OPP) of KShs 2,023,500 and positive ROA of 8%. This therefore shows improved performance. There is however need for testing the significance difference. T test is then conducted to test whether there is any significant difference between the periods. The table below indicates the significance level of the two variables which measure the performance of the financial perspective.

One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
OPP	2.336	10	.042	2227544.9	103076.0	4352014
ROA	2.081	11	.062	2226574.3	-128342	4581490

The T test analysis indicates that the T value for OPP is 2.336. The figure is positive because OPP has a high value. Likewise the t value for ROA is 2.081 and positive because of the high value of ROA mean. The significant difference is 0.042 and 0.062 for OPP and ROA respectively. Since the mean is 0.05, there is a significant difference in terms of OPP. The conclusion is that performance contracting has had a significant positive impact on OPP, but little or no impact on ROA. This may mean that the assets were still not being fully utilized.

KENGEN (graph 4b)



Graph 4b above shows that KENGEN had mean OPP of KShs 3,762,500 and ROA of 9% for the two year period before performance contracting. However, OPP fell to KShs 3,325,000 and ROA reduced to 6% after the introduction of the performance contracts. As indicated the two periods recorded operating profits and positive ROA. However, the level of profitability and returns on assets is different. There is need to test how significant this

One-Sample Test

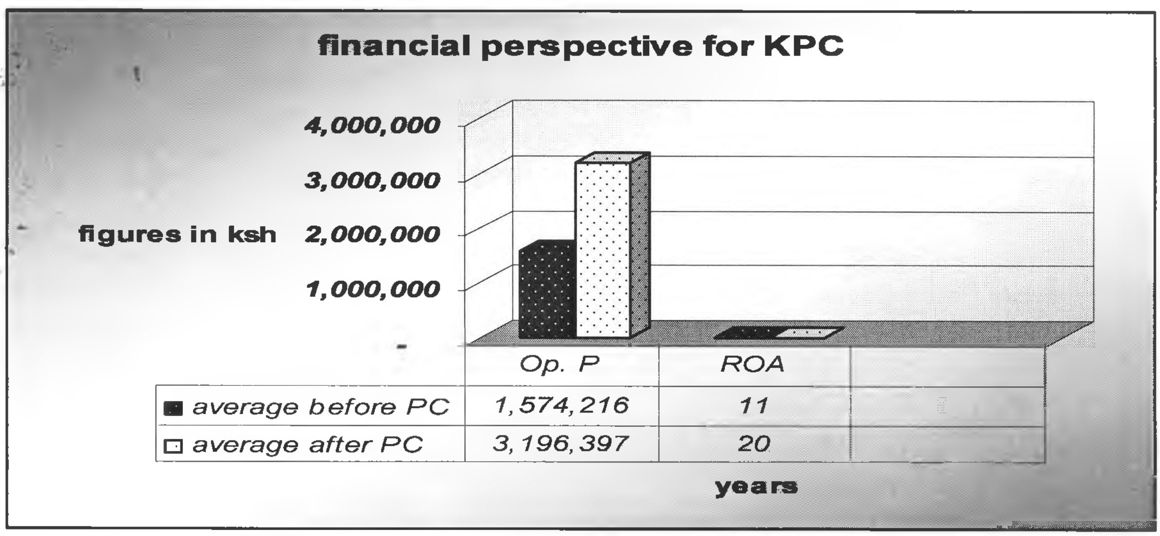
	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
F2	1.760	10	.109	4107879.3	-1091472	9307231
F3	2.081	10	.064	2781281.5	-196470	5759033

F2 is OPP; F3 is ROA

difference is. T test is then conducted to test whether this difference is statistically significant.

The T test analysis indicates that the T value for OPP is 1.760, positive because OPP has a high value. Similarly, the t value for ROA is 2.081 and positive because of the high value of ROA mean. The significance difference is 0.109 and 0.064 for OPP and ROA respectively, both above 0.05. This means that performance contracts have not had significant impact on OPP and ROA.

KPC (graph 4c)



Graph 4c indicates that KPC had OPP of KShs 1,574,216 and ROA of 11% for the two year period before performance contracts. Both variables improved to KShs 3,196,397 and 20% for OPP and ROA respectively after the introduction of the performance contracts. This improvement however needs to be tested for statistical difference. T test is conducted to test whether this difference is significant.

One-Sample Test

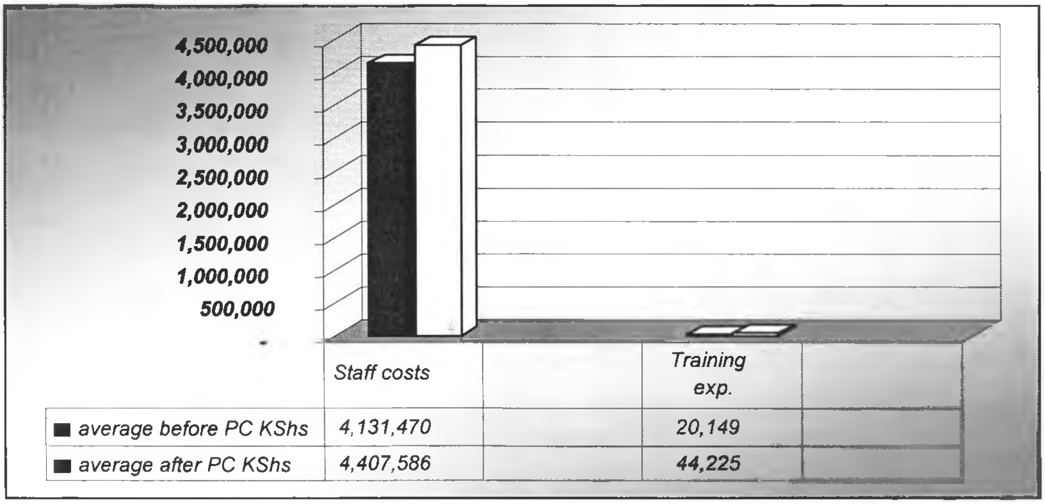
	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
F2	2.624	9	.028	948625.60	130839.1	1766412
F3	2.515	9	.033	1313503.6	131825.4	2495182

The T test analysis indicates that the T value for OPP is positive 2.624 because OPP has a high value. Likewise the t value for ROA is 2.515 and positive because of the high value of ROA mean. The significance difference is 0.028 and 0.033 for OPP and ROA respectively. Thus, performance contracting has had a significant positive difference on both OPP and ROA.

We can conclude that introduction of performance contracting has had significant positive impact on the financial performance of these companies.

(ii) Employee/People Perspective

KPLC (graph 4d)



The above graph 4d shows the levels of staff costs and training expenses for KPLC for the two year period before introduction of performance contracts and two years after introduction of the performance contracts. As indicated, the period before performance contracts had mean staff costs of KShs 4,131,470 and mean training expenses of KShs 20,

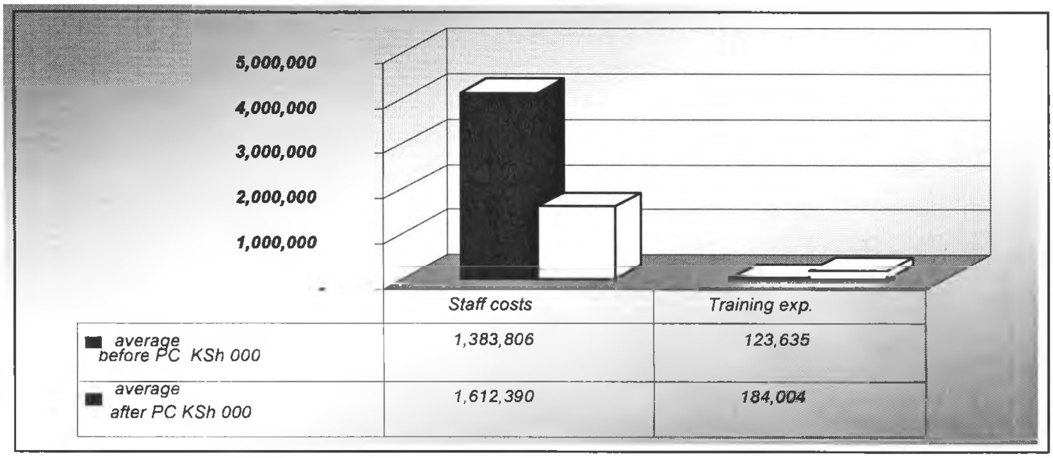
140. These parameters increased to KShs 4,407,580 and KShs 44,225 respectively after performance contracts. The mean number of employees was 6,243 and 6,166 for the two years before and two years after performance contracts respectively. The levels, and cost per staff, of staff costs and training expenses for the two periods differ, but there is need to test how significant the difference is. T test is conducted to test whether this difference is significant.

One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
F2	2.624	9	.028	948625.60	130839.1	1766412
F3	2.515	9	.033	1313503.6	131825.4	2495182

The T test analysis indicates that the T value for staff costs is positive 2.624 because it has a high value. Likewise the t value for training expenses is 2.515 and positive because of the high value of mean training expenses. The significance of the difference is 0.028 and 0.033 for staff costs and training expenses respectively. Since both are below 0.05, this shows that performance contracting has had significant impact on staff costs and training expenses.

KENGEN (graph 4e)



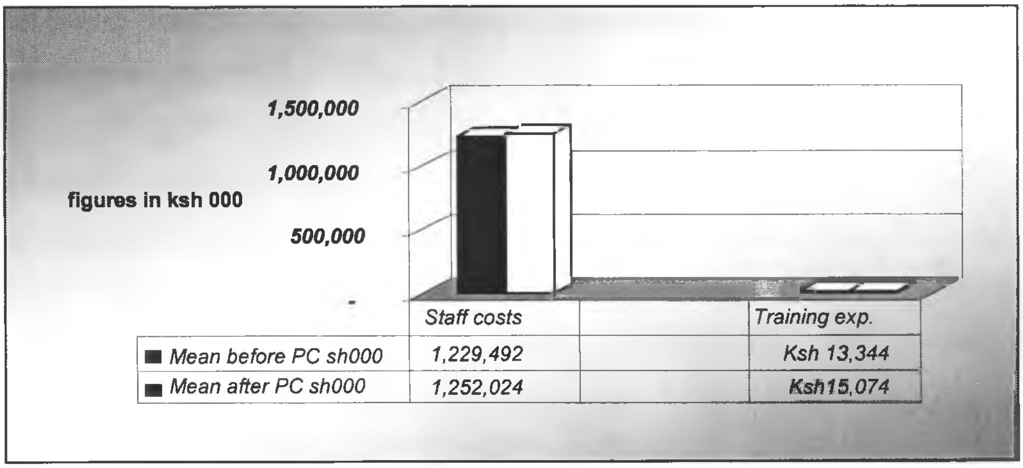
Graph 4e above shows the mean staff costs and training expenses for KENGEN for the two year period before performance contracts and two year period after the introduction of the performance contracts. The graph shows an increase in mean staff costs from KShs 1,383,806 to KShs 1,612,390 for the two years before and two years after performance contracting. Similarly, training expenses increased from KShs 123,635 to KShs 184,004 respectively for the same periods. However, mean number of employees fell from 1,524 to 1,510. Thus, absolute costs and costs per employee for staff costs and training expenses differ for the two periods differ. T test is then conducted to test whether this difference is significant.

One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
F2	1.010	1	.497	2075809.3	-2.4E+07	2.8E+07
F3	1.258	1	.428	898197.00	-8176485	9972879

The T test analysis indicates that the T value for staff costs is 1.010, positive because staff cost has a high value. Similarly the t value for training expenses is 1.258 and positive because of the high mean value. The significance difference is 0.497 for staff costs and 0.4287 for training expenses respectively. Thus, since both parameters have significant difference above 0.05, this means that performance contracting has not had significant impact on either staff costs or training expenses.

KPC (graph 4f)



Graph 4f above shows that KPC had staff costs of KShs 1,229,492 and training expenses of KShs 13,344 for the two year period before performance contracts. These parameters increased to KShs 1,252,024 and KShs 15,074 respectively for the two years after the introduction of performance contracts. The mean number of employees also increased from 1,425 to 1,554 between the two periods. Thus, the graph indicates that the two periods differ. T test is then conducted to test whether this difference is significant.

One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
F2	1.022	1	.493	621418.00	-7104895	8347731
F3	1.024	1	.492	633549.00	-7224921	8492019

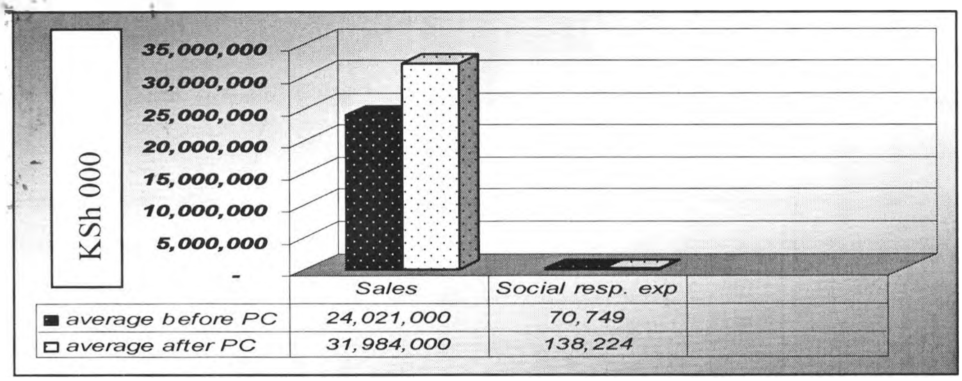
The T test analysis indicates that the T value for staff costs is 1.022 and positive because staff cost has a slightly high value. Likewise the t value for training expenses is 1.024 and positive because of the high mean value. The significance difference is 0.493 for staff cost and 0.492 for training expenses respectively. Thus, since both parameters have significant difference above 0.05, this means that performance contracting has not had significant impact on either staff costs or training expenses.

In conclusion, performance contracting has impacted significantly on staff costs and training expenses for KENGEN, while impacting marginally on staff costs and training expenses for KPLC and KPC.

(iii) Customer/Stakeholder Perspective

The companies are related by the fact that they are suppliers and customers of each other, in addition to having other customers. The analysis of customer and social perspective focused on the sales of the companies and social responsibility expenses. The results for each individual company were as follows;

KPLC (graph 4g)



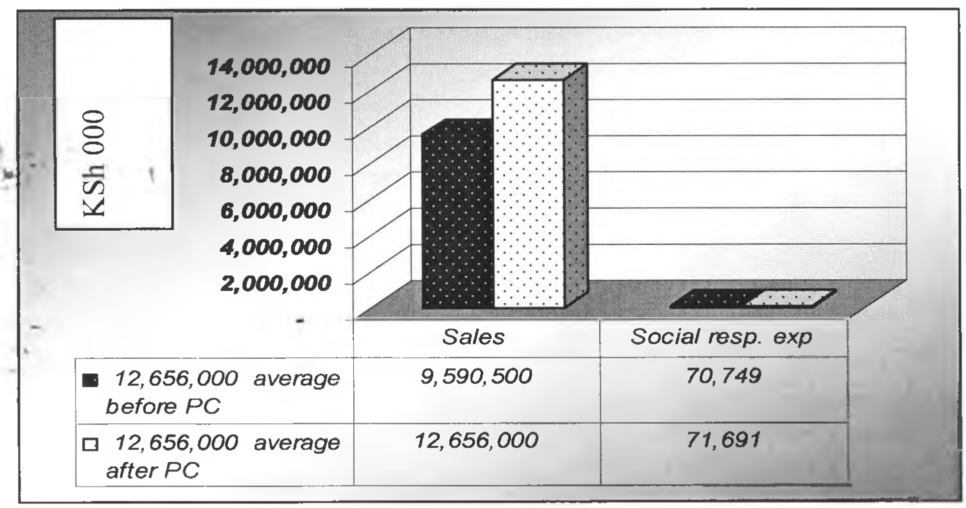
Graph 4g above shows mean sales and mean social responsibility expenses for KPLC were KShs 24,021,000 and KShs 70,749 respectively for the two year period before performance contracting. These variables increased to KShs 31,954,000 and KShs 135,224 respectively in the two year period after the introduction of the performance contracts. This increase however needs to be tested for significance of the difference. T test is then conducted to test whether this difference is significant.

One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
F2	2.624	9	.028	948625.60	130839.1	1766412
F3	2.515	9	.033	1313503.6	131825.4	2495182

The T test analysis indicates that the T value for sales is positive 2.624 because it has a high mean value. Likewise the t value for social responsibility expenses is 2.515 and positive because it has high mean value. The significance of the difference is 0.028 and 0.033 for sales and social responsibility expenses respectively. Since both are below 0.05, this shows that performance contracting has had significant impact on sales and social responsibility expenses.

KENGEN (graph 4h)



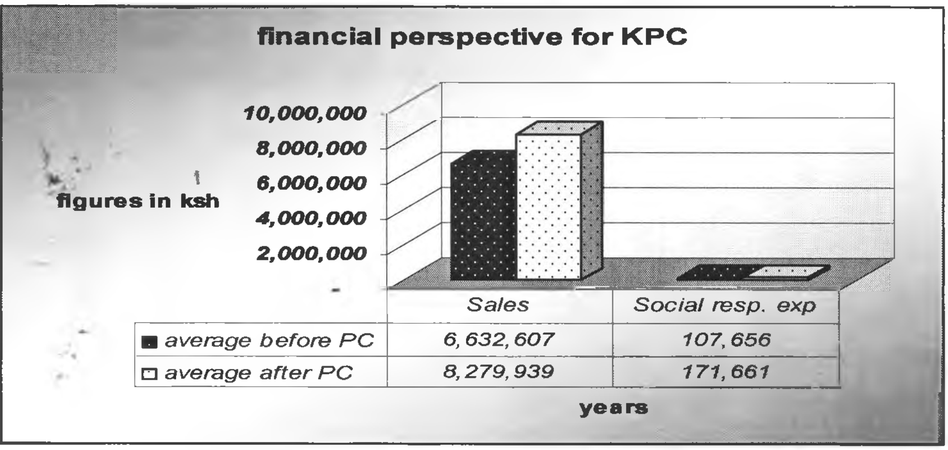
This above graph 4h shows that mean sales and social responsibility expenses for KENGEN were KShs 9,590,500 and KShs 64,180 respectively for the two year period before performance contracting. These variables increased to KShs 12,656,000 and KShs 71,691 respectively for the two years after performance contracts. This absolute increase however should be tested for significance using T test.

One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
F2	1.015	1	.495	4830624.3	-5.6E+07	6.5E+07
F3	1.011	1	.496	6363845.5	-7.4E+07	8.6E+07

The T test analysis indicates that the T value for sales is 1.015 and positive because sales ıave a high mean value. Likewise the t value for social responsibility expenses is 1.011 and ›ositive because of the high mean value. The significant difference is 0.495 for sales and).496 for social responsibility expenses respectively. Thus, since both parameters have ;ignificant difference above 0.05, this means that performance contracting has not had ;ignificant impact on either sales or social responsibility expenses.

KPC (graph 4i)



Graph 4i above shows the levels of sales and social responsibility expenses for KPC for the two year period before and two years after performance contracting. The graph indicates an increase in mean sales and social responsibility expenses by KShs 1,647,332 and KShs 64,005 respectively two years after performance contracts. This increase however is tested for significance using T test.

One-Sample Test

	Test Value = 0					
	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference Lower	Upper
F2	1.022	1	.493	621418.00	-7104895	8347731
F3	1.024	1	.492	633549.00	-7224921	8492019

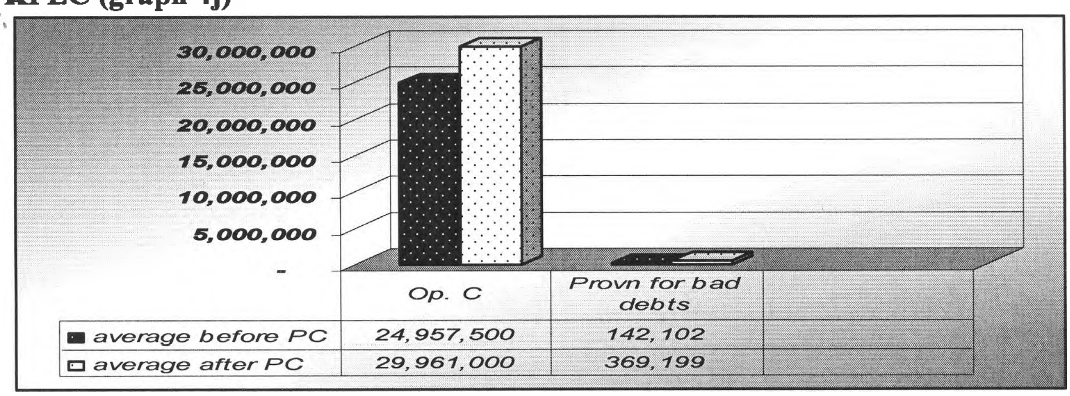
The T test analysis indicates that the T value for sales is 1.022 and positive because it has a high mean value. Likewise the t value for social responsibility expenses is 1.024 and positive because of the high mean value. The significant difference is 0.493 and 0.492 for sales and social responsibility expenses respectively. This means that since both parameters have significant difference above 0.05, performance contracting has not had significant impact on either sales or social responsibility expenses.

To conclude on the customer and social perspective, it is observed that performance contracting impacted significantly on KPLC while seemingly having no significant impact on KENGEN and KPC. This means that increases in sales and social responsibility expenses for KENGEN and KPC may not be directly attributed to performance contracts.

(iv) Internal Business Processes Perspective

The analysis of internal processes perspective focused on the operating costs of the companies and provision for bad debts. The results for each individual company are as follows;

KPLC (graph 4j)



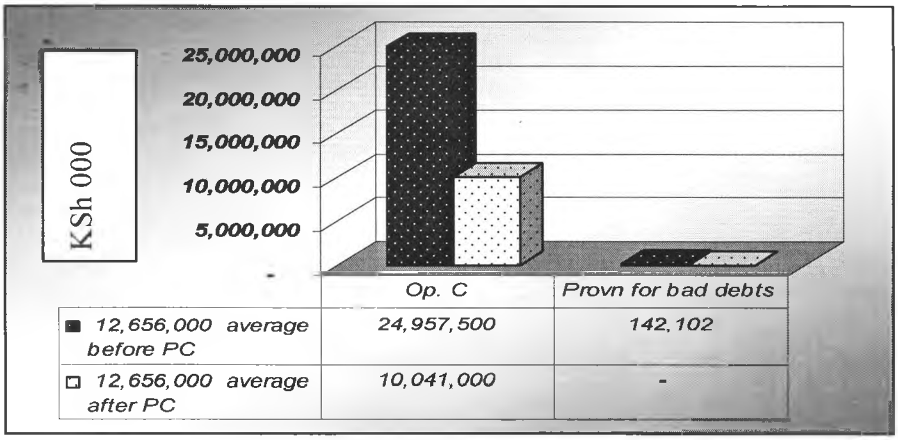
The amounts in the graph 4j above are in KShs '000. The graph shows an increase in mean operating costs and mean provision for bad debts by KShs 5,003,500 and KShs 227,098 respectively two years after performance contracts over the two years before performance contracts. This increase is then tested for significance using T test.

One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
F2	1.598	1	.356	1230021.0	-8551044	1.1E+07
F3	1.344	1	.407	1106760.5	-9354112	1.2E+07

The T test analysis indicates that the T value for operating costs is 1.598 and positive because it has a high mean value. Likewise the t value for provision for bad debts is 1.344 and positive because of the high mean value. The significance of the difference is 0.356 and 0.407 for operating costs and provision for bad debts respectively. Since significant difference for both are over 0.05, we conclude that performance contracts have not had significant impact on operating costs and provision for bad debts.

KENGEN (graph 4k)



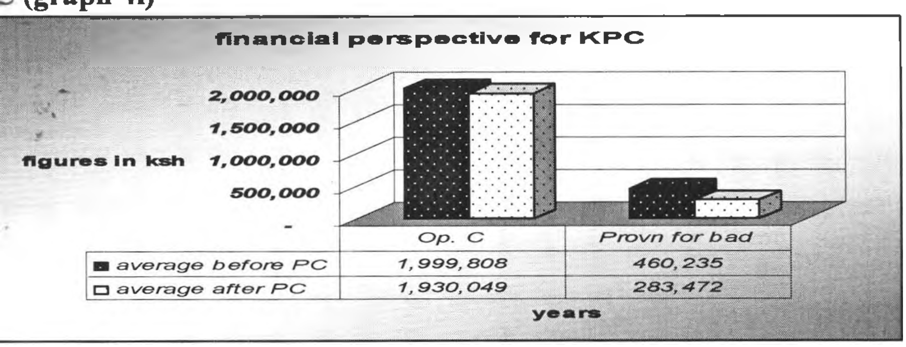
Graph 4k shows an increase in mean operating costs by KShs 5,759,500 two years after performance contracts over the two years before performance contracts. However, since the company's only customer is KPLC, there was no provision for bad debts. The increase in operating costs is then tested for significance using T test.

One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
2	1.011	1	.496	12549801	-1.5E+08	1.7E+08
3	1.000	1	.500	5020500.0	-5.9E+07	6.9E+07

T test analysis indicates that the T value for operating costs is 1.011 and positive iuse it has a high mean value. The significance of the difference is 0.496 for operating s. Thus, since the significant difference is above 0.05, we conclude that performance racting has not impacted significantly on the operating costs.

C (graph 4l)



figures in graph 4l above are in KSh '000. The graph shows decrease in mean rating costs and provision for bad debts by KShs 69,759 and KShs 176,763 respectively KPC for the two year period after performance contracts over the two year period ore performance contracts. This decrease is then tested for significance using T test.

One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
-2	1.598	1	.356	1230021.0	-8551044	1.1E+07
-3	1.344	1	.407	1106760.5	-9354112	1.2E+07

T test analysis indicates that the T value for operating costs is 1.598 and positive ause it has a high mean value. Likewise the t value for provision for bad debts is 1.344

and positive because of the high mean value. The significant difference is 0.356 and 0.407 for operating costs and provision for bad debts respectively. Thus, since the significant difference is above 0.05, we conclude that performance contracting has not impacted significantly on these two parameters.

Conclusion on first objective and remarks

The above analysis shows that performance contracting has had varied degrees of impact on the four perspectives, and on the different companies. While the impact on financial perspective has been significant, changes in employee, customer, social and internal processes perspectives may not be directly attributed to performance contracting. These changes may also be attributed to other factors.

4.3 Second Objective

The second objective was to establish the extent to which managers were involved in the design of performance contracts. The objective tested the extent of the managers' participation in performance contracts negotiation. This includes the setting of objectives, defining strategies, determining the performance targets and determining rewards for improved performance. It is based on the knowledge that for performance contracting to be successful, there needs to be clear objective setting, definition of strategy and performance target determination with the persons who sign performance contracts.

A target population of 27 top managers of the parastatals in the Kenya energy sector was targeted. 18 of them responded to the questionnaire, representing 67% response rate as follows;

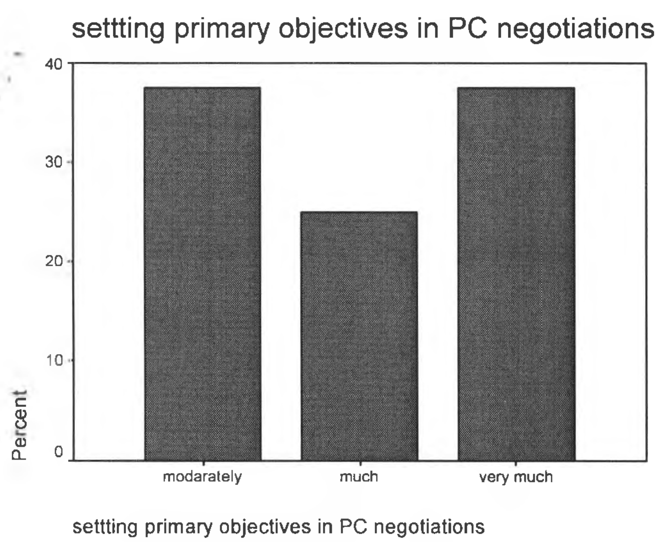
Company	Target	Total Response	MD & Deputy	Departmental Heads	% response
KENGEN	11	9	2	7	33.3
KPLC	8	7	-	7	25.9
KPC	8	2	-	2	7.4
Total	27	18	2	16	66.7

As shown in the table above, out of the total respondents from the three companies targeted, only one Managing Director (MD) and a Deputy MD from KENGEN responded. All the other respondents were departmental heads.

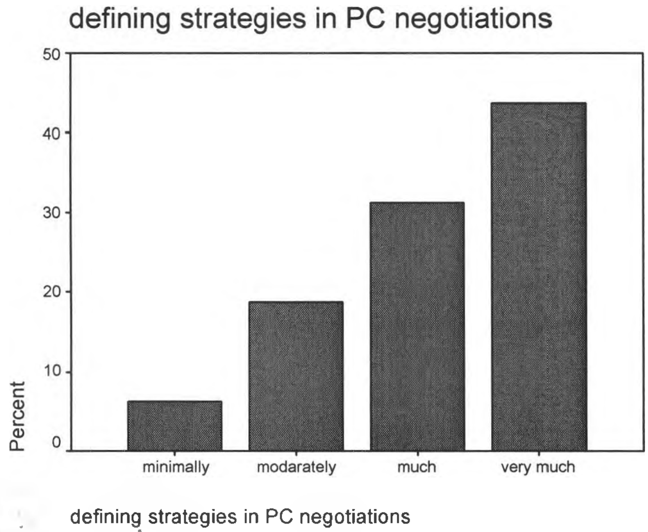
SPSS package was used to capture and analyze data using descriptive statistics. The responses have been analyzed using sequence of independent variables in the conceptual framework, where both quantitative and qualitative analyses have been used to explain the responses.

The analysis of the responses to the questionnaire is summarized by the graphs 4m (i) to (iv) below;

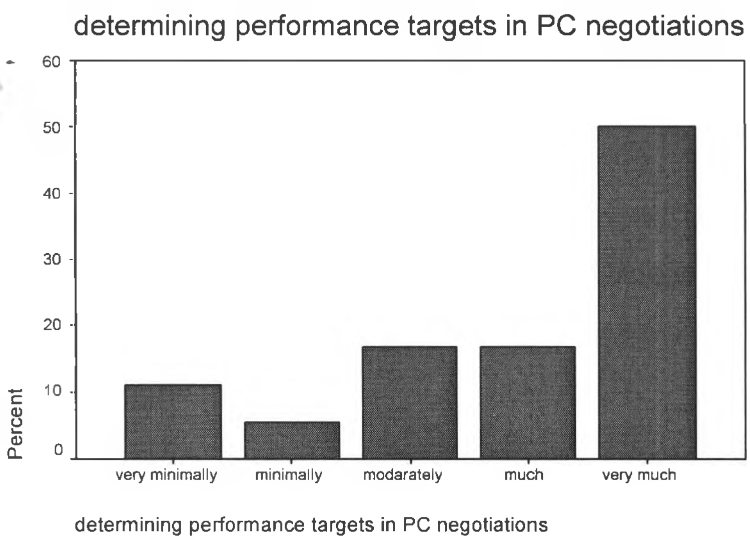
Graph 4m (i)



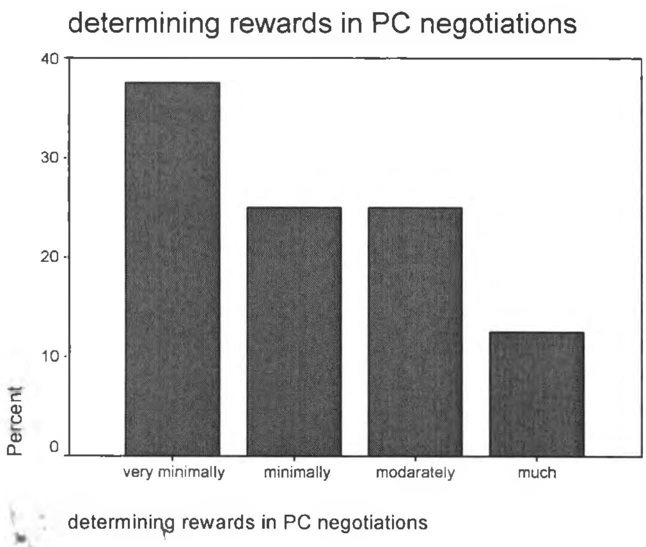
Graph 4m (ii)



Graph 4m (iii)



Graph 4m (iv)

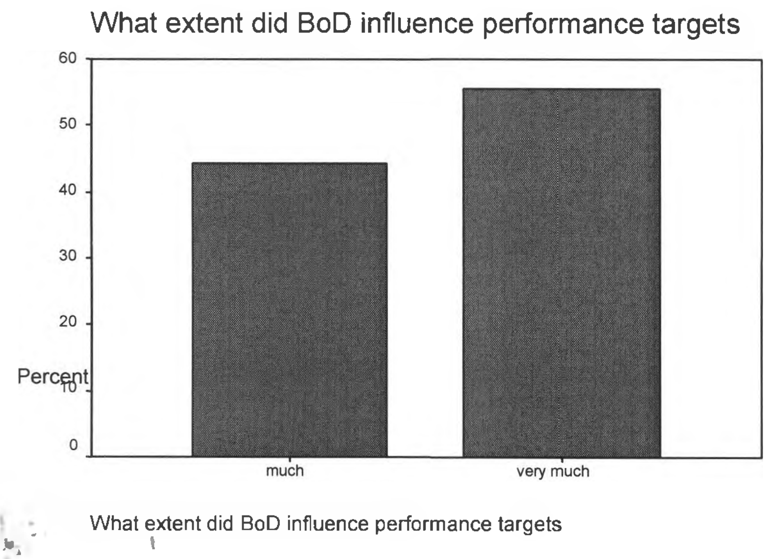


Graphs 4m (i), (ii) and (iii) show that majority (66%), (77%) and (50%) respectively of the managers were involved to a high extent in the setting of primary objectives, defining of strategies and determining performance targets. This is because these are mainly done by top management, who were the subject of this study. However, graph 4m (iv) indicates that only 11.1% of the respondents were involved in determination of rewards for improved performance. This may just be the MD who signed with the government and since performance contracting is a 'drip down' process.

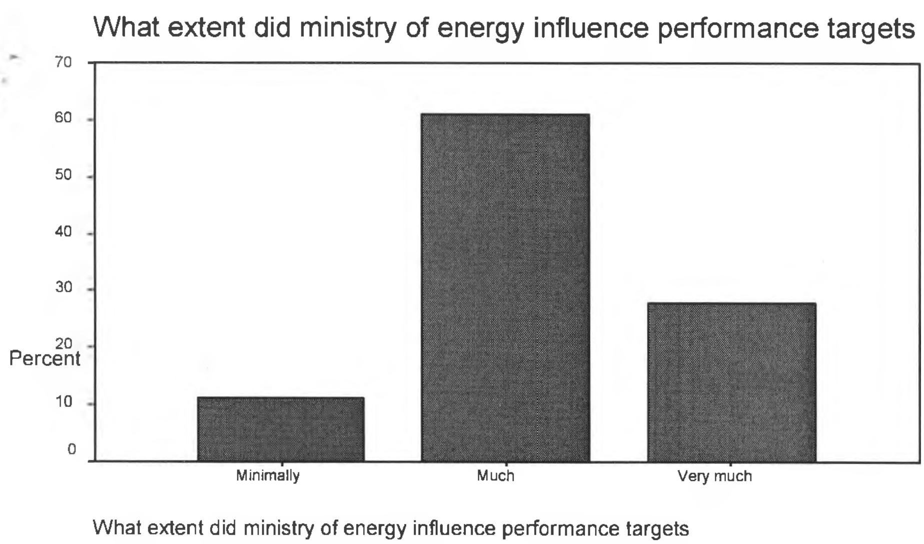
4.4 Third Objective

The third objective was to establish the extent to which performance contracting has allowed autonomy in decision making. It sought to determine the extent to which stakeholders in the petroleum industry influenced the management. These stakeholders include the Board of Directors, Ministry of Energy, the Treasury, Office of the President, Inspector General of corporations and State Corporations Advisory. The overall results are shown by graphs 4n (i) to (vi) below;

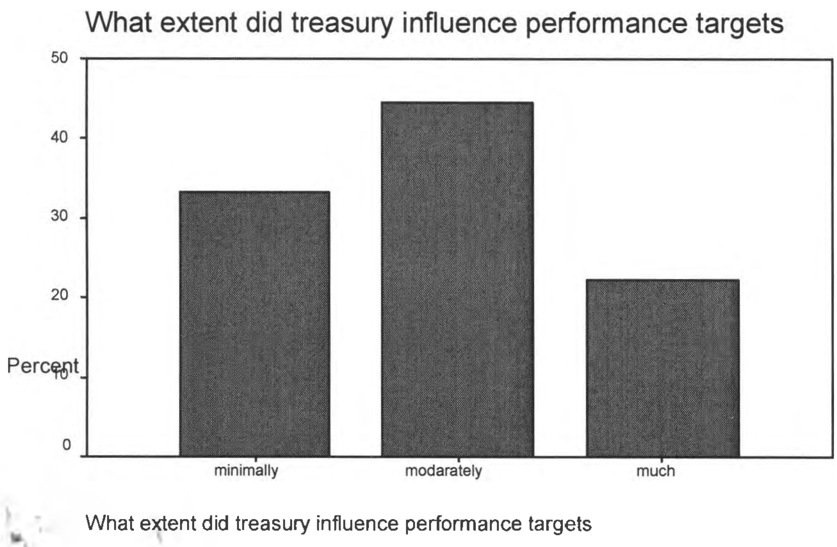
Graph 4n (i)



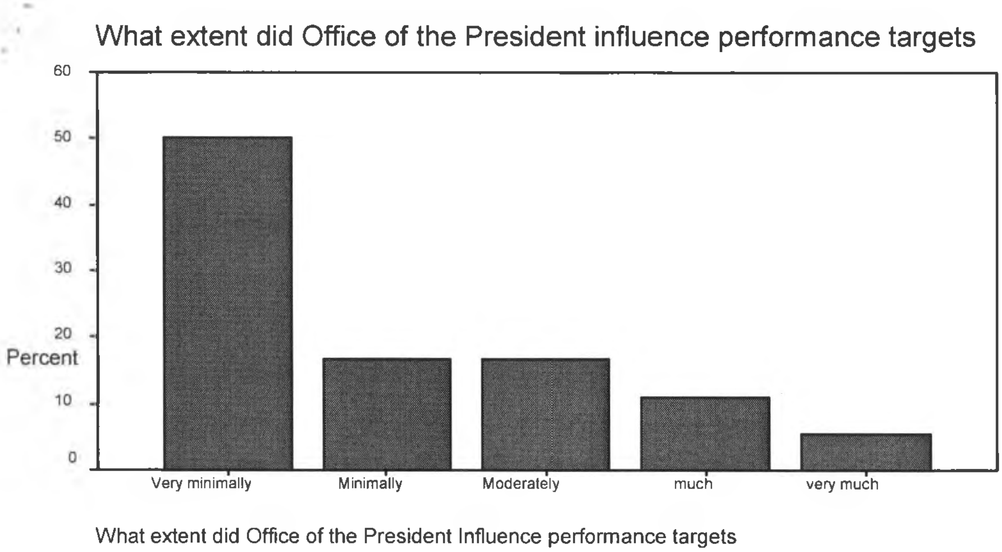
Graph 4n (ii)



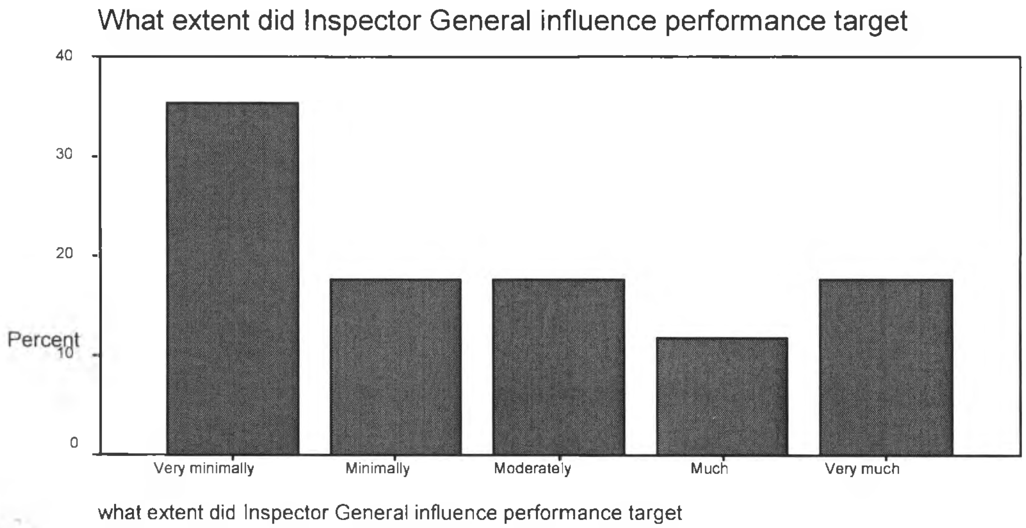
Graph 4n (iii)



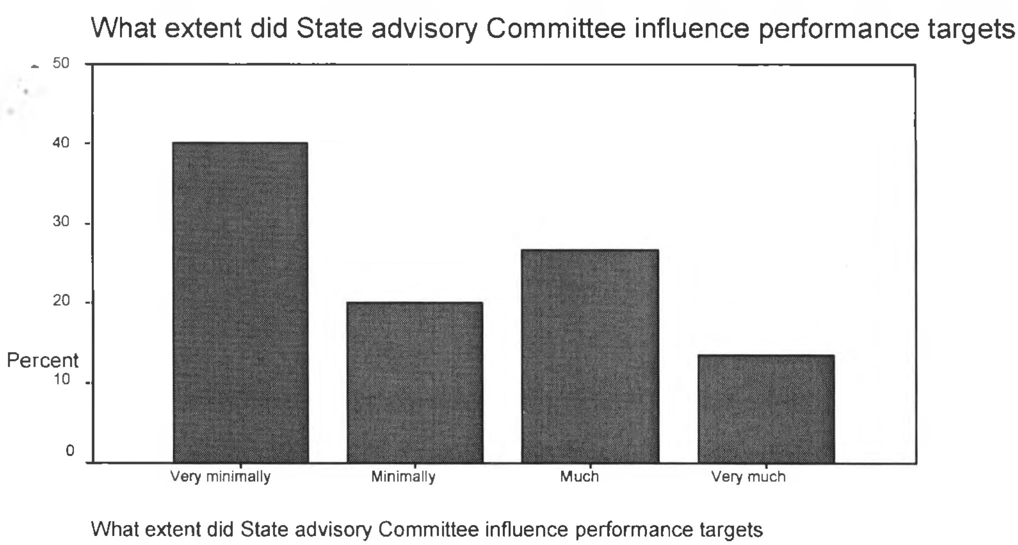
Graph 4n (iv)



Graph 4n (v)



Graph 4n (vi)



Graphs 4n (i) and (ii) indicate that 55.6% and 60% of the respondents felt that the Board of directors and Ministry of Energy influenced the management. However, as per graph 4n (iii) and (iv), only 22.2% and 19% felt the Treasury and the Office of the President respectively as influencing decisions. Similarly, 19% and 25% said that the Inspector General and the State Corporation Advisory Committee influenced their decisions.

4.5 Fourth Objective

The fourth objective was to establish the main challenges facing these parastatals in the adoption and implementation of the performance contracts. Majority of the respondents (78%) felt that meeting the performance targets and monitoring of periodical results were the main challenges. Another 66.7% of the respondents felt that achieving maximum performance consistent with the business plan was one of the most challenging responsibilities in fulfilling the current performance contract. 55.6% of the respondents on the other hand thought that maintaining in place systems and procedures was one of the most challenging responsibilities in fulfilling the current performance contract.

4.6 Comparison with theory

Studies done in a number of countries mentioned have shown improved performance of their public corporations that have adopted performance contracts as compared with those without performance contracts and compared with periods prior to performance contracts. The studies also show increased autonomy is a necessary prerequisite to increased transparency and accountability. In addition, for performance contracts to succeed, there should be performance information, evaluation and incentive systems.

This study shows increased performance of the parastatals in the Kenyan energy sector. This increase can partly be attributed to performance contracts, especially the financial perspective. This could be because financial information is what is immediately used to determine performance. Managers may have focused more on financial perspectives. Employee, customer and social, and internal processes perspectives have not been significantly influenced by performance contracts. This could be because these were initial years of performance contracts. More studies need to focus on this area.

Just like in the other countries, managers in the Kenyan parastatals were involved in setting objectives and defining strategies. However, there was more influence from the parent ministry on decision making. This study would therefore recommend reduced influence by the parent ministry.

CHAPTER FIVE

5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary and Findings

This study aimed at achieving four objectives. First, to evaluate the impact of performance contracting on the performance of parastatals in the energy sector. Secondly, to establish the extent to which managers were involved in the design of performance contracts. Thirdly, to establish the extent to which performance contracting has allowed autonomy in decision making. Finally, to establish the challenges facing these parastatals in the adoption and implementation of the performance contracts.

5.1.1 Impact of Performance Contracts on Performance

This study has established that performance contracts have had varied positive impact on the performance of the parastatals. The three companies studied indicated a growth in the four perspectives, but the highest impact has been on the financial perspective. This could be because financial perspective is what is immediately used to determine performance. Since performance contracting was in its initial stages of implementation, managers may have focused more on financial improvement. Although the level of growth varied among the three parastatals, there is an indication that the implementation of the performance contracting impacted positively. However, it is also important to mention that other factors may have contributed to the growth of the sector.

5.1.2 Manager Involvement in Design of Performance Contracts

This study found that majority of the managers were involved in performance contracts negotiation. This includes the setting of objectives, defining strategies, determining the performance targets and determining rewards for improved performance. It is based on the knowledge that for performance contracting to be successful, there needs to be clear objective setting, strategy defining and performance target determination with the persons who sign performance contracts. However, the managers were not involved in determination of rewards for improved performance. They may therefore feel demotivated where they are not included in determining their rewards for improved performance. A good performance management system should have known reward for improved performance.

5.1.3 The extent to which performance contracting has allowed autonomy in decision making

The study found out that most managers felt that the Board of Directors and the Ministry of Energy were the most influential in decision making process. There was very minimal interference from the Treasury, the Office of the President and the State Corporation Advisory Committee. The study can therefore conclusively say that performance contracting has considerably allowed some autonomy in decision making compared to periods prior to their introduction. The managers can therefore make critical business decisions similar to commercial enterprises without fear of political influence and under hands.

5.1.4 The challenges facing these parastatals in the adoption and implementation of the performance contracts.

The performance contracting management system in government parastatals has brought two main challenges as identified by this study. Firstly, meeting the performance targets has been cited as a challenge. Though not addressed in this study, possible reasons may be attributed to this, among them unreasonable targets. It is also possible that since they are not involved in determining rewards for improved performance, the managers see no reason to exceed targets. The second challenge is monitoring of periodical results as one of the principles of performance contracts. It is possible also that the instruments set to promote coherence and enhance the efficiency of the system are hindered by lack of well defined evaluation mechanisms. There is need to adopt and implement good corporate governance in fulfilling the performance contracts.

Conclusions

This study has shown that performance contracts have been successful tools in improving the financial performance of the parastatals under study. As observed under 4.2 (i), the financial performance of the three parastatals improved. However, while the impact on financial perspective was significant, changes in employee, customer, social and internal processes perspectives may not be directly attributed to performance contracting. These changes may also be attributed to other factors. As observed under 4.2 (ii), performance contracts have improved the corporations' employee perspectives, but there were no improvements in customer and internal process perspectives (4.2 (iii) and 4.2 (iv) respectively). Being the most observable performance indicator, financial performance may have been prioritized at the expense of other perspectives.

This study also concludes that there has been a high level of involvement of managers in the setting of objectives, defining strategies and determining targets (4.3). However, there is minimal involvement in determination of performance rewards. There should therefore be increased involvement of managers in determining rewards for improved performance. This will make them feel fully involved and they will put more effort to improve performance of their parastatals in order to achieve those rewards which they have set.

In addition, as per 4.4, there still exists influence on the management of the parastatals from the Board of Directors and the parent Ministry of Energy. Increased autonomy in running these parastatals is therefore required in order to improve their performance.

Lastly, it is an important observation under 4.5 that majority of managers find meeting performance targets as their biggest challenge, yet claim to have been involved in determining those targets (4.3). This may cast doubts on whether there is clarity of determination of such performance targets, or whether such targets are realistic.

Overall, the study can infer from the improved financial performance that performance contracting as a management tool has encouraged proper utilization of resources and has encouraged participation in the decision making process of the organizations.

The study however draws the challenge of rewarding improved performance, reviewing periodical results and influence from Board of Directors and Ministry of Energy as a set back in the execution of performance contracting.

Limitations of the study

This study encountered some limitations as follows;

First, the decision on what data to proxy for each of the four performance perspectives above was not easy. This is subjective because several variables could be used to proxy a perspective.

In addition, the presentation of financial information in the financial statements for individual company was different. This requires knowledge of financial accounting to be able to extract the information to suit the study.

The main limitation of balance score card is that business performance is described by metrics. So what one can see in numbers is some kind of abstraction, rather than the whole picture.

There was also difficulty in accessing the respondents due to their busy schedules and getting information which some felt is confidential.

Performance contracting is itself a large area of study. Thus, not all aspect of contracting could be considered in this study.

Recommendations

This study recommends a further study in the best practices on the field of performance contracting, more so in the challenges in the implementation of the performance contract. The study indicates that parastatals continue to lay more emphasis on the financial perspective aspects of management. This has led to less or no focus on the other three perspectives. For the parastatal to remain focused and enhance growth this research recommends a further research on the application and implementation of balance scorecard in line with the performance contracting. The study also recommends further research on other aspects of performance contracting.

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APPENDIX 1: FINANCIAL STATEMENTS EXTRACTS
2003 TO 2006 YEARS OF INCOME

1.1 Kenya Electricity Generating Company Ltd (KENGEN)

	2003 KShs 000	2004 KShs 000	Avg KShs 000	2005 KShs 000	2006 KShs 000	Avg KShs 000
Sales	10,218,000	8,963,000	9,590,500	11,012,000	14,300,000	12,656,00
Gross Profits	5,791,000	4,827,000	5,309,000	2,495,000	2,735,000	2,615,00
Operating Costs	4,427,000	4,136,000	4,281,500	8,517,000	11,565,000	10,041,00
Operating Profits	4,422,000	3,103,000	3,762,500	2,880,000	3,776,000	3,328,00
Taxes paid	-	-	-	77,818	91,174	84,49
ROA	9	6	7	5	7	[illegible]
No. of staff	1,532	1,515	1,524	1,508	1,512	1,51
Staff costs	1,364,884	1,402,728	1,383,806	1,495,823	1,728,957	1,612,39
Training exp.	118,276	128,994	123,635	173,553	194,454	184,00
Social responsibility expenses	48,926	52,118	50,522	64,180	79,202	71,69
Provision for bad debts	-	-	-	-	-	-

1.2 Kenya Power and Lighting Company Ltd (KPLC)

	2003 KShs 000	2004 KShs 000	Average KShs 000	2005 KShs 000	2006 KShs 000	Average KShs 000
Sales	24,176,000	23,866,000	24,021,000	29,013,000	34,955,000	31,984,000
Gross Profit	6,062,000	8,328,000	7,195,000	10,655,000	11,479,000	11,067,000
Operating Costs	26,905,000	23,010,000	24,957,500	27,172,000	32,750,000	29,961,000
Operating Profits	(2,728,000)	856,000	(936,000)	1,841,000	2,206,000	2,023,500
Taxes paid	10,129	7,811	8,970	20,372	72,732	46,552
ROA	(21)	4	(8)	8	9	8
No. of staff	6,269	6,216	6,243	6,130	6,202	6,166
Staff costs	4,453,110	3,809,830	4,131,470	4,172,251	4,642,920	4,407,586
Training exp.	13,811	26,486	20,149	36,824	51,626	44,225
Social responsibility expenses	63,246	78,251	70,749	95,446	181,002	138,224
Provision for bad debts	315,493	(31,290)	142,102	151,906	586,492	369,199

1.3 Kenya Pipeline Company Ltd (KPC)

	2003 KShs 000	2004 KShs 000	Average KShs 000	2005 KShs 000	2006 KShs 000	Average KShs 000
Sales	6,527,997	6,737,216	6,632,607	8,108,365	8.451,512	8,279,939
Gross Profit	3,027,254	3,951,315	3,489,285	4,643,329	5,230,846	4,937,088
Operating Costs	1,990,022	2,009,593	1,999,808	2,296,172	1,563,926	1,930,049
Operating Profits	1,228,239	1,920,193	1,574,216	2,535,060	3,857,734	3,196,397
Taxes paid	436,027	785,546	610,787	780,468	1,915.130	1,347,799
ROA	9	12	11	16	24	20
No. of staff	1,415	1,434	1,425	1,455	1,452	1,454
Staff costs	1,228,468	1,230,516	1,229,492	1,276,900	1,227,148	1,252,024
Training expenses	12,180	14,508	13,344	16,647	13,501	15,074
Social responsibility expenses	98,840	116,472	107,656	197,232	146,089	171,661
Provision for bad debts	462,117	458,352	460,235	426.456	140,488	283,472

APPENDIX 2: LETTER OF INTRODUCTION

Dear Sir/Madam,--

Re: The Impact of Performance Contracting on the Performance of Companies in the Energy Sector

I am an MBA Candidate in the Department of Business Administration, School of Business, University of Nairobi. I am in my research year of my postgraduate studies focusing on "The impact of performance contracting on the performance of companies in the energy sector".

The purpose of my research is to identify the impact of performance contracting on the performance of companies in the energy sector, especially the parastatals. Some of the specific objectives of the survey component of the research include:

a) To evaluate the impact of performance contracting on the performance of parastatals in the energy sector.
b) To establish the autonomy of the parastatal heads in decision making.
c) To establish the extent to which managers were involved in the design of Performance contracts.
d) To establish the challenges facing the parastatals in the adoption and implementation of the performance contracts.

If you are interested in the results from this study you are welcome to request a copy of the final report by supplying your name and email address. Any queries regarding the questionnaire or the overall study can be directed to the undersigned.

Please be assured that this information is sought for research purposes only and your responses will be strictly confidential. No individual's responses will be identified as such and the identity of persons responding will not be published or released to anyone. All information will be used for academic purposes only. Please assist me in gathering enough information to present a representative finding on the Performance Contracting by completing the attached questionnaire. Your participation is entirely voluntary and the questionnaire is completely anonymous. Thank you very much for helping with this important study.

Sincerely, **Christopher Kirathe, Mobile: +254-722-433448 Email: chriskirathe@yahoo.com**

APPENDIX 3: QUESTIONNAIRE

PART A: PERSONNAL AND ORGANIZATIONAL DETAILS

Questionnaire Number .... Date ....

Please provide the following information regarding yourself.

1. Name of Department.....................

2. Designation of the respondent:

....

3. The number of years you have worked for the Company. (Please tick)

Less than 1 year	[ ]
1 – 3 years	[ ]
4 – 9 years	[ ]
10 or more years	[ ]

4. Your highest level of education (please tick)

Secondary level	[ ]
Diploma level	[ ]
Bachelors Degree	[ ]
Postgraduate Degree(s)	[ ]

Other (specify)..

PART B: PERFORMANCE CONTRACTING AND MEASUREMENT PRACTICES

1. To what extent were you involved in performance contracts negotiation?

Factor	Very minimally	Minimally	Moderately	Much	Very much
Setting of primary objectives					
Defining strategies					
Determining the performance targets					
Determining rewards for improved performance					

2. Were the performance targets freely negotiated and agreed upon?

   a) Yes [ ] b) No [ ]

3. To what extent have the following influenced performance target setting?

Factor	Very minimally	Minimally	Moderately	Much	Very much
Board of Directors					
Ministry of Energy					
The Treasury					
Office of the President					
Inspector – General (Corporations)					
Sate Corporations Advisory Committee					

4. Indicate the extent to which the following parties influence decisions relating to investment.

Factor	Very minimally	Minimally	Moderately	Much	Very much
Board of Directors					
Ministry of Energy					
The Treasury					
Office of the President					
Inspector – General (Corporations)					
Sate Corporations Advisory Committee					

5. Indicate the extent to which the following parties influence major decisions relating to major finance decisions (eg major loan acquisition, dividend decisions and major asset disposal decisions).

Factor	Very minimally	Minimally	Moderately	Much	Very much
Board of Directors					
Ministry of Energy					
The Treasury					
Office of the President					
Inspector – General (Corporations)					
Sate Corporations Advisory Committee					

6. Indicate the extent to which the following parties influence decisions relating to top human resource recruitment.

Factor	Very minimally	Minimally	Moderately	Much	Very much
Board of Directors					
Ministry of Energy					
The Treasury					
Office of the President					
Inspector – General (Corporations)					
Sate Corporations Advisory Committee					

7. How often are decisions of the board vetoed by any other party?

a) Very frequently [ ]

b) Frequently [ ]

c) Often [ ]

d) Less often [ ]

e) Not at all [ ]

8. Are you provided with feedback after performance evaluation by the supervisory body?

a) Yes [ ] b) No [ ]

9 What are some of the challenges facing the implementation of performance contracts in your company?

a) Political interference [ ]
b) Corruption within the company [ ]
c) Tribal staff hiring practices [ ]
d) Management malpractices [ ]
e) Interference from the Energy Ministry [ ]
f) Tribal patronage [ ]
g) Political patronage [ ]
h) Others...

....

10. What are the most challenging responsibilities and commitments from the current performance contracts? (Please tick)

Responsibilities and commitments	**Tick**
Achieving maximum performance consistent with the business plan	
Meeting the performance targets	
Monitoring and evaluating periodical results against performance targets	
Maintaining in place such systems and procedures to reasonably facilitate objective assessment of performance by the government	
Adopting and implementing good corporate governance practices in the company towards enhancing prosperity and corporate accounting	
Realizing shareholders long-term value while taking into account the interest of the stakeholders	

Thank you for Taking Your Time to Fill the Questionnaire