EFFECTS OF GOVERNMENT BAILOUT ON FINANCIAL PERFORMANCE OF COMMERCIAL STATE OWNED ENTERPRISES IN KENYA

By

SETH O. ONYANGO

A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS OF MASTER OF BUSINESS ADMINISTRATION DEGREE, SCHOOL OF BUSINESS

UNIVERSITY OF NAIROBI

OCTOBER 2016

DECLARATION

This Research Project is my original work and has never been submitted for a degree in any other University.

Signed……………………….. Date ………………………

SETH ODHIAMBO ONYANGO

D61/79583/2015

School of Business, University of Nairobi.

This Research Project has been submitted for examination with my approval as University Supervisor.

Signed……………………….. Date ………………………

DR. SIFUNJO KISAKA.

Senior Lecture, Department of Finance and Accounting

School of Business, University of Nairobi.

ACKNOWLEDGEMENT

I would like to take this opportunity to acknowledge to all the people who played a big role in assisting me complete this project and the study as a whole. I would first of all, thank the Lord almighty for giving me good health to start and complete this project successfully, without his grace and mercy, I would not have come this far.

To my supervisor, Dr. Sifunjo, I take this opportunity to thank you for the proper guidance you have given me and I also thank you for your dedication, time and effort. Your comments, advice, criticism and suggestions were highly appreciated. Without them, this undertaking would not have come to this end.

Lastly to my wife Mercy Abayo and my parents who have been with me throughout this journey. God bless you all.

DEDICATION

I dedicate this work to my Wife Mercy Abayo Ong'injo, my family and all those who supported me in the completion of this project. Thank you and May God bless you abundantly

TABLE OF CONTENTS

DECLARATION i
ACKNOWLEDGEMENT ii
DEDICATION iii
LIST OF TABLES vi
ABSTRACT vii
CHAPTER ONE 1
INTRODUCTION 1
1.1 Background to the Study 1
1.1.1 Government Bail-Out 2
1.1.2 Financial Performance 4
1.1.3 State Owned Enterprises in Kenya 5
1.1.4 Government Bail-Out and Financial Performance 6
1.2 Research Problem 6
1.4 Value of the Study 10
CHAPTER TWO 12
LITERATURE REVIEW 12
2.1 Introduction 12
2.2 Theoretical Literature Review 12
2.2.1 Agency Theory 12
2.2.2 Stewardship Theory 14
2.2.3 The Public Choice Theory 15
2.2.4 Resource Based View Theory 16
2.3 Determinants of Financial Performance of State Owned Enterprises 17
2.3.1 Government Bail-out 17
2.3.2 Corporate Governance 18
2.3.3 Industry Competition 19
2.3.4 Political Environment 20
2.4 Empirical Literature Review 21
2.4.1 Review of International Researches 21
2.4.2 Review of Local Research 24
2.5 Conceptual Framework 28

2.6 Summary of Literature Review 28
CHAPTER THREE 30
RESEARCH METHODOLOGY 30
3.1 Introduction 30
3.2 Research Design 30
3.3 Population and Sample 30
3.3.1 Population 31
3.3.2 Sample 31
3.4 Data and Data Collection Instruments 31
3.5 Data Analysis 32
3.5.1 Conceptual Model 32
3.5.2 Analytical Model 33
CHAPTER FOUR: 35
DATA ANALYSIS, FINDINGS AND DISCUSSIONS 35
4.1 Introduction 35
4.2 Summary Statistics 35
4.3 Estimated or Empirical Model 36
4.3.1 Correlation Analysis 36
4.3.2 Regression Analysis 38
4.4 Interpretation of findings 40
4.5 Discussions 41
CHAPTER FIVE: 42
SUMMARY, CONCLUSION AND RECOMMENDATIONS 42
5.1 Introduction 42
5.2 Summary of the study 42
5.3 Conclusion 43
5.4 Limitation of the Study 44
5.5 Recommendations for Further Research 45
5.6 Recommendation for Policy 46
REFERENCES 47
APPENDICES 53
Appendix 1: Financial Performance Ratios 53
Appendix 2: List of State Owned Enterprises Bailed out 55

LIST OF TABLES

Table 4.1: Descriptive Statistics 35

Table 4.2: Correlation Analysis 37

Table 4.3: Model Summary 38

Table 4.4: Analysis of Variance.. 39

Table 4.5: Regression Coefficients 39

ABSTRACT

Government bailout is where a government provides financial support to the State Owned Enterprises, state corporations or county Governments when facing financial difficulties or bankruptcy. It is believed that when Government bail-out the state owned Enterprises it is investing and perhaps expects to realize returns in the future on behalf of the taxpayers. Government bail-out should in an ideal situation help improve the financial performance of the State Owned Enterprises however that has not been evident as the State Owned Enterprises bailed out continue performing dismally and would request for continuous bail-out. The objective of the study was to determine the possible effect of the Government bail-out on financial performance of State Owned Enterprises. The population for this study comprised of commercial state owned Enterprises that have been bailed out by the Government in Kenya. The model had a Correlation value of 0.953 which depicts good linear relationship between predicted and explanatory variables. The model was also strong with an R-square value of 0.908 which was adjusted for errors to 0.723. This depicts that the independent variables explains 72.3% of the changes in financial performance as measured by the variables. An analysis of the financial performance ratios indicates that profitability ratio did not immediately increase in post government bailout era, meaning that government bailout should be seen as a long term intervention strategy. This applied to all the State Owned Enterprises studied. The study recommended the need to look at the valuation of enterprises that are up for government bailout.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Government bailout is where a Government provides financial support to the State Owned Enterprises, state corporations or county Governments when facing financial difficulties or bankruptcy. Governments all over the world have been faced with the dilemma of bailing out institutions both private and public that either offer essential services or whose failures would have serious economic impacts in the country's' economy. Governments may bail out State Owned Enterprises mainly for social improvement and to prevent social economic failures (Smith, 2011).

According to Corporate law theory and practice shareholder (citizens) relation with State Owned Enterprises and the implications of ownership and control are highly considered. However bailout and the resultant Government shareholding, ownership and control at many State Owned Enterprises have left the corporate theory and practice in chaos. When the Government shareholding is present in an organization agency theory, nexus of contracts thought to citizens/ director primacy debate, progressive corporate law and other existing theories breakdown which in turn makes the State Owned Enterprises perform poorly hence considered for bail-out (Verret, 2009).

State owned enterprises are always implicated in serious fiscal problems and poor financial performance in most African countries due to their inefficiency, lack of good corporate governance practices, and provision of poor products and services. They

occasionally achieve some non-commercial and non-financial objectives, which are later used to justify why their continuous poor financial performance. Kenya has constantly been depending on assistance from world financial services organizations financial such as World Bank and the International Monetary Fund ("IMF") due to its recurring economic crisis which has been in existence since the mid-1970s, this is partially due to the continuous poor performance by the state owned enterprises (Mwaura, 2007). This leads to constant bail-out to the state owned Enterprises.

1.1.1 Government Bail-Out

Casey and Posner (2015) defined Bailout as an ex post Government transfer which may be inform of a loan, cash or other consideration. Government bail-out stated back in the 1920s and 1930s when there were bank failures due to economic depression in the United States of America. High level of attentions was given to the prominent and well known institutions that are branded as “Too big to fail”. Due to this the United State of America creates the Federal Deposit Insurance Corporation in 1933 as a response to the crises. Government interventions are therefore the technique oftenly used to solve such problems. Since then the Federal Government of the USA has never shied away from proving financial support to certain businesses. Big State Owned Enterprises like Chrysler, General Motors, and Citi group have all been bailed out by the USA Government. The Government's position was not clear as to which firms should be bailed out and which should not be bailed out. This is because Lehman was left to die a natural death yet it met the criteria of “too big to fail” (smith, 2011).

Some people however, did not accept government bailouts, banking crisis that was evidenced in 1980s in the USA was widely accepted by many as having been well managed by the Federal government and the FDIC, and the method and practice was copied by Government officials who encountered similar crises in Europe and Japan in the 1990s. Another best model of resolving bank crisis was advanced by Swedish Government to resolve the banking crisis in 1992 which was same as Continental Illinois intervention (Smith, 2011).

It is believed that when Government bail-out the State Owned Enterprises it is investing and perhaps expects to realize returns from the operations of the State owned enterprise in the future on behalf of the taxpayers who are the shareholders. Government bailout is accepted by the citizens (taxpayers) with anticipation that they are temporal, for emergency, and may offer solution to the market and the capitalist dealings may not change structurally (Todorova, 2009).

In Kenya, Government bail-out has been common in the recent times with the most recent being Kenya Airways although taken negatively by the public. It is believed that the management of the State Owned Enterprises are corrupt and running the State Owned Enterprises without the interest of the public at heart and incase of liquidity challenges the taxpayers money is used to bailout the State Owned Enterprises. Conflict of interest and politics are seen as the major cause of the poor financial performance by the State owned Enterprises.

1.1.2 Financial Performance

Financial performance measures firms operating policies and resources in monetary terms. It covers the primary modes of operation of the firm and how it generates its revenue. The term is also used to assess the general performance of a firm and to determine its overall financial health. Financial performance is a very crucial element for firms engaging in business. It is a topic that is greatly discussed and remains of relevance to both academic scholars and practicing managers (Venkatramann & Ramanujam, 1986).

Financial performance of a firm indicates how efficiency, effectiveness and relevance a firms resources are applied. Financial viability which is an element of financial performance on the other hand is the firm's ability to survive. For an organization to remain viable resources outflows need to be less than inflows. As indicated by International Development Research Centre (IDRC) (1999) Organizations that need to be financially viable should meet the following conditions; the organization should have multiple sources of finances, positive net cash flow and surplus or profit. Stakeholders based view stipulates indicates that the various measurement tools for evaluating financial performance depend on the influence by the stakeholders (Abdi, 2015).

According to Estrin and Perotin (1991) Government as the owner, the State owned enterprises may not purely concentrate on profit maximization since the Government has political, economic and social objectives to achieve unlike private commercial firms that are profit oriented. Financial performance in state owned enterprises will be inferior due to weaker governance arrangements and their numerous objectives. Hence, the State

Owned Enterprises continue to achieve other objectives other than profit maximization leading to poor financial performance which then paves way for continuous Government bail-out.

1.1.3 State Owned Enterprises in Kenya

State Owned Enterprises (SOEs) in African countries have been in existence since early 1950s and continued to grow in the sub-Saharan Africa by the 1980s (Etukudo, 1997). They are however, associated with history of countinued poor performance (Boko & YuanJan, 2011).

Rising expectations by the taxpayers have influenced Governments and have forced them to reform the corporate governance systems and practices in state owned enterprises, so as to improve their operations and gain high level of competitiveness which will eventually lead to high financial performance (Dockey & Herbert, 2000).

State owned Enterprises emerged in Kenya with the colonial Government and were to provide services which the private sector couldn’t provide. The areas or sectors included export of agricultural produce, communication and transportation, manufacturing and agricultural trade facilitation (Mwaura, 2007). They are formed through an act of parliament, section, 2 of the state corporation act, a legal notice or through the normal State Owned Enterprises act cap 486.

These state owned State Owned Enterprises have however, been performing poor financially leading to constant bail-out by the Government. Despite the Government bail-out some of the State Owned Enterprises do not perform well while others perform well

after the bail-out. It’s on this basis that this study is investigating the effects Government bail-out has on the financial performance of the state owned Enterprises.

1.1.4 Government Bail-Out and Financial Performance

It is expected that the poorly performing State Owned Enterprises when bailed out by the Government would perform better financial as was witnessed in the United States when the federal Government bailed out GM and Chrysler motors. The Federal Government injected cash to form equity in GM and a soft loan to Chrysler motors with condition to restructure and be competitive enough. The State Owned Enterprises later became profitable and can compete favorably in the Auto industry (Goolsbee & Krueger, 2015).

Government bail-out has also worked well in China in boosting the banking sector of china. The banks were bailed out by the Chinese Government and restructure to make them profitable. This boosted the banking industry in china (Cull & Xu, 2003).

In Kenya it’s not clear the effects of Government bail-out on the state owned State Owned Enterprises financial performance because some of the State Owned Enterprises become profitable for a short period then later go under requiring another Government bailout like Uchumi supermarket. It is therefore based on this background that this study is carried out to investigate the possible effects the Government bail-out has on the financial performance of State owned Enterprises.

1.2 Research Problem

Government bailouts arise mostly due to the Agency problems. According to Agency theory as was developed by Jesen and Meckling in 1976 explains the relationship

between the agent and the principal. They described agency relationship as a contract where a person or a group of people (principal) engage another person (agent) to perform particular professional services on his/their behalf which they do not have expertise on or do not have time to perform, it involves delegating some decision-making authorities to the agent and sitting back to check what has been done by the agent. In the Agency relationship there exists problems; the problem of difference in desires, goals and objective of the principal and those of the agent and the problem arise when the principal's attitude towards risk differs from that of the agent. This leads to Agents (managers) are managing the company with their interests at heart leading to poor financial performance and liquidity challenges that thereafter lead to Government bailout.

Governments continued bail-out on state owned State Owned Enterprises has been of great concern both internationally and locally. Some researchers are against the practice while others believe it's the only way a Government intervene on its falling enterprises that are seen to be "too big to fail" institutions. According to Todorova (2009) Government bail-out are accepted by the taxpayers because they believe it's a temporary event, initiated during emergency, they may provide solutions to the market and wouldn't operationally change capitalist associations. However, no temporary stimulus and bailouts can address the systemic instability in financial capitalism identified by Post Keynesians and Institutionalists. However, according to Poole, (2010) A bailout regimes are not acceptable over time in a market economy due to misrepresentation of risk acceptance which eventually lead to encouragement of excessive risk taking over time due to federal backstop.

The Government of Kenya has on the other hand in several occasions bailed out state owned Enterprises that have had financial difficulties and the performance of the State Owned Enterprises are still questionable and therefore there has been a question of whether the Government still need to continue bailing them. Kenya has been in the road after having bailed out Kenya Airways, Uchumi Supermarket, Pan Africa paper mill and Mumia Sugar Company. Even though Government continue bailing out numerous of the state owned enterprises the effects of the Government bailout is never known on the performance of the corporations. Some of the State Owned Enterprises get uplifted grow financially while others continue performing dismally. State Owned Enterprises that go for state support sends the wrong signal and undermines the Government's ability to support the broader economy.

Makhoha, (2012) analyzed the effects that privatization of state owned enterprises have on financial performance of former state owned enterprises that are listed at the NSE. The study concluded that privatizing state owned enterprises would have a positive influence on how the firms perform financially as it would increase their profitability and activity ratios. The results of the study showed varied performance results from the other ratios. Government control on the State owned State Owned Enterprises is therefore seen as a huddle that affects the financial performance of the State Owned Enterprises. This therefore explains why there would be continuous bail out on the State Owned Enterprises us they will continue performing dismally.

Ong'onge and Awino (2015) on the other hand investigated the effect financial autonomy would have on financial performance of the commercial state owned corporations. The aim of the study was to establish how the level of autonomy of commercial state

corporations in Kenya would influence their financial performance. The researcher recommended that there is need to improve the corporation's financial autonomy from the Government so as to achieve high financial performance. They further recommended that the Government should give the corporation's the autonomy and independence to make decisions on investment, expansion and implementation of day – today business activities. It is therefore evident that Government control and lack of autonomy in decision making by the State owned Enterprises leads to poor financial performance which thereafter leads to continued bailout by the Government using taxpayers' finances.

Abdi (2015) in investigating the relationship existing between corporate governance and organizational performance of state owned corporations in Kenya. He found out that corporate governance practices have a positive relationship to organizational performance of state corporations in Kenya.

Ongeti (2014) also investigated the relationship between organizational resources, corporate governance and financial performance of Kenyan state corporations. As a result of Government bailout the state owned State Owned Enterprises that are undergoing financial difficulty are advanced resources that would spar their financial performance.

In view of the above researches which are inclined towards the effects of corporate governance and financial autonomy on financial performance of state owned enterprises, none of the researchers had investigated the effects of Government bail-out on the financial performance of state owned enterprises. This research will therefore help determine the effects of Government bailout on the financial performance of the State-owned Enterprises.

Government bail-out should in an ideal situation help improve the financial performance of the State Owned Enterprises however that's has not been evident as the State Owned Enterprises bailed out continue performing dismally and would request for continuous bail-out.

1.3 Research Objective

The objective of the study is to determine the possible effect of the Government bail-out on financial performance of State Owned Enterprises.

1.4 Value of the Study

Issues have been continuously raised on whether it's prudent for Governments to use tax payers' money in bailing out poorly performing state-owned State Owned Enterprises. The output of this research will help the Government of Kenya and more specifically the National Treasury get enlightened on what exact measures to take incase its faced with such challenges going forward. This may trigger formulation and implementation of national policies on Government bailout.

The study will help the Government be able to way options on whether to privatize the State Owned Enterprises or to carry out continuous bail-out on the underperforming the State Owned Enterprises.

The findings of the research may also help the public who are the tax payers' understand whether their finances are put into good use when the Government bails out state owned Government State Owned Enterprises that are performing poorly financial.

The finds can also be used by stake brokers who are trading in shares of Government linked Enterprises to determine and analyze the possible movement in share prices of the firms in the stake exchange market.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews literature relating to Government bail-out and the financial performance of state owned Enterprises. The literature review is organized in the following sections: Section 2.2 discusses the Theoretical literature review of the topic, section 2.3 discusses the Determinants of financial performance of state owned Enterprises, section 2.4 discusses the empirical studies, section 2.5 illustrates the conceptual framework and section 2.6 discusses the summary of the literature review.

2.2 Theoretical Literature Review

This section reviews the theories related to Government bail-out and financial performance of state owned enterprises. Sub-section 2.2.1 reviews the Agency theory, Sub-section 2.2.2 reviews stewardship theory, Sub-section 2.2.3 reviews the public choice theory and Sub-section 2.2.4 reviews resource based view theory. The section therefore in summary outlines the Theoretical relationship between Government bail-out and financial performance of state owned enterprises.

2.2.1 Agency Theory

The agency theory developed by Jensen and Meckling (1976) and Eisenhardt (1989) have continued to be popular amongst current researchers while examining and explaining the relationships that exists between the shareholders (owners) of the firms or company

(principle) and managers who are the agents entrusted with the responsibilities of managing them (agents) (Mbo & Adjasi, 2013). In this case the principal and the agent get into wrangle when the agent does not address or implement the interests of the principle. The case of Government owned Enterprises it becomes very difficult to locate the principal as the Government acts on behalf of its citizens who are the ultimate principals who have no knowledge and authority about the undertakings. Toninelli (2000) in his study also noticed the agency problem and further branded the management of the State Owned Enterprises as "Agents without principals". Li and Xia, (2007) equally realized the problem and faulted it on principle or the taxpayers inability to monitor the agent.

State owned State Owned Enterprises suffer serious Agency problems all over the world as was stated by Menozzi and Urtiaga (2004) State owned State Owned Enterprises undergo a double agency problem because the agent who is likely to be a politician with own agenda will represent the state's interest in the company. Similarly State owned State Owned Enterprises may suffer another agency problem of being overseen by different levels of Government.

Due to the static assumptions of Agency theory Doanaldson and Davis (1991&1993) developed Stewardship theory. They termed agency theory as suffering from being static as it only considered the relationship between the principal and the agent at a single point in time and did not consider learning of individuals during interaction.

The Agency problem therefore may affect the performance of the state owned Government agency financially. The Agency problem arise due to the representations in

the Boards of the State owned State Owned Enterprises by politicians. Among firms that have been previously bailed-out, politically connected ones demonstration expressively poorer operating and financial performance than those that are not politically connected during the bailout period (Faccio et al. 2006). This therefore explains why the State owned Enterprises may continuously be bailed out.

2.2.2 Stewardship Theory

Agency theory has in most cases influence the organization theories and practices, this makes managers in the State Owned Enterprises as agents whose interest may differ from there principals who are the shareholders (Jensen & Meckling, 1976). There has however, been seen that alternatively, sociological and psychological governance approaches such as Stewardship theory assumes juniors as collectivists, trustworthy and pro-organizational. Stewardship theory as was developed by Donaldoson and Davis (1991&1993) view the managers not as agents' parse but as trust worth and with the public interest at heart. Stewardship theory has in the modern management been framed as the organizational behavior. It assumes that no conflict exists between the managers (agents) and the owners (principal) and the goal of good governance is to find mechanism and structure that enable the proper and effective coordination between two parties (Donaldson, 1990). Stewardship theory has placed greater value on goal convergence among the principal and the agent rather than the agents' interests alone (Slyke, 2007)

Stewardship theory may also affect the financial performance of the state owned Enterprises leading to continued bailout this is because it may be difficult for an individual to rationally decide whether his nature is that of a steward or an agent. This is

because stewardship theory assumes that becoming a steward or an agent is as a result of a rational process.

2.2.3 The Public Choice Theory

Public choice theory was advanced by Buchanan and Tullock (1986) in order to explain how public decisions are made. Decisions in this case are made through public voting, politicians and or political action committees. Public Choice Theory analyses the principle applied by people in making collective decision making.

Chinese and Indian State owned enterprises indicated that it was not practical and impossible for boards to act in contradiction to the will of a principal or main shareholder (Rajagopalan and Zhang, 2008). And in this case Government with the backing of the taxpayers is the dominant shareholder and the Board of directors should always reflect the view of the state in making decisions about the company.

In terms of Public choice theory efficiency is never in itself a policy objective of state owned State Owned Enterprises therefore there is unlikely that a state owned company with essentially the same production functions as an efficiently operated private enterprise may comparably perform well financially.

Public choice theory is however criticized due to lack of incentives by citizens to monitor and evaluate the actions taken by the Government [Government officials and politicians] (Shaw, 2008). The citizen are often blamed because they are always ignorant of their roles and not being able to give incentives (Anthony, 1957, as cited in Shaw, 2008) and

thus weakens incentive to managers with public interest when executing their work (Mbo & Adjasi, 2013)

This taken into consideration explains why Bailed out state owned Enterprises may not perform well financial. The Government of Kenya through the National treasury have always bailed out Kenya Airways because of the following reasons; There would be job losses of about 4000 jobs leading to loss worth Kshs. 10 billion Kenya shillings per year, other purchases of Kshs.50 billion, annual forex earnings of about Kshs. 50 billion and disruption of floriculture export trade (Muriithi, 2015).

2.2.4 Resource Based View Theory

The competitive advantage of a firm is derived by the availability of resources at their disposal to use (Mwailu & mercer, 1983). This is the device used by management to assess and determine the availability of amount of state owned enterprises strategic resources; it is based on the idea that for a company to gain competitive advantage over the peers or competitors in the market the resources should be applied effectively and efficiently.

The Resource based theory was also widely spread by among other scholars Hamel and Prahalad, (1994) who viewed firms as resources based which, depending on how they are uniquely and adequately combined and applied would make a firm have a competitive edge over its competitors in the industry. This was also supported by Grant, (1991) who holds a view that a firm's available resources indicate its primary source of good performance.

When the firms are bailed out by the Government there resource base is raised and are therefore expected to gain competitive advantage over other companies in the same industry. The theory worked well in the USA when the Federal Government bailed out General motors (GM) and Chrysler motors in 2009, the State Owned Enterprises are currently doing well competitively world over. The decision to bail-out GM and Christler was risky but finally, the companies where brought back to a sustainable level. They did not believe it could work. In particular, they were not sure about how viable Christler-Fiat merger would be in the long-run (Goolsbee & Krueger, 2015). However, it seem not have not worked well in Kenya as the bailed out State Owned Enterprises continue performing poorly.

2.3 Determinants of Financial Performance of State Owned Enterprises

This section discusses the determinants of financial performance of state owned enterprises these include Government bail-out, corporate governance, industry competition and political environment. It discusses the relationship of each to financial performance of state owned enterprises.

2.3.1 Government Bail-out

Government bail-out is where the Government intervenes when a private company, state owned company or Government linked company is under financial crisis and is likely to go under. The effort made by U.S. Government for example to bail-out and restructure the operations of General Motors and Chrysler in 2009 when they were facing economic and financial crisis made the companies competitive and profitable enough to compete with other companies in the Automobile industry (Goolsbee & Krueger, 2015).

The Government can carry out the bailout in many ways; by cash injections as the USA injected cash in GM as equity to boost the company and also by advancing the company soft loans as the USA provided loan to Chrysler which boosted their operations. Other ways would include tax exemptions, priority services as the Government of Kenya has provided to Kenya Airways by instructing all Government ministries, departments, state corporations and Government linked State Owned Enterprises to fly with Kenya Airways (GOK circular, 2016).

These actions by Governments are perceived to help boost the profitability of the State Owned Enterprises as was experienced in the USA when they bailed out GM and Chrysler motors ignited there performance and made them competitive. Kenya on the other has bailed out a number of State Owned Enterprises including Kenya Airways, Uchumi supermarket, Post Bank, Mumias Sugar Company etc.

2.3.2 Corporate Governance

Corporate governance is the system and standard rules, practices and processes that are followed in directing and controlling a company. It also refers to the mechanisms and the relationships required in the corporate management of State Owned Enterprises. It includes authority, accountability, stewardship, leadership, direction and control exercised in organizations including state owned enterprises (Mwongozo, 2015). Corporate governance reforms have been collectively exhibited statistically significant positive impact on performance in Indian State owned State Owned Enterprises although the performance is less than the State Owned Enterprises without Government ownership (Gnan, Hinna & Monteduro, 2014).

Mixing Politics and corporate governance is complicated and striking an ideal balance between social and commercial goals can be a near impossible undertaking. In theory, a State Owned Enterprises may have been established to provide services that can benefit the citizens or the taxpayers. But in reality some or many State Owned Enterprises may be accountable and report to the ruling political party. The original motive of providing efficient, effective and affordable services to the citizens and taxpayers at large is lagging and this to a large extent affects their financial performance.

Kenya has made a step in encouraging good corporate governance practices in the State owned State Owned Enterprises by developing the Mwongozo cord of conduct that is giving guidelines on how the State Owned Enterprises are supposed to be managed so as to perform effectively. What is needed therefore is clear political leadership and commitment to change so as to realize good governance (Mwongozo, 2015). With the implementation of the Cord of conduct the state owned State Owned Enterprises will be able to perform well financial among other objects for which they are intended to achieve.

It is believed that good corporate governance practices would trigger high financial performance in State Owned Enterprises and will enable them compete effectively with the other State Owned Enterprises in their various industries or deliver better services to the citizens.

2.3.3 Industry Competition

Some state owned Enterprises are commercial and share the same industry with other players market competing for same clients. As was established in China non-state owned

Enterprises seem to be advantaged in some governance mechanisms and practices than state owned Enterprises, but market competition however, matters more for State Owned Enterprises than for private companies. It is suggested that competition can reduce managerial gaps and limit costs for both state owned enterprises and private companies which in turn make State Owned Enterprises to perform (Hu, Song, & Zhang, 2004).

Some of the state owned Enterprises such as Kenya power and lightning company, Kengen, Geothermal Development Company, Kenya airways etc. enjoy monopoly in their industries, and it is believed that if they would have strong competitors there financial performance would increase.

2.3.4 Political Environment

Politics has a lot of influence on how the state owned State Owned Enterprises are managed. This is because as the agency theory stipulates Government is the principal and the Management of the State Owned Enterprises are the agents. The principal is represented by the politicians who have their own interests and also the interest of the Government to pursue. State Owned Enterprises that are politically connected demonstration a significant poorer performance operationally than the non-connected state owned enterprises during the bailout period (Faccio et al., 2006). When SOEs are bailed out politicians in some instances become the ultimate beneficiaries, this is because they are able to use their political muscles to extract most or all of the rents from borrowers, lenders, and other stakeholders (Bertrand et al. (2004), Shleifer & Vishny (1994) as cited by Faccio et al., 2006).

In view of the foregoing, it is evident that politics of the country affects the financial performance of the State owned Company and Government Linked State Owned Enterprises. Politics also influences the possibility of a company being bailed out in case of financial instability.

2.4 Empirical Literature Review

This section reviews the literature relating to Government bail-out and financial performance of state owned enterprises. Sub-section 2.4.1 discusses the international literature and Sub-section 2.4.2 discusses the local literatures. Most of the local researches have been done on the area of corporate governance.

2.4.1 Review of International Researches

Many scholars have researched on the areas of Government bailout and effects of financial performance of State owned Enterprises. For instance Faccio et al. 2006 investigated the chance of Government bailouts of 450 firms which are politically connected from 35 countries between 1997-2002 and he found out that firms connected politically are more likely to be bailed out frequently than similar non-connected firms. They further found out that firms that are connected politically are unaccountably likely to be bailed out when International Monetary Fund or the World Bank gives financial assistance to the country where the firm domiciled. This makes the State Owned Enterprises to perform poorly because they are well connected and are assured of continuous bailout in case of financial difficulties or when they face liquidity challenges.

Gropp, Hakenes & Schnabel (2010) investigated the competitive effects that rise out of Government bailout policies. They created a degree of bailout perception by rating information's, where they constructed the market share of insured competitor banks for a given bank and analyzed its impact and variability on banks' risk-taking behavior, they sampled many banks from OECD countries. They found out that Government guarantees increased the risk appetite of the banks that were not protected. However, the it was found out that public guarantee did not increase the protected banks' ability to take risk. Due to the Government Guarantee the banks lacked aggressiveness to counter the market and risk-taking strategies therefore could lead to there under performance compared to the other competitor banks.

Giannetti, and Simonov, (2013) investigated the effects that bank bailouts would impact on the supply of credit and the financial performance of banks' during Japanese banking crisis in the 1990s. Their findings indicated that the size of the capital injection relative to the initial financial condition of bank is crucial for the success of bank bailouts. They established that capital injections that are enough to reestablish bank capital requirements increase the supply of credit and spur investment, however, they noted that not only do capital injections that are small fail to increase the supply of credit, but they also encourage the ever greening of nonperforming loans. From there study the banks would perform well by being able to provide more credit to its clients, however, the level of nonperforming loans would increase hence affecting the performance of the bank in the long run.

Bai, Lu and Tao (2006) in studying the Multitask Theory of state owned enterprise reforms: Empirical evidence of China did realize that reforms of China's state-owned

enterprises (SOE's) are gradual and done on a selective approach. They found out that most of the state-Owned enterprises are unprofitable and the few exceptional ones tended to be sheltered be Government protection in selected industries. The underperformance would hence lead to bail-out in case of financial difficulties.

Hu, Song, and Zhang (2004) Investigated Competition, Ownership, Corporate Governance and Enterprise in China. The study utilized World Bank survey data of over 700 Chinese firms which catted across seven various sectors and five cities/towns between 1996 and 2001 so to assess the relative importance of the above three parameters, independently, jointly, and how they interact. They found out that; when the parameters are examined independently each element is significant in explaining the efficiency of their example firms. However, when jointly examined, ownership structure and corporate governance are relatively more important, while the competition effect was less significant; There appeared to exist some degree of substitutability between two pairs: privatization and corporate governance, and privatization and competition; It was also observed that private companies seemed to have undue advantage in some governance mechanisms over SOEs, however, market competition largely matters for SOEs than for the private companies. They suggested that the three views were indeed incomplete by themselves, and a complete package required some combination of these determinants. In view of the above state owned State Owned Enterprises are well resourced and need to perform better as they are more observant on the market competition that the private counterparts. Hence, the bailout would help ignite their financial performance.

Zhenhui and Melissa (1999) investigated the economic performance of 13 Argentine SOEs. Among them, one displayed a behavior consistent with profit maximization, eight exhibited a behavior consistent with output maximization with a maximum loss constraint, and four showed a behavior consistent with employment maximization. Such behavior taken together was consistent with the use of SOEs to achieve Government macroeconomic targets. This therefore may explain why the state owned Enterprises to some extent are not able to perform effective and competitively.

Indian state owned enterprises are considered to be performing below par and performance is measured using profitability. Profitability review alone is seen to ignore the social and economic objective which equally to a large extent forms part of state-owned enterprises objectives. These socio-economic objectives may include the wealth creating , promotion of redistribution of income and wealth, employment creation, promotion of regional development, promotion of import substitution among others (Nayar, 1990)(as cited by Ahuja & Majumdar, 1998).

2.4.2 Review of Local Research

Makhoha, (2012) analyzed the effects of privatization on financial performance of former state owned enterprises that are listed at the NSE. The study employed descriptive survey design on a population of privatized former SOEs quoted at NSE. The study used secondary data sources in collecting information; internet, periodic report and brochures for a period of five years before and five years after privatization of each SOE. The data was analyzed using a regression model where the independent variable performance is regressed against dependent ratios i.e. profitability ratio, liquidity ratio, leverage ratio and

activity ratios, a t-test statistic, to test the hypothesis on whether there was any significance difference in financial performance after privatization was also performed. The study concluded that privatization had a positive impact on the financial performance of these firms as it increased their profitability and activity ratios. The results of the study also showed varied performance results from the other ratios. Government control on the State owned State Owned Enterprises is therefore seen as a huddle that affects the financial performance of the State Owned Enterprises. This therefore explains why there would be continuous bail out on the State Owned Enterprises us they will continue performing dismally.

Ong'onge and Awino (2015) while investigating the relationship between financial autonomy and financial performance of the state owned commercial corporations in Kenya. The population was comprised of all commercial state owned enterprises in Kenya, which were thirty one. They used descriptive statistics and a census method was used because the commercial state corporations are few. The research design of descriptive survey was preferred because it assisted the researcher to identify and describe the area of study and assisted in explaining the collected data in order to properly examine the differences and similarities. Questionnaires where used to collect the required data through a drop and pick method. Data collected were presented using descriptive statistics and were analyzed using multiple regressions model. They found out that financial autonomy would increase public confidence and accountability hence would lead to optimal financial performance. In the light of the research findings, the researcher recommended that there is need for financial autonomy of the state owned enterprises to improve their financial performance. The Government should therefore

surrender the decisions on investment, expansion and day – today business activities to the corporations so as to allow for optimal financial performance. It is therefore evident that Government control and lack of autonomy in decision making by the State owned Enterprises leads to poor financial performance which thereafter leads to continued bailout by the Government using taxpayers' finances.

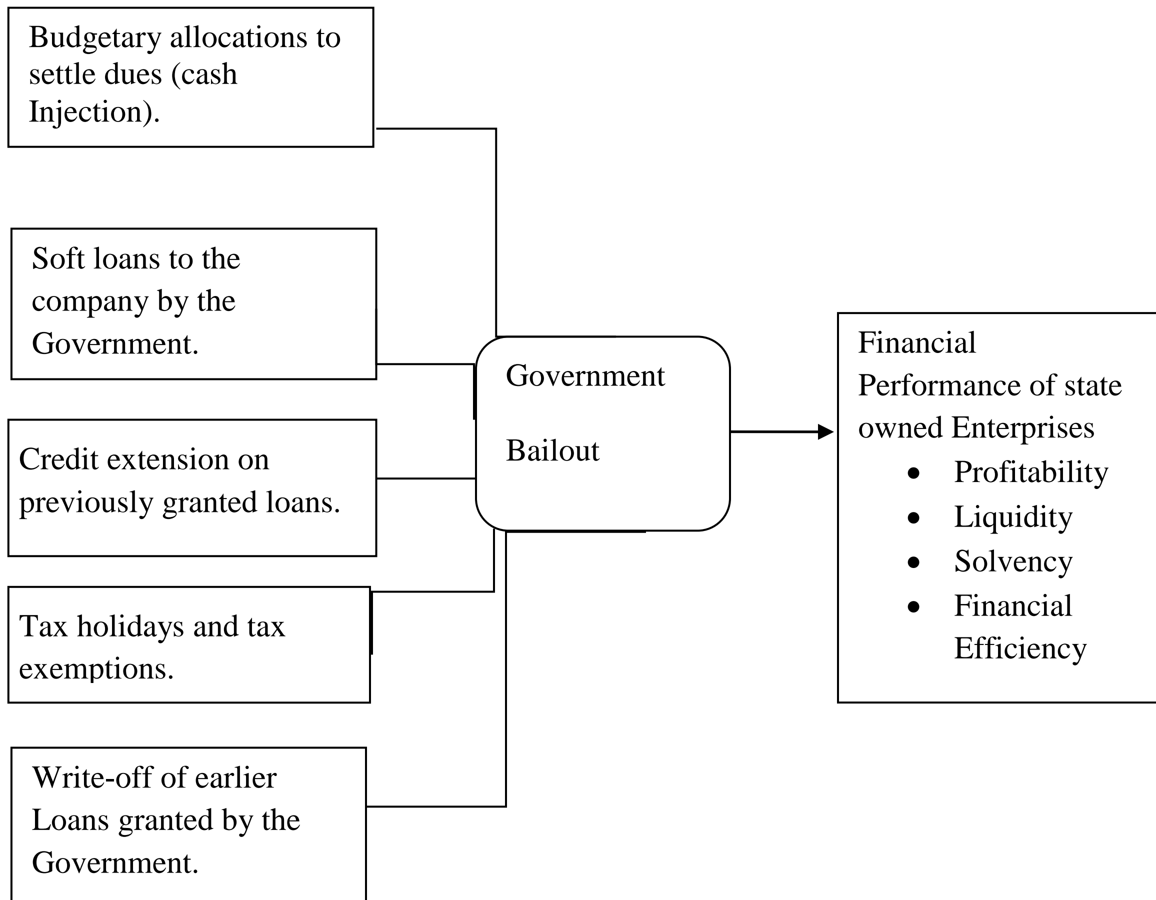
Abdi (2015) investigated the effects of corporate governance on organizational performance of state corporations in Kenya. The objective of the study was to determine the effect of corporate governance on organizational performance of State Corporations in Kenya. The study population was 184 state corporations out of which 60 state corporations were selected for the study. Secondary data was used annual reports and financial statements for the year 2010-2014. A regression model was used to analyze the relationship between organizational performance and corporate governance practices. The study found out that there is a positive relationship between corporate governance practices and organizational performance of state owned enterprises in Kenya. In view of the above good corporate governance practices would lead to high financial performance by the state owned Enterprises. With good corporate governance the State Owned Enterprises are expected to be more profitable after Government bail-out.

Ongeti (2014) investigated the relationship between organizational resources, corporate governance and performance of Kenyan state corporations. The study's main objective was to establish the influence of corporate governance structures on the relationship between organizational resources and performance of Kenyan state corporations. Through a cross-sectional descriptive survey, data was obtained using a semi-structured questionnaire. The questionnaire was administered through a drop and pick method to a

sample of 95 Kenyan state corporations out of which 63 filled and returned the questionnaires. Through multivariate and hierarchical regression analyses, findings indicated that there exists a significant relationship between aggregated organizational resources and financial performance. However, the organizational resources could only explain 8.3 percent of performance of Kenyan state corporations. In view of the above, available organizational resources have a great impact on the financial performance of an organisation. As a result of Government bailout the state owned State Owned Enterprises that are undergoing financial difficulty are advanced resources that would spar their financial performance.

Gitari (2008) carried out a study to find out the relationship between corporate governance and financial performance on state owned enterprises a case study of New Kenya Cooperative Creameries (NKCC). The study objective was narrowed down to corporate governance and the financial performance of NKCC. The researcher sought to determine and assess the corporate governance systems and practices in place and financial performance of the corporation. It was found out that the Board of directors of NKCC adopted practices of good corporate governance which were review and improved over time and had yielded improved financial performance.

2.5 Conceptual Framework



2.6 Summary of Literature Review

It can be concluded that most of the researches that have been done on Government bail-out condemn the practice as most of the State Owned Enterprises bailed out end up performing poorly financially. However there are researches that support Government bail-out as the only way Government can intervene to save the "too big to fail" State Owned Enterprises.

A number of empirical studies have been performed in Africa in the subject of State owned State Owned Enterprises performance, but more often focusing on how

privatization affects organizational performance as opposed to effects of Government bail-out. In that regard, Marandu (2003) examines how privatization affects SOE performance in Dar-es-Salaam and finds no significant improvement on their financial performance purely attributable to privatization. Kanyoma, (2008) using a 10-year data to investigate performance trends before and after privatization also failed to establish any material positive impact privatization has on firm's financial performance, the same goes for a Ghana based study by Ntiri, (2010) (as cited by Mbo & Adjasi, 2013)

Other studies that have been undertaken locally on the effects of financial performance of state owned Enterprises are on the effects of corporate governance on the financial performance of state corporations in Kenya. This therefore leaves a gap on the effects of Government bail-out on the financial performance on the state owned Enterprises.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses procedures that were used in data collection and analysis in order to answer the research question. The chapter is organized in the following sections: Section 3.2 discusses the research design to be adopted, Section 3.3 discusses the population and sample, Section 3.4 discusses the Data and data collection instruments and Section 3.5 discusses the Data analysis.

3.2 Research Design

The research used descriptive research design and a census method was used since there are few commercial state owned Enterprises that have been bailed out by the Government. The population comprises of the entire commercial state owned Enterprises that have been bailed out by the Government of Kenya. Descriptive research design was suitable because it assisted the researcher to study the elements in totality without difficulty. The design also assisted the researcher to develop descriptive statistics that assisted in explaining the relationship among variables.

3.3 Population and Sample

This section discusses the total population of the study that was considered for the research and the sample drawn from the population and the method of sampling.

3.3.1 Population

The population for this study comprised of commercial state owned Enterprises that have been bailed out by the Government in Kenya. The study population is twenty nine State Owned Enterprises (29) as per the summary statement of outstanding loans and grants as at 30th June 2015 from the National Treasury.

3.3.2 Sample

Stratified random sampling was employed which is a method of sampling that involves the clustering the population into smaller groups known as strata. This helped to identify one state owned enterprise from each stratum. In stratified random sampling, the stratus is formed based on the categories of bailout. One State Owned enterprise that was bailed out recently and is within the study period of five years after bailout from each stratum is taken. The stratus is then pooled to form a random sample. The researcher preferred Stratified sampling because it enabled collection of data from state corporations in all five categories of bailout: Cash injections, Loans, loan restructures of previous loans, Tax exemptions/ tax holidays and Write-offs.

3.4 Data and Data Collection Instruments

The study utilized secondary data only. The data was obtained from the state owned Enterprises annual financial statements. The data consisted financial results of the state corporations over seven years period, two years prior to bail out and five years after bailout in order to analyze their performance and study the trend in financial performance.

3.5 Data Analysis

The study used SPSS Version 24 to analyze data obtained. The SPSS report contained Correlation analysis identifying the relationships existing between variables. Descriptive statistics such as mean and standard deviation were also obtained and used in describing the characteristics of the variables. The results were Regressed analysis and a relationship between the independent and dependent variables was established.

3.5.1 Conceptual Model

Y = f(X_1, X_2, X_3, X_4)………………………………………………………………… (i)

Profitability measures the extent to which a business generates a profit from the use of its assets i.e. Land, Labor and Capital. In this study the researcher used Rate of return on assets (ROA) to measure the profitability of the State Owned Enterprises that have been bailed out by the Government.

This is given by, ROA = $\frac{Net\ Operating\ Income}{Total\ Assets}$

Liquidity measures the ability of a farm to meet its financial obligations as they come due in the short term, without interfering with its normal operations. In this study the researcher used the current ration to measure the liquidity of the State Owned Enterprises.

Current Ratio = $\frac{Current\ Assets}{Current\ Liabilities}$

Solvency measures the firm's ability to pay all financial obligations if all assets are sold and continue viable operations after financial adversity. In this study the researcher used Debt to Equity ratio to measure the solvency state of the State Owned Enterprises.

$$\text{Debt to Equity ratio} = \frac{Total\ Liabilities}{Total\ Equity}$$

Financial Efficiency is the measure of the intensity with which a business uses its assets to generate gross revenue and the effectiveness of production, purchasing, product pricing and financial decisions. In this study the researcher used Asset Turn Over to measure the financial efficiency of the State Owned Enterprises.

$$\text{Asset Turn Over} = \frac{Gross\ Revenue}{Total\ Assets}$$

The researcher after analyzing individual variables expected a positive relationship between the variables and the financial performance of the state owned Enterprises, as was witnessed with the USA Government after making an effort to rescue and restructure General Motors and Chrysler in the midst of the 2009 economic and financial crisis the State Owned Enterprises became competitive and profitable enough to compete with other State Owned Enterprises in the Automobile industry (Goolsbee & Krueger, 2015).

3.5.2 Analytical Model

The model of analysis will be as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where:

$β_1$, $β_2$, $β_3$, and $β_4$ are the coefficient terms that was used to measure the sensitivity of the dependent variable (Y) to unit change in the predictor variables. ε was the error term which captured the unexplained variations in the model.

Y = Financial Performance of State owned Enterprises.

X_1= Profitability.

X_2 = Liquidity.

X_3 = Solvency.

X_4= Financial Efficiency.

α = Constant term indicated the level of performance in the absence of any of independent variable.

The study generally used descriptive statistics to analyze data. The Descriptive statistics used included frequency distribution; mean scores, standard deviation and coefficient of variation. Multiple regression analysis was appropriate due to existence of various independent variables. The coefficient of determination (R2) was used to test the overall regression model. T-test and F-test was used to test on the individual significance and the significance for the whole model respectively. Analysis was done on the State Owned Enterprises financial performance two years before bailout and five years financial performance after the bailout.

CHAPTER FOUR:

DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter describes the data analysis, findings and discussions about the findings. The chapter is organized in the following sections: Section 4.2 discusses the summary statistics, Section 4.3 discusses the estimates and empirical model, Section 4.4 discusses the interpretation of findings and Section 4.5 discusses the discussions on the findings.

4.2 Summary Statistics

Table 4.1 gives the summary statistics of the main variables that have been included in the model including: minimum, maximum, mean, standard deviation, skewness and kurtosis. The data analyzed are: financial performance, profitability, liquidity, solvency and financial efficiency.

Table 4.1: Descriptive Statistics

Descriptive Statistics									
	N	Minimum	Maximum	Mean	Std. Deviation	Skewedness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
Performance	7	-430.13	49.29	-178.6746	183.64152	-.166	.794	-1.835	1.587
Profitability	7	-.02	.02	.0032	.01480	-1.263	.794	.781	1.587
Liquidity	7	1.67	9.71	4.2320	2.87651	1.275	.794	1.372	1.587
Solvency	7	.18	.77	.5817	.25698	-1.208	.794	-.766	1.587
Efficiency	7	1.51	2.97	2.3091	.62125	-.221	.794	-2.294	1.587

Source: Research data

The results show that profitability measured using return on assets had a mean of .0032 with a minimum of -0.02, a maximum of 0.02 and standard deviation of 0.0148. This depicts that on average, the state owned enterprises in Kenya enjoyed the returns on assets at 0.3%.The standard deviation calculated at 0.0148 indicated little variance from the mean. Liquidity ratios were estimated from the calculations to have a mean of 4.232 with variations rising from 1.67 to 9.71. It was also noted from the analysis that solvency was estimated at 0.5817 with the values increasing from a minimum of 0.18 to a maximum of 0.77. Financial efficiency on the other hand was estimated at 2.309 with fluctuations ranging from 1.51 and 2.97.

4.3 Estimated or Empirical Model

Regression analysis was undertaken by fitting an equation of the effects of government bailout on financial performance ratios of government bailed State Owned Enterprises. The researcher regressed Y=performance against independent variables profitability(X1), liquidity(X2), solvency (X3) and financial efficiency (X4). A test of significance was carried out to test the differences between the averages means and median of the data and the results were presented in quantitative form and tables and graphs where applicable. The analysis of data relied on Microsoft (MS) excel statistical package (SPSS).

4.3.1 Correlation Analysis

After the descriptive analysis, the study conducted Pearson correlation analysis to indicate a linear association between the predicted and explanatory variables or among the latter. It, thus, help in determining the strengths of association in the model, that is,

which variable best explained the relationship between Government bailout and financial performance as measured the return on assets. It also helped in deciding which variable(s) to drop from the equation given low linear relationship or multicollinearity.

Table 4.2: Correlation Analysis

Correlations						
		Performance	Profitability	Liquidity	Solvency	Efficiency
Pearson Correlation	Performance	1.000	.617	-.674	.599	.944
	Profitability	.617	1.000	-.893	.906	.699
	Liquidity	-.674	-.893	1.000	-.766	-.789
	Solvency	.599	.906	-.766	1.000	.647
	Efficiency	.944	.699	-.789	.647	1.000
Sig. (1-tailed)	Performance	.	.070	.048	.078	.001
	Profitability	.070	.	.003	.002	.040
	Liquidity	.048	.003	.	.022	.017
	Solvency	.078	.002	.022	.	.058
	Efficiency	.001	.040	.017	.058	.

Source: Research data

**. Correlation is significant at the 0.01 level (2-tailed); *. Correlation is significant at the 0.05 level (2-tailed).

From the Table 4.2, it can be deduced that there was a good, positive and significant correlation between profitability and financial performance given correlation value (R) of 0.617 at $p < .07$. The results presents a moderate, negative and significant relationship between liquidity and financial performance ($R = -0.674$; $p = .048$). Also noted was that there was a good, significant correlation between solvency and financial performance ($R = 0.599$; $p = .078$). Finally the study noted a good positive but moderate correlation between financial efficiency and performance ($R = 0.944$; $p = 0.001$)

4.3.2 Regression Analysis

The linear regression method used for this study was the least square method. This was used to determine the line of best fit for the model through minimizing the sum of squares of the distances from the points to the line of best fit. The regression analysis utilized the following equation:

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_3 X_3 + \varepsilon$

Where, Y represent financial performance, X_1 represent profitability, X_2 represent the liquidity, X_3 represent the solvency while X_4 represented financial efficiency β_0 is regression constant, β_1 to β_4 are regression coefficients.

Table 4.3: Model Summary

Model Summary[b]					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.953[a]	.908	.723	96.60988	2.986

Source: Research data

a. Predictors: (Constant), profitability, liquidity, solvency and financial efficiency

b. Dependent Variable: Financial performance

The R value shows the simple correlation of 0.953 indicates a high degree of correlation. The R2 value on the other hand indicates how much of the total variation in the dependent variable, Financial Performance, can be explained by the independent variables, Profitability, liquidity, solvency and Financial efficiency.

The model goodness of fit statistics shows that the regression model was good owing to lack of serial autocorrelation as the Durbin Watson value was 2.986. This depict that there is no autocorrelation in the data. The model had a Correlation value of 0.953 which depicts good linear relationship between predicted and explanatory variables. The model

was also moderately strong owing to R-square values of 0.908 which was adjusted for errors to 0.723. We find that the adjusted R^2 of our model is 0.723 with the $R^2 = 0.908$ that means that the linear regression explains 90.8% of the variance in the data.

Table 4.4: Analysis of Variance

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	183678.317	4	45919.579	4.920	.176[b]
	Residual	18666.936	2	9333.468		
	Total	202345.253	6			

Source: Research data

a. Predictors: (Constant), Profitability, liquidity, solvency, financial efficiency

b. Dependent Variable: Financial performance

Table 4.4 shows that the model was significant owing to F-test value of 4.92 at significance value of 0.176 ($p > .05$). Belle (2008) stated that insignificant F-significance indicates weak regression model as means of the groups (independent and dependent variables) are equal. Thus, this indicates that, overly, the regression model statistically significantly does not predict the outcome variable therefore not a goodness of fit

Table 4.5: Regression Coefficients

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-1019.228	365.049		-2.792	.108
	Profitability	255.655	9403.985	.021	.027	.981
	Liquidity	16.345	37.170	.256	.440	.703
	Solvency	53.985	380.833	.076	.142	.900
	Efficiency	320.099	105.357	1.083	3.038	.093

Source: Research data

a. Dependent Variable: Financial performance

From the Table above, the following regression equation was established:

$$Y = -1019.228 + 255.655X_1 + 16.345X_2 + 53.985X_3 + 320.099X_4$$

From the model, when other factors (profitability, liquidity, solvency, financial efficiency) are at zero, the financial performance will be -1,019.228. Holding liquidity, solvency, and financial efficiency constant, a unit increase in profitability would lead to 255.655 increases in financial performance of the state owned enterprises.

Holding other factors (profitability, solvency, financial efficiency) constant, a unit increase in liquidity would lead to a 16.345 increase in financial performance. Further, holding profitability, liquidity, financial efficiency constant, a unit increase in solvency would lead to a 53.985 increase in financial performance while a unit increase in the financial efficiency would lead to 320.099 unit increase in the financial performance of the state owned enterprises.

4.4 Interpretation of findings

Test of significance of performance for both pre and post bailout performance were done using MS excel Z test statistic on 2 sample means for each of the periods. The analysis of the profitability ratios for the five (5) state owned enterprises studied showed that the bailout by the government led to the State Owned Enterprises increasing their net return on investment. The liquidity ratio showed improved performance in the post bailout era with the only exception being company 4 which showed a decline. Correlation tests that were done showed that profitability ratios are positively related to performance for all the five State Owned Enterprises. Solvency ratios are negatively related to the financial performance with only two companies and

positively related to the other three SOEs. Liquidity and efficiency ratios were both positively and negatively related to performance for some State Owned Enterprises.

The positive relationship between profitability and financial performance for all the five State Owned Enterprises studied confirms the results of the overall trends in financial performance, where by profits increased with 2 State Owned Enterprises being an exception.

4.5 Discussions

The study has established that financial performance of government bailed out state owned enterprises (SOEs) is positively influenced by the government bailout. In addition it has proven that profitability should not be the only criteria used to judge performance of the government bailed out SOEs as other factors also have significant influence on their financial performance.

CHAPTER FIVE:

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter describes the summary of the findings from chapter four, the conclusions and recommendations of the study. The chapter is organized in the following sections: Section 5.2 will discuss the summary of findings, Section 5.3 will discuss the Conclusions, Section 5.4 will discuss the Limitations of the Study, Section 5.5 will discuss the Recommendations for Further Research and Section 5.6 discusses the Recommendations for policy.

5.2 Summary of the study

The study had the main objectives of establishing the pre and post government bailout of SOEs and developing a performance predictive model for these SOEs. Secondary data was used and the data was coded and analyzed using SPSS package. The objectives were achieved by analyzing financial ratios i.e. profitability, liquidity, solvency and financial efficiency. Regression analysis between performance (y) as the dependent variable and each of the financial ratios was done.

The profitability results showed that all the five State Owned Enterprises did not immediately gain from the process but that is not for assumption that the process was not successful. The liquidity ratio results showed that government bailout enables some State Owned Enterprises to be able to compare

their ability to fulfill their short term commitments out of their liquid assets. This was noted in State Owned Enterprises in the commercial, finance and industrial sector.

The solvency ratio results indicated that some State Owned Enterprises were able to improve their ability to meet their short and long term debt commitments while for one company there was no significant change this was for State Owned Enterprises in all the sectors apart from the industrial sector.

The financial efficiency ratio for four State Owned Enterprises indicated that government bailout resulted to the State Owned Enterprises being able to improve their efficiency in using their assets to generate sales. The financial efficiency ratios therefore showed that government bailout results to improved efficiency for the company. Generally all the sectors showed that government bailout can result to improved results and the only exception being the industrial sector.

An analysis of the overall financial performance shows that four of the five State Owned Enterprises studied had better overall financial performance. These State owned enterprises were in the finance and commercial sector. This means that performance is relative and needs to be viewed in a broader perspective.

5.3 Conclusion

An analysis of the financial performance ratios indicates that profitability ratio did not immediately increase in post government bailout era, meaning that government bailout should be viewed as a long term strategy. This applied to all the State Owned Enterprises.

The liquidity ratios showed improved performance in the post government bailout era, with the only exception being company 2 which showed a decline and company where the results were almost the same. The financial efficiency ratios indicated that post government bailout performance was much better with the only exception being company 1 and company 2. The two State Owned Enterprises had better performance in pre government bailout era.

The solvency ratios showed mixed performance with three State Owned Enterprises showing better post government bailout performance and company 2 showing minimal significant changes. Company 2 is in the finance sector.

The test for significance on whether pre government bailout performance is significantly different from the post government bailout era was done sing the Z tests for 2 sample means showed that overall performance was not significantly different in pre and post government bailout era in company 2, company 3, company 4, and company 6 while it was significantly different in company 1 and company 5 which are in the commercial and allied sectors

5.4 Limitation of the Study

The study used financial data derived from financial statements of the six State Owned Enterprises studied collecting the data proved quite a challenge because it had to be gotten from the financial reports prepared by the National Treasury which proved time consuming and quite expensive. The researcher faced a challenge in determining a sample for the State Owned Enterprises to be studied. This was brought about by the

limiting time frame of the researchers study which was two years prior to and five years after government bailout and the State owned enterprises face financial difficulties variedly and therefore were not bailed out in the year or period. The study also faced difficulties in pursuit of drawing firm conclusions regarding government bailout and performance of State owned enterprises, among them was lack of adequate time ,this was because the study applied survey design which is very time consuming because of nature of financial data collected. Therefore capturing all aspects therefore was not possible due to time constraints.

The study used descriptive statistics to value performance and to obtain valid information, however reliability of this method and its validity was in questions because most State Owned Enterprises tend to manipulate financial data to show that the company is performing well.

Lastly financial constraints were the other limiting factor for the researcher as the research became quite expensive exercise especially when gathering data.

5.5 Recommendations for Further Research

The study has shown that overall financial performance in the pre and post government bailout era is significant but weak. This should however not put a halt to the government bailout process. However, this should be done on critical state owned enterprises that offer essential services. There is need to look at the valuation of enterprises that are up for government bailout.

Government bailout is sometimes seen to have failed in Kenya mainly because it was

done in a legal vacuum leaving it to the whims of those in power. The government bailout bill limits the participation of government bailout to Kenyans by reserving a specific fraction of the total value of the SOEs assets being privatized to Kenyans while the government still maintains a considerable share of the assets even though they are not a controlling majority. This provision has been an avenue whimsical management of the process Restriction to Kenyans is a move that undermines the realization of the objectives of divestiture.

This study was conducted on the State owned Enterprises which are fully owned enterprises by the Government of Kenya. This However did not include Government linked entities which are listed in the Nairobi Securities Exchange. There is need to establish the effects of government bailout on share prices of the Government linked entities listed in the Nairobi Securities Exchange.

5.6 Recommendation for Policy

The Government of Kenya therefore need to develop a policy that outlines proper mechanisms that ensures that the essential State Owned Enterprises that are under performing financial are bailout and given adequate support to enhance their future performance.

The Government of Kenya should also develop policy that recognizes bailout and procedures of bailout and not take as hardhoc only when the SOEs are in crisis.

REFERENCES

Abdinassir, A.A., (2015). Effect of corporate governance on Organizational performance of state Corporations in Kenya. *Unpublished MBA project university of Nairobi*

Austan D. G., & Alan B. K. (2015). A Retrospective Look at Rescuing and Restructuring General Motors and Chrysler. Retrieved July, 25, 2016

Bai, C.E., Lu, J., & Tao, Z., (2006). The multitask theory of state enterprise reform: empirical evidence from China. The American Economic Review, 96, 353-357

Boko. F and YuanJian. Q (2011) 'Failure of State-Owned Enterprises in Benin' School of Management Wuhan University of Technology

Buchanan, J.M., & Tullock, G., (1986). The calculus of consent: Logical foundations of constitutional democracy. *University of Michigan press*.

Casey, A.J., & Posner, E.A., (2015). A framework for Bailout regulations. The University of Chicago Law School, Coase-Sandor Institute for Law and Economics. Retrieved February 11, 2015

Dockery, E. & Herbert, W. E. (2000). Corporate governance and enterprise restructuring in transition economies: evidence from privatized Polish State Owned Enterprises, *Managerial Finance, 26 (9),* 80-92

Donaldson, L., (1990). The ethereal hand: Organization economics and management theory. Academy of management review, 15, 369-381

Donaldson, T and Preston, L (1995). The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications. *The Academy of Management Review, 20*, 65-91

Etukudo,A (1997) ‘Issues in Privitasation and restructuring in Sub Sahara. *Journal of Business Ethics, 15 (3),* 364–369

Gautam, A., & Sumit K. M., (1998). An Assessment of the Performance of Indian State-Owned Enterprises. *Journal of Productivity Analysis, 9,* 113-132

Giannetti, M., & Simonov, A., (2013). On the real effects of bank bailouts: Micro evidence of Japan. American Economic Journal, 5, 135-167

Gitari, J. M., (2008). Corporate governance and the financial performance of state corporations: The case of new Kenya Cooperative Creameries. *Unpublished MBA project, University of Nairobi, School of Business*

Gnan, L., Hinna, A., & Monteduro, F., (2014). Financial performance in indian state-owned enterprises following corporate governance reforms. *Emerald Group Publishing Limited,* 29

Grant, R.M., (1991). The resource-based Theory of competitive advantage: Implication for strategy formulation. *California Management review, 33,* 114-135

Gropp, R., Hakenes, H., & Schnabel, I., (2010). Competition, Risk-shifting and public bail-out policies. The review of Financial Studies, 24(6), 2084-2120

Hamel, G. & Prahalad, C.K., (1994). Competing for the future. *Harvard Business School Press,* 1994

Jensen, M. C., & Meckling, W. H., (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics, 3(4),* 305-360.

Kiarie, M., (2007). The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya. *Fordham International Law Journal, 31,*

Li, S., & Xia, J., (2007) ', The Roles and Performance of State Firms

Mara, F., Ronald,M., & John, M. (2006). Political Connections and Corporate Bailouts. *The Journal of Finance*, *61*, 2597-2635

Mbako, M., & Charles, A., (2013). *Drivers of Organizational Performance: A State-Owned Enterprise Perspective*. From University of the Free State, 25-27 September 2013. Retrieved July, 25, 2016.

Mercy, O. & Zachary, A., (2015). The effect of autonomy on financial performance of the Kenyan owned commercial state corporations. *Prime Journal of Business Administration and Management (BAM), 5(6),* 1868-1880.

Muriithi, (2015). Three reasons why Kenya Airways deserve a bailout from the Government. Tuko.co.ke

Mwailu, & Mercer, (1983). Human resource scorecard: A roadmap to balance scordcard. World journal of social sciences, 4(1), 70-79

Mwongozo, (2015). The cord of governance for state corporations.

Nayar, B. R. (1990). The Political Economy of India's Public Sector. Bombay: Popular Prakashan Private Limited.

Ntiri, A.N (2010) 'Can Performance of State Owned Enterprises improve when Prvitized?: The case of Ghanaian firms, Blekige Institute of Technology, School of Management

OECD (2005) 'OECD Guidelines on Corporate Governance of State-Owned Enterprises' Organisation for Economic Co-operation and Development

Ongeti, W.J., (2014). Organization resources, corporate governance structure and performance of Kenyan state corporations. *PhD Thesis University of Nairobi, School of Business*

Pamela, R. A. M., (2013). The effect of privatization on financial Performance of firms listed at the Nairobi securities exchange. *Unpublished MBA project university of Nairobi.*

Rajagopalan, N., & Zhang, Y., (2008). Recurring failures in corporate govrnance: A global disease? *Business horizon, 52,* 545-552

Robert, C., & Lixin, C. X., (2003). Who gets credit? The behavior of bureaucrats and state banks in allocating credit to Chinese state owned enterprises. *Journal of Development Economics, 71(2),* 533-559

Roy, C. S. (2011). The Dilemma of Bailouts. *The Independent Review, 16,* 15-26

Saul, E., & Virginie, P., (1991). Does ownership always matter? *International Journal of Industrial Organization, 9(1),* 55-72

Shaw,J (2008) 'Public Choice Theory' The concise encyclopedia of Economics, http://www.econlib.org/library/Enc/PublicChoiceTheory.html

Slyke, D. M., (2007). Agents or stewards: Using theory to understand the Government-nonprofit social service contracting relationship. Journal of public administration research and theory, 17(2), 157-187

Studenmund, A. H. (2006). Using econometrics: a practical guide. Pearson International edition.

Toninelli, P.A (2000) (ed.), The Rise and Fall of State-Owned Enterprise in the Western World, Cambridge, Cambridge University Press, pp. 49-72.

Urtiage, M. G., & Menozzi, A., (2004). Board composition and performance in state owned enterprises: Evidence from the Italian public sector utilities sector

Vasudevan, R., & Venkatraman, N., (1986). Multi-objective assessment of effectiveness of strategic planning: a discriminant analysis approach. *Academy of management journal, 29,* 347-372

Venkatraman, N. & Ramanujam V. (1986). Measuring business performance in strategy research: A Comparison of Approaches. The Academy of Management Review, 11(4), 801-814

Verret, J. W., (2009). Treasury Inc: How the bail-out reshapes corporate theory and practice. *Yale journal on regulation, 27*, 283-350.

William, P. (2010). Ending Moral Hazard. *Financial Analysts Journal, 66,* 17-24

World Bank (2012) World Development Indicators database, World Bank, September 2012 http://databank.worldbank.org/databank/download/GDP.pdf

Yifan, H., Frank, S., & Junxi, Z. (2004). Competition, Ownership, Corporate Governance and Enterprise Performance: Evidence from China. University of Hong Kong, Hong Kong Institute of Economics and Business Strategy web

Zdravka, T. (2009). What Makes a Bailout Acceptable? *Journal of Economic Issues, 43,* 319-325

Zhenhui, X., & Melissa, H. B., (1999). The Economic Performance of State-owned Enterprises in Argentina an Empirical Assessment. *Review of Industrial Organization, 14,* 355-375.

APPENDICES

Appendix 1: Financial Performance Ratios

Means of the Financial performances Ratios of the Five companies					
year	profitability	Liquidity	Solvency	Efficiency	Performance
1	(0.02)	9.71	0.24	1.72	(303.76)
2	(0.01)	5.42	0.18	1.77	(346.61)
3	0.01	5.45	0.71	1.51	(430.13)
4	0.01	1.67	0.69	2.53	(152.34)
5	0.01	1.76	0.75	2.97	(49.44)
6	0.01	2.72	0.77	2.69	49.29
7	0.02	2.90	0.73	2.96	(17.73)

Kenya Broadcasting Corporation					
year	Profitability	Liquidity	Solvency	Efficiency	Performance
1	0.00	0.07	(1.29)	0.01	(425.00)
2	0.00	0.07	(1.25)	0.09	(1,656.00)
3	0.00	0.08	1.01	0.30	(1,871.80)
4	0.00	0.07	1.01	0.20	(1,210.00)
5	0.01	0.06	1.12	0.20	(1,016.60)
6	0.01	1.00	1.32	0.10	(656.00)
7	0.02	1.00	1.43	0.20	(1,682.00)

Kenya National Trading Corporation					
year	Profitability	Liquidity	Solvency	Efficiency	Performance
1	(0.01)	1.00	0.22	7.45	(14.90)
2	(0.01)	1.10	0.17	7.45	(8.86)
3	0.01	1.50	0.14	5.82	(6.36)
4	0.00	2.80	0.06	11.19	1.29
5	0.01	2.90	0.06	13.33	2.01
6	0.01	3.30	0.06	12.12	2.52
7	0.00	3.20	0.05	13.12	3.65

IDB Capital Limited					
year	**Profitability**	**Liquidity**	**Solvency**	**Efficiency**	**Performance**
1	(0.05)	40.79	0.01	0.01	(36.80)
2	(0.06)	22.40	0.01	0.11	(37.34)
3	0.01	23.22	0.02	0.18	10.07
4	0.02	2.43	0.02	0.11	12.19
5	(0.01)	4.06	0.01	0.13	6.38
6	0.01	5.07	0.02	0.15	56.19
7	0.03	3.25	0.01	0.17	5.18

National Oil Company					
year	**Profitability**	**Liquidity**	**Solvency**	**Efficiency**	**Performance**
1	(0.08)	1.20	2.09	0.44	(872.12)
2	0.00	0.93	1.74	0.55	11.17
3	0.00	0.77	2.10	0.41	18.43
4	0.02	1.09	2.14	0.33	277.82
5	0.02	0.99	2.18	0.33	316.01
6	0.02	0.87	2.20	0.33	387.74
7	0.03	1.02	2.05	0.45	483.52

Kenya Meat Commission					
year	**Profitability**	**Liquidity**	**Solvency**	**Efficiency**	**Performance**
1	0.02	5.49	0.15	0.71	(170.00)
2	0.02	2.59	0.23	0.67	(42.00)
3	0.01	1.68	0.29	0.86	(301.00)
4	0.02	1.96	0.23	0.82	157.00
5	0.01	0.79	0.38	0.87	445.00
6	0.01	3.34	0.24	0.77	456.00
7	0.01	6.03	0.13	0.84	1,101.00

Appendix 2: List of State Owned Enterprises Bailed out

Commercial State Corporations:				
No.	**Name of Corporation/Entity**	**Form of Bailout**	**Date of Bailout**	**Amount**
1	Agro-Chemical and Food Company	Guaranteed Loan paid by GOK	1995	1,202,075,120
2	Kenya Meat Commission	Loans and Capital injections	2005	940,241,100
3	Muhoroni Sugar Company ***(In Receivership)***	Restructuring of Loans	2004	117,123,100
4	Miwani Sugar Company ***(In Receivership)***	Restructuring of Loans	1977	78,088,180
5	Nzoia Sugar Company	Restructuring of Loans	1978	182,139,360
6	South Nyanza Sugar Company	Restructuring of Loans	1988	253,317,120
7	Agricultural Development Corporation	Restructuring of Loans	1997	179,606,321
8	Nyayo Tea Zones Development Corporation	Loan converted to Equity	2015	200,000,000
9	New Kenya Creameries Cooperative Limited	Loans and Capital injection		52,607,460
10	Kenya Electricity Generating Company	Loan Converted to Equity	2013	85,863,291,794
11	Kenya Pipeline Company	Loan Converted to Equity	2004	317,456,817
12	Kenya Power and Lighting Company	Loan Converted to Equity	2015	49,619,175,421
13	National Oil Corporation of Kenya	Capital injection	2006	90,000,000
14	Agricultural Finance Corporation	Loan/ capital Injection	2002& 2015	1,562,294,453
15	Consolidated Bank of Kenya	Capital injection	2015	500,000,000
16	Kenya Post Office Savings Bank	Capital injection	2006	202,000,000
17	National Bank of Kenya	Loan converted to prefered shares	2003	2,000,000,000
18	National Housing Corporation	Loan Converted to Equity/capital injection	2003	10,120,000,000
19	East African Portland Cement	Guaranteed Loan paid by GoK	1994	40,080,285
20	IDB Capital Limited	Guaranteed Loan paid by GoK	2006	532,000,000
22	Kenya Broadcasting Corporation	Capital injection	2010	400,000,000
23	Postal Corporation of Kenya	Guaranteed Loan paid by GOK	2002	1,151,000,000
24	Kenya National Trading Corporation	Tax arrears paid by GOK	2010	54,000,000

25	Kenya Tourist Development Corporation (***Converted to Kenya Tourism Finance Corporation***)	Capital Injection	1996	48,000,000
26	Uchumi supermarket ltd	Loan	2009	407,000,000
27	Kenya Industrial Estates	Loan	1987	426,213,120
28	Kenya Airways	Loan	2015	24,224,000,000
29	Mumias Sugar Company	Loan	2015	2,000,000,000