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Effects Of Privatization On Performance Of Privatized Public Enterprises Listed In The Nairobi Security Exchange In Kenya: A Survey Of Privatized Firms In The Nairobi Security Exchange

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Abstract:

Public corporations have been criticized for inefficiency and mismanagement. They are said to contribute to many of the problems that hinder economic growth, such as public sector deficits, domestic and foreign borrowing and misallocation of resources. They are characterized by widespread misuse of funds due to lack of proper internal management and government interferences. Due to this, some of the public corporations have either been privatized or commercialized. There is therefore need to assess privatization strategy and relate it to the overall performance of the institutions privatized which are listed on the Nairobi Security Exchange. Therefore, project researched on the relationship of privatization and performance of firms listed on the Nairobi Security Exchange. The target population was public corporations that are privatized and listed in the Nairobi Security Exchange (NSC). Secondary data and questionnaire for different variables was used in this study. Descriptive statistics such as percentages, frequency tables, graphs and regression analysis was used to analyse the data. The conclusion was that the board of directors was best placed in managing the firm. The privatized company's profits have been aided by corporate governance which was key to performance in privatized firms. Privatized companies in the Nairobi Security exchange have been aided by corporate governance, and management performs better after privatization. The study found that privatization has a significant influence on the performance of firms listed on the Nairobi Security exchange. The coefficient of determination R^2 showed that 64.4% of the variations in the financial performance was explained by the independent variables.

The study concludes that management can perform better after privatization; the privatized companies can perform differently and avoid borrowing funds not unless in financial crisis since there is a relationship between debt ratio and the performance. The absence of conflict between managers and stakeholders was an important determinant of performance for privatized firms. The study concludes that culture of an organization helps the privatized firms and companies benefit from an organization culture existing after privatization, it is key to performance and is a good opportunity for future growth that privatized companies maintain the culture.

Key words: Management, Leadership, Training, Development

1.Introduction

Privatization has been conceptualized in a broad and narrow sense (Ramamurti, 2000). In the broad sense, it refers to any shift of activities or particularly the production of goods and services function from the public to the private sector. This includes outsourcing, contracting-out, franchising, and privatization of public finance, liberalization, the sale of state property to the private sector and concession. In the narrow sense, privatization represents the sale of state-owned enterprises (SOEs) to the private sector.

The general definition of privatization, advocated by the World Bank and International Monetary Fund, usually refers to denationalization, particularly the sale of state property to the private sector, including the direct sale of the whole or parts of SOEs to private agents and share issue privatizations (SIPs)

1.1.Statement Of The Problem

In 1991, the government announced privatization measures in the budget speech (GOK, 1991). This was followed by the launch of the privatization and Public Enterprise Reform Program in July 1992. Today, more than a two decade after their initiation, varying degrees of success with privatization of public corporations has been noted in some while failures for diverse reasons have been reported in others. With

the general welfare level of the average Kenyan decreasing from 56% of the population in 1990 to 48% of the population in 2001 (GOK, 2003). One wonders, "if the privatization process has improved the financial performance of these institutions?"

The statistics available from the Kenya National Bureau of Statistics shows that Nairobi Security Exchange is the sub-Saharan Africa's fourth-largest bus ranking number one in East Africa (ROK, 2012). The World Bank (WB, 2012) report shows that NSE, like many other emerging markets, suffers from the lack of liquidity in the market (WB, 2012). The Kenyan government has made several reforms aimed at attracting foreign investment via the Nairobi Securities Exchange and also privatization reform. The Exchange was opened to foreign investors for the first time in January 1995, but with a maximum limit of 20% shareholding for institutions and 2.5% of individuals (NSE, 2012). The ceiling on foreign investment has been increased to 40% for institutions and 5% for individuals, but a relatively small percentage of listed companies are available to foreigners (NSE, 2012).

Data available from the Delta Touché show that Since 1991 over 140 of the 207 former state owned Enterprises earmarked for privatization have been private (Deloitte, 2011). Different methods or techniques have been employed to privatize these state owned enterprises (SOEs). Financial ratios for the prior and post privatization period reveal that the performance after privatization increased compared to the industry ratios (NSE, 2012). For instance in Kenya, after the privatization Kenya Airways registered a gross profit of Ksh.237, 204,000 from a previous gross loss of Ksh.53, 867,000 in 1992. In 1994, earnings per share rose to -0.09 from -1.11 in 1993. Return on investment rose to -0.007 from -0.103 in the same period (Kenya Airways, 1989–1998).

Research done on privatization in emerging economies (De Castro & Uhlenbruck, 1997; Laban & Wolf, 1993; Nellis & Kikeri, 1989; Ramamurti, 2000) has neither considered post-privatization performance and management practices of state owned enterprises (SOEs), nor have researchers examined the relationship between privatization and performance of newly privatized firms. Most work on privatization either takes the macro public view, usually aiming to demonstrate the benefits of privatization to the public (De Castro & Uhlenbruck, 1997). The transition from state-owned to private enterprise is a dramatic change. As Goodman and Loveman (1991) put it, like the takeovers of public corporations, the privatization of government assets or services is a radical change. Managing such a radical change requires the presence of a catalyst, having the vision and stamina to bring the transformation needed for the success of the new organization. Bass (1998) noted that "inspirational managers may reframe opportunities so that the environment is transformed from a situation of opportunity into which the manager is followed".

There is therefore need to assess privatization strategy and relate it to the overall performance of the institutions privatized which are listed on the Nairobi Security Exchange.

1.2. Study Objectives

The study sought to establish the effect of privatization on the performance of privatized firms in Kenya with reference to the Nairobi Security exchange.

- To examine the effect of privatization on corporate governance of privatized firms in Nairobi Security exchange.
- To evaluate effects of privatization on the management skills of privatized firms in Nairobi Security exchange.
- To explore the effect of privatization on organization culture of privatized firms in Nairobi Security exchange.
- To examine the effects of privatization on the government policy of the privatized government enterprises at the Nairobi Security Exchange

2. Literature Review

2.1. Theory Of Risk And Return

Dilemma in working capital management is to achieve desired tradeoff between liquidity and profitability (Raheman & Nasr, 2007). Referring to theory of risk and return, investment with more risk will result in more return. Thus, firms with high liquidity of working capital may have low risk then low profitability. Conversely, a firm that has low liquidity of working capital, facing high risk results to high profitability. The issue here is in managing working capital, firms must take into consideration all the items in both accounts and try to balance the risk and return.

The principle is that potential return rises with an increase in risk. Low levels of uncertainty (low risk) are associated with low potential returns, whereas high levels of uncertainty (high risk) are associated with high potential returns. According to the risk-return tradeoff, invested money can render higher profits only if it is subject to the possibility of being lost (Soenen, 1993).

2.2. Portfolio Theory

Modern Portfolio Theory (MPT) proposes how rational investors should use diversification in order to optimize their portfolios. It also discusses how a risky asset should be priced. This does not mean that the early economists ignored financial markets. Irving Fisher (1930) had already outlined the basic functions of credit markets for economic activity, specifically as a way of allocating resources over time and had recognized the importance of risk in the process. In developing their theories of money, John Maynard Keynes (1936), John Hicks (1934, 1935, 1939), Nicholas Kaldor (1939) and Jacob Marschak (1938) had already conceived of portfolio selection theory in which uncertainty played an important role.

However, for many economists during this early period, financial markets were still regarded as mere casinos rather than markets properly speaking. In their view, asset prices were determined largely by expectations and counter-expectations of capital gains and thus they were held up by their own bootstraps as it were. John Maynard Keynes's beauty contest analogy is representative of this attitude.

As such, a good amount of ink was spent on the topic of speculative activity (i.e. The purchase temporary sale of goods or assets for later resale). For instance, in their pioneering work on futures markets, John Maynard Keynes (1923, 1930) and John Hicks (1939) argued that the price of a futures contract for delivery of a commodity will be generally below the expected spot price of that commodity (what Keynes called normal backwardation). This, Keynes and Hicks argued, was largely because hedgers shifted their price risk onto speculators in return

for a risk premium. Nicholas Kaldor (1939) went on to analyse the question of whether speculation was successful in stabilizing prices and, in so doing, expanded Keynes's theory of liquidity preference considerably.

3. Empirical Review

3.1. Profitability

Firm's profitability refers to the net difference between a firm's revenues and expense. It would seem pretty straight forward that the higher the firms profitability the higher the returns it pays to the stakeholders. Boardman and Vining (1989) examine the economic performance of 500 largest non-US firms in 1983, classified by ownership structure as state-owned, privately owned, or mixed ownership enterprises (ME). Their study employed four profitability ratios and two measures of X-efficiency.

Pinto, Belka and Krajewski (1993) test whether privatization is required to improve performance of SOEs by examining how the Polish state sector responded in the three years following the "Big Bang" reforms of 1990. These liberalized prices, tightened fiscal & monetary policy and introduced competition but did not include privatization. Verify significant performance improvement due to macroeconomic stabilization package, even without privatization. Improvements mostly due to imposition of hard budget constraints, tight bank lending policies, and enhanced credibility about government's "no bailout" pledge.

Megginson, Nash, and van Randenborgh (1994) Compare 3-year average post-privatization financial and operating performance ratios to the 3-year pre-privatization values for 61 firms from 18 countries and 32 industries from 1961-1989. Tests significance of median changes in post versus pre-privatization period. Also binomial tests for % of firms changing as predicted.

3.2. Corporate Governance

Privatized firms can rely on formal approaches to provide governance have seen the weakest returns while those that utilized private solutions of ownership concentration and links between insiders and private 'ordering agents' have had much stronger returns. They estimate that relative to foreign ownership, the most effective structure, disperse ownership structures deliver just one tenth the impact on performance (Frydman, Gray, Hessel and Rapaczynski, 1999).

Outsiders are more effective than insiders in improving performance. As an illustration of one of these studies, Djankov (1999) studied CIS countries and found that for privatization to have a positive impact, the ownership stake needed to be greater than 30 percent and the owner had to be a foreigner. From a governance perspective these firms benefit from private governance chains of concentrated ownership and links to an ordering agent.

3.3. Managerial Skills

LaPorta, Lopez-de- Silanes, Shleifer (2011) Using data from 92 countries, examine whether government ownership of banks impacts the level of financial system development, the rate of economic growth, and growth rate of productivity. Find government ownership is extensive, especially in the poorest countries, that these holdings retard financial system development, and restrict economic growth rates, mostly due to impact on productivity. Tian (2011) Studies relation between state shareholding and corporate performance of 825 publicly traded Chinese companies in 2011.

Kim (2007) summarized these studies well. After reviewing current literature on the relative performances of private and public firms, he concluded that performances of POEs are generally much better than those of SOEs and partially privatized enterprises. These previous studies employed various sample data sets: from one country (e.g. Canada, India, Poland, China etc), from one industrial sector (e.g. Aviation industry, financial industry, etc.), or from many countries. In spite of the difference in the data set, the result is very robust and enough to generalize: SOEs tend to perform worse than POEs.

According to (Jones, 2006) attempts have been made to group types of culture by how they impact on the behaviour of individuals and groups in an organization. He contends that constructive cultures encourage interaction with others and approach tasks in ways that help them to meet higher-order satisfaction needs. Sathe, (1983) argues that culture guides the actions of an organization's members without the need for detailed instructions or long meetings to discuss how to approach particular issues or problems. He contends that culture reduces the level of ambiguity and misunderstanding between functions and departments. In effect, it provides a common context and a common purpose for those in the organization. However, this is only the case when an organization possesses a strong culture, and where the members of the organization have internalized it to the extent that they no longer question the legitimacy or appropriateness of the organization's values and beliefs.

3.4. Research Gap

Despite two decades of experience with privatization, United States of America local government use of contracting in public service delivery remains relatively flat. Market approaches to public goods provision emphasize the competitive state, and attribute a limited degree of privatization to bureaucratic resistance. In addition, the study only handles one factor while else the current study intends to find out several factors, this study therefore sought to fill this gap. Privatization is not only about economics; it is also about politics. Political interest groups play a major role. Privatization also represents an overarching political agenda to alter the relationship between government and citizen.

4. Methodology

This study used exploratory research design and survey in nature since the study sought to get general information on the effects of privatization of State Corporation on their performance. The study was based on primary data of the eight corporations at the NSE. Target population for the study was all the privatized state owned firms in Kenya listed at the NSE. The target population was grouped into individual privatized firm and from each firm a sample of six management staff in the financial department sampled. Random sampling was used in choosing the sample within the stratum. The sample was selected from five sectors which includes, Agriculture, Banking,

Commercial and services, energy and insurance where the SOE operate from. Descriptive statistics were used to summarize the data. This included percentages (relative frequencies) and absolute frequencies. To measure the study's objectives, the research objective was computed whereby values were accorded in accordance with the Likert scale ratings and total score computed. These individual scores for the objectives was regressed against the respondents' ranking of the performance after privatization. Multiple-linear regression model was to interpret the data.

5. Results And Discussions

5.1. Performance

From the findings on the proportion of annual gross profit attributed to privatization, the study found that more than 20% of annual gross profit could be attributed to privatization. Similarly, from the findings on the proportion of overall goals achieved attributed to privatization, the study found that more than 40% of overall goals achieved in the privatized firms listed in Nairobi Security exchange could be attributed to privatization.

5.2. Effect Of Privatization On Corporate Governance Of Privatized Firms In Nairobi Security Exchange

The study found that most of the companies in this study had established board of directors to implement corporate governance. The board of directors was best placed in managing the firm the privatized companies profits have been aided by corporate governance which is key to performance in a privatized firm. The findings from the study indicate further that companies profits have been aided by corporate governance, management perform better after privatization. The study found that there existed relationship between the corporate governance and financial performance of privatized firms in Nairobi Security exchange, one unit increase in corporate governance through privatization results in a 0.161 unit increase in the financial performance.

5.3. Effect Of Management Skills Of Privatized Firms In Nairobi Security Exchange

The study found that management can perform better after privatization; the privatized companies can perform differently and avoid borrowing funds not unless in financial crisis since there is a relationship between debt ratio and the performance, the absence of conflict between managers and stakeholders is an important determinant of performance of privatized firms. The study found that there existed relationship between management skills and financial performance privatized firms in Nairobi Security exchange, one unit increase in managerial skills through privatization results in a 0.422 unit increase in financial performance.

The findings are in line with Agency theorists believed that privatization stimulates the design of new management, including accounting systems (Macias, 2002). Further, privately owned firms are presumed to be governed by business goals and the capital market acts as a deterrent to managerial non-profit behaviour. Privatization is also intertwined with public financing and allocative efficiency reducing net budgetary transfers, eliminates possible external debt liabilities and decreases the adverse effects of deficit financing.

5.4. Effect Of Organization Culture Of Privatized Firms In Nairobi Security Exchange

The study found that the culture of an organization helps the privatized firms, companies benefit from an organization culture existing after privatization, it is key to performance and as a good opportunity for future growth that privatized companies maintain the culture.

The study further found that privatized firms can develop and maintain a strong reputation, even when they have better investment opportunities. The study also found that Privatized firms in Nairobi Security exchange have an effect on organization culture which affects the financial performance; the study indicated that a one unit increase in organization culture through privatization results in a 0.178 unit increase in the financial performance.

5.5. How Government Affected By The Privatized Government Enterprises At The Nairobi Security Exchange

The study found that government policy on privatization help in better management of privatized companies, the government policy on privatization influenced firm performance on returns to stakeholders. The privatized firms always get better returns on assets than small companies as the government policy may envisage.

The study also established that government policy on privatization has worked for the benefit of privatized companies. Through regression analysis the study found that a one unit increase in government policy control through privatization results in a 0.811 unit increase in the financial performance.

5.6. Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.803(a)	.644	.618	.78381

Table 1

Predictors: (Constant), corporate governance, managerial skills, organizational culture, government policy.

Multiple regression model was applied to determine the relative importance of each of the four variables on the financial performance after privatization. The regression model was as follows:

The results as shown in the table indicates that the coefficient of regression, $R = 0.803$ shows a good strength of the relationships between independent variables and the dependent variable. The coefficient of determination $R^2 = 0.644$ shows the predictive power of the model and in

this case 64.4% of the variations in the financial performance is explained by the independent variables. The adjusted coefficient of determination R^2 shows the predictive power when adjusted for degrees of freedom and sample size. In this case, after the adjustments 61.8% of the variations in the financial performance in the privatized are explained by the independent variables.

6. Conclusion

The study concludes that the board of directors was best placed in managing the firm the privatized companies profits have been aided by corporate governance which is key to performance in a privatized firm. Privatized companies in the Nairobi Security exchange have been aided by corporate governance, management perform better after privatization.

The study concludes that management can perform better after privatization; the privatized companies can perform differently and avoid borrowing funds not unless in financial crisis since there is a relationship between debt ratio and the performance, the absence of conflict between managers and stakeholders is an important determinant of performance of privatized firms.

The study concludes that the culture of an organization helps the privatized firms. Companies benefit from an organization culture existing after privatization, and it is crucial to performance and has a good opportunity for future growth. Privatized firms can develop and maintain a strong reputation, even when they have better investment opportunities.

7. Recommendations

The study found that government policy on privatization help in better management of privatized companies, the government policy on privatization influenced firm performance on returns to stakeholders. The privatized firms always get better returns on assets than small companies as the government policy may envisage. From the perspective of privatization, the state's role should remain confined to supply-side economics, safeguarding the infrastructures, maintaining law and order, and correcting market distortions. The focus should be on providing an environment suitable for commercial mobility rather than on direct interventions into enterprise decisions.

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