

Effect of privatization on performance of public corporations



Stock exchanges anywhere in the world provide a platform for investors and capital raisers to come together and get what they want. They assist in trading of stocks and bonds. Apart from that, it can be viewed as a liquidity providing platform. For this purpose, the stock exchange has to have a set of rules that will govern the execution and clearing of trade. Some of the responsibilities of a stock exchange are also enforcing standard rules to reduce transaction costs and monitoring of the trading to prevent manipulations like insider trading.

A share or stock company model does issue shares of stock that are available through one or more stock market exchange. Shareholders purchase the shares of stock and become part owners in the company. This is a highly desirable status for many companies, as it can help generate significant amounts of revenue that make it possible for the company to grow in ways that would not be possible if the corporation remained privately held.

Etukudo (2002) notes that capital markets transfer funds from savers to investors in productive assets such as plant and machinery as well as to providers of services. Capital markets also provide a mutually beneficial bridge between those who have short-time horizons and companies and projects with longer prospects. In addition, enterprises are provided with equity capital through the stock market, short, medium and long-term debt is made available through the bond market, and short or medium-term debt is provided through the banking sector. The financial intermediaries in all these transactions constitute the financial service sector and while the constituents of the sector and their relative importance vary from country to

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country, they generally include banks, stock exchanges, brokers and insurance companies.

1. 1. 1. 2 Privatization of public corporations

Boubakri and Cosset (1994) note that privatization has turned into a major phenomenon for the developed world as well as the developing world, particularly so over the last decade, with state-owned enterprises (SOEs) being privatized at an increasing rate.

Ramamurti, (1991) note that the objectives of privatization are numerous. Country studies show that these objectives include improving government cash flows by reducing subsidies and capital infusions to SOEs, promoting popular capitalism through a wider ownership of shares, restraining the power of trade unions in the public sector, redistributing incomes and rents within society, satisfying foreign donors by reducing the government's role in the economy and especially enhancing the efficiency and the performance of the SOE sector based on the rationale that the private sector outperforms the public sector.

Privatization in the 1990s led to the sale of 207 enterprises. Kenya Airways (KQ) was rated the most successful privatization venture in Africa. The Government has earmarked 33 companies for full or partial sale, these include; the National Bank of Kenya (NBK), the Kenya Commercial Bank(KCB), the Kenya Power and Lighting Company (KPLC), KenGen, Kenya Petroleum Refineries, the Kenya Ports Authority (KPA), Telkom Kenya and Kenya Railways Corporation. The methods of sale will range from

concessioning, sale at the Nairobi Stock Exchange, and securing strategic partnerships with major players in the relevant sectors.

1. 2 Statement of the Problem

A study by Boubakri and Cosset (1994) examined the financial and operating performance of newly privatized firms in developing countries and noted that findings in for developing markets could be different from those of developed countries because the capital market may not play its monitoring role. To take account of the possibility that some of the differences between preprivatization and postprivatization performance could be due to economywide factors, the authors used performance measures adjusted for market effects in addition to unadjusted performance measures. The results were generally less significant when they adjusted the performance ratios for market effects. The authors thus concluded that this evidence brings to light the importance of considering a benchmark against which the performance of sample firms can be compared.

Limi (2003) studied the influence of the level of economic development on the post-privatization growth rates in public infrastructure within the telecommunications industry and found that although privatization generally spurred network expansion in terms of telephone main lines by 4. 4% in medians (5. 4% on average), the performance improvement was dependent on the level of economic development. It is only the low-income and lower middle-income countries which can expect a significant positive privatization effect. Thus, it is important to account for economic development in assessing the privatization effects of public infrastructure stocks.

From the foregoing it is thus useful to undertake a study to evaluate privatization and performance of public corporations listed in the Nairobi Stock Exchange.

1. 3 Purpose of the Study or General Objective

The purpose of this study is to evaluate privatization and performance of public corporations listed in the Nairobi Stock Exchange

1. 4 Research Questions or Specific Objectives or Hypotheses

This study is guided by the following research objectives formulated to aid in gathering the information regarding the research topic.

Review literature on privatization of public corporations in Kenya

To determine privatization factors in the Nairobi Stock Exchange

To analyze privatization implications on public corporation performance in Nairobi Stock Exchange

1. 5 Importance or Justification or Rationale of the Study

The information generated by this study will be important for stock markets in the East Africa in understanding the implications of privatizing public corporations. This will benefit stock markets in Uganda, Tanzania and wider Eastern Africa which has the stock markets at their infancy stages.

It will also assist policy makers who want to make use of performance measures of the stock market in advising public corporations on privatization prospects that may arise when listing in the stock market. In addition, it will

guide policy makers of new baselines to use when determining privatization options for public corporations.

Educators too in the education industry will find the information obtained from this study beneficial to their curriculum in imparting knowledge to students and researchers who are researching on the sector and how it can greatly benefit the country.

1. 6 Scope of the Study

The study will be limited to the Nairobi Stock Exchange for the duration 2008-2010. Nairobi Stock Exchange has about fifteen active stock broking firms with fifty two listed companies. I will focus on five of the stockbrokerage firms and fifteen of the listed companies. The use of the listed firms was due primarily to data availability and reliability because they are required by law to provide end of year financial statements. However, firms that were not listed for the entire period under study were left out of the sample. The study used annual reports that are available at the Nairobi Stock Exchange.

1. 7 Definition of Terms

1. 7. 1 Privatization

Privatization means the sale of public utilities to private concerns.

1. 8 Chapter Summary

This chapter covered the background of the research, the problem statement, the purpose of the study or general objectives of this research, the research objectives, the significance and scope of the research i. e.

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importance of the study and the definitions of Terminologies used in this research.

Further, this chapter has specifically pointed the relevance of the study in regards to public corporations, and how they, in a bid to improve performance, employ a privatization strategy in light of global trends.

2. 0 Chapter 2: Literature Review

2. 1 Introduction

This chapter will review relevant literature in line with the study objectives.

2. 2 Privatization of Public Corporations in Kenya

ROK(1965) noted that the establishment of the parastatals was driven by a national desire to (i) accelerate economic social development; (ii) redress regional economic imbalances; (iii) increase Kenyan Citizen's participation in the economy; (iv) promote indigenous entrepreneurship; and (v) promote foreign investments (through joint ventures). This desire was expressed in the Sessional Paper No. 10 of 1965 on African Socialism and its application to planning in Kenya.

A comprehensive review of the public enterprises performance was noted by (ROK, 1979) (the Report on the Review of Statutory Boards) that pointed that there was clear evidence of prolonged inefficiency, financial mismanagement, waste and malpractices in many parastatals; and (ROK, 1982) (the Report of the Working Party on Government Expenditures) which concluded that productivity of the state corporations was quite low while at the same time they continued to absorb an excessive portion of the budget,

becoming a principal cause of long-term fiscal problem. The enactment of the State Corporations Act was a major attempt to streamline the management of the state corporations. The performance of most of the corporations continued to deteriorate due to the continued reliance on limited public sector financing.

Sessional Paper No. 4 of 1991 on Development and Employment in Kenya underlined the need to implement privatization and divestiture of State corporations urgently in view of the managerial problems afflicting the parastatals leading to poor return on government investments, the existence of a larger pool of qualified manpower, availability of more indigenous entrepreneurship to permit private sector led economy and the need for non-tax revenue for the Government. The Programme began in July 1992 with the issuance of the Policy Paper on Public Enterprises Reform and Privatization which pointed out that there were 240 commercial public enterprises with public sector equity participation and classified the PEs in to two categories: (i) 207 Non strategic commercial public enterprises which were to be privatised and 33 Strategic Commercial public enterprises which were to be restructured and retained under public sector ownership and control. By the time the first phase of the programme came to an end in 2000, most of the non-strategic commercial enterprises had either been fully or partially privatized, liquidated, sold under receivership while the strategic commercial enterprises to be retained under government operation had been reduced to 15 and later to 14 enterprises.

The following is a list of privatized public enterprises by PUBLIC

FLOATATIONS- Bamburi Portland Cement Co. Ltd, E. A., CMC Holdings
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Oxygen Ltd, National Bank of Kenya, Kenya Airways, Mumias Sugar Company; by PARTIAL DIVESTITUTRES - Kenya Commercial Bank Ltd, Uchumi Supermarkets Ltd, General Motors (K) Ltd, and Housing Finance Company of Kenya.

2. 3 Privatization Factors in the Nairobi Stock Exchange

2. 3. 1 Methods of privatization

The term privatization has been applied to three different methods of increasing the activity of the private sector in providing public services: 1) private sector choice, financing, and production of a service; 2) public-sector choice and financing with private sector production of the service selected; 3) and deregulation of private firms providing services. In the first case, the entire responsibility for a service is transferred from the public sector to the private sector, and individual consumers select and purchase the amount of services they desire from private providers. For example, solid-waste collection is provided by private firms in some communities. The third form of privatization means that government reduces or eliminates the regulatory restrictions imposed on private firms providing specific services.

The second version of privatization refers to joint activity of the public and private sectors in providing services. In this case, consumers select and pay for the quantity and type of service desired through government, which then contracts with private firms to produce the desired amount and category of service. Although the government provides for the service, a private firm carries out the actual execution of it. The government determines the

service level and pays the amount specified in the contract, but leaves decisions about production decisions to the private firm.

2. 3. 2 Advantages and Disadvantages of Privatization

Etukudo (2002) states that in sub-Saharan African countries with a high level of illiteracy, public offer for sale of state-owned enterprises has its limitations due to cumbersome formalities in the prospectus as well as complicated application forms, etc. As banking facilities are concentrated in urban centres, the use of public offer in privatization works to the disadvantage of those in rural areas with few banking facilities.

On the whole, Etukudo (2002) contends that privatization programmes have led to marked increases in stock market capitalization as well as increases in the quantity and range of issues traded on the market. The stock exchange has attracted a considerable number of players to the market leading to increased competition within the capital market. The structure and function of capital markets affect the availability of capital, influence investment processes and also influence the ways in which business managers who approach investors project the current performance and future potential of their enterprises.

2. 4 Privatization implications on public corporation performance in Nairobi Stock Exchange

Yarrow (1986) notes that as firms move from public to private ownership, their profitability should increase. First, given that shareholders wish the firm to maximize profit, newly privatized firms' managers should place greater emphasis on profit goals. Second, privatization typically transfers both control

rights and cash flow rights to the managers who then show a greater interest for profits and efficiency relative to pleasing the government with higher output or employment (Boycko, Shleifer and Vishny, 1993).

In addition, Boycko, Shleifer and Vishny (1993) state that following privatization; firms should employ their human, financial and technological resources more efficiently because of a greater stress on profit goals and a reduction of government subsidies.

Meggison, Nash and van Randenborgh (1994) note that governments expect that greater emphasis on efficiency will lead the newly privatized firm to increase its capital investment spending. Once privatized, the firm should also increase its capital expenditures because it has greater access to private debt and equity markets and it will have more incentives to invest in growth opportunities.

Meggison et al (1994) believe the switch from public to private ownership should lead to a decrease in the proportion of debt in the capital structure because with the end of government debt guarantees the firm's cost of borrowing will increase and because the firm has a new access to public equity markets. The authors further note that with privatization, dividend payments should increase because unlike government's private investors generally demand dividends and dividend payments are a classic response to the atomized ownership structure which most privatization programs led to.

In terms of output Meggison, Nash and van Randenborgh (1994) contend that privatization should increase output because of greater competition, <https://assignbuster.com/effect-of-privatization-on-performance-of-public-corporations/>

better incentives and more flexible financing opportunities. On the other hand Boycko, Shleifer and Vishny (1993) predicts a fall in output since the government no longer subsidizes the newly privatized firm to maintain inefficiently high output levels.

Kikeri, Nellis and Shirley (1992) assert that governments expect the level of employment to decline once the SOE which is usually overstaffed turns out private and no longer receives government subsidies. However, in growing sectors, the newly privatized firm could absorb surplus labor through new capital investment and more productive use of existing assets.

2. 5 Empirical experience

Jones, Jammal & Gokgur (1999) undertook an impact study applied to 81 privatizations (covering not just infrastructure firms but a range of firms already operating in competitive markets (in agriculture, agro-industries, tradable and non-tradable sectors) in Cote d'Ivoire and concluded that firms performed better after privatization and that they performed better than they would have had they remained under public ownership. The study also found that the set of transactions as a whole contributed positively to economic welfare, with annual net welfare benefits equivalent to about 25% of pre-divestiture sales. These results stemmed from a number of effects, including increases in output, investment, labor productivity, and intermediate-input productivity.

2. 5 Chapter summary

The chapter highlighted the different studies that sought to address the research gap. Chapter three will point out the methodology to be used in the study.

Chapter 3: Research Methodology

3. 1 Introduction

This chapter will discuss the research methodology that will be used as the basis of this study. The chapter will also discuss the population of study, sample frame and sampling techniques, data collection methods as well as data analysis and data presentation methods to be employed in the study.

3. 2 Research Design

The research design employed in this study will be empirical in nature and will be aimed at delivering answers to the research questions outlined in the problem statement.

3. 3 Population and Sampling Design

3. 3. 1 Population

The population involved in the study are four privatized public corporation that have listed on the NSE. Population refers to the entire group of people, events, or things of interest that the researcher wishes to investigate.

Population forms a basis from which the sample or subjects for the study is drawn.

3. 3. 2 Sampling Design and Sample Size

Methods that we will use in our paper to analyze the operating and market performance are descriptive statistics for evaluating the post listing share price performance and the financial ratio analysis using the accounting data to evaluate public corporation performance as well as their risk and return relationships profile.

Documents will be collected from the organizations' resource center, individual file record, libraries of various universities, company reports, company newsletter and other printed materials (e. g. newspaper cuttings, journals, text books, conference reports, articles, training packages) that were made available for the purpose of the research.

3. 4 Data Collection Methods

In order to achieve the set objectives, I will collect data from the Nairobi stock exchange database and from the financial statements of the individual companies under study. The collected data will be captured in form of tables. This will be used to capture performance of privatized public corporations listed on the Nairobi Stock Exchange.

3. 5 Research Procedures

3. 6 Data Analysis Methods

This study will use the quantitative method of data analysis. The quantitative analysis is applied using descriptive statistics. According to Denscombe (1998) descriptive statistics involves a process of transforming a mass of raw data into tables, charts, with frequency distribution and percentages which are a vital part of making sense of the data. Data will be analyzed using <https://assignbuster.com/effect-of-privatization-on-performance-of-public-corporations/>

Statistical Package for Social Sciences (SPSS) program and presented using tables and pie charts to give a clear picture of the research findings at a glance.

3. 7 Chapter Summary

The chapter describes the methodology that is to be used in carrying out the study. The chapter has also indicated that, data will be analyzed using SPSS and presented in inform of chart and tables. The next chapter will present the findings of the research.