Comparative analysis of financial performance of selected privatized firms listed in Nairobi stock exchange

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Accepted 7 November, 2015

Since early 1990s, many state owned enterprises (SOEs) were earmarked for privatization and consequently privatized using different privatization methods. Many of these have thus been listed and the shares traded on the Nairobi Securities Exchange. The purpose of this study was to find out whether the method employed in divesting these SOEs have had an impact on the post divestiture financial performance of the enterprises in terms of profit, liquidity, solvency and productivity using \textit{ex post facto} survey design. The target population was all the companies privatized by public floatation, competitive bidding and finally, pre-emptive rights listed in Nairobi stock exchange by 2005. A sample of a few companies, were selected using stratified sampling from which proportion allocation procedure was applied. Thereafter, secondary data was collected from records in Nairobi Stock Exchange regarding these companies. Data collected was first cleaned, coded for completeness before being analyzed in terms of mean ratios on financial performance five years prior and post privatization period for the selected firms; tables and line graphs; paired t-test were also analyzed. The study revealed that firms privatized by competitive sale showed significant improvement on profit, liquidity, solvency and productivity as opposed to those privatized through public floatation and pre-emptive rights. Other findings were firms privatized by public floatation recorded significant improvement on profitability and productivity followed by liquidity and solvency. Notwithstanding this, the study also showed that firms privatized by pre-emptive rights reported insignificance in all the parameters of financial performance. It is thus recommended that sale of public enterprises by competitive bidding has positive implication on the financial performance in terms of profitability, liquidity, solvency, productivity and therefore should be considered. Similarly, sale by public floatation especially where the government retains majority shareholding should be discouraged and instead, a strategic partner should be identified to turn around the organizations. Lastly, it is recommended that under pre-emptive rights, minority shares should be left to the insiders so the outsiders can bring the synergy required to turn around the organization.

**Key words:** Public share flotation, pre-emptive rights and competitive bidding, financial performance.

**INTRODUCTION**

Following the economic collapse of world economies partially attributed to the Second World War (WWII), and the great depression, increased public spending was adopted by many world economies as a stimulus package. In this regard, the role of government in stabilization and allocation of resources was emphasized. This saw an increase in state involvement in the production of goods and services. For instance, the nationalized companies were transformed into entities, which became part of the government departments (Muir and Saba, 2005). Newly independent countries faced many challenges such as insufficient capital to invest in order to create employment; foster the growth and expansion of infant industries. In the end, government considered public enterprises as one of the alternatives towards the economic meltdown (Shirley and Nellis, 2011). However, as early as 1970s, many governments

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had recognized the fact that SOEs were performing poorly. Poor SOEs performance was associated with labor rigidities in the market, sloppy management of the enterprises, government interference, overreliance on government funding, increased fiscal and foreign debt occasioned by huge wage bill, wastages and continuous bailout by the respective government. Similarly, SOEs provided poor and unreliable service failed to meet demand and was lagging behind in technology areas like telecommunications (Shirley, 2013). Mismanagement, bureaucracy, waste, pilferage incompetence and irresponsibility by directors and employees are the main problems that have made SOEs fail to achieve their objectives (Shirley, 2013).

As part of revitalizing their growth, World Bank and IMF advised the respective government to empress privatization. Many economies adopted this and as a result the economic policy, privatization became a deliberate option to counter the challenges of privatization. The modern idea of privatization as an economic policy was pursued for the first time by the Federal Republic of Germany in 1957, when the government eventually sold majority stake of Volkswagen to private investors. The next big move in privatization came in the 1980s with Margaret Thatcher's privatization of Britain Telecom. The phenomenon spread to France when Chirac spearheaded privatization of large banks in France. It also spread to other continents as Japan and Mexico privatized government owned communication companies (Megginson, et al, 1996). They accumulated huge financial losses and absorbed a disproportionate share of domestic credit. By 1985, they had become an unsustainable burden on the budget (Jerome, 2005).

In Kenya, following poor performance of public enterprises it was no longer tenable for the government to continue taking the burden of managing the enterprises. Outflow from central government to parastatals was equivalent to 1% of the GDP in 1991 and continued to rise over the years. In order to reverse the situation coupled with pressures from Bretton institutions, the government embarked on privatization ventures by transferring ownership or control from public to private sector. The methods used to divest SOEs then were public offering of shares on Nairobi Securities exchange; sale of shares by private placement; Negotiated sales in so far as pre-emption right exist and have been exercised; sale of enterprises assets (including liquidation); Employee/management buy-out; and finally, leasing or reward of management contract; and New private investment in the enterprise (GOK, 2005). Whereas, some of the methods were considered costly, others were viewed as political with minimal economic gains. According to Mario (2008), the choice of the method and the way it is carried out can have the same or greater importance than the very option to privatize in the first place.

Problem statement and purpose

In Kenya, there had been research attempts to examine the effects of firm performance on privatization. Most of the findings indicate that there have been general improvements in performance organization. Studies however, show variance and inconsistency in performance in parameters such as profits, solvency, productivity and capital employed. In a study by Odondi (2008) on performance of newly privatized firms, privatized firms performed better than pre-privatization. Similar findings were reported by Ochieng and Ahmed (2014) in a case study of Kenya Airways performance in post divestiture period reported increased financial efficiency and profits as well as liquidity and debt ratios. In contrast, Cook and Kirkpatrick, (2003) in an empirical analysis suggests that there is a robust negative correlation between privatization and economic growth in developing countries. Similarly, Makokha (2013) argues that privatization of firms is not a guarantee to all aspects of growth. In her study on the effect of privatization on financial performance of firms listed at the Nairobi securities exchange, she reported that privatization had no effect on net return in addition to negative correlation with leverage ratios. On the other hand, she reported improved liquidity ratios after privatization.

Notwithstanding these mixed findings, there were hardly any attempts to examine why there is variation in performance. The influence of the method of privatization has escaped scholarly attention. Privatization methods such as public floatation, competitive sale and sale by pre-emptive right exist and have been used in divesture of public enterprises. Bennett et al. (2007) explains that, privatization methods have strengths and weaknesses, blend well in varied economic environment and match in different entrepreneurial engagements. Moreover, the methods may have implications, for instance, on ability of management to pursue organizational goals as well as the speed at which privatization programme is expedited. Considering this potential, this study sought to find out whether the method or technique used in privatizing public enterprises have any effect on its post divestiture performance in terms of profitability, liquidity, productivity and solvency.

Conceptual framework

In order to realize the set objective, a conceptual framework was developed linking the dependent variables and independent variables. The independent variables constituted the methods of privatization namely public floatation, competitive bidding and pre-emptive
The dependent variable in this case was financial performance of the firms measured in terms of profitability, productivity, liquidity and solvency. These variables are summarized in Figure 1.

Measurement of variables

**Profitability:** Profit is the quality of the gain or benefit. Return on equity Return, return on sales and return on assets are the indicators used to measure profitability (Megginson & Netter, 2005). Rate of Return on Equity (ROE) is the coefficient of net income to permanent business assets and measures the earning power of the assets employed. It was calculated by dividing net profit after tax by average.

**Productivity:** This variable was measured by the use of sales divided by total assets. Productivity is a measure of efficiency and it is expected that privatization alters the practice of corporate finance in economies that experienced large privatizations, and impacted the returns earned by individual investors who purchased stock in a privatized company.

**Solvency:** Solvency refers to creditworthiness of a company. The solvency ratio measures the size of a company's after-tax income; excluding non-cash depreciation expenses, as compared to the firm's total debt obligations. It provides a measurement of how likely a company will be to continue meeting its debt obligations. Note that the lower a company's solvency ratio, the greater the probability that the company will default on its debt obligations. It was measured in terms in a ratio that compares total debts with total assets by dividing the sum of short term and long term debts with total assets.

**Liquidity:** Liquidity is the ability of a firm to meet financial obligations as they come due in the short term, without disrupting the normal operations of the business. Liquidity is measured by current ratio, a measure of a firm's short-term solvency. This is measured by the ratios of total debt to total assets and debt to equity. This compares total current assets to total liabilities. It was computed by dividing total current assets with total current liabilities.

METHODOLOGY

The researcher adopted expost facto survey design. This design is suitable because it examines events that have already taken place without manipulation of variables (Oso and Onen, 2002). The method provided a framework for examining the current conditions, trends and status of events. It facilitates the description of population characteristics of a given phenomenon in a natural condition, enables exploration of differences and comparison between categories of the population (Kothari, 2004). Additionally, results from surveys may be generalized to a large population from which the sample
is drawn and also explore how characteristics predict one from the other (Kerlinger, 2005).

The target population was all the privatized companies by public floatation, competitive bidding and pre-emptive rights respectively listed in NSE by 2005 based on the information available at Nairobi Securities Exchange. The population was stratified in relation to privatization methods namely public floatation, competitive bidding and pre-emptive rights from which proportion allocation procedure was adopted. Document analysis was used to collect secondary data from annual reports and internet. The data was for five years before and after privatization. The data collected was on profits based on returns on equity, liquidity, solvency and productivity.

The data collected was analyzed by the use of Microsoft excel and SPSS version 20. Raw data was put into excel spreadsheets file after which formulas were applied to calculate the ratios for all the companies that were studied in regards to financial performance; profits, liquidity, solvency and productivity. Descriptive statistics and line graphs were used to present means and trends in financial performance. Paired t test was used to examine whether mean differences in financial performance was significant. The variables of the study to measure performance in terms of ratio are profit, liquidity, solvency and productivity. The methods have been used by Makokha (2013).The data analysis methods and the variables under study have been used by Makokha (2013), Waweru et al. (2013) and Ochieng and Ahmed (2014). The ratios were calculated as indicated under the sub-section on measurement of variables.

Findings and discussions

Performance in terms of variables; profit, liquidity, solvency and productivity were calculated before and after privatization. Student’s paired test distribution was then used to test for the difference between means for each company in regards to method of privatization

Privatization by competitive sale

Financial performance was examined by calculating means for each variable five years before and after privatization for the company that was sold by competitive bidding. Paired t test was used to examine whether the mean differences are significant. The results show that the firms sold by competitive bidding posted significant performance in profits \((p < 0.05)\), liquidity \((p < 0.05)\) solvency \((p < 0.05)\) and productivity \((p < 0.05)\). The findings supports the findings by Bennet et al. (2007) where it was reported that sale by competitive bidding confers management rights to control firms operations which increases production efficiency and consequent profits. Further, in competitive bidding money from the sale is used to clear debts thus the owners usually take control of the firm.
when debts have been settled (Megginson and Netter, 2001).

**Privatization by public floatation**

Financial performance was examined by calculating each variable; profit, liquidity, solvency and productivity, five years before and after privatization on each of the three companies. The results are represented in appendix two, three and four and in line graphs (Figures 3, 4 and 5). Paired t-test was used to examine whether the mean differences are significant in the financial performance.

The findings shows that productivity increased at the sixth year and stagnated at the 8th year while liquidity increased after the sixth year, profits dropped after the 5th year and increased slightly by the 10th year. On the other hand, productivity started increasing after the 7th year and fell slightly by the tenth year, while solvency hardly increased after privatization. Further analysis was done using paired t-test and revealed that firm performance was significant in liquidity (p < 0.05) and solvency (p < 0.05). However, for productivity (p > 0.05) and profitability (p > 0.05) mean differences were insignificant.

In the case of companies sold by public floatation, the study findings are presented in Figure 4.

The findings shows that after privatization, liquidity increased almost yearly up to the tenth year while profitability increased after the 5th year up to sixth year then it fell slightly up the tenth year. Productivity increased after the 6th year and remained almost at the same level for the rest of the years and finally, solvency fell from the 6th year. Further analysis was done using paired t-test to examine mean differences. Using t-test,
the results showed that firm performance was significant in profitability ($p < 0.05$), liquidity ($p > 0.05$) and productivity ($p < 0.05$) but solvency ($p < 0.059$) was insignificant. Perhaps, capital injected and public expectation catalyzed performance in the company. According to Bennet (2007) public floatation are keen to improve performance due to mass expectation and scrutiny. In the third company sold by public floatation, liquidity and productivity which were high before privatization remained almost at the same level. However, productivity recorded increase from year 7 and while profitability rose from the 8th year.

Paired sample t-test was used to examine differences in means, the study shows that mean differences are significant in profits ($p < 0.05$) and productivity ($p < 0.05$) but solvency ($p > 0.05$) and liquidity ($p > 0.05$) do not reflect significant differences. Thus, privatization improved the performance of the firm especially on profits and productivity that were low before privatization. Privatization may have increased accountability. Bennet et al. (2004) argues that public floatation is on one hand pressed to perform due to their massive support and political connection to rationalize the political and economic strategy of privatization. On the other hand, they have to grapple with conflicts of government interest versus organization objectives. Indeed none of the three companies recorded improved performance in the four aspects. Nellis (2005) points out public floatation's, though popular, they face the challenges of government interference. The author appoints that in Gambia, benefits of privatization have often been limited by government interference especially when government floats minority shares.

**Privatization by pre-emptive Rights**

Performance of firms on profit, liquidity, solvency and productivity was examined by means and paired t-test, five years before and five years after privatization for two companies. Performance of the first firm is reflected in Figure 6.

Trends in Figure 6 indicates that after privatization, profitability slightly increased after the 5th year but fell from the 6th year. Liquidity fell between the fifth year and seventh year but rose from the 7th year to ninth year then it fell by 10th year. After privatization, solvency recorded modest increase Productivity rose between 6th and eight year and later fell between 9th -10th year. Further, analysis was done using paired t test to examine differences. The findings indicate that there was no significant change in all aspects as all p values are greater than critical values. This implies privatization had no effect on firm performance. Thus, sale of firms by pre-emptive rights is not a guarantee to making profits. Perhaps, retention of original owners may stall prompt structural changes to realize profitability. Bennet et al. (2007) argues that, a method of privatization determines the speed at which privatization process is expedited. Sale by pre-emptive rights and consequent initiatives to improve on performance is normally a slow process as owners exercise their rights in propagation or rejection of certain risks (Oliver and Nellis, 1998).
Results for the second company sold by pre-emptive rights is reflected in Figure 7.

The results indicate that profitability fell after privatization then rose in 7th year and fell by 8th year and then recorded a modest increase up to 11th year. Liquidity recorded increase after privatization and only fell slightly in the 11th year. Solvency fell after privatization and recorded marginal increase up to the tenth year. Productivity fell after privatization and then rose in 7th year and reached the peak in the 8th year. This declined between 10th and 11th year. Further analysis was done using paired t-test. Findings show that it is only liquidity \((p = 0.006)\) that record significant improvement. Otherwise, profitability \((p = 111)\), solvency \(p = 806)\) and \((p = 0.513)\) did not record significant increase. Perhaps the increase in liquidity is as result of capital injected through the sale of rights.

According to Koimet (2006) one of the challenges that were facing government parastatals is lack of operating capital in the face of slow economic growth. However, lack of significant change in other parameters confirms demerits of sale by preemptive rights. The sale by preemptive rights retains majority of former owners hence strategic decisions to enhance productivity may be slower. Oliver and Nellis (1998) supports that most government use pre-emptive rights as the means to fulfill political objectives which may not necessarily improve performance. Thus, strategic decisions such as staff
rationalization critical to productivity and profit making may be at a slow pace.

Conclusion and way forward

Summary

The first objective was to find out if there is a significant change in performance of SOEs after divestiture; this was to be achieved by comparing pre-divestiture and post divestiture financial performance of firms privatized by competitive sale of shares. The results indicate that firms recorded better performance in profits, liquidity, solvency and productivity. The second objective was to find out whether there is a significant change in performance of SOEs privatized via public floatation sale of shares. This was to be achieved by comparing pre-divestiture and post divestiture financial performance of the privatized firms. Among the three studied firms, none recorded significant performance in all parameters of growth. The first company recorded significant change in liquidity and solvency but profit making and production efficiency of the strategic objectives of privatization was not recorded after privatization. The second company recorded growth in profitability, liquidity, and productivity but solvency remained weak. The third company recorded significant growth in liquidity but productivity, profitability and solvency remains elusive. The third objective sought to find out whether there is significant change in performance of SOEs privatized pre-emptive rights. The first company recorded no significant increase in any of the four measures of firm performance. However, the second company registered significant performance in liquidity.

Conclusion

In conclusion, it can be observed that the firms that were sold by competitive bidding recorded significant improvement in all aspects of financial performance in terms of productivity, profitability, liquidity and solvency. Out of the three companies sampled, only in firms privatized by public floating, one firm recorded significant improvement on profitability and productivity, the second on liquidity and solvency and third on profitability, liquidity, and productivity thus only one registered significant performance in three out of four parameters. Liquidity was the only improvement in firms sold by pre-emptive rights. Therefore, privatization by pre-emptive rights and public floatation has hardly achieved the strategic objectives of privatization as it has been seen that not all the aspects of financial performance have improved significantly. We can then conclude that competitive sale is the best method to use for privatization in Kenya.

Way forward

On the basis of the findings, it is recommended that sale of public enterprises by competitive bidding rationalizes privatization efforts as it is associated with financial turnaround, since the firm privatized using this method showed significant improvement in all the four parameters of financial performance. Similarly, sale by public floatation especially where the government retains majority shareholding should be discouraged and instead a strategic partner should be identified to turn around the organizations since it has been seen that not all aspects of financial performance showed any significant increase. Lastly, it is recommended that under pre-emptive rights, minority shares should be left to the insiders so the outsiders can bring the synergy required to turn around the organization and also table new ideas that can be useful in reforming the organization.

REFERENCES


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