FACTORS INFLUENCING INVESTMENT DECISIONS IN THE PARASTATALS IN KENYA.

BY

WAMALWA N. EDITH

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA), SCHOOL OF HUMANITIES AND SOCIAL SCIENCES, KENYATTA UNIVERSITY

JULY 2003
DECLARATION

This Research Project is my original work and has not been presented for any degree at Kenyatta University or any other university.

Signed ___________________________ Date __29th__ July, 2003__________

Wamalwa N. Edith
D53/7392/01

This Research Project has been submitted for examination with my approval as the university supervisor.

Signed ___________________________ Date __29-7-2003__________

Dr. Elijah W. Khakame
Lecturer and Chairman,
Department of Finance
Kenyatta University
DEDICATION

To my loving and supportive parents, dad David S.K. Wamalwa and mum Efrance G.

Wamalwa, whose dream i live to realize.
ACKNOWLEDGEMENT

I wish to recognize the very supportive role played by several people in the completion of not only this Research Project, but also the entire MBA program.

First and foremost, I am greatly obliged to the members of my family for the overwhelming support they have accorded me throughout the program. Special thanks to my dad David and mum Efance who together never got tired to support me morally and financially in the quest for education. Am also grateful to my sisters Cate, Esther, Rozal and Sophie, and my brothers Bill, JohnKen and MarkDennis for their immeasurable love, care and support. To my uncle Goddie who constantly printed my work, I say thank you.

Second, special thanks go to my supervisor Dr. Elijah W. Khakame, who patiently and conscientiously guided me through the research. Without his dedication, tireless efforts, positive suggestions and interest in my work, this project would not have been possible.

Third, I wish to register my appreciation to all my classmates for the valuable suggestions and contributions throughout the study period. I wish all of you joy and happiness in your future endeavors. For all those people who assisted me in any way, I thank you all.

Above all, very special thanks go to the Almighty God for giving me life and being a constant source of inspiration.

GOD BLESS YOU ALL.
ABSTRACT

This study identifies factors that influence investment decisions in the parastatals in Kenya. The parastatals have turned out to be non-performing and are a major drain on the country’s resources. The study was guided by 3 specific objectives. It sought to identify the policies set by the government regarding the establishment and management of the parastatals and establish whether they are in harmony.

The study made use of both primary and secondary data. Descriptive statistics was used to analyze quantitative data with the help of Statistical Package for Social Sciences (SPSS) computer software package. The study established that there’s harmony between policies set by the government and parastatals. The findings further revealed that various factors influence investment decisions in the parastatals but with different magnitudes. Generally, the study attests that the parastatals are not performing well and that privatization is the key to enhancing efficiency and profitability in the parastatals.

The study recommends that policy formulation must be flexible and should focus on creating an environment that encourages the seeking and development of new sources of funding parastatals. There is also need to introduce programs that will increase managerial autonomy and accountability. Further studies could endeavor to investigate factors influencing investment decisions in the informal sector. Further additional research can be performed on finding ways to overcome the challenges defined in this study. Moreover future research effort may be carried out using different data analysis techniques for comparison.
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background to the Study

In Kenya, a Parastatal refers to a State Corporation. Under the State Corporations Act Cap 446 (1987), 'State Corporation' has various meanings. First, the President may by order establish a state corporation as a body corporate to perform the functions specified in the order. Second, it may be a body corporate established by or under an Act of Parliament. Third, it also represents a bank or a financial institution licensed under the Banking Act or other company incorporated under the Companies Act, the whole or the controlling majority of the shares or stock of which is owned by the government or by another state corporation. Finally, it may refer to a subsidiary of a state corporation.

Parastatals are funded differently depending on how and why they were established. They may be funded through grants, loans and/or through bilateral arrangements. There are those parastatals established and are expected to generate their own revenue after the first grant. They include among others the Industrial and Commercial Development Corporation (ICDC), Kenya Railways (KR) and Chemilil Sugar Company. Others are funded on a yearly grant basis. These include those parastatals which offer services like the Universities. Sometimes, loans are given directly to the beneficiaries. This occurs in cases where the parastatal is given capital to start off and it cannot sustain itself.
A review of the parastatals economic growth performance over the last decade indicates that they have turned out to be non-performing parastatals. Since 1993, the government of Kenya has been pursuing an ambitious program of macroeconomic and structural reform (Interim Poverty Reduction Strategy Paper, July 13, 2000). Among the key features of this program was the initiation of parastatal reform based upon restructuring of strategic parastatals and divestiture of non-strategic enterprises. The Kenyan government is committed to removing itself from business and commercial activities.

The Policy Framework Paper (1996 – 1998) reveals that privatization of 211 non-strategic public enterprises has started, with the Government divesting its holdings in over 100 firms (including 43 tea factories in which it turned over the bulk of its shareholdings to farmers) by the end of 1995. In addition, it has reduced its holdings in another six enterprises, including Kenya Airways (KA), Kenya Commercial Bank (KCB) and the National Bank of Kenya (NBK). The Government is also making progress in parastatal reform. Initial steps to restructure key public enterprises like the Kenya Ports Authority (KPA), Kenya Railways (KR), Kenya Power and Lighting Company (KPLC) and Kenya Posts and Telecommunications Corporation (KPTC) have begun. However, further steps will need to be taken in order to accelerate progress in this area and thereby improve on the low investment efficiency that limits economic growth.

The Interim Poverty Reduction Strategy Paper (2000) further indicates that to enhance efficiency in those parastatals that would not be immediately privatized, the legal framework that at present allows government intervention will be reviewed. The aim will be to ensure that boards of directors and management are given autonomy to operate
within their mandate and performance requirements while being accountable for their operations.

The foregoing has highlighted the status of the parastatals in Kenya and some of the measures taken by the government. The parastatals have not been performing well thereby initiating parastatal reforms by the government. Part of the reason for being non-performing parastatals is the complexity nature of investment decisions and the uncertainty in cash flow involved. It can therefore be seen that investment decisions is a critical problem area in the parastatals and the Kenyan government is trying out by all means to avoid or minimize it. Thus, it requires special examination.

1.2 Statement of the Problem

The parastatals in Kenya have turned out to be non-performing and are a major drain on the country’s resources. They have continued to rely heavily on the Treasury for funding despite the fact that they are capable of being self-generating. During the opening of the ninth parliament, in his speech, President Mwai Kibaki mentioned that his government will deal with non-performing parastatals that were capable of being self-generating and yet still relied on the Treasury for funding. The government also guarantees loans to these parastatals for investment projects but their management cannot repay these loans thereby forcing the government to pay these loans since it is the guarantor. This has contributed to a setback in the revival of the Kenyan economy.
Several factors influencing investment decisions in the parastatals in Kenya have been enumerated both in theory and in various discussions (workshops and seminars). Measures have been suggested and some applied but no major success has been realized. Therefore it seems that the real and major factors have not been identified and if they have, the correct measures have not been taken. Thus, the complexity and risky nature of investment decisions leading to inefficiencies in the parastatals still persists. This study was therefore conceived with the above conception in mind to fill the existing gap by identifying and analyzing the major factors that influence investment decisions in the parastatals. The researcher will also try to identify and recommend appropriate strategies to be adopted by the government ministries and the parastatals in Kenya.

1.3 Objectives of the Study

The overall objective of the study is to establish and analyze the factors that influence investment decisions in the parastatals in Kenya. The study will be guided by the following specific objectives:

1. To identify the policies set by the Kenyan government regarding the establishment and management of parastatals.

2. To identify the policies set by the parastatals and establish whether they are in harmony with the government policies.

3. To recommend the appropriate strategies to be adopted by the government and the parastatals in order to improve efficiency in investment decision making and implementation.
1.4 Significance of the Study

The findings of this study are expected to be beneficial to the following groups:

1. The Kenyan government while formulating policies and strategies necessary for the promotion and enhancement of investments in the parastatals.

2. The parastatals by guiding them on choice of the most profitable and viable investment project and appropriate strategies to follow that will increase the firm’s efficiency.

3. By guiding investors regarding parastatals which operate efficiently.

4. The study is expected to contribute to the body of knowledge in the field of academia and act as a basis for further research.

1.5 Scope of the Study

The study is designed to take place in Nairobi. This area has been chosen because it is the capital city of Kenya and holds the headquarters offices of government ministries which are parent ministries to various parastatals. Furthermore, a large proportion of parastatals have their operations based in Nairobi. Thus this gives a broad perspective of the target population desirable for this study.

1.6 Definition of Working Concepts

**Parastatal** – A State Corporation which is wholly or partly owned and controlled by the government.

**Treasury** – A department of the State that controls public revenue and regulates funds of a country.
**Investment decisions** – It is the process of identifying, analyzing and selecting investment projects whose returns (cash flows) are expected to extend beyond one year (Horne and Wachowicz, 2001).

**Grant** – Is a funding/donation from a government to meet a particular cost. Is not repayable.

**Bilateral arrangements** – Assistance in form of loans from friendly countries.

**Privatization** – In this context, privatization is regarded simply as the transfer of all or any of three kinds of property rights from the State to the private sector, ownership rights, operating rights and development rights since these constitute the most common type of privatization in sub-Saharan Africa.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

The parastatals in Kenya have turned out to be non-performing in the recent past. The complexity nature of investment decisions and the uncertainty in cash flow involved has been a major contributing factor. Therefore, the study aims at identifying and analyzing the factors influencing investment decisions in the parastatals in Kenya. In this section, the researcher examines the contribution that the existing literature can make towards the understanding and knowledge of the subject.

2.2 Nature of Investment Decisions

The investment decisions of a firm are generally known as the capital budgeting or capital expenditure decisions. A capital budgeting decision involves the firm's decision to invest its current funds most efficiently in the long-term assets in anticipation of an expected flow of benefits over a series of years (Pandey, 1999). The long-term assets are those which affect the firm's operations beyond the one year period.

In the investment analysis, it is cash flow which is important, not the accounting profit (Brigham, 1978). Therefore expenditures and benefits of an investment should be measured in cash. The firm's value will increase if investments are profitable and add to the shareholders' wealth. Thus, investments should be evaluated on the basis of a criterion which is compatible with the objective of the shareholders' wealth maximization.
2.3 Importance of Investment Decisions.

According to Quirin and Richard (1977), investment decisions require special attention because of the following reasons:

- **Growth**

The effects of investment decisions extend into the future and have to be endured for a longer period than the consequences of the current operating expenditure. A firm's decision to invest in long-term assets has a decisive influence on the rate and direction of its growth. A wrong decision can prove disastrous for the continued survival of the firm; unwanted or unprofitable expansion of assets will result in heavy operating costs to the firm. On the other hand, inadequate investment in assets would make it difficult for the firm to compete successfully and maintain its market share.

- **Risk**

A long-term commitment of funds may also change the risk complexity of the firm. If the adoption of an investment increases average gain but causes frequent fluctuations in the earnings, the firm will become more risky. Thus, investment decisions shape the basic character of a firm.

- **Funding**

Investment decisions generally involve large amount of funds which make it imperative for the firm to plan its investment programmes carefully and make an advance arrangement for procuring finances internally or externally.
• **Irreversibility**

Most investment decisions are irreversible. It is difficult to find a market for such capital items once they have been acquired. The firm will incur heavy losses if such assets are scrapped.

• **Complexity**

Investment decisions are among the firm’s most difficult decisions. They are an assessment of future events which are difficult to predict. It is a complex problem to correctly estimate the future cash flow of an investment. Economic, political, social and technological forces cause the uncertainty in cash flow.

**2.4 Types of Investment Decisions**

There are many ways to classify investments. They include:

1) **Expansion and diversification**

A firm may add capacity to its existing product lines to expand existing operations. Expansion of a new business requires investment in new products and a new kind of production activity within the firm. Sometimes a company acquires existing firms to expand its business. In either case, the firm makes investment in the expectation of additional return. Investments in existing or new products may also be called as revenue-expansion investments.

2) **Replacement and modernization**

The main aim of modernization and replacement is to improve operating efficiency and reduce costs. Cost savings will reflect in the increased profits, but the firm’s revenue may remain unchanged. Assets become outdated and obsolete with technological changes. The firm must decide to replace those assets with new assets that operate more economically. Replacement decisions help introduce more efficient and economical assets and
therefore, are also called cost-reduction investments. However, replacement decisions which involve substantial modernization and technological improvements expand revenues as well as reduce costs.

3) Mutually exclusive investments

Mutually exclusive investments serve the same purpose and compete with each other. If one investment is undertaken, others will have to be excluded.

4) Independent investments

Independent investments serve different purposes and do not compete with each other. Depending on the profitability and availability of funds, the company can undertake both investments.

5) Contingent investments

Contingent investments are dependent projects - the choice of one investment necessitates undertaking one or more other investments. For example, if a firm decides to build a factory in a remote, backward area, it may have to invest in houses, roads, hospitals and schools to attract employees. Thus, building of factory also requires investment in facilities for employees. The total expenditure will be treated as one single investment.

6) Mandatory/non-revenue producing investments

These are investments that comply with the government orders, labour agreements, or insurance policy terms concerning safety and/or the environment.

2.5 Characteristics of a Sound Investment Evaluation Criterion

The essential property of a sound technique is that it should maximize the shareholders’ wealth. According to Porterfield (1965), the following characteristics should also be possessed by a sound evaluation criterion:
a) It should consider all cash flows to determine the true profitability of the project.
b) It should provide for an objective and unambiguous way of separating good projects from bad projects.
c) It should help ranking of projects according to their true profitability.
d) It should recognize the fact that bigger cash flows are preferable to smaller ones and early cash flows are preferable to later ones.
e) It should help to choose among mutually exclusive projects that project which maximizes the shareholder's wealth.
f) It should be a criterion which is applicable to any conceivable investment project independent of others.

2.6 Capital Expenditure Planning Phases

According to Schall and Haley (1977), most firms prepare at least a short-run budget that indicates planned capital outlays for the current and immediately forthcoming periods. At least five phases of capital expenditure planning and control can be identified:

1. Generation of investment ideas

Investment opportunities have to be identified or created; they do not occur automatically (King 1975). Investment proposals of various types may originate at different levels within a firm. A system under which proposals originate with top management is referred to as a top-down system, and one in which proposals originate at the plant and division level is referred to as a bottom-up system. Large corporations are a mixture of both these approaches. Investment ideas emerge from below and above and authority is usually divided between senior management, which approves large projects, and division management, which has discretion up to some limit (Schall and Haley, 1977).
2. Developing Cash Flows Estimation

Estimation of cash flows is a difficult task because the future is uncertain. Operating managers with the help of finance executives should develop cash flow estimates. The risk associated with cash flows should also be properly handled and should be taken into account in the decision process. Estimation of cash flows requires collection and analysis of all qualitative and quantitative data, both financial and non-financial in nature. Large companies would have a management information system providing such data.

Pandey (1999) notes that executives in practice do not always have clarity about estimating cash flows. A large number of companies do not include additional working capital while estimating the investment project cash flows. A number of companies also mix up financial flows with operating flows.

Although the companies claim to estimate cash flows on incremental basis, some of them make no adjustments for sale proceeds of existing assets while computing the project’s initial cost. The prevalence of such conceptual confusion has been observed even in the developed countries. In the UK, Rockley (1973) found out that half of the companies were treating depreciation as cash flows.

3. Evaluation

The evaluation of projects should be performed by a group of experts who have no axe to grind (Pandey, 1999). For example, the production department may be generally interested in having the most modern type of equipments and increased production even if productivity is expected to be low and goods cannot be sold. This attitude can bias their
estimates of cash flows of the proposed projects. It is therefore necessary to ensure that an impartial group scrutinizes projects and that objectivity is maintained in the evaluation process.

4. Authorization

It may not be feasible in practice to specify standard administrative procedures for approving investment proposals. Screening and selection procedures may differ from one firm to another. When large sums of capital expenditures are involved, the authority for final approval may rest with top management. The approval authority may be delegated for certain types of investment projects. Delegation may be affected subject to the amount of outlay, prescribing the selection criteria and holding the authorized person accountable for results. Funds are appropriated for capital expenditures after the final selection of investment proposals. The formal plan for the appropriation of funds is called the capital budget. Generally, the senior management tightly controls the capital expenditures. Budgetary control may be rigidly exercised particularly when a company is facing liquidity problem. The expected expenditure should become a part of the annual capital budget integrated with the overall budgetary system.

5. Project Monitoring: Progress Review and Post Completion Audits

The investment process should not end with the decision to accept a project (Hall, 1974). Continual monitoring of the project is the necessary next step to help ensure project success. Therefore, firms should perform progressive reviews followed by post completion audits for all large projects, strategically important projects regardless of the size and a sample of smaller projects. Post completion audits allow management to determine how close the actual results of an implemented project have come to its
original estimates (Smith, 1994). When they are used properly, progress reviews and post-completion audits can help identify forecasting weaknesses and any important factors that were omitted. With a good feedback system, any lessons learned can be used to improve the quality of future investment decision making.

Monitoring of projects can also have important psychological effects on managers. For instance, if managers know in advance that their capital investment decisions will be monitored, they will be more likely to make realistic forecasts and to see that original estimates are made. In addition, managers may find it easier to abandon a failing project within the context of a formal review process.

2.7 Motive for Establishing Public Enterprises

It is observed that various motives are behind the establishment of public enterprises in the sub-Saharan African countries (SSA). For instance in Uganda, the Uganda Development Corporation created in 1963 a subsidiary known as African Business Promotions Ltd., the objective of which was to "establish and promote our own people in the trade and commerce field generally so that Ugandans may play a reasonable part and hold a reasonable share of the country's commerce" (Thomas, 1969).

Similarly in Kenya, for desire of sufficient indigenous private entrepreneurship after independence, the government had to use parastatals to fill the existing entrepreneurship gap. Thus, public enterprises served as a means to promote the establishment of private African enterprises (Eckert, 1987). In 1955 in Kenya, among registered companies, there were about 246 new companies owned by Europeans with a nominal capital of £8.9
million, 99 companies belonging to Asians with a nominal capital of £3.6 million, and only one company belonging to an African with a nominal capital of £250. Government therefore had to set up some parastatals in order to implement the programme of indigenization. They included the Industrial and Commercial Development Corporation (ICDC), the Development Finance Corporation of Kenya (DFCK), the Industrial Development Bank (IDB), the Kenya Industrial Estate Programme (KIE) and the Rural Industrial Development Centres (RIDC). At its inception in 1954, the objective of the Industrial Development Corporation was to promote the industrial and economic development of Kenya. But, by 1967, the objective of the Corporation was extended to include the indigenization of the Kenyan economy.

It is necessary to bear this aspect of economic nationalism in mind when evaluating the success of privatization in Africa. An appreciation of the political function of most public enterprises in Africa can explain why some governments have dragged their feet in respect of the privatization of some public enterprises in situations where locals of those countries did not adequately fill the entrepreneurship gap. In a Financial Times interview with Roger Matthews (1996), the President of Zimbabwe, Robert Mugabe, stressed the need to use privatization as an instrument for empowering the indigenous people. He said:

“What we inherited was a system in which the blacks were, by and large, workers and the whites were the employers and entrepreneurs. We want to see blacks go into the manufacturing sector”.
In a similar vein, the Nigerian Head of State during his state visit to the United Kingdom in June 1973 declared the following:

"We are consolidating our political independence by doing all we can to promote more participation by Nigerians in our economic life while attracting more investment in sectors of the economy where Nigerians are not yet able to rely on themselves."

Apart from using parastatals to build up local entrepreneurship, there were other equally important reasons for the establishment of public enterprises. For instance, in the United Republic of Tanzania, socialist ideology played an important role in the setting up of state-owned enterprises. Thus, in the Tanzanian Second Five-Year Plan for Economic and Social Development, emphasis was laid on the fact that considerable benefit will accrue in the long run from the expansion of public ownership because:

(a) it will be possible to create a genuine Tanzanian industrial know-how faster than under conditions of unrestricted private enterprise;

(b) it will be possible to pursue a more effective industrial strategy than is possible under private enterprise

(c) the profits made in industry will be re-invested in United Republic of Tanzania.

Thus, the government as the representative of the people regarded ownership of the means of production by Tanzanians as an "antidote to capitalist exploitation".

In the case of Ghana before independence, it was noted that the country's economy consisted of three levels: at the top were the Europeans and Levantines owning the large commercial enterprises; in the middle were the Asians and Middle Easterners engaged in
wholesale and retail trading with a virtual monopoly of general transport services including motor spare parts; at the bottom were the Africans pursuing farming, petty trading and rudimentary services (Ankomah, 1970). The establishment of state enterprises in Ghana was primarily to promote economic growth not to serve an ideology. However, government legislation, the Ghanaian Enterprises Decree of 1968, was directed at increasing the participation of Ghanaians in the modern sector of the economy.

In a few cases, state enterprises were created in response to pressure from a political lobby group rather than on the basis of economic logic. An example of this is the Nigerian National Supply Company which turned out to be of no benefit to the people. In some cases, some companies became public as a rescue operation from closure, like the banks and some schools.

2.8 The State as an Engine of Development

It was an acknowledged tenet of prevailing development theory in the 1950s and 1960s that the enormous and urgent problems of development cannot be solved by private enterprise and that governments must get away from their traditional caretaker and regulatory functions and move into an era of active participation in the productive sector. This led to ministries of agriculture going into actual agricultural production instead of only being engaged in research, and ministries of mines being involved in mineral exploitation rather than just producing maps of mineral resources. Thus in Nigeria, the Second National Development Plan (1970-74) declared that the government will seek to acquire, by law of necessity, equity participation in a number of strategic industries that will be specified from time to time. In order to ensure that Nigerians themselves
determine the economic destiny of Nigeria, the government will seek to widen and intensify its positive participation in industrial development.

Private entrepreneurship seemed to concentrate on processing industries without touching basic ones. Public companies had to be set up to fill such vacuums especially in areas like steel production, fertilizer manufacturing, air transport and other public utilities, education and health services. It is noteworthy that in some of these public enterprises, the provision of services to the public was a priority only to be followed by the maximization of profits.

This approach to economic development was not peculiar to Africa alone. For example in Malaysia, the government in 1969 drew up a New Economic Policy (NEP) following disappointment with the government’s pre-1969 record of economic achievement. The new policy discredited the laissez-faire approach to development and directed the Government to participate more directly in the establishment and operation of a wide range of productive enterprises either through wholly owned enterprises or through joint ventures with the private sector. Nevertheless, the expansion of state-owned enterprises in Africa also stemmed from the needs of political leaders for greater authority over their societies than from failures of the market. Such state companies served as good foundation for official patronage like jobs, funds and status among other benefaction.

There is a difference of approach to the public enterprise sector between Francophone and Anglophone African countries. In Francophone countries, the public sector is of
crucial importance in economic development and public enterprises have a prime rule in the economic system with special administrative and management units charged with control and surveillance. For instance, the Government of Côte d'Ivoire plays a bigger role in directing the economy than most other Anglophone African governments. One result is the provision of a better information base on public enterprises in Francophone than Anglophone countries.

Similarly, in Senegal even the political change of 1983 did not usher in any drastic reforms of parastatals solely because these state enterprises constituted an important political base for the ruling party. In fact, it was government policy to strengthen the position of state-owned enterprises through a deliberate policy of co-optation into the government political structure (World Bank Research Report, 1995).

2.9 Earlier Attempts to Restructure Public Enterprises

During the early days of their establishment, some public enterprises operated at a profit. For example, in Nigeria, the former Electricity Corporation of Nigeria, the Government Railway, the commodity boards as well as the regional marketing boards all generated surpluses which were reinvested in development projects. The then Eastern Nigeria Marketing Board provided 5 million pounds for the establishment of the University of Nigeria at Nsukka (Udoji, 1975).

In the United Republic of Tanzania, the Tanzanian Development Corporation had 60 subsidiaries in such areas as agriculture, mining, manufacturing, construction, commerce and services. In 1967 the Corporation had invested about 4.5 million pounds in 31
projects. Similarly in Uganda, the Uganda Development Corporation had in 1967 a gross turnover of over 22 million pounds and an investment of over 5 million pounds in seven projects. Also in Kenya, especially in the 1970s, state-owned banks spurred growth and were important in the establishment of non-bank financial institutions as well as extensive rural banking.

It can be argued that if, in those days, public enterprises were efficient in their operation, then they can surely be made to operate profitably once again. It has been suggested, in this connection, that one of the steps that can be taken would be for governments to re-examine the relationship existing between them as proprietors of these enterprises and the boards and managements of the enterprises. The idea of reforming public enterprises started long before the era of privatization. Some pressure had to be put on governments both inside and outside public service for parastatals to be run in a business-like manner.

At the enactment of the Nigeria Railways Corporation Act in 1955, the Minister of Transport and Works remarked that:

"It is government's view that a public utility of this kind is better operated on quasi-commercial lines by a statutory corporation than a government department. The rigidity of control and the established formalism which are proper and necessary in the operation of a government department are not suited to a public utility which should not only provide the service required by the public but should do so on sound financial lines."

Several attempts were made by governments to reform public enterprises. It is estimated that up till the 1970s at least 50 per cent of the corporations in Nigeria and Ghana had had
public inquiries conducted into their operations and that between 1960 and 1966 the Nigerian Railways alone had 13 inquiries into its activities (Udoji, 1975). Following a special committee set up in 1961 by the Federal Government of Nigeria, a public policy statement was issued to the effect that public corporations should enjoy an appropriate measure of independence and should not be subjected to direct government interference in their day-to-day activities.

Despite such official policy pronouncements, the worst problem afflicting the parastatals—political interference in the affairs of the corporations continued unabated; chairmen usurped the powers of chief executives, ministers usurped the powers and functions of both chairmen and chief executives. The management of some of the corporations was chaotic, as it became a hotbed of power struggles. In such a confused situation, the finances and general management of these enterprises were in such a parlous state that, in 1986, the Nigerian Federal Government issued instructions to the effect that the volume of non-statutory transfers to all economic and quasi-economic parastatals will constitute no more than 50 per cent of their present levels. Public enterprises were required to provide the balance from price increases, charges, tariffs and rates.

Similarly, in Zambia, the former president, Kenneth Kaunda, emphasized the fact that the Zambia Industrial and Mining Corporation Limited (ZIMCO) and its subsidiaries were business enterprises first and state-owned companies thereafter. They were therefore to operate no less efficiently than any other business undertaking.
2.10 Current Efforts at Public Enterprise Reform

Many governments have attempted to restructure those parastatals over which they still wish to maintain ownership. Methods adopted for restructuring include:

1. Legal and institutional restructuring involving a revision of the legal framework governing parastatals as well as the introduction of institutional frameworks aimed at achieving a better relationship between government and top management.

2. Establishing an independent role for the boards of directors and ensuring transparent accountability of general management.

3. Management reorganization through the use of modern management methods and tools.

4. Organizational and operational restructuring involving reduction in management hierarchies and reorganization of production processes and marketing and information systems;

5. Financial reforms focusing on assets and debt/equity structure, reduction of subsidies and tightening of credit, ensuring budget discipline and timely settlement of bills.

As a result of various reforms and restructuring, a survey in 1984 of 48 public enterprises in North and sub-Saharan Africa showed that 12 enterprises reported net profit margins in excess of 4 per cent while five enterprises reported net profit margins greater than 10 per cent. Then, ten of the 48 enterprises had returns on shareholders' equity of 25 per cent or higher (Nellis and Kikeri, 1989).
The restructuring of an ailing enterprise is an expensive affair. For this reason, some governments set up privatization trust funds which are state holding companies serving a temporary bridging function. The funds have been used to ward off public enterprises from government interference pending their divestiture, or to maximize the value of residual shares held by government for sale later on, or to effect restructuring before privatization. For example, Zambia established a privatization trust fund which functions as a "warehouse" for minority stakes reserved for sale later on.

However, for a great number of public enterprises, no amount of tinkering with reforms can turn the companies around owing to endemic political interference. Thus, a former chief executive of the Nigeria Ports Authority remarked in 1979 that:

"It became impossible to manage with firmness capital development projects approved by the board after unnecessary haggling took months to gain ministerial approval; appointments to posts were controlled by members of the board, and the Ministry's interference in addition to ministerial dictates on practically every issue was the norm".

In order to overcome the political problem while governments still retained the ownership of the enterprises, recourse was to management contracts where private enterprises took contracts to manage public enterprises. For example, in Senegal, as a result of management contract, la Société de Transports du Cap-Vert (SOTRAC) greatly improved its performance. In many African countries, some of the large publicly owned hotels and airlines are managed on contract by private management firms responsible for all decisions on purchasing, marketing, employment and production.
2.11 Conceptual Framework

The researcher has come up with a model that puts forth six factors which influence investment decisions in the parastatals in Kenya. They are as follows:

1. Government policies

Government policies are crucial because they regard the establishment and management of the parastatals. Some of the set policies are a major obstruction to profitable investment decisions being made. The policies of liberalization and privatization of the parastatals should be fully fledged so as to allow private investors to come in without major restrictions. The government acknowledges that private institutions are best suited for implementing investment programs and that the role of government needs to be limited to establishing prudential rules which protect savers and investors but which allow adequate flexibility for private financial institutions to develop innovative instruments, models and methods of finance (Interim Poverty Reduction Strategy Paper, July 13, 2000). Despite this, many parastatals in Kenya are not yet fully privatized and they are still controlled by the government.

2. Political interference

Political interference may be a major hindrance factor to the successful growth of the corporations. Part of the problem of the governance of parastatals in Kenya today is the fact that boards are appointed in a haphazard manner, with no regard to competence and qualifications (The East African Standard, March 23, 1999). An unqualified management team generates incompetent investment ideas which fail in the long run.
3. Unclear financial framework

A clear financial framework gives a comprehensible outline of the firm's financial position and plan for the future. It enables the parastatals to determine key measures like the cost of capital, vital for evaluating investment projects. The finance executives should be able to come up with a clear financial framework for the firm. Lack of clear financial framework may result to investing in projects which are not profitable and viable.

4. Fluctuating Inflationary Periods.

In an inflationary environment, the financial manager must know how to incorporate inflation into capital budgeting analysis. The capital budgeting analyst should merely predict the actual amount of cash flow that will occur, taking into account the inflationary trend. Incase of rampant fluctuations, it is then a very complex and uncertain task. This may result into unprofitable investment decisions being made.

5. Poor project identification and implementation

Identification of project ideas is the most critical aspect of the investment process and should be guided by the overall strategic considerations of a firm. It needs appropriate managerial focus. Each potential idea should be developed into a project. A corporation should have systems for estimating cash flows of projects. A multi-disciplinary team of managers should be assigned the task of developing cash flow estimates. Once cash flows have been estimated, projects should be evaluated to determine their profitability. Employment of modern project evaluation and selection techniques should be put in place. The government should adopt a policy of not investing in new projects before thorough feasibility studies are conducted to show the profitability and viability of projects. (Public Investments Committee Report, 2002).
Continual monitoring of the project during implementation is an essential step to help ensure project success. Progress reviews followed by post completion audits for all investment projects should be carried out. Progress reviews or status reports can provide especially during implementation phase of a project, early warnings of potential cost overruns, revenue shortfalls, invalid assumptions and outright project failure. Information revealed through progress reviews may lead to revised forecasts, remedial actions to improve performance or project abandonment.

Lack of project monitoring may lead to heavy losses being incurred by the corporations. KPTC’s financial deterioration in the late 1980’s and early 1990’s occurred in part because of a hugely expanded investment program. Commitments extended far beyond the projected level of investment for the Third Telecommunications Development program that KPTC agreed to with one of its major lenders, the World Bank, in 1985-86, and appeared to have strained the limits of KPTC’s financial ability to sustain its capital spending program (KPTC’s Annual Report and Accounts for 1987-88).

6. Technological Advances

The old days of a cozy and stable technology and of static organizational structure have gone. We now face a rapidly changing economic and technical environment (Stern, 1989). In a dynamic and rapidly changing world, institutions and structures that can continually respond to change are required. In other words, there is a vital need to institutionalize the policy making process so that it can both react to and anticipate change. Engineering massive organizational and system changes in a move to cope with the dynamic nature of technology is complicated and very expensive.
2.11.1 Proposed Model

In order to capture the relationship between investment decisions, which is a dependent variable and the factors that influence it in the parastatals, the following model is suggested.

(i) \( ID = f(G, P, U, FI, PI, TA) \)

Where:

- \( ID \) = Investment decisions
- \( G \) = Government policies
- \( P \) = Political interference
- \( U \) = Unclear financial framework
- \( FI \) = Fluctuating inflationary periods
- \( PI \) = Poor project identification and implementation
- \( TA \) = Technological advances

The equation (i) above can be expanded into a regression model as follows:

(ii) \( ID = \alpha_0 + \alpha_1 G + \alpha_2 P + \alpha_3 U + \alpha_4 FI + \alpha_5 PI + \alpha_6 TA + E_t \)

Where:

- \( E_t \) is the error term and
- \( \alpha_0, \alpha_1, \alpha_2 \ldots \) are the parameters to be estimated so as to determine the factors that influence investment decisions in the parastatals in Kenya.

2.12 Summary

In this chapter, we have looked at the contribution of existing relevant literature towards the topic under study. Thus the study will attempt to relate the various aspects of investment decisions to the Kenyan parastatals scenario which is still at the verge of
growth and recovery. The various factors which influence investment decisions in the parastatals will be carefully analyzed.
CHAPTER THREE

3.0 METHODOLOGY

3.1 Research Design

The study adopted a descriptive survey research design which entails making careful description of the phenomena (Borg and Gall, 1989). According to Kathuri and Pals (1993), the descriptive survey method is appropriate because it explores the relationship between variables in their natural settings.

3.2 The Population of the Study

The target population included the government ministries and the parastatals. The accessible population included the parent ministries with their parastatals in Nairobi.

3.3 The Sample and Sampling Procedures

The researcher used stratified random sampling in order to group the population under the study into two strata: government ministries and parastatals. A sample of 4 government ministries and 4 parastatals was purposively selected. Purposive sampling allows the researcher to use cases that have the required information with respect to the objective of the study (Mugenda and Mugenda, 1999). The sampling frame consisted of the finance officers from the 4 government ministries and 4 parastatals purposively selected. Samples of 5 officers each were randomly drawn from each group hence the sample size was 40.

3.4 Data Collection Instruments

Both primary and secondary data was used in this study. Primary data was collected using questionnaires and interview schedules. The questionnaire included both structured
and unstructured questions in order to capture both qualitative and quantitative data. The interview schedule enabled the researcher to obtain in-depth and greater clarity to responses given through probing and prompting. Secondary data was obtained from all the relevant published and unpublished sources. Pre-testing of the questionnaire was carried out before actual data collection. This was done so as to identify any defects in the questionnaire, such as ambiguity, length and terminology.

3.5 Data Collection Procedure

Having sought permission from the head of the organizations, the researcher personally explained the importance of the research to the respondents and assured them of confidentiality of the information given. Arrangements were made concerning the convenient time and place for the interview so as to suit the respondent. The “drop and pick later” method was used where personal interview was not be possible and also when it was not possible to wait for the questionnaire to be filled.

3.6 Data Analysis

The instruments yielded both qualitative and quantitative data. These data was analyzed using descriptive statistics so as to address each research objective. Quantitative data was analyzed using the Statistical Package for Social Sciences (SPSS) computer software package. Descriptive measures were used to describe and summarize data. These included frequency distributions and percentage tables. To analyze qualitative data, unstructured questions were carefully recoded and transcribed. The results were presented in the form of written reports. Qualitative data was used to supplement, explain and interpret quantitative data.
3.7 Variable Definition

In this study, the dependent variable was investment decisions while the independent variables were the various factors influencing the investment decisions. These included: government policies, political interference, unclear financial framework, fluctuating inflationary periods, poor project identification and implementation and technological advances.
CHAPTER FOUR

4.0 DATA ANALYSIS, FINDINGS AND INTERPRETATION

4.1 Introduction

This chapter contains the summaries of data collected and presentation of findings of the study. These are divided into various sections which correspond to data collected from the questionnaires received.

4.2 Overview of Survey Results

A total of 40 questionnaires were issued to respondents. Of these, 10 went to the Ministries and 30 went to the Parastatals. The sampling frame consisted of finance officers from the Ministries and Parastatals purposively selected. Only a total of 35 questionnaires were received back in time to be included in this analysis. 29 of the questionnaires received were those served to the Parastatals. Thus, of those who responded, 80% were respondents from the Parastatals, whereas 20% were respondents from the Ministries. The overall response rate was 87.5%.

4.3 Respondents Views

The study sought to evaluate the respondents’ level of agreement with some speculations about investment decisions.

i. Investment decisions are among the firm’s most difficult decisions to make.

The results indicate that 40.0% and 42.9% of the respondents strongly agree and agree respectively that investment decisions are among the firm’s most difficult decisions to make. Only 17.1% disagree with that speculation.

Table 1 summarizes the respondents’ views.
Table 1: Investment Decisions are Difficult to Make.

<table>
<thead>
<tr>
<th>Level of agreement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>I strongly agree</td>
<td>14</td>
<td>40.0</td>
</tr>
<tr>
<td>I agree</td>
<td>15</td>
<td>42.9</td>
</tr>
<tr>
<td>I disagree</td>
<td>6</td>
<td>17.1</td>
</tr>
<tr>
<td>Total</td>
<td>35</td>
<td>100</td>
</tr>
</tbody>
</table>

ii. Investment decisions usually affects the risk of the firm and influences the firm’s growth in the long run.

A greater percentage of the respondents (68.6%) feel that investment decisions have an effect on the risk and growth of the firm unlike 25.7% of the respondents who disagree with that speculation. The results are summarized in Table 2.

Table 2: Effects of Investment Decisions on Risk and Growth of the Firm.

<table>
<thead>
<tr>
<th>Investment decisions affect risk and growth of the firm</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>24</td>
<td>68.6</td>
</tr>
<tr>
<td>No</td>
<td>9</td>
<td>25.7</td>
</tr>
<tr>
<td>Total</td>
<td>33</td>
<td>94.3</td>
</tr>
<tr>
<td>Missing</td>
<td>2</td>
<td>5.7</td>
</tr>
<tr>
<td>Total</td>
<td>35</td>
<td>100</td>
</tr>
</tbody>
</table>
4.4 Government Policies and Extensive Investment

The Kenyan government has set various policies regarding the establishment and management of the parastatals. Amongst them, most respondents mentioned the privatization policy through strategic partners, general restructuring of the parastatals and introduction of regulatory bodies. The study aimed at establishing whether the set government policies favoured extensive investment to be made in the parastatals or not. As Table 3 shows, the set government policies favour extensive investment to be made in the parastatals. 60% of the respondents reported in agreement compared with 40% of the respondents who didn’t think that government policies favoured extensive investment to be made in the parastatals.

<table>
<thead>
<tr>
<th>Government policies favour extensive investment</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>21</td>
<td>60</td>
</tr>
<tr>
<td>No</td>
<td>14</td>
<td>40</td>
</tr>
<tr>
<td>Total</td>
<td>35</td>
<td>100</td>
</tr>
</tbody>
</table>

From the analyses, 60% of the respondents reported that the set government policies tend to lessen government influence on the parastatals thereby broadening shareholding that prompts extensive investment. Regulatory bodies also ensure fair play and encourage participation. On the other hand, 40% of the respondents reported that the set government policies were very harsh thereby hindering extensive investments to be made in the parastatals.
4.5 Harmonization of Policies

Analyses of the parastatals indicate that apart from the government policies, they also set their own policies to govern their management and operations. The research identified some policies set by the parastatals such as direction of investment - type, period and amounts of investment; remunerations, operational, efficiency and employment policies. The study aimed at determining whether the policies set by the parastatals are in harmony with the government policies.

The results indicate that there is harmony between government policies and policies set by the parastatals as shown in Table 4.

<table>
<thead>
<tr>
<th>Policies set by the parastatals in harmony with government's</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>19</td>
<td>54.3</td>
</tr>
<tr>
<td>No</td>
<td>12</td>
<td>34.3</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
<td>88.6</td>
</tr>
<tr>
<td>Missing</td>
<td>4</td>
<td>11.4</td>
</tr>
<tr>
<td>Total</td>
<td>35</td>
<td>100</td>
</tr>
</tbody>
</table>

54.3% of the respondents reported that the policies set by the parastatals are in harmony with the government’s policies because parastatals are government set ups and are by registration guaranteed by the government.
4.6 Generation of Investment Projects

Investment proposals of various types may originate at different levels within a firm. A system under which proposals originate with top management is referred to as a top-down system whereas one in which proposals originate at the plant and division level is referred to as a bottom-up system. Sometimes "top-down" signifies that approval authority rests with senior management. On the other hand, "bottom-up" signifies that approval rests with the lower levels (Schall and Haley, 1977). Actually, most large corporations are a mixture of both these approaches. Investment ideas emerge from below and above and authority is usually divided between senior management, which approves large projects, and division management, which has discretion up to some limit.

Research findings show that 1 to 2 investment proposals are generated in one financial year. Generation of these investment ideas usually rests with the senior management. The ministries and parastatals have set up investment departments to help ensure that viable and profitable projects are selected. Strategic measures like employing modern project evaluation and selection techniques are used. All the proposal projects are ranked and appraised on individual merit and the best selected. Despite these, it was reported that there are some challenges faced during implementation of investment projects. They include environmental issues, budget constraints, concerns of interested parties, and disagreement of senior managers on which project to finance i.e. the various departments involved.
4.7 Funding Investment Projects

The research sought to find out the sources of funds for investment projects in the parastatals. The study found out that a greater percentage (42.9%) comprises of funds from the Treasury followed by funds through bilateral arrangements (25.7%). The analyses though indicated that investment projects could be funded from multiple sources. Some were funded by the Treasury, through bilateral arrangements and even from self generated revenue. In industrialized countries, private capital plays the main role in funding the investments. The summaries of the responses from the survey are outlined in Table 5.

*Table 5: Sources of Funds for Investment Projects*

<table>
<thead>
<tr>
<th>Sources of funds</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self</td>
<td>6</td>
<td>17.1</td>
</tr>
<tr>
<td>Treasury</td>
<td>15</td>
<td>42.9</td>
</tr>
<tr>
<td>Local investors</td>
<td>3</td>
<td>8.6</td>
</tr>
<tr>
<td>Foreign investors</td>
<td>2</td>
<td>5.7</td>
</tr>
<tr>
<td>Bilateral arrangements</td>
<td>9</td>
<td>25.7</td>
</tr>
<tr>
<td>Total</td>
<td>35</td>
<td>100</td>
</tr>
</tbody>
</table>

The funds are provided in form of grants and/or loans. The loans are repaid depending on the repayment schedule and loan contracts agreed upon by the parties involved. Some respondents reported that they generate their own revenue that is used to make the long-term payments.
4.8 Factors Influencing Investment Decisions

The overall objective of this study was to establish and analyze the factors that influence investment decisions in the parastatals in Kenya. The respondents were asked to rate six factors according to the given categories. The results are presented in Table 6.

<table>
<thead>
<tr>
<th>Factors</th>
<th>Rating</th>
<th>Very common (%)</th>
<th>Common (%)</th>
<th>Uncommon (%)</th>
<th>Never (%)</th>
<th>Overall Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government policies</td>
<td>54.3</td>
<td>42.9</td>
<td>2.9</td>
<td>-</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Political interference</td>
<td>51.4</td>
<td>40.0</td>
<td>8.6</td>
<td>-</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Unclear financial framework</td>
<td>10.2</td>
<td>45.7</td>
<td>37.1</td>
<td>7.0</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Fluctuating inflationary periods</td>
<td>17.6</td>
<td>55.9</td>
<td>23.5</td>
<td>2.9</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>Poor project identification</td>
<td>17.1</td>
<td>54.3</td>
<td>25.7</td>
<td>2.9</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Technological advances</td>
<td>42.4</td>
<td>33.3</td>
<td>15.2</td>
<td>9.1</td>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>

As shown in Table 6, 54.3%, 51.4% and 42.4% of the respondents rated government policies, political interference and technological advances respectively as very common factors influencing investment decisions in the parastatals. 45.7%, 55.9% and 54.3% of the respondents rated unclear financial framework, fluctuating inflationary periods and poor project identification respectively as common. Only a smaller percentage of the firms rated the factors as being uncommon and/or rever.
Overall rank order calculations were performed based on a weighing scale with 1 (4 points) - Very common to 4 (1 point) – Never. The calculations are summarized in Table 7.

**Table 7: Order Rank Calculations**

<table>
<thead>
<tr>
<th>Factors</th>
<th>Government Policies</th>
<th>Political Interference</th>
<th>Unclear Financial Framework</th>
<th>Fluctuating Inflationary Periods</th>
<th>Poor Project Identification &amp; Implementation</th>
<th>Technological Advances</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>19 * 4 = 76</td>
<td>18 * 4 = 72</td>
<td>6 * 4 = 24</td>
<td>4 * 4 = 16</td>
<td>9 * 4 = 36</td>
<td>16 * 4 = 64</td>
</tr>
<tr>
<td></td>
<td>15 * 3 = 45</td>
<td>14 * 3 = 42</td>
<td>14 * 3 = 42</td>
<td>17 * 3 = 51</td>
<td>14 * 3 = 42</td>
<td>12 * 3 = 36</td>
</tr>
<tr>
<td></td>
<td>1 * 2 = 2</td>
<td>3 * 2 = 6</td>
<td>12 * 2 = 24</td>
<td>12 * 2 = 24</td>
<td>10 * 2 = 20</td>
<td>3 * 2 = 6</td>
</tr>
<tr>
<td></td>
<td>0 * 1 = 0</td>
<td>0 * 1 = 0</td>
<td>3 * 1 = 3</td>
<td>1 * 1 = 1</td>
<td>1 * 1 = 1</td>
<td>2 * 1 = 2</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>123</td>
<td>120</td>
<td>93</td>
<td>92</td>
<td>99</td>
<td>108</td>
</tr>
<tr>
<td><strong>OVERALL RANK</strong></td>
<td>1</td>
<td>2</td>
<td>5</td>
<td>6</td>
<td>4</td>
<td>3</td>
</tr>
</tbody>
</table>

Table 7 shows that government policies, political interference and technological advances are ranked first, second and third respectively. Poor project identification is ranked fourth, unclear financial framework fifth and fluctuating inflationary periods sixth.

The respondents were further requested to list any other factors not specified above which they think influence investment decisions in the parastatals. The factors listed included:

1. Risk and uncertainty
2. Institutionalized corruption
3. Lack of project monitoring
4. Lack of policy harmonization
5. Lack of implementation and enforcement of policy plans
6. Lack of transparency in tendering and awarding of contracts

39
4.9 Performance of the Parastatals

In seeking to determine how the parastatals are performing, the respondents’ views and levels of agreement/disagreement were sought in respect to certain selected statements. Table 8 indicates that a significantly larger proportion of respondents (68.4%) and (67.6%) agree that privatization is the key to enhancing profitability and efficiency in the parastatals and that the government should take immediate action on non-performing parastatals respectively. A relatively small percentage of the respondents (18.7%) and (14.7%) respectively are in disagreement. Conversely, a large proportion of respondents (60%) disagree that the parastatals are performing very well. Only a small fraction of respondents (17.7%) are in agreement.

Table 8: Level of Agreement/Disagreement

<table>
<thead>
<tr>
<th>Statement</th>
<th>Agree Strongly (%)</th>
<th>Agree somewhat (%)</th>
<th>Neither agree nor disagree (%)</th>
<th>Disagree somewhat (%)</th>
<th>Disagree strongly (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Privatization is the key to enhancing profitability and efficiency in the parastatals</td>
<td>32.9</td>
<td>35.5</td>
<td>12.9</td>
<td>6.6</td>
<td>12.1</td>
</tr>
<tr>
<td>The parastatals in Kenya are performing very well</td>
<td>6.1</td>
<td>11.6</td>
<td>22.3</td>
<td>31.4</td>
<td>28.6</td>
</tr>
<tr>
<td>The government should take immediate action on non-performing parastatals</td>
<td>38.2</td>
<td>29.4</td>
<td>17.7</td>
<td>5.9</td>
<td>8.8</td>
</tr>
</tbody>
</table>
4.10 Action to be Taken Incase of Non-Performing Parastatals

The respondents were requested to give recommendations to the Kenyan government on what action it should undertake in case of non-performing parastatals. The following actions were suggested:

i. Privatization
ii. Restructuring
iii. Sale/divestiture
iv. Get more efficient managers

Full privatization concerns the sale of a state corporation to one or more private companies. With full privatization, the regulation function is completely separated from the ownership and operation functions. Full privatization where it has been affected has led to improvements in performance.

Divestiture through a sale of assets or through a management buyout can be partial or complete. In the case of partial divestiture, a joint venture is created in which the government and private companies assume co-ownership and co-responsibility in managing and operating the parastatals. Both parties provide capital for investments and share in the risks as well as in the returns. Optimally, the jointly owned company should be financially independent.

A divestiture leaves the government with only the task of regulation since in theory, the private company should be concerned about maintaining its asset base. But private companies may not always take the long view. Even with an asset sale, the regulator may need to scrutinize the utility’s plans for renovating or enhancing its assets. Divestiture is
widely used across countries. Even though governments may find divestiture ideologically or even constitutionally difficult to contemplate, they should not dismiss it without evaluation. Divestiture as a strategy is most likely to be effective where local financial institutions are well developed.

4.11 Privatization Strategy

The study also sought the respondents’ views on how effective they perceived the privatization strategy being undertaken by the government is in improving profitability and efficiency in investment decisions in the parastatals. The research findings indicate that a significantly larger proportion of respondents (33.3%) and (42.4%) think that the privatization strategy undertaken by the government is very effective and effective respectively compared to a smaller proportion (18.2%) and (6.1%) who think it is less effective and ineffective in that order. This is depicted in Table 9.

<table>
<thead>
<tr>
<th>Privatization strategy Effectiveness</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very effective</td>
<td>11</td>
<td>33.3</td>
</tr>
<tr>
<td>Effective</td>
<td>14</td>
<td>42.4</td>
</tr>
<tr>
<td>Less effective</td>
<td>6</td>
<td>18.2</td>
</tr>
<tr>
<td>Ineffective</td>
<td>2</td>
<td>6.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Under the first phase of the privatization program, which was initiated in 1992, the government privatized a large number of small and medium-sized enterprises, but progress in privatizing key utilities and transportation enterprises has been slow. In
2000/01, the government accelerated the second phase of its privatization program on the basis of a new privatization strategy that emphasizes limiting the role of government in commercial activities, putting in place an appropriate regulatory framework and using competitive bidding and other modalities to ensure transparency and fairness. This is being done with assistance from the World Bank. The Kenya Posts and Telecommunications Corporation has been split into TELKOM and the Postal Authority, and a regulatory body has also been created. Moreover, a license was provided to a second cellular telephone operator to increase competition in the sector. In this context, the government has offered for sale 49% of the government's share in TELKOM.

The separation of Kenya Power and Lighting Company into power generation (KenGen) and power distribution (KPLC) is well advanced and will pave the way for the restructuring and privatization of both companies. Regarding Kenya Railways, the government decided to offer unitary concessions to private sector operators. The government's short-term strategy for the Kenya Port Authority is to improve the availability and reliability of container terminal handling equipment by refurbishment and replacement, while partly privatizing certain services of the port, including the container terminal, through a strategic partner (Letter of Intent and Memorandum of Economic and Financial Policies, July 12, 2000).

4.12 Future of the Parastatals in Kenya

The respondents were asked to give their own opinion on what they think is the future of the parastatals in Kenya. 91.2% of the respondents felt that they would be privatized so as
to step up their efficiency and to return to profit making path. 8.8% of the respondents were not very certain with some even indicating that the parastatals will be eliminated.

The Interim Poverty Reduction Strategy Paper, July 13, 2000 points out that the government is committed to removing itself from business and commercial activities in the medium term. To this end Cabinet will adopt a new privatization strategy and programme with an implementation plan that would set out the privatization transactions to be carried out with appropriate milestones. The machinery for implementing privatization will be re-invigorated and the process of privatization made more transparent. The means to enable wider citizen participation in the enterprises being privatized will be introduced.

To enhance efficiency of parastatals that would not be immediately privatized, the legal framework that at present allows Government intervention in their operations will be reviewed. The aim would be to ensure that Boards of Directors and management are given autonomy to operate within their mandate and performance requirements while being accountable and responsible for their operations. Responsibility for decision-making on cost controls, pricing and competition will be separated from those concerning the disposal and restructuring of public corporations.

4.13 Regression Analysis

The Researcher went ahead to establish whether there was a relationship between investment decisions, which was a dependent variable and factors influencing it in the
parastatals. The Researcher had suggested a model that implied that there was a linear relationship of the form:

$$ID = \alpha_0 + \alpha_1G + \alpha_2P + \alpha_3U + \alpha_4FI + \alpha_5PI + \alpha_6TA + E_t$$

Where:

ID = Investment decisions

G = Government policies

P = Political interference

U = Unclear financial framework

FI = Fluctuating inflationary periods

PI = Poor project identification and implementation

TA = Technological advances

$E_t$ is the error term and

$\alpha_0, \alpha_1, \alpha_2, \ldots, \alpha_6$ are the parameters to be estimated so as to determine the factors that influence investment decisions in the parastatals in Kenya.

After carrying out regression analysis the following linear equation was obtained.

i. $$ID = \alpha_0 + \alpha_1G + \alpha_2P + \alpha_3U + \alpha_4FI + \alpha_5PI + \alpha_6TA + E_t$$

ii. $$ID = 1.368 - 0.854G - 0.549P + 1.134U + 0.975FI + 1.422PI - 1.066TA + E_t$$

From the above linear equation, it can be deduced that there is a negative relationship between the factors afore-mentioned and investment decisions apart from unclear financial framework, fluctuating inflationary periods and poor project identification.

A correlation coefficient (R) was further calculated in order to determine how much of the dependent variable is explained by the independent variables. A correlation
Coefficient (R) was obtained as 0.693 (69.3%) implying that the independent variables explained the dependent variable 69.3%, while the remaining 31.7% is explained by other factors which were not captured by the model.
CHAPTER FIVE

5.0 CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

Based on the findings of this study, it can be concluded that investment decisions are difficult to make and that they usually affect the risk and growth of the firm. The findings of this study established that there is harmony between government policies and policies set by the parastatals. Despite this, government policies and political interference were found to be very common influential factors in investment decision making in the parastatals. Various factors though have been found to influence investment decisions in the parastatals in Kenya but with different magnitudes.

Generally the results attest that the parastatals are not performing well and further indicate that immediate action should be taken to help bail out the ailing parastatals. The study has pointed out that non-profit making parastatals should not be kept afloat by government subsidies. The study has also established that privatization is the key to enhancing efficiency and profitability in the parastatals.

5.2 Limitations of the Study

The results of this study should be interpreted in the light of some limitations. The study was constrained by the following limitations:

i. It was very difficult to convince the respondents to fill in the questionnaire completely as they regarded most information requested as confidential. Thus some questions were left blank and yet the sample size was relatively small.
ii. It took a lot of time in getting back the questionnaires because the respondents were very busy. Some respondents did not even submit back the questionnaires. Consequently, the generalization of the results of this study must be done with caution, since some samples may not be representative of the parastatals in Kenya.

5.3 Recommendations and Suggestions for Further Research

The Kenyan government must act swiftly in a move to help curb the non-performing state of the parastatals. Policy formulation must focus on creating an environment that encourages the seeking and development of new sources of funding parastatals. Policy formulation should therefore be flexible enough in the provision of funding for the establishment and maintenance of the parastatals. Programs should also be introduced that will increase managerial autonomy and accountability.

This study concentrated only on factors influencing investment decisions in the parastatals. Further studies could endeavor to investigate factors influencing investment decisions in the informal sector. It would be interesting to adjust the questionnaire appropriately so as to gain knowledge on challenges faced in the informal sector. Further additional research can be performed on finding ways to overcome the challenges defined in this study. To illustrate, the research may expand the sample size and/or conduct research that deals with the limitations of this study. Moreover future research effort may be carried out using different data analysis techniques for comparison.
REFERENCES


Porwal, L.S. (1976), Capital Budgeting in India, Sultan Chand.


The East African Standard, March 23, 1999


APPENDIX I

SPECIMEN LETTER TO THE RESPONDENTS

KENYATTA UNIVERSITY
SCHOOL OF HUMANITIES AND SOCIAL SCIENCES
DEPARTMENT OF FINANCE
P.O. BOX 43844.
NAIROBI.

To the Respondent,

RE: REQUEST TO CONDUCT A STUDY.

I am a postgraduate student researching on the topic "Factors Influencing Investment Decisions in the Parastatals in Kenya."

You have been selected as one of the respondents in this study. I would like to request you to complete the questionnaire. The information supplied will be used strictly for academic purposes only and will be treated with utmost confidentiality.

Your cooperation will be highly appreciated.
Thank you.

Edith N. Wamalwa.
APPENDIX II

QUESTIONNAIRE

Background information
Name of the Ministry/Parastatal
Department
Year of Incorporation/Establishment (for Parastatals)
Title/Position of Respondent
Number of years employed in the Ministry/Parastatal

Please answer the following questions by placing a tick in the boxes or fill in the blank spaces provided.

1. Investment decisions are among the firm’s most difficult decisions to make.
   - I strongly agree [ ]
   - I agree [ ]
   - I disagree [ ]

2. (i) Investment decisions usually affect the risk of the firm and influences the firm’s growth in the long run. Do you support this claim?
   - Yes [ ]
   - No [ ]
   (ii) If no, give your view.

3. Which policies have been set by the government regarding the establishment and management of the parastatals?
4. (i) Do you think the set government policies favour extensive investment to be made in the parastatals?

Yes [ ]

No [ ]

(ii) Give reasons for your answer above.

--------------------------------------------------

5. (i) Are there any policies set by the parastatal?

Yes [ ]

No [ ]

(ii) If yes, which ones are they?

--------------------------------------------------

6. (i) Do you think the policies set by the parastatal are in harmony with the government’s policies?

Yes [ ]

No [ ]

(ii) Give reasons for your answer above.

--------------------------------------------------

7. How many investment proposals do you come up with in one financial year?

(1-2) [ ]

(3-5) [ ]

(6 and over) [ ]
8. Who generates investment ideas in your Ministry/Parastatal?
   Senior management [ ]
   Plant and division level management [ ]
   Both [ ]

9. What measures have been taken by your institution/firm to ensure that profitable and viable projects are selected?


10. What challenges do you face during implementation of an investment project?


   Self [ ]
   Treasury [ ]
   Local investors [ ]
   Foreign investors [ ]
   Bilateral arrangements [ ]
   Others (Specify)

12. (i) Are the funds provided in form of grants or loans?

(ii) Specify any other form not indicated in (i) above.

13. How are the loans repaid?


54
14. (i) Some of the factors influencing investment decisions in the parastatals in Kenya are given below. Please tick appropriately according to the order you feel is more appropriate.

<table>
<thead>
<tr>
<th>Factors influencing investment decisions</th>
<th>Very Common</th>
<th>Common</th>
<th>Uncommon</th>
<th>Never</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government policies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political interference</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unclear financial framework</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fluctuating inflationary periods</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poor project identification and</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>implementation</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technological advances</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(ii) Specify any other factors if any and rank them accordingly.

<table>
<thead>
<tr>
<th>Factors influencing investment decisions</th>
<th>Very Common</th>
<th>Common</th>
<th>Uncommon</th>
<th>Never</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

15. Please indicate your level of agreement/disagreement with the following statements?

<table>
<thead>
<tr>
<th>Statement</th>
<th>Agree strongly</th>
<th>Agree somewhat</th>
<th>Neither agree nor disagree</th>
<th>Disagree somewhat</th>
<th>Disagree strongly</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Privatization is the key to enhancing profitability and efficiency in</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>the parastatals.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. The parastatals in Kenya are performing very well.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. The government should take immediate action on non-performing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>parastatals.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
16. What action would you recommend to the Kenyan government to undertake in case of non-performing parastatals?

17. Generally, how effective do you think the privatization strategy undertaken by the government is in improving profitability and efficiency in investment decisions in the parastatals?
   - Very effective [ ]
   - Effective [ ]
   - Less effective [ ]
   - Ineffective [ ]

18. What do you think is the future of parastatals in Kenya?
APPENDIX III

TIMETABLE OF EVENTS

(a) Plan of Activities

<table>
<thead>
<tr>
<th>Activity</th>
<th>Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Pilot study</td>
<td>One week</td>
</tr>
<tr>
<td>2. Data collection</td>
<td>Five weeks</td>
</tr>
<tr>
<td>3. Data coding</td>
<td>Six weeks</td>
</tr>
<tr>
<td>4. Data analysis</td>
<td>Seven weeks</td>
</tr>
<tr>
<td>5. Report writing &amp;</td>
<td></td>
</tr>
<tr>
<td>Compilation</td>
<td>Five weeks</td>
</tr>
</tbody>
</table>

(b) Schedule of Activities

<table>
<thead>
<tr>
<th>PHASE</th>
<th>DESCRIPTION</th>
<th>NUMBER OF WEEKS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>I</td>
<td>Pilot study</td>
<td></td>
</tr>
<tr>
<td>II</td>
<td>Data collection</td>
<td></td>
</tr>
<tr>
<td>III</td>
<td>Data coding</td>
<td></td>
</tr>
<tr>
<td>IV</td>
<td>Data analysis</td>
<td></td>
</tr>
<tr>
<td>V</td>
<td>Report writing &amp;</td>
<td></td>
</tr>
<tr>
<td>Compilation</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

NOTE: Some activities overlap so that the same time used for one activity may be used for another activity.
# APPENDIX IV

## BUDGET

<table>
<thead>
<tr>
<th>ITEM</th>
<th>KSHS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Proposal writing</strong></td>
<td></td>
</tr>
<tr>
<td>(i) Travelling expenses</td>
<td>3,500</td>
</tr>
<tr>
<td>(ii) Typing and Printing 26 pages @ 30/=</td>
<td>780</td>
</tr>
<tr>
<td>(iii) Photocopying 5 copies @ 3/= per page</td>
<td>390</td>
</tr>
<tr>
<td>(iv) Binding 5 copies @ 80/=</td>
<td>400</td>
</tr>
<tr>
<td>(v) Miscellaneous</td>
<td>5,500</td>
</tr>
<tr>
<td><strong>Sub-Total</strong></td>
<td><strong>10,570</strong></td>
</tr>
<tr>
<td><strong>2. Estimated cost of project</strong></td>
<td></td>
</tr>
<tr>
<td><strong>a. Data Collection and Analysis</strong></td>
<td></td>
</tr>
<tr>
<td>(i) Typing and printing 5 pages of questionnaire @ 30/=</td>
<td>150</td>
</tr>
<tr>
<td>(ii) Photocopying 40 copies @ 3/= per page</td>
<td>600</td>
</tr>
<tr>
<td>(iii) Traveling expenses</td>
<td>5,500</td>
</tr>
<tr>
<td>(iv) Computer entry and analysis</td>
<td>6,000</td>
</tr>
<tr>
<td>(v) Researcher</td>
<td>9,500</td>
</tr>
<tr>
<td>(vi) Stationery</td>
<td>5,800</td>
</tr>
<tr>
<td><strong>Sub-Total</strong></td>
<td><strong>27,550</strong></td>
</tr>
<tr>
<td><strong>b. Production and Final Document</strong></td>
<td></td>
</tr>
<tr>
<td>(i) Typing and Printing 80 pages @ 30/=</td>
<td>2,400</td>
</tr>
<tr>
<td>(ii) Photocopying 5 copies @ 3/=</td>
<td>1,200</td>
</tr>
<tr>
<td>(iii) Binding 6 copies @ 300/=</td>
<td>1,800</td>
</tr>
<tr>
<td>(iv) Miscellaneous</td>
<td>12,000</td>
</tr>
<tr>
<td><strong>Sub-Total</strong></td>
<td><strong>17,400</strong></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>55,520</strong></td>
</tr>
</tbody>
</table>