

## A CRITICAL ANALYSIS OF THE USE OF THE MERGER STRATEGY ON GOVERNMENT PARASTATALS IN KENYA

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### ABSTRACT

**T**here are many advantages that come with the application of the merger strategy, but at the same time, there are disadvantages that come with it. The disadvantages are not building blocks to success of government parastatals with respect to parastatals mergers. As will be seen from the study below, mergers have a short-term and long-term effect with respect to job-losses. This will mostly affect the semi-skilled work-force, whereas the highly-skilled workforce and the managers will be forced to take pay-cuts. This will definitely have an effect on the standards of living of those affected in the process.

At the same time, the research reveals that, the merger strategy on government parastatals will bring about the issue of nepotism and ethnicity in the merged parastatals. It will affect many and will make the getting of services purely on tribal basis and on the 'who-knows-who' basis. This is a great hindrance to the development of any nation, and will definitely be of great hindrance to the development of Kenya as a nation. The ugly head of corruption will also be witnessed when the government merges the parastatals. Corruption has been known to run institutions down, and the same is likely to be witnessed by the Kenyan government in its bid to reduce the number of parastatals through the merging strategy.

**KEY WORDS:** Merger strategy, Job-Loss, Corruption, Nepotism, Ethnicity.

## 1.0 INTRODUCTION

State enterprises are universal phenomena in the economic systems of developing and developed countries, and they were created in most countries to accelerate economic and social development (G.O.K report 2013). By way of looking at how countries thrive to increase the market value of the goods and services produced in their countries through the process of industrialization, then it is possible to analyze the roles of these state corporations in national development.

From the 1980s, S.Cs have been highly criticized due to their poor performance. It has been argued that, the reason for their poor performance is excessive political interference as well as poor management interests (autonomy). At the same time, these enterprises were taking up huge government funds through subsidies, and this was being done at the expense of other government programmes. According to the report, by 1980, the fiscal burden of these enterprises was at all time highs, and had greatly contributed to the general decline of the fiscal situation in the country. The political situation in the country, and the interference that came with it, made the setting of the objectives for the enterprises, and the evaluation later on, very hard to accomplish. With changing technologies, the globalization of financial markets, and more demand for international trade to take-up, there was more demand for the state enterprises to ease their ways of doing businesses, be more free and flexible than they were at the time, which was a very difficult task for the state corporations.

A Presidential Review Committee (P.R.C) on South African Public Enterprises was set-up, to look into ways in which the Kenyan State-Owned Enterprises (S.O.Es) can be improved, by internationally bench-marking them against the South African Public Enterprises. Through their report, various approaches had been suggested for the overall evaluation of the state enterprises, which intern argued in the favor of mergers and privatizations. First, these include profit-ratios in terms if financial and social aspects and this was to be done using the accounting prices. Second, is the global assumption of the change from state to private ownership of public enterprises, and will the involvement of the debate as to whether it is competition or ownership change from private to public that will matter the most when it comes to the growth of economic efficiency. The third suggestion was to look at how state-owned enterprises are run, and whether a change in management practices in public enterprises at both state and enterprise level leads to their improvement.

Globally, over the years, there has been a change in the way in which the S.O.Es have been run and managed. This has led to general principles and practices being formulated and practiced in different parts of the world. The principles are driven principally by the global pursuit of good corporate governance necessary for viability and sustainability (G.O.K report, 2013). Globally, the Organization for Economic Co-operation and Development (O.E.C.D) is responsible for championing the creation of principles of several governments in regard to S.O.Es. Over the years, these principles have been taken-up and localized by different countries that are members and non-members of the O.E.C.D.

A look at state-corporations in countries like Australia, China New Zealand, Singapore and South Africa, and a review of their management, shows that, they are run using the principles that have been described by O.E.C.D. South Africa, for example, that is also a member of the O.E.C.D, has localized the guidelines stated by the O.E.C.D on governance of the state corporations into their own local situation, with the whole aim of addressing the local challenges that may arise (G.O.K report, 2013). Kenya experienced reasonably high economic growth during the first two decades after Independence, leading to significant improvements in livelihoods (Bird & Karira, 2009).

In attempts to address management issues that may arise, and their overall performance, countries like South Africa and China, which are both members of the O.E.C.D, have embraced performance contracting as a key tool to the general management to their S.O.Es (G.O.K report, 2013). They have fine-tuned the performance contracting data-capture, monitoring and evaluation systems, and have improved on the ways in which appointments are made, what rewards are made, the incentives and sanctions that are in place. It is therefore key for Kenya to take-up and implements the best practices that will ensure that the state corporations maximize on the available resources and reach their full potential over the years.

There is a crucial part played by mergers in the industrial development of any sector of the economy. Over the years, there have been numerous merger deals taking place. These mergers have resulted in the privatization of public enterprises across the world, for example, Europe, China and Brazil, and also in North America. In these respective countries, the distinct characteristics are mostly the rise of public equity funds.

### **1.2 Statement of the Problem**

Over the years, Kenya government has been running a total of two hundred and sixty two parastatals. However, as a follow-up to a government directive made in the 1980's to reduce the number of parastatals in the country, recently, a team of experts handed in a report to the president, and part of their recommendation concerning the running of the Kenya S.Cs is that, some of these parastatals should be merged., trimming down their numbers from the two hundred and sixty two to one hundred and eighty seven (Omondi, 2013). These, according to Omondi, was for the reason of effective and complimentary engagement between the state and the market, and at the same time, make policy-making, regulation and service delivery roles clear and efficient. This directive may be advantages and disadvantageous when it comes to the application of merger as a strategy in the S.Cs, and as much as there are advantages that come with the merger strategy, there are several disadvantages that may accompany it, and are key and should be highly considered before the merger processes is considered and undertaken. This paper therefore sets to examine the ups and downs that will come with the use of the merger strategy of the parastatals by Governments, and give reasons as to why such factors should be taken into consideration before the merger strategy is undertaken by these government institutions, and it will be a case study of the mergers of Kenyan Parastatals.

### **1.3 Justification and Significance of the Study**

One of the main areas that the Kenyan government needs to focus on more so as to accomplish the goal of growth in Vision 2030 is through growth in employment ratios. There is also the need to eradicate some vices in the society such as corruption, ethnicity, and nepotism. This will help bring about unity in the country, and in the process, growth of the economy. At the same time, the country will also grow from being a 'third-world' nation to being a 'second-world' nation. However, this progress may be either promoted or hindered by the use of the merger strategy by the Kenyan government in the merger of parastatals from the current two hundred and sixty two to the proposed one hundred and eighty seven. This paper therefore seeks to shed more light on the advantages and disadvantages of this specific strategy, and therefore, the document will be of significance to the following:



## 2.0 LITERATURE REVIEW

### 2.1 Mergers, Job-loss and Lower Standards of Living

Over the last two decades or so, there has been a rapid growth in the unemployment levels across the world, and this was more-so witnessed by member countries of the European Union (E.U). The high labour adjustment costs in Europe have long been held responsible for this poor labour market performance, which has been termed as 'Euro sclerosis' (Gugler & Yurtoglu, 2003). According to Gugler and Yurtoglu, the studies that analyse the effects of adjustment costs on demand for labour around the world, mostly find that, the U.S labour markets adjust more quickly to economic shocks than its European or Japanese counterparts. This statement had previously been proposed by Balakrishnan & Michelacci (2001), who found out that, most differences that arose in the dynamics of unemployment were mostly due to the different ways in which countries responded to economic shocks. Studies in the European markets and in the U.S market by Gugler & Yurtoglu (2003) indicate that, mergers have different effects as to how the labour market is demanded, more-so in the U.S and European markets. This is mainly because, these firms, especially the ones in the U.S, do not need the restructuring effects of mergers to enable them adjust to the economic shocks in the countries.

Mergers are usually considered as major steps undertaken as companies and entities in their existence, and mergers are usually accompanied by major restructuring or even closure of certain departments within the combined entity (Gugler & Yurtoglu, 2003). The already existing management team is likely to be situated with a new management group, and the new team will mostly rely on the fulfilling of the new contracts than accomplishing on the previous contracts the organization had with the stakeholders (Shleifer & Summers, 1988). Conyon et al. (2002 a, b, c) reveal that, mergers and acquisitions greatly decrease the rate at which labour in the market is demanded, and this was specifically true in the U.K in the subsequent years in which a merger and acquisition had taken place. Through the authors' analysis, there seems to be a direct relationship between a reduction in the labour force in the organization and merging of organizations.

Most of the literature available is on the effects that the merger strategy has on corporate organizations, and very little has been written on how this strategy has an effect on government-run parastatals and entities. There is little evidence on the change in the composition of employees in plants after ownership change apart from evidence on the average skills composition of employees (Balsvik & Haller, 2012). Studies carried out in Finland reveal some changes in the skills composition, and this is mainly due to the decrease in the number of skilled and semi-skilled workers that the organizations have after the merger process has taken place (Almeida, 2007). Balsvik & Haller (2012), however, argue that, although the composition of these average skills does not fluctuate a lot, this could greatly reflect on the changes that could be present in terms of the employees who work in the organization before and after the merger and acquisition process has taken place. Lichtenberg & Siegel (1900) in their studies found out that, job-loss due to mergers is mainly restrained to the central office staff. However, this argument has since been heavily contradicted by Heyman et al. (2011), when they argued that, there can be no comparison on the extent of staff turn-over once a merger has taken place, as compared to other times when there was no ownership change. Balsvik & Haller (2012) carried out further studies and they concluded that, there is rich evidence on excess turnover in the subsequent years to the change in ownership due to either a merger or an acquisition. The study goes ahead to reveal that, there is a high probability of one losing their job, especially for the semi-skilled workers, and the resignation of the highly-skilled workers before a domestic to domestic ownership change may occur. This may particularly be true when different parastatals in Kenya are merged, as there is the risk of losing the highly-skilled manpower, as well as job-losses for the semi-skilled labour force. At the same

time, even for the workers who will be left after the merger process has taken place, there is expected to be a reduction in the wages earned; but this is not expected to apply for the highly-skilled workers of these newly-formed parastatals. This theory is highly supported by Siegel & Simons (2010) who found out that, even though employees in firms that had been subjected to the merger process earn higher wages than those not subjected to the merger process (that is, two years before the merger to the year of the merger), they also discover that, wages decrease from the period before the merger to that after the merger. This results in the standards of living enjoyed by the existing employees to drop significantly. Heyman et al. (2011) in their study on Sweden using the employer-employee data, examined the various effects of mergers and acquisitions on a number of employees who ranged from various groups. They concluded that, wages will tend to be higher for the top management after the merger and acquisition process, but the trend is reversed for the medium and lowly-skilled employees who will either get huge pay-cuts or end-up losing their jobs. This has both a short term and long term effect on the standards of living of those whose lives have been directly or indirectly affected by the merger process, and this is expected to happen to the employees of the Kenyan parastatals that are expected to be merger.

## 2.2 Mergers, Ethnicity and Nepotism

According to Mbai (2003), ethnicity (or tribalism) can be defined as the act of having a common consciousness of being one in relation to the other group; whereas nepotism involves the use of friendships or blood relations criteria to distribute or disperse public service. The Oxford Advanced Learners dictionary defines the term 'Ethnic' as that which is connected with or belongs to a nation, race or tribe that shares a cultural tradition; and 'Ethnicity' as the fact of belonging to a particular tribe. Nepotism has been defined as the act of giving unfair advantages to your own family, especially if one is in a position of power, mostly by giving them jobs.

In Africa, ethnicity has a very strong power, and has been known to be of very strong powers that it can 'move mountains' (Akuloba, Gumo & Omare, 2012). The authors noted that Talcott Parson had earlier on talked about the emancipation of individuals of all categories from what he called *diffuse particularistic solidarities*, which basically meant ethnicity.

During the colonial era in Kenya, tribe was not only a measure of administrative units, but was used to show and rank the different characteristics that one tribe had in regard to the others. This intern was what colonialists and missionaries alike used in their process of ensuring that Africans were managed administratively in the European's respective colonies. This policy was drummed-up by a Kenyan by the name of Tom Mboya, who asserted that:-

*“The European colonial powers and even missionaries for a long time tended to build-up tribal antagonisms. It made it easier to influence people, if they could find an amenable tribe to use it against another, which was hostile”*

It is often admitted that more than the colonial administration, the post-independence political leadership in Africa has exploited ethnic differences in earnest in order to maintain themselves in positions of power (Akuloba et al. 2012). This also applies to other parties that want to remain in other positions that are powerful, and that may not necessarily be political in nature. Many people in reality, especially those in Africa, have benefited in one way or another from this ethnic and nepotism monster. For example, ethnicity and nepotism has assisted many to get good houses in towns, to get postings to good jobs, to occupy

powerful offices, and also to rise up the ranks in their respective jobs. To those who benefit from the vice, ethnicity and nepotism may be okay and acceptable. However, the reality of the matter is, it has led to outright discrimination among the people; and is an outright denial of people off their democratic rights of equality and justice.

In Kenya, ethnicity and nepotism always reveal their ugly head when it comes to almost all aspects of human life. Akuloba et al. (2012) noted that, ethnic-based thinking is a big challenge, and is usually a threat to any kind of development and advancement, and is at times considered to be slightly less dangerous than poverty, diseases and illiteracy. Majority of the Kenyans only deny to have been involved in ethnicity and nepotism acts verbally; however, the two vices are prominent features in the society, and affect matters that involve the society, that is, political, religion, education, employment, and even to some extent, development of the nation.

In cases of employment, many Kenyan citizens who qualify to be employed are usually left-out (especially when it comes to government parastatals). This is because, they fail to know the 'who-is-who' in the government, or even worse, and they fail to be of the same ethnic community as the parastatal bosses and chiefs. Namwaya (2006) noted that, majority of those holding powerful government positions in Kenya have been observed to be filling the employment positions in their ministries and parastatals with their relatives and constituents who are close associates. In these scenarios, the people who are usually narrowed-down for the jobs are those close relatives and those not known to them or are not from their ethnic community are left-out. Such is what is expected to be experienced when the Kenyan parastatals are merged, and the number of parastatal bosses reduced. This will act as an avenue for them to recruit, train and employ employees, and their criteria will be based on nepotism and tribalism factors.

In the African context, where Kenya is apart, nepotism and ethnicity binds people close together, even more than other societal features such as religion. This fact is what leads to its' eradication being more of a verbal norm than an actual activity. Ethnicity, and even narrower, nepotism, have an effect on the society in terms of development; and in cases of most African states, it eventually leads to the growth of corruption, as will be discussed in the following chapter.

### **2.3 Merger and Corruption**

The study of corruption usually faces many challenges, and one of the biggest challenges is defining the term 'Corruption' itself. The same had been proposed earlier by Jain (2001) who suggested that, although it is difficult to agree on a precise definition on corruption, there are consequences that corruption refers to that talk about the acts in which the power of the public office is used for personal gain in a manner that contravenes the rules of the game. However, Myint (2000) defined corruption as 'the use of public office for private gain'. This therefore means that, the act of abusing one's personal official position, stature, or even rank for their own personal gain, can be termed as corruption. This may entail carrying-out such vices as:- bribery, extortion, fraud, embezzlement, nepotism, cronyism, appropriation of public assets and property for private use, and influence peddling (Myint, 2000).

From the above list of corruption vices, it can be seen that some corruption practices can be more of a 'one-man show' where the practice can be carried out without the involvement of other parties other than the officials themselves. An example of this is fraud and embezzlement of funds. On the other hand, other corruption practices involve the presence of other parties for them to be successful, and this includes:- bribing, extortion and cronyism. In this chapter, focus will be on those specific practices where those in public offices and hold top positions, bureaucrats, and politicians use their authority that they have been

delegated upon them badly to better their own economic status at the expense of others. These activities, as will be seen, will lead to two scenarios playing out, that is, imprisonment of individuals since this is an illegal activity, while on the other hand, may lead to a strong dislike for the individual involved in the vice by the public.

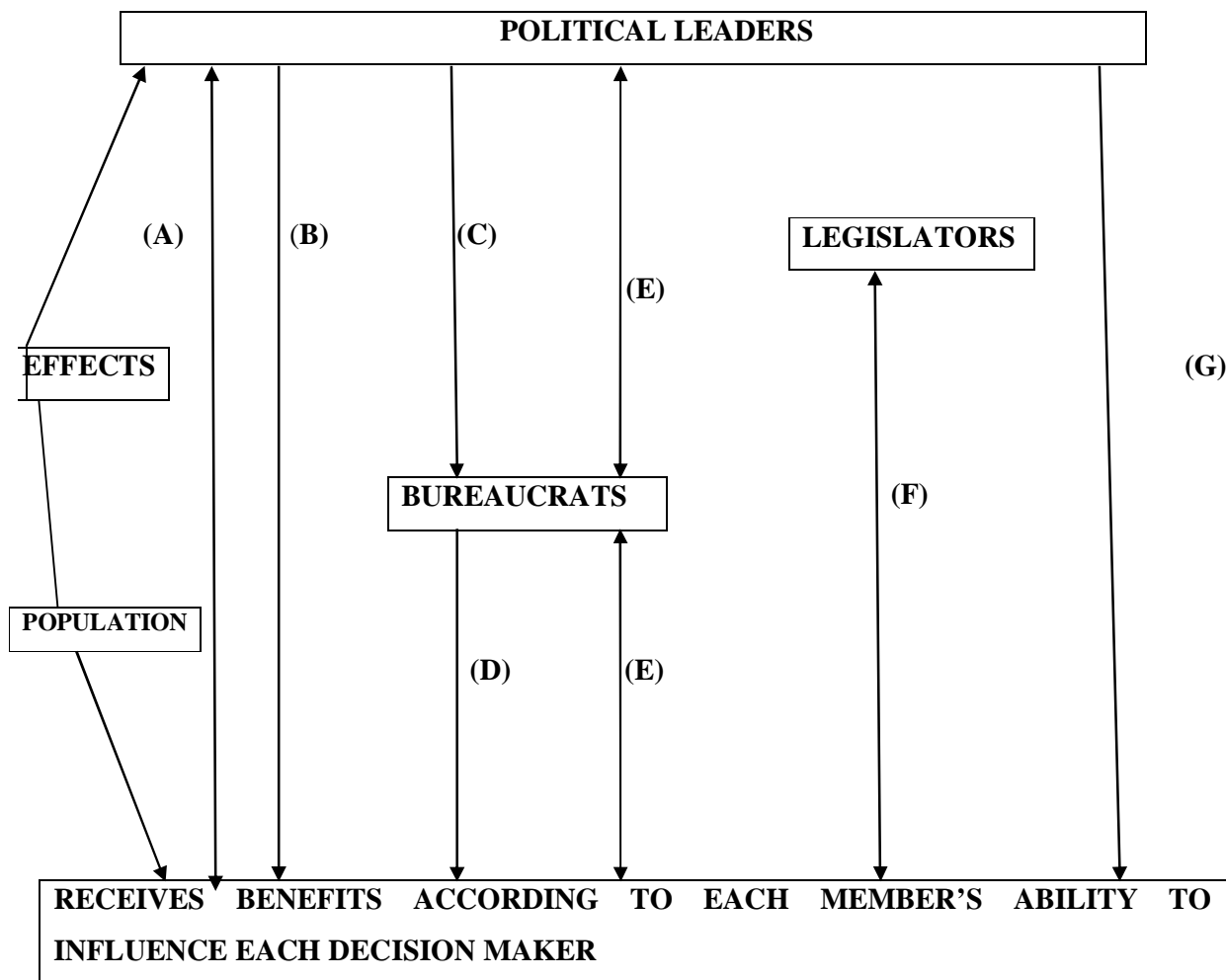
Corruption was the buzz word for the National Rainbow Coalition (Narc), and the Party of National Unity (P.N.U), the winning parties during the 2002 and 2007 national presidential elections campaigns in Kenya respectively (Ngunjiri, 2010). However, John Githongo, who was once the Permanent Secretary in-charge of Ethics and Anti-corruption, studied and analyzed corruption in Kenyan offices, and from his findings, he described it as being a systematic and it easily diffuses across all departments and offices in Kenya. A study carried out by Transparency International (T.I) on Corruption Perception Index (C.P.I) as at 2008 revealed that, Kenya was ranked at the lower scale, that is, at the lower twenty percent (20%) of all nations classified. From this high rank in terms of corruption cases, the general public now views the government offices to be highly corrupt offices. A survey that was carried out by World Bank and the Kenya Institute of Public Policy Research showed that, graft still oiled the wheels of doing business in Kenya, and that half of the firms that were involved in the survey revealed that they had been asked for a bribe by senior public officials in the previous year (Ngunjiri, 2010).

World Bank carried out a research on the world's poorest nations in 1996, and Kenya was highly ranked at position 17. The C.P.I that was carried out in 2008 revealed that of all the East African nations, Kenya was perceived to be the most corrupt. Corruption in the country has been a very big deal where in 1997, the International Monetary Fund (I.M.F) suspended Kenya and never sponsored Kenya's enhanced Structural Adjustment Program. This is mainly due to the fact that the government at the time was reluctant to carry-on with guided reforms and curbs corruption and deal with corruption cases adequately.

There are different types of corruption cases. However, three types are most distinct, and they are:- Grand corruption, Bureaucratic Corruption and Legislative corruption. Grand corruption is the type of corruption where an individual uses their political elite where they exploit their power to make economic policies (Jain, 2001). Since politicians are elected or if not, through the role entrusted on them of being societal guardians, they are required to come-up with ways of distributing their resources and they should mainly have the interests of the populace in their mind (Krueger, 1993). However, corrupt politicians may result in the altering of national policies or enacting policies that will only benefit them at the cost of others. According to Porta & Vannucci (1997), public spending is divested to those sectors where gains from corruption are greatest and little attention is paid to whether the needs of the collectivity are served by these works or services. This type of corruption case has dire consequences on the society.

Bureaucratic corruption is where one uses corrupt practices when dealing with either their superiors, the public or both; and they themselves are appointed bureaucrats(Jain,2001). In this kind of corruption, public citizens may be asked to produce a bribe so that they can get a service that is entitled to them, or speed-up a certain process, so that things may be done faster than usual. This may even be extended to the receiving of specific services that they are not supposed to receive.

Legislative corruption looks at the ways and extent to which the voting behaviour of legislators can be influenced (Jain, 2001). Corruption of this nature may likely feature 'vote buying' and this is by the legislators (when they wish to be elected again) and some officials. When they want to have an individual of their own enacted (Rose-Ackerman, 1998; Rose-Ackerman, 1999). These three types of corruption cases can be seen in the diagram shown below:-



**Fig. 1 Corruption Relationship in a Democratic Society**

Adopted from Jain (2001).

**Key:**

**(A)- Grand Corruption**

**(B)- Make Public Policy**

**(C)- Appoint**

**(D)- Provide Services**

**(E)- Bureaucratic Corruption**

**(F)- Legislative Corruption**

**(G)- Enact Laws**

Corruption has a huge effect on the economic development of Kenya as a nation. This is mainly because, through corruption, there is misallocation and misappropriation of the resources within the country, including funds. This has an effect on the economy in that, through these corrupt systems, the regular systems are denied the opportunity to receive services from the government. The short and long term effects of this are that, they end-up not trusting the government, and hence, there is no interaction between the government and its citizens. As these people have to get things done, they create their own ways of doing things such as to resolve disputes and/or enforce contracts or get ways to circumvent the rules and laws (Ngunjiri, 2010). Merger of parastatals in Kenya will lead to an increase in the corruption cases that will have effects as stated above. This will be one of the short-term and long-term effects of the merging of parastatals in Kenya.

### **3.0 CONCLUSION AND RECOMMENDATIONS**

There are many advantages that come with the application of the merger strategy, but at the same time, there are disadvantages that come with it. The disadvantages are not building blocks to success of government parastatals with respect to parastatal mergers. As seen from the above study, mergers have a short-term and long-term effect with respect to job-losses. This will mostly affect the semi-skilled work-force, whereas the highly-skilled workforce and the managers will be forced to take pay-cuts. This will definitely have an effect on the standards of living of those affected in the process.

At the same time, the research reveals that, the merging strategy will bring about the issue of nepotism and ethnicity in the merged parastatals. It will affect many and will make the getting of services purely on tribal basis and on the 'who-knows-who' basis. This is a great hindrance to the development of any nation, and will definitely be of great hindrance to the development of Kenya as a nation. The ugly head of corruption will also be witnessed when the government merges the parastatals. Corruption has been known to run institutions down, and the same is likely to be witnessed by the Kenyan government in its bid to reduce the number of parastatals through the merging strategy.

In view of this, the following recommendations have been put forward:

- I. The government should re-deploy most of the workers that were working previously in the merged parastatals. This should be done in a fair and just manner.
- II. The government should come up with the option of 'voluntary-retirement', and those who decide to take it up should be given all their dues plus hefty allowances. At the same time, the retirement age should be brought forward, from the current sixty years to fifty five; and those who have attained this age should be retired and given good retirement benefits. All this is in the opposition of retrenchment.
- III. For the retained workers, their benefits should not be slashed. Their salaries should not be reduced, and they should be motivated more in terms of more allowances.
- IV. The government should strengthen its stand on Corruption, Nepotism, and Tribalism, especially in its offices; and those found guilty of the same vices should have strong disciplinary action taken upon them.

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