PUBLIC ENTERPRISES IN REFORM AND PRIVATISATION IN KENYA

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Kenya's PE Background

In Kenya, as in most developing countries, the period after independence was marked by a deliberate policy of direct participation by the Government in production and trade over and above the control structures inherited from the colonial regime. A variety of social, economic and political objectives were set, including decolonisation, rapid development, the redress of regional imbalances, increased participation by Kenyan citizens in the economy and promotion of indigenous entrepreneurship. In addition to the Government's desire to participate directly in the production and trade sectors of the economy, private investors (particularly foreigners) sought government participation in joint ventures to ensure continued government support for such ventures.

Later, another category of Public Enterprises, Development Finance Institutions, (DAIS) were created to provide financing for development projects unable to obtain financing from conventional private sector sources. Similarly, investments made in enterprises by the Government, in its role as trustee for Kenyans who were not endowed with risky capital resources or the necessary entrepreneurial skills at the time of independence, became permanent holdings by the Government due to a lack of a conscious effort to divest those investments to citizens as they became wealthier and gained business skills.

During the 1970s, it became increasingly apparent that government participation in the economy had grown well beyond the Government's original intentions. Furthermore, a large debt exposure among PEs resulted in increased vulnerability. This caused PEs to be highly leveraged because of their static equity base. Operating losses and inadequate returns on investments further eroded the already weak capital bases of the PEs.

The resultant administrative and regulatory interventions introduced to protect the ailing PEs resulted in a diversion of limited managerial capabilities and resources from the fundamentally more important areas of policy, infrastructural investment, development of social services and the management of the economy.
While the creation of the PEs was perhaps appropriate at independence, the changed circumstances, together with poor performance record of the PEs, have mandated the need to review continued government participation in them and/or the macro-economic policy environment, and the sectoral policies as well as enterprise-specific policies in which the PEs operate.

Past Efforts to Improve Performance of Public Enterprises

The Government of Kenya has made a number of attempts in the past to improve PE sector performance. In 1979, following the publication of a government report on parastatals, the Parastatal Advisory Committee was formed. At the same time the Government enlarged the role of the Inspectorate of State Corporations to serve as a troubleshooting, management audit and consulting service for parastatals.

In 1982, the Government released the findings of a Working Party on Public Expenditure, which detailed many serious deficiencies in the financial and economic performance of PEs. The report suggested a series of reforms and proposed the possibility of reducing the role of PEs and replacing it with increased private sector activity. As a result of the Working Party Report, direct budgetary transfers to the PEs were severely restricted, declining from Kshs.1.12 billion in 1982 to Kshs. 0.36 billion in 1984. Ironically, the resulting gap was at first financed by flows from the banking system, which increased from Kshs. 0.16 billion in 1982 to Kshs.1.2 billion in 1984, thus neutralising the intended effect of making capital available for productive new investment instead of propping up ailing public sector ventures.

By the fiscal years 1989/1990 and 1990/91, however, the flow of funds from the Government to PEs had returned to the 1982 levels.

Piecemeal Reform Attempts

Past efforts by the Government to improve the performance of PEs was coupled with reform measures. However, these reform measures followed a firm-by-firm approach. As a result the progress towards reform of the PE sector has been slow and unco-ordinated. The need for a comprehensive PE reform programme with well identified core elements and clear policy guidelines has therefore become apparent.

It is in the light of these experiences that the Government of Kenya has recently come up with a comprehensive PE reform and privatisation programme.

PE reform includes all restructuring and operations rationalisation measures aimed at
making the PE sector viable while privatisation and divestiture involve the transfer of a function, activity, organisation or investment holding from the public to private sector.

**Kenya's PE Reform and Privatisation Programme**

The Government of Kenya is now in the process of implementing a comprehensive PE reform programme whose overall aims have been spelt out as:

(i) enhancing the role of the private sector in the economy by shifting more of the responsibility for production and delivery of goods and services from the public to the private sector; to create a more level playing field by eliminating preferential treatment, including monopoly rights; and to enable the private sector to enter the areas of activity of the PEs on an equitable basis;

(ii) reducing the demand of the PE on the Exchequer so as to improve the use of Kenya's scarce resources, and to enhance the returns on those resources by achieving greater efficiency in both private and public enterprises through greater responsiveness to market signals and commercial criteria;

(iii) reducing the role and rationalising the operations of the PE sector;

(iv) improving the regulatory environment by selecting more economically rational means of regulation, thereby reducing conflicts of interest between the regulatory and commercial functions of PEs that are consistent with government policy;

(v) broadening the base of ownership and enhancing capital market development.

**Scope of PE Reform and Privatisation**

There are about 240 commercially oriented PEs with direct or indirect government ownership. Of these, the Government has designed 33 PEs as strategic enterprises and intends to retain its ownership and active Board participation in them for the time being. The remaining 207 PEs have been classified as non-strategic enterprises and constitute the Government's privatisation programme.

The Government has defined PEs as 'strategic' if they provide essential services or are considered to play a key role from the viewpoint of national security, health and protection of environment.

The Government has also stated its intention to divest its interest in companies where it
has minority holdings. The divestiture is mainly for budgetary resource mobilisation for the Government.

The process of privatisation is not viewed as an end in itself but as an integral and visible element of the Government's overall PE reform programme and a progressive effort to promote productive efficiency, to strengthen competitive forces in the economy and to support entrepreneurial development.

**Policy Guidelines for PE Reform**

The discernible primary objectives of the PE reform programme appear to be:

*to reduce the financial burden of the PE sector on government;*

*to enhance the efficiency and performance of the PE sector;*

*to bring about financial discipline, managerial and financial autonomy, appropriate incentives and accountability, all aimed at having the PEs operating on commercial principles.*

The principles of the PE reform programme which are guiding action toward the desired objectives have been articulated as follows:

*The operations of the PE reform will include only viable commercial activities, except for certain cases where the Government directs the PE also to undertake activities for other than commercial reasons. However, such non-commercial activities will only be retained on a separate operational and accounting basis and with contractual arrangements giving the PE full compensation for the activity through transparent budgetary provisions.*

*Where PE operations currently include regulatory functions, these will be divested and either eliminated or assigned to a separate regulatory body.*

*PEs will operate on a self-sustaining basis and with a hard budget constraint that will oblige them to institute and maintain adequate financial discipline. Subsidies will be phased out except for those relating to non-commercial activities as mentioned above.*

*A major goal of PEs will be profitability through efficient operations in a competitive environment. Over the longer term, a crucial reform objective is to move to market pricing wherever competition is possible. This goal will be promoted through the break up of monopolies, reduction of trade barriers, and*
elimination of barriers to private entity. In order to facilitate PE achievement of these aims, their managements will be provided with the maximum autonomy over key operational variables such as prices, procurement and salary levels, when compatible with prevailing conditions.

Public Service PEs operating under monopolistic conditions will, in common with private entities of similar nature, be regulated as needed to protect the public interest, primarily through review and approval of tariffs, maintenance and replenishment of all kinds of capital resources, and cost containment. Such regulation will be implemented through autonomous specialised bodies operating independently from the Government line structure, thus insulating them from political interference.

The legal and regulatory framework within which PEs are to operate will be streamlined to provide a "level playing field", with the aim being to facilitate an equitable and fair basis for the efficient functioning of both public and private sector enterprises under competitive and freely market-based conditions, and to provide protection to consumers when necessary. With this objective, the legal framework applicable to the private sector, including the Companies Act, will be made equally applicable to PEs.

Government's ownership functions over majority-owned PEs will include the same rights and responsibilities as the analogous functions in the private sector. In its ownership role the Government will thus:

- select and appoint competent and qualified persons to PE boards according to a widely publicised and transparent process;

- provide PEs' management with clear, non-conflicting objectives;

- agree with management on the strategy and corporate instruments reflecting it;

- leave management as free as possible to achieve the objectives;

- oblige management to full and transparent accountability and perform "ex poste" evaluations of management performance.

All aspects of PE business will be performed in a commercial and transparent manner. The fact of being a PE will not constitute an acceptable reason for directly or indirectly according favourable treatment to PEs, such as exemption from taxes or fiscal charges or preferential access to imported or domestic inputs.
The foregoing principles are designed to secure autonomy from political interference.

**Policy Guidelines for Privatisation**

Privatisation and divestiture have been defined as the transfer of a function, activity, organisation or investment holding from the public to the private sector. Privatisation and divestiture are strategies of enhancing the role of the private sector in the economy by shifting more of the responsibility for production and delivery of goods and services from the public to the private sector.

The principles of the privatisation/divestiture programme which are guiding action toward the desired objectives have been articulated as follows:

- PEs will be divested into competitive markets and purchasers will therefore not obtain an intact or unregulated monopoly.

- Purchasers will not be accorded special protection or access to credit on concessionary terms.

- In cases where the Government retains a minority shareholding, it will not exercise any special or extraordinary voting rights, except in limited, predetermined and well defined policy areas.

- There will be moratorium on new Government investments in enterprises that are to be privatised, except for financial and operational restructuring that are necessary to prepare PEs for sale.

- All privatisation sales will be on a cash-only basis, with the possible exception of shares sold to the workforce of the affected firms.

- No specific class of potential purchasers will be excluded from participating in the privatisation/divestiture process.

- All transactions will be conducted in an open and transparent manner consistent with normal standards of commercial discretion.

Unless justified by the existence of legal rights no predetermined direct sale or negotiations by private treaty will be entertained except after publicly solicited bids have been obtained. All aspects of the transactions will be in the public domain where appropriate. This means:

- a prospectus or offering memorandum will be prepared and publicised for each firm
to be sold;

-a full body of financial, management and other information will be available for disclosure to the investing public;

-fair and equitable bidding procedures will be established;

-criteria for ranking bids will be established and publicised;

-bids will be opened in public;

-the valuation of the assets and the details of all offers received will be placed in the public domain.

-To promote and ensure the competitiveness of the markets in which privatised companies will operate, the Government will continue to build upon existing anti-monopoly legislation and the institutional capacity to implement it in a transparent manner.

-No new PEs will be established in the productive sector, except for investments made purely for venture capital assistance through the Development Finance Institutions.

Privatisation/Divestiture Process

The privatisation/divestiture process is perceived as involving two main and distinct phases. The first phase is preparation and entails a detailed review of the PE, covering operational, financial and legal issues, in order to determine its current condition, potential strengths, weaknesses, and financial restructuring requirements, if any. This is followed by the construction of operational and financial models for the PE to project likely results under several scenarios. These steps lead to a valuation of the PE as a going concern, which forms the basis for establishing a range of values that can be used in negotiations with prospective investors and setting the share price for a public offering. For comparative purposes, asset valuation is also conducted to ascertain the value from both a replacement and a liquidation perspective. This phase concludes with the preparation of a privatisation plan of action that fully documents the results of all the analysis conducted up to this stage. The action plan also includes a detailed set of recommendations on how to proceed to execute the transaction.

The second and final phase is execution and entails the implementation of the transaction. By this stage, all key decision-makers have approved the privatisation action plan. Tasks to be performed during this stage include, where necessary, the
preparation of the sales documentation, (e.g. prospectus, information memorandum) completion of any financial and operational restructuring required prior to divestiture, resolution of all outstanding legal issues that affect the sale, the design and implementation of a PR campaign to inform the public of the impending sale, and finally the execution of the sale itself.

**Methods of Privatisation/Divestiture**

There are a number of alternative ways of effecting privatisation/divestiture. Common among these are:

(i) public offering of shares on the stock exchange;
(ii) sale of shares by private placement;
(iii) negotiated sales;
(iv) sales of PE assets (including liquidation);
(v) new private investments in PEs;
(vi) employee/management buy outs;
(vii) leasing or award of management contracts;
(viii) joint venture: commercial agreement between a PE and one or more business partners to operate a business;
(ix) franchising: a fixed-term contract or licence to a company to operate a service.

The choice of a privatisation option is often determined according to the following criteria:

- Objectives pursued by the Government for each sale.
- Record of performance and economic prospects.
- Size of the PE and the ability to mobilise private funds.

**Institutional Arrangements**

In order to achieve the Government's objectives in the PE reform and privatisation programme, the Government has created a high level policy-making body, the Parastatal Reform Programme Committee (PRPC), the functions of which are:

- to supervise and co-ordinate the implementation of the PE reform programme in general;
- to prioritise and determine the timing of the sale for each non-strategic PE;
to approve the operational guidelines for privatisation to be followed, including the criteria and procedures to be followed in the divestiture decisions;

to give final approval or rejection for the sale of public assets;

to monitor and evaluate the progress of implementing the programme;

to provide political impetus for privatisation and participate in building public awareness and the national consensus in support of the Government programme.

Another body, the Executive Secretariat and Technical Unit (ESTU) has been established to act as an autonomous execution agency and as the Secretariat of the PRPC. The ESTU is responsible for the management, coordination and implementation of the privatisation/divestiture programme as approved by PRPC.

The Department of Government Investments and Public Enterprises (DGIPE) has been established within the Ministry of Finance and charged with specific powers and functions which are designed to render it as autonomous as possible. The DGIPE is responsible for those aspects of the reform programme that are related to parastatals which are to remain in state hands. Indeed the DGIPE is expected to carry out effective oversight and leadership of the PE reform process. This would include roles traditionally carried out by “parent” ministries. The sector ministry's functions in relation to PEs are expected to be limited to developing sector-wide policies and programmes. The PE Boards of Directors are expected to be responsible for setting corporate operational policies and to ensure that executive managements carry them out.

References

(i) OVP/MOF, Policy Paper on Public Enterprise Reform and Privatization (July 1992)

(ii) OVP/MOF, Kenya's Parastatal Reform Programme (November 1991)


(vi) Shirley M. Mary, Managing State-Owned Enterprises, World Bank Staff Working Paper No. 577
