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THE EFFECT OF STRATEGIC MERGERS ON OPERATIONAL COST REDUCTION AND PERFORMANCE OF PARASTATALS IN KENYA: A COMPARATIVE ANALYSIS ACROSS DIRECTORATES OF AGRICULTURE AND FOOD AUTHORITY

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Abstract

This paper examines the effect of strategic mergers on the performance of parastatals in Kenya, using the case of Agriculture and Food Authority. The institutions which were merged to form AFA includes, Coffee directorate, Sugar directorate, Tea directorate, Nuts and Oils directorate, Fibre directorate, Horticultural crops directorate and Pyrethrum directorate. These directorates' performance was analyzed and compared in terms of performance across board. A sample of 223 respondents was selected out of 500 target population. A questionnaire was used to collect views on the various dimensions of cost reduction. The findings show that though in some directorates cost reduction was witnessed, its contribution to firm performance was considered minimal and average in many cases. The study therefore concludes that in order for cost savings as a result of mergers in parastatals and public sector organizations, to add value in terms of performance, there is need to plough back the savings to the affected institutions in order to achieve the necessary impact.

Keywords: *Strategic mergers, Agricultural and Food Authority, operational costs, performance, Parastatal, growth*

1. Introduction

Strategic mergers have proved useful in reengineering businesses that were on the verge of collapse. This has not only been the case in businesses but also in public sector organizations. For example mergers and acquisitions have been the most popular growth strategy for decades in the US economy. The 1990s and 2000s also featured markedly increased volume of European mergers and acquisitions. Economic growth deregulation and the development of the common European economy accelerated the acquisition process in the EU countries, (Lahovnik, 2011). Meyer and Alten (2008) state that in merging parties that have divergent view on how combined resources should be deployed; had findings that suggested that although mergers may have a promising synergy potential, this potential may not be realized because parties are unable to resolve incompatible strategies. Different management tools like quality management, benchmarking, time based competition; outsourcing, partnering and reengineering have been used to enhance and dramatically improve the operational effectiveness of a company, but fail to provide the company with sustainable profitability. Mergers occur mainly in response to certain shocks, such as deregulation and technological changes, resulting in high merger activity in the period surrounding shocks. This leads to time series clustering of merger within the industry (Agarwal & Bhattacharjea, 2006). The uncertainty of a major organizational change, such as merger, may enhance organizational silence and increase employees' feelings of insecurity and anxiety.

According to Kevin (2014) China and the countries of Africa south of the Sahara have adopted diverse sets of reforms in the past couple of decades, in order to stimulate growth the reduction of poverty reforms initiated in the late 1970's in china were driven by strong political will and relied on a gradual but consistent trial error process on evidence rather than theory or ideology. Careful experimentation was essential for the design, sequencing and implementation of many of the successful reforms in china.

Muthama (2013) mergers and acquisitions are categorized into four major types on the basis of product and market in which the acquirer and the acquired company operate before merger. Horizontal merger involves two firms operating and competing in the same kind of business activity and geographical market. Vertical merger integrates the operation of supplier and customer. In a backward vertical merger, the customer acquires the supplier, where as in forward merger the supplier acquires the customer. He further stated that renewed interest in mergers and acquisitions in the present context is due to two reasons, first because of increase in the number of cross national mergers and second due to increase in the financial stakes involved and the corresponding realization that majority of mergers and acquisitions fail to create value or meet their objectives.

A company seeking to merge or take over another firm will evaluate all options so as to acquire these generic strategies, (Kangethe, 2013). Merger is a tool used by companies for the purpose of expanding their operations often aiming at an increase of the long term profitability (Ireri, 2011). Cost reduction is one possible outcome of mergers and hence it's important to investigate how the merger at AFA has led to improved performance in terms of customer satisfaction, employee productivity

2. Research Problem and Scope

This paper discusses the role of mergers in contributing to the performance of parastatals in Kenya as a consequence of cost reduction due to savings from merged operations.

Parastatal restructuring has been taking place in order to get better performance and service delivery and these efforts have been motivated by the fact that the state parastatals have been underperforming and the public have demanded for better service delivery (Lankeu & Maket, 2012).

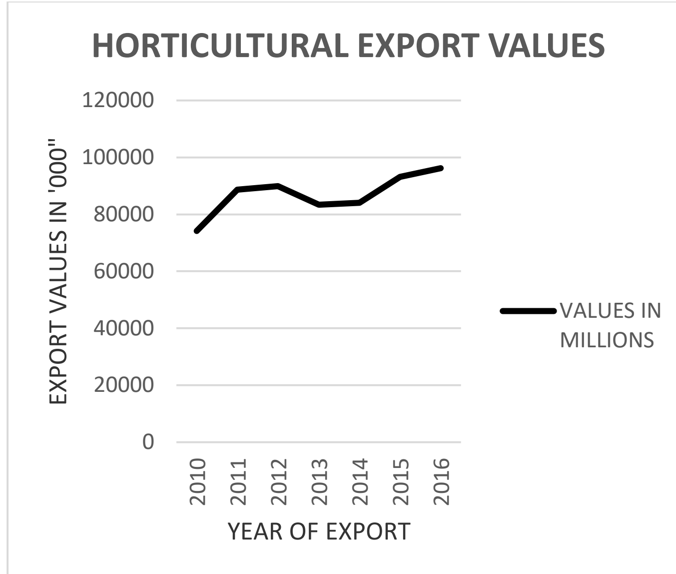
According to Mulwa and Murithi (2009), the positive impact of liberation of sugar industry is that the firm was able to adjust to international production and marketing standards, which may have taken longer to achieve if it was not open to competition. Merger strategy is a result of adjusting to environment so as to improve on the performance

The implementation of the new constitution, policy and legal frame work in 2010 includes a comprehensive bill of rights to be free from hunger and adequate food of acceptable quality. The Kenya's vision 2030 aims at transforming Kenya in to be a newly industrialized middle- income economy providing quality life to all citizens by the year 2030.

The AFFA act 2013 came into effect in January 2014. The Act consolidates the laws on the regulation and promotion of agriculture and makes provision for related matters, in line with the provisions of the fourth schedule of the constitution of Kenya. The authority has the potential adequate infrastructure and experience to provide foundation for transformed agriculture.

The Horticultural crops development Authority which was established under the Agriculture act cap 318 in 1967 to promote and develop the production and marketing of Horticultural produce. The mandate had been carried since then until the implementation of the new constitution in 2010 which pushed for the change. This was done to achieve the mandate of the Crops Act 2013 the aim was to transforming and improve efficiency of the agricultural sector has been the main focus. The following institutions were merged to form AFA; the Horticultural crops directorate the Tea board of Kenya, Pyrethrum Authority, Fiber crops, Nuts and Oil crops, Food crops, Sugar board of Kenya and Coffee board of Kenya.

The figure below gives a pointer to the outcome of the merger whereby the directorate of HCD has recorded improved performance. This however is only one directorate and also one aspect of performance measure which just the export. It is important to find out how the merger has influenced performance in other areas of the authority.



Source: Horticulture web statistics, 2017.

Figure 1 Performance of Horticultural crops directorates

Despite evidence of some notable increase in sales from some directorates such as the horticultural directorates as seen in graph above, no empirical study has been conducted after the merger to elucidate the contribution of the merger to the performance of the various directorates. Consequently data is missing to guide decisions on the new organization's performance strategies especially during and after the merger period. This paper fills this knowledge gap and seeks to provide evidence on the effect of the merger on cost reduction and its contribution to the performance of the new parastatal.

3. Guiding Research Question.

The following research question and research hypothesis guided the enquiry:

i. How has cost reduction as a result of mergers contributed to the performance of Agriculture and Food Authority Directorates?

H_0: There is no statistically significant difference between performance due to cost reduction from mergers across directorates of Agricultural and Food Authority

4. Literature and Theoretical Foundations

Strategic mergers are anchored on various theories and many researchers have investigated the area and found out the rationale for organizations engaging in mergers. However most studies have involved private sector organizations and very few look into the issue of mergers in public sector organizations.

This research is anchored on the following theories:

i. The Resource Based View

The Resource based view is concerned with mapping the resources of the firm and capabilities to the opportunities in the external environment. The firms sustainable profits do not come from necessarily accruals from imitating other firms but instead from exploiting the identified gaps between them. Penrose in 1957 developed the VRIN model which stands for resources which are valuable, rare, imperfectly, imitable hard to copy and non-substitutable with other resources. According to (Kibwi, 2015) the RBV points out that, firms can develop sustained competitive advantage only by creating value in a way that is rare and difficult for competitors to imitate. The theory is applicable because after the merger the organization is expected to be unique in the delivery of services to the customers.

Competing firms could enter the market with resources which are able to tear down the competitive advantage of the competing firm, which results in reduction of firm "resource-based view which explains its ability in the delivery of sustainable competitive advantage if resources are managed in a way that their its outcomes cannot be copied by competitors, which creates a barrier in competition (Martynova & Renneboog, 2008).

In terms of performance, resource may increase the firms' capacity to charge high prices and thus contribute to performance by helping the firm to appropriate value linked to competitive advantage. Further more resources may be used to erect entry barriers and so increase performance at the industry level (Newbert, 2007).

ii. Competitive Advantage Theory

The Porters Competitive advantage theory states about the ability of an enterprise to sustain a market position by supplying quality products and services on time and at competitive prices through acquiring the flexibility to respond quickly to changes in demand and through successfully managing product differentiation by building up innovative capacity and an effective marketing system (Altenburg et al 1998). This theory is relevant because in an organization the porter's five forces come in to play. These are buyers' power, the suppliers' power, threat to entry, threat of substitutes and organization rivalry.

According to Julio, (2016) Sustainable competitive advantage construct is an important antecedent of organizational performance because it highlights fundamental attributes for organizations to achieve positive economic consequences. The organizational performance targets the quality and profitability of goods and services and the return on investments, as well as the reduction of operational costs, compounding the overall performance of the company against the competition, (Paladino,2007). Competitive advantage hence puts the company in a superior position compared to its competitors.

iii. Reduction of Costs as an outcome of Strategic Mergers

According to (Davidson & Ferrett 2007) mergers generate research and development spillovers. Regarding cost reduction, (Smith & Graves 2005) in their study found out that cost containment is a major management concern and failure to contain costs or rapidly raising inputs costs makes a firm to be inefficient as compared to competitors hence causing organizational decline. Acquisitions and mergers translate to the boost in the purchasing power in the acquiring of office equipment supplies in large orders placement, companies can easily negotiate for prices with their supplies in large orders placement. Improved industry visibility and market reach where companies easily merge to capture new markets and easily grow earnings and revenues (Sufian & Habibullah, 2009).

The strategy implemented by the firm with competitive advantage provides the opportunity for a reduction in costs (i.e. low cost) in the provision of a product and/or service with some proximity on product and/or service attributes to providers of the alternative differentiation strategy in a broad market segment (Tim, 2008). In theory mergers create synergies, gain economies of scale expand operations and cut cost. Investors expect mergers to deliver enhanced market power.

Mergers can enable a reduction in buildings running costs such as maintenance, cleaning, administrative support and communications. However, such savings are, generally, only significant where the buildings are being closed completely. The nature of some of the costs involved means that a partial closure often only results in a relatively small reduction in cost being generated (for example, heating) whereas the complete closure of a building will enable those costs to be reduced to zero. The merger AFA has brought about the sharing of regional offices by staff working in the field. The process is such that there is one large office in a region and staff in the directorate share the same office who were initially located in small offices. The combined cost of renting the office has hence gone down. Putting aside savings from rent, the organization also saves on personnel who were manning these offices or deploys them to other more productive areas and therefore enhances performance.

5. Methodology and Design

The research design to be employed in this study is descriptive. The major purpose of descriptive research design is to describe the state of affairs as it is at present. It is the process of collecting data to answer questions concerning the status of the subjects in the study. Kothari (2011) describes descriptive research as concerned with the characteristics of a particular individual.

The paper is based on findings collected using the views of a target population of 500 from which a sample of 223 cases were selected using the Yamane sample calculator formula as follows; Yamane sample calculater as shown below:

$$n= \frac{N}{1 + N (e)^2}$$

Where:

n is the sample size

N is the size of the population

e is the confidence level,

This study adopted a confidence level of 95% and the margin of error is therefore 5% which is acceptable in the social research (Cooper & Schindler, 2003). Further, a stratified random sampling technique was used to ensure that all the directorates were represented.

Data was collected using structured questionnaires using a 5 point likert scale and analyzed using descriptive statistics as well as regression model to establish the strength of the relationship. Tables and charts were used to present findings.

6. Findings and Discussions

This section gives the findings on the various variables as analyzed using various descriptive statistics and presented through bar charts. The section seeks to show whether various variables had effect on firm performance. The measurement used in this case was a 5 point Likert scale. The question was asked as to what extent cost reduction as a result of mergers contributed to firm performance. The respondents were expected to rate this variable as “very high”, “high”, “average”, “low” and “very low”.

Effect of Cost Reduction from Mergers on Performance

From the findings we see that nobody rated the performance as a result of cost reduction brought about by mergers as very high. However, the findings show that majority (43%) of the respondents rated the performance as a result of cost reduction to be average while 28% rated it as high. This shows that mergers might not have contributed considerably to cost reduction and in essence may not have led to greatly to improved performance of the Agricultural and Food Authority (AFA) but on average there was some improvement. This is corroborated by the findings that 30% of the respondents rated the contribution of cost reduction as low and very low cumulatively. This finding is shown by figure 2 below.

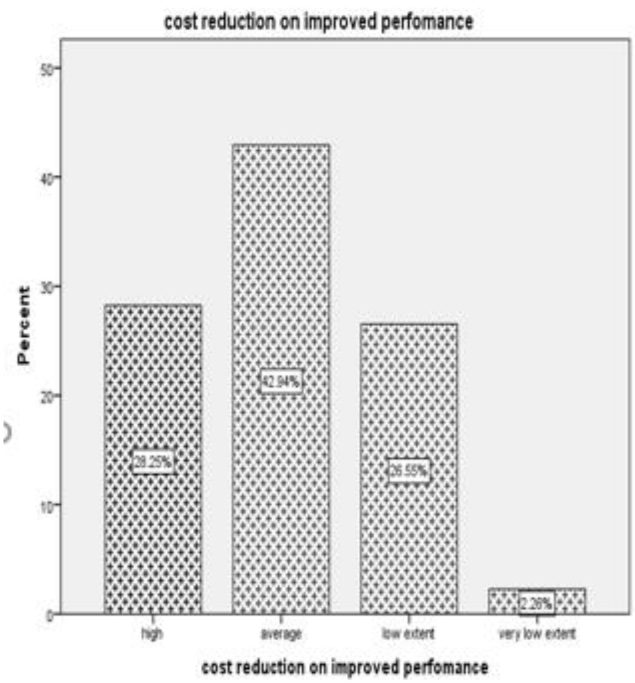


Fig. 2 Effect of Cost Reduction from Mergers on Performance

The findings in figure 2 above is further supported by the descriptive statistics which show that majority of the respondents agreed that cost reduction through various aspects contributed minimally to performance of the firm as a result of mergers. The mean scores are slightly below average and lies between 1.9 and 2.8 and a standard deviation of between 0.5 and 0.7, which shows high consensus on all the variables among the respondents. From the findings we therefore conclude that cost reduction may not have been realized to a meaningful extent as a result of mergers and therefore may not have achieved better performance overall. These findings are given below in table 1, as per the various measurement aspects.

Table 1: Descriptive statistics of Cost Reduction and Performance

Measurement Aspects	N	Mini Mum	Maxi mum	Mean	Std. Deviation
Cost reduction of rental expenditure	177	1.00	5.00	2.8023	.59390
Cost reduction in office expenses	177	1.00	4.00	2.2090	.67951
Cost reduction through centralized buying	177	1.00	4.00	2.0904	.75586
Cost reduction on office supplies	177	1.00	4.00	1.9322	.75071
Cost reduction on vehicle expenses	177	1.00	4.00	2.0508	.75582
Cost reduction on field officers reaching farmers	177	1.00	4.00	1.9718	.77187

To get a feel of how the various directorates were affected by mergers in as far as performance was concerned, a comparison was made and the findings show that in deed there was a difference on performance levels in various directorates as shown in the figure below.

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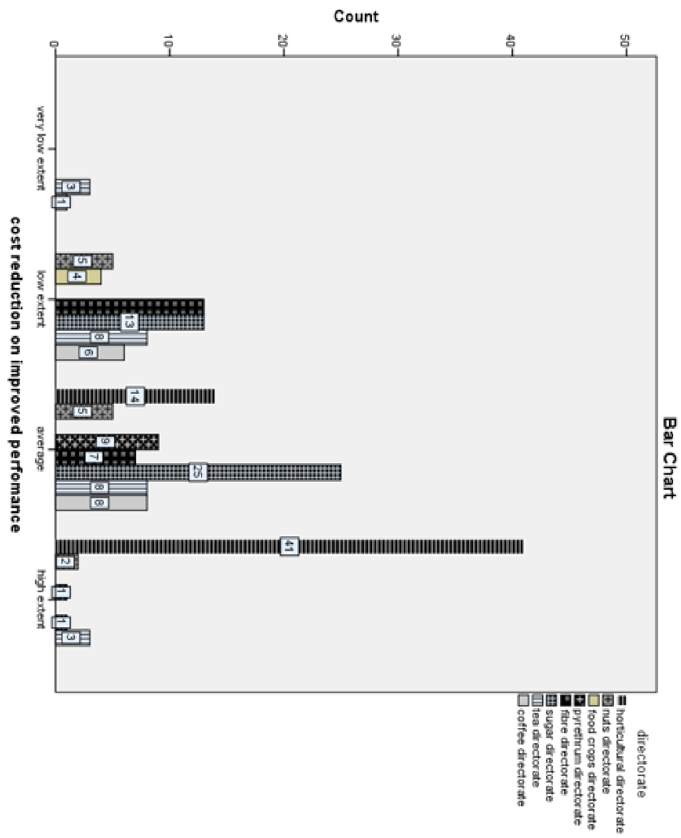

Fig. 3: Effect of Cost reduction on performance across Directorates

From figure 3 it is evident that six out of eight representing 75% of the directorates rating their performance as a result of cost reduction as very low and low. This was seen in the nuts, food crops, fibre, sugar, tea and coffee directorates. On the hand only five out eight directorates rated the performance as a result of cost reduction due to mergers as high. In this category the horticultural directorate was the one with the highest (41) which is equivalent to 74% of its respondents. The rest of the directorates rated their performance as average. This explains why overall the performance was seen to be moderate from the earlier analysis. It can also be explained by the fact that most of the directorates were in the traditional products were affected by other factors outside the issues addressed by mergers.

The findings presented in the preceding sections, shows that mergers in government entities may require than average effort to implement to attain performance improvement at the local level. Of specific importance is a way of transferring benefits to individual units. This is in regard to cost savings, work environment and over all organizational performance. The fact there was statistically significant differences between the scores for these variables shows that certain units or directorates benefited more from the merger more than others and the reason for improved performance in these units.

Horticultural directorates was seen to have ranked highly in all the dimensions that were investigated. This shows that the merger worked well for this unit unlike others like tea, coffee and food directorate which recorded moderate improvement on all aspects measured. This again proves that mergers for nonprofit units may not be a viable without carefully planned measurement criteria. It is important to note that resulted in changes that needed to be strategically managed to avoid fatigue and fear from the stakeholders especially the employees. Overall the merger did not contribute much to the performance of the firm and hence more strategies may have to be devised to make the merger more appealing to all stakeholders. It should be able to contribute to employee motivation to strive for better performance (Schuler & Jackson, 2001). Employee are the back bone of a company for they are the ones who innovate and make creative decisions to move the organizational goals (Armstrong, 2011).

7. Hypotheses Tests

The study hypothesis was that there was performance and cost reduction across the various categories of the directorates at AFA was same stated as follows:

1. **H_0:** The distribution of organizational Performance is the same across the AFA directorates.
2. **H_0:** The distribution of cost reduction is the same across AFA directorates.

These hypotheses were rejected because the tests results using Kruskal Wallis test showed that there is a significant difference between performances of the categories at AFA directorates. The test was significant at 0.000 level making us to reject the null hypothesis at the proposed significance level of 0.05. Likewise, the hypothesis relating to cost reduction was also rejected because from the test results, there was a statistically significant difference between cost reductions across directorates at .000 level as compared to the acceptable level of 0.05. These findings are in line with the other analysis results which showed that some directorates performed better while others were not significantly influenced by mergers in relation to cost reduction.

From these findings we can argue that for public organizations, mergers might not be best option to bring about cross cutting improvement in performance since the synergies built might be working against some of the unite involved due to differences in focus and products.

8. Summary Recommendations and Conclusions

This study found that cost reduction was not significant in improving performance as a result of the merger. However, it was evident that cost reduction was achieved differently across directorates. The same applies to performance where different levels of performance was achieved by different directorates.

The cost reduction was in terms of rent, vehicles, purchasing among others even though it was not of much significance to be felt in the organization. This implies that mergers may not have been a cost cutting initiative or the effects were not significantly felt by the concerned directorates. This is contrary to the expectations of strategic planners who have recommended mergers as a means for maintaining costs of organizations as per the literature.

We recommend that cost savings attained from strategic moves be reinvested back to the firm to influence output.

9. Further Research Areas

Further research should be done on other Parastatals in the Ministry of Agriculture which were merged like (KALRO) Kenya Agriculture and Livestock and Research Organization for comparison purposes.

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