

**IMPACT OF TURNAROUND STRATEGIES ON COMPANY'S  
PERFORMANCE: CASE STUDY OF FINANCIALLY DISTRESSED  
ORGANIZATIONS IN KENYA.**

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**A RESEARCH PROJECT SUBMITTED TO THE FACULTY OF  
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## DECLARATION

This research is my original work and has not been submitted for a degree in any other University.



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This research has been submitted for presentation with our approval as University Supervisors

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## **ABSTRACT**

Turnaround strategies have been a big issue in most organizations, especially in making them reverse the declining trend in their profitability. The purpose of this study is to evaluate the impact of turnaround strategies, adopted by selected parastatal organizations i.e. Kenya Airways Limited, Kenya Power & Lighting Company Limited, East Africa Portland Cement Limited, Kenya commercial Bank Limited, National Bank of Kenya Limited, and Uchumi Supermarkets Limited in improving their financial performance. The study involved carrying out analytical review of key accounting ratios, derived from audited financial statements for last eleven years, 1992 to 2002. Structured questionnaires and past audited financial statements were used to capture the relevant data, which was analyzed using financial ratios, descriptive statistics and Regression Analysis to achieve the objectives of the study. The hypotheses in this study were tested using t-test to establish whether or not the strategies adopted helped to reverse the negative trends on profitability. The study is of great use to the individual organizations mentioned, other organizations with related objective, Governments institutions, Investors interested in investing in those organizations, and the general public for purpose of information, on turnaround strategies.

## **CHAPTER 1: INTRODUCTION**

### **1.1 Background information**

A crucial aspect of any organization is its capital structure. This is because the capital structure determines the way in which the various activities of the organization are financed. The capital structure is therefore based on the organization's long term plan or strategy that determines the level of both equity and debt. The management of the organization is responsible for the daily operations and shareholders expect them to be responsible for outlining the best capital structure. The assumption held by the investors and other stakeholders is that the firm is a going concern and will continue to operate into the foreseeable future.

However, the organization may fail and shareholders as well as other stakeholders should be cognizant of this fact. The word failure may be vague due to the varying degrees of failures. For instance, a company may be regarded as technically insolvent if it is unable to meet its current financial obligations. However, such insolvency may be temporary and can be subjected to various remedies. Such remedies form the turnaround strategy. In extreme cases the net worth of the company would be negative, as the liabilities exceed the assets. The insolvency can crystallize into bankruptcy, where divestiture would be one of the strategies to adopt. Financial failure means anything between technical insolvency and bankruptcy.



Since an organization may experience various forms of failure, the strategy adopted would have varying degrees of harshness. If the outlook is sufficiently hopeless, liquidation may be the only feasible alternative. Turnaround strategies have been adopted by a number of organizations, achieving varying degree of success. Among these organizations are, parastatal that were forced into privatization by development partners, in order to improve efficiency, and remove their dependency on the Government. The privatization programme undertaken by the Government of Kenya includes divestiture of non-strategic parastatal bodies, which was undertaken to achieve the following objectives:

- (i) Remove the Government from the management of public organizations
- (ii) Improve accountability and transparency.
- (iii) Improve on fiscal monetary policies.
- (iv) Reduce corruption and to improve on governance.
- (v) Reverse the poor financial performance and loss made by public organizations.

This study examined, those public organizations that were privatized, and how they faired in their endeavour to fulfill the task that was placed before them.

These organizations include:

- (i) Kenya Airways Limited (KQ)
- (ii) Kenya Power & Lighting Company Limited (KPLC)
- (iii) East Africa Portland Cement Limited (E APC)
- (iv) Kenya Commercial Bank Limited (KCB)
- (v) National bank of Kenya Limited (NBK)

(vi) Uchumi Supermarkets Limited

Since each Parastatal has varying degree of financial performance, as compared to others, an individualistic analysis of each parastatal financial performance for the period 1992 to 2002, was examined. Below is a summary of the analysis that depict their financial performance before privatization:

**1.1.1 Summary of the financial performance**

This section summarizes the financial performance for the Parastatal for five years before they were privatized:

**(i) Kenya Airways Limited. (KQ)**

The company was incorporated in 1977 and as a wholly owned by the Government of Kenya to act as a national flag carrier of Kenya. On inception it acquired certain assets and staff of the defunct, East Africa Airways Corporation. Over the years, however there was a gradual deterioration in financial and operational performance, which led to the decline in the airline's reputation. The company experienced significant financial losses over the first 16 years of its existence, thus placing a heavy re-financing burden on the Government. During the late 1980s, a substantial part of the existing fleet of aircraft was acquired, through foreign loan that was guaranteed by the Government, but this didn't make things better. This persistent failure of the airline made the Government appoint new Board of Directors, chaired by the late Philip Ndegwa, a former Governor of Central Bank of Kenya .The new board was mandated to commercialize the airline and prepare it for eventual privatization.

In February 1992, the board commissioned Speed Wing Consultant; an independent consulting arm of British Airways plc, to conduct a thorough review of the airline's operations and make recommendations on ways and means in which the Company's financial performance, would be improved.

The findings of the review necessitated the board to enter into a service agreement with Speed Wing Consultant to implement the recommendation of the review, Subsequently, airline adopted several turnaround strategies, which in 1996, culminated into a public offer of 235,423,896 ordinary shares, of Ksh 11.25 each.

**(ii) Kenya Power & Lighting Company Limited. (KPLC).**

The organization history dates back 1875, when Seyyied Bargash, the Sultan of Zanzibar, acquired a generator to light his palace and nearby streets in Zanzibar. Consequently, Harrali Esmailjee Jeevanjee, a wealthy merchant in Mombasa, acquired the generator in 1908, and transferred it to the Mombasa Electric Power & Lighting Company. During the same year, an engineer, Mr. Clement Hertzell, was granted the exclusive right to supply electricity to the then district and town of Nairobi. This led to the formation of the Nairobi Power & Lighting Syndicate. In 1922, the two companies, in the Nairobi and Mombasa were merged and a new company, East Africa Power & Lighting Company (EAP&L) was incorporated. In 1936, EAP&L obtained, generating and distribution licenses in Uganda, thereby entrenching its presence in the East Africa region. However, in 1948, the Uganda Electricity Board (UEB) was established by the Ugandan Government to take over distribution of electricity in the country.

In, 1954: The Kenya Power Company (KPC) was created by EAP&L-for transmitting power from Uganda through the Tororo-Jinja-line. In 1983: with its operations confined only to Kenya, EAP&L was renamed The Kenya Power & Lighting Company Ltd. (KPLC). The functions of generations were split from transmission and distribution. This made Kenya Power Company, a separate entity responsible for public-funded power generation projects. Later this Company was renamed, Kenya Electricity Generating Company (Ken-Gen), while KPLC handled the distribution of power generated by the former. Although the organizations shares were quoted on the Nairobi Stock Exchange in 1972, its financial performance continued to decline, in spite of the Government support. This necessitated the organization to adopt turnaround strategies to address the problems.

**(iii) East Africa Portland Cement Limited (EAPC)**

East Africa Portland Cement is the second largest cement manufacturing company in East Africa and was listed on the Nairobi Stock Exchange (NSE), in early, 1972. The organizations accordingly underwent period of financial distress, which the board and management had to address, and in order to reverse the negative trend in its profitability, turnaround strategies were adopted to help steer it to profitability.

**(iv) Kenya Commercial Bank Limited. (KCB)**

The history of the Kenya Commercial Bank dates back to 1896 when its predecessor, the National Bank of India opened a branch in Mombasa to handle business that the infant port was attracting at the time. Eighty years later, the bank

extended its operations to Nairobi, which had become the headquarters of the expanding railway network.

In 1970, Kenya Commercial Bank was formed to take over all but two branches of National and Grind lays Bank. The Government acquired a 60% shareholding in the bank; with the remaining 40% being retained by Grindlays Bank plc.

However, in 1976 the Kenya Government acquired the remaining shares held by Grind lays Bank hence gaining 100% control. In 1971, Kenya Commercial Finance Company Limited, a wholly owned subsidiary, of Kenya Commercial Bank Limited. was incorporated as a financial institution to undertake various financial transactions that would normally not be undertaken by a commercial bank, and in 1972, Savings and Loan Kenya Limited was acquired to specialize in mortgage finance. At its formation in 1970, the bank had 76 outlets, 32 of which were full time branches. At the end the branches had grown to 246 outlets throughout Kenya, of these 64 were full time branches while the rest were sub-branches and mobile units. This eventually enabled the Bank to control 54% of the total banking outlets in the country.

#### **(v) National Bank of Kenya Limited (NBK)**

The Bank became operational in 1968 as Kenya's indigenous commercial bank, having an initial share capital of ksh.20 million. Prior to the public offer in 1994, the bank had 33 outlets, including 17 fully-fledged branches nation wide. Prior to the public offer the bank made huge losses and had high level of non- performing loans, hence failing to pay dividend to the Government.

In order to address these problems, the Government through the policy of privatization sold significant shares to the public. Later, the new board and management undertook turnaround strategies in their endeavour to address the past poor financial performance of the bank and to steer it to profitability.

**(vi) Uchumi Supermarkets**

The Government, in 1975, founded Uchumi Supermarkets, to retail essential commodities at reasonable prices and to create a market for locally manufactured goods. However Uchumi Supermarkets faced various challenges which included stiff competition, from other, Supermarkets, and as a result it started to face declining, profitability.

Table one gives the summary of the average financial performance for the four of the six organizations’ that were selected for privatization programme shown below:

**Table 1: Average financial performance before privatization**

Ratios	K/Airways	KCB	NBK	Uchumi
Earning per share	(0.21)	6.95	3.03	2.42
Return on equity	0.44	0.099	0.044	0.11
Return on investments	0.067	0.006	0.006	0.05
Operating profit margin	1.02	0.012	0.10	0.12
Debt asset ratio	1.17	0.94	0.89	0.58
Current ratio	0.81	1.02	1.08	1.37

Source: Audited Financial Statements

The above data excludes those of Kenya Power & Lighting Company, and East Africa Portland Cement, as such data were not available, because they started trading their share in Nairobi Stock Exchange way back in 1972.

## **1.2 Problem Statement**

After privatization of the government-controlled parastatal, the Board of Directors and Management were faced with immense challenges that emerged. Key among them was huge losses associated with poor financial performance, and how the survival of these organizations could be guaranteed since losses had depleted their capacity to perform. Other Companies in both Public and private sector were also experiencing this scenario. These organizations had to undertake turnaround Strategies, which triggered a radical change in the way they were managed. However, it is not known to what extent the turnarounds Strategies were successful and which one was not. New board of directors and management were faced with several problems, key among them were, serious losses and how to reverse the negative trend associated with poor financial performance of these organizations, at a time when many other companies in the private and Public sector were facing financial crises, including liquidation and insolvency. This triggered radical change in the way those organizations were doing business, hence forcing them to adopt new strategies. This created the need to formulate the way forward. Such organizations were to undertake turnaround strategies, in order to help them overcome the new Wave of change, which was sweeping across the globe. However ,it is not known to what extent the turnaround Strategies were successful and which ones were not.

### **1.3 Objectives Of The Study**

The main purpose of the study was to determine the effectiveness of turnaround strategies adopted by financially distressed parastatal organizations.

The specific objectives were:

Find out the turnaround strategies adopted by financially distressed organizations and to determine their effect/impact on the financial performance.

- (i) Find out the critical turnaround strategies that were adopted and their effect on the organization financial growth, liquidity and stability.
- (ii) Evaluate the financial performance using ratio analysis and trend, to determine the success or otherwise of the organizations' financial performance and condition, using the following ratios, Profitability, Liquidity, Earning per share, Return on equity, and Return on investment.
- (iii) Which turnaround strategies were most critical and mostly adopted by the organization, as derived from the questionnaires.
- (iv) Determine the suitability or otherwise of those ratio, as a management tool to gauge the success of turnaround.

### **1.4 Hypotheses**

The supporting hypotheses for the study are:

- (i) Turnaround Strategies adopted have no effect on the financial performance of these parastatal.



- (ii) There is no relationship between the turnaround Strategies adopted and the financial performance of these parastatal.

### **1.5 Significance of the study**

This study will be useful to top policy makers in identifying the turnaround strategies that will help improve the financial performance. The research has also cited cases of companies in other parts of the world, which have undergone similar situations and were successfully turned around. Their citation may help investors and lenders, not to press the panic button, when their investment portfolio has started experiencing financial difficulties.

It will also act as a new insight toward the development of a model that can help managers identify and apply appropriate turnaround strategies in addressing financial distress that may befall an organization.

The study may facilitate the establishment of a regulatory framework that could deal with financial distress. It may also help Shareholders/Investors to rescue organizations that are worth to rescue.

### **1.6 Scope And Limitation**

The scope of the study will be limited to the financial statements and other reports that fall part of the results from turnaround strategies adopted by the Parastatal Bodies under the study. Although financial statement analysis are a useful tool for understanding a firm's performance and condition, great care should be exercised as such statements suffer from the following limitations:

Seldle Point

**i). Heuristic and Intuitive character:**

The ratios are often not related logically to a well-defined theoretical framework. Instead they have been suggested in a somewhat impressionistic manner. In the absence of a well-defined theoretical underpinning, the traditional univariate approach to financial statement analysis seems to have some deficiency.

**ii). Development of Benchmarks:**

Many firms, particularly the larger ones have operations spanning a wide range of industries. Given the diversity of their product lines, it's therefore difficult to find suitable benchmarks for evaluating their financial performance and condition

**iii). Window Dressing:**

Firms may resort to window dressing to project a favourable financial picture

**iv). Price Level Changes:**

Financial statements are based on historical costs and do therefore not take into account price level changes.

**v). Variation in Accounting Policies:**

Business firms have some latitude in the accounting treatment of items like depreciation, valuation of stocks, research and development expenses, foreign exchange transactions, provision for reserves, and revaluation of assets. Due to diversity of accounting policies found in practice, comparative financial statement analysis may be vitiated.

**vi). Interpretation of Results:**

Though industry averages and other yardsticks are commonly used in financial ratios, it is somewhat difficult to judge whether a certain ratio is good or bad. In other instances a firm may have some favourable ratios and some unfavorable ratios. In such situation, it is somewhat difficult to form an overall judgment about its financial strength or weakness.

**vii). Correlation among ratios:**

Financial ratios often show a high degree of correlation. This is so because several ratios have some common elements and that some items tend to move in harmony and often confusing if one employ a large number of ratios in financial statement analysis.

**1.7 Definition Of Terms**

- (i) Business reengineering:** Is defined as a fundamental rethinking and radical redesign of business processes to achieve dramatic improvement in critical contemporary measure of performance such as cost, quality, service and speed (Dr Hammer 1993)
- (ii) Financial Distress:** Is defined as a condition that inhibit a company to generate sufficient internal surplus on a continual basis, and hence making it dependent on frequent infusion of external funds(Varshney Committees State Bank of India).

Defined this as the impact of increasing gearing on profitability and may finally bring about a pervasive 'corporate gloom effect' which saps morale internally and damages public image externally Financial distress is likely to be encountered well before the trigger point of cash flow crisis.

**(iii) Financial failure:** is defined as an event signifying an inability to pay debts as they come due, an entrance into bankruptcy proceeding, or an explicit agreement with creditors to reduce debts. (Supreme court (280 U.S.291 (1930))

**(iv) Turnaround strategies:** can be defined as those steps that companies can undertake to reverse a negative trend and get the company back on track to profitability.

**(v) Bankruptcy:** this is a legal proceeding for liquidating or reorganizing a business.

**(vi) Liquidation:** this is a process of terminating a firm as a going concerned.

**(vii) Reorganization:** this is an attempt of a failing company to continue operating as a going Concerned

**(viii) Business risk:** This is the equity risk that comes from the nature of

the firm's operating activities.

- (ix) Financial risk:** This is the equity risk that comes from the capital structure of the firm.
- (x) Financial distress cost:** This is the direct and indirect cost associated with going bankrupt and or avoiding a bankruptcy filing or cost associated in rescuing financially trapped firms.
- (xi) Technical insolvency:** This is a situation when a firms' debts obligations outstrip the available resources that can easily be converted into cash .
- (xii) Financial analysis:** The process that involves reclassification and summarization of information through the establishment of ratios and trends.
- (xiii) Analysis of financial statement:** This refers to the examination of the statements for the purpose of acquiring additional information regarding the activities of the business.
- (xiv) Ratio:** This is the mathematical relationship between two quantities in the form of a fraction or percentage.
- (xv) Ratio analysis:** This is concerned with the calculation of relationships which after proper identification and interpretation may provide information about the operations and state of affairs of the organization.
- (xiv) Liquidity ratio:** This is a measure of the organization s' ability to meet their short term maturing obligations.

**(xvii) Current ratio:** This expresses the relationship between the organizations current assets and its current liabilities.

## **CHAPTER 2: LITERATURE REVIEW**

### **2.0 Introduction**

Modern capital structure theories deal with the controversy that has developed over whether the capital structure of a firm as determined by its financing decision affect its cost of capital. Traditionalist argues that the firm can lower its cost of capital and increase market value per share by the judicious use of leverage. Modigliani and Miller, on the other hand, argue that in the absence of taxes and other market imperfections, the total value of the firm and its cost of capital are independent of capital structure. The net income operating approach is based on the notion that there is a conservation of investment value, no matter how you divide the pie between debt and equity claims, the total pie or investment value of the firm stays the same. Therefore, the amount of leverage is said to be irrelevant, when determining the capital structure..

In the world of corporate income taxes, there is a substantial advantage to the use of debt as interest charged on debt is tax allowable, and hence the firm benefits from tax shield. Gearing can lower the overall or weighted average cost of capital, which the company is requested to achieve on its operations, and up to a point, raise the market value of the firm. However, this effect can only be relied upon at relatively safe gearing levels. Companies can expect the market to react adversely to excessive gearing ratios. The implication for project appraisal is reasonably clear. Strictly, the appropriate cut-off rate for new investment is the marginal cost of capital but if no change in gearing is caused by the new activity, the weighted average cost of capital (WACC) would be used.

Although debt has its attractions, it is potentially lethal. (Pike, 2002), as Considerable care should be taken when prescribing the appropriate use of debt, that will enhance shareholder wealth without new threatening corporate collapse. Levels of gearing that may look acceptable in calm trading conditions may suddenly appear undesirable when conditions worsen. Other studies that considered debt structures are Bulow and Shoven (1978), White (1980), and Gertner and Scharfstein (1991), analyzed how debt structure affect liquidation values when firms are in financial distress. Ideally financial difficulties do not usually occur singly and highly geared companies are relatively less well placed to surmount them. The bondholders are primarily concerned with protecting the value of the firms' assets and will try to take control away from shareholders. They have a strong incentive to seek bankruptcy to protect their interest and keep shareholders from further dissipating the assets of the firm. The net effect of all this fighting is that a long, draw-net and potentially quite expense legal battle get started

Meanwhile, as the wheel of justice turns in their ponderous way, the assets of the firm lose value because management is busy trying to avoid bankruptcy, instead of running the business. Normal operations are disrupted, and sales are lost. Valuable employee leave, potentially fruitful programs are dropped to preserve cash, an otherwise profitable investment are not taken.

These are all indirect bankruptcy costs or costs of financial distress, whether or not the firm ultimately goes bankruptcy, the net effect is a loss of value because the



firm chose to use debt in its capital structure. It is this possibility of loss that the amount of debt that a firm will choose to use.

## **2.1 Causes and symptoms of corporate failure**

Although the causes of financial difficulties are numerous, many failures are attributable either directly or indirectly to management. Non-financial problem lead to losses, which in turn lead to financial strain and eventual failure, usually the cause, is a series of errors, and the difficulty evolves gradually. Because the sign of potential distress are evident prior to actual failure, a creditor may be able to take corrective actions before failure finally occurs, William H Beaver, (1966), Thompson and Strickland (1987), further states that, some of the most common causes of business troubles are:

- (i) Ignoring the profit-depressing effect of an overly aggressive effort to “buy” market share with deep price cuts.
- (ii) Being burdened with heavy fixed costs because of an inability to utilize plant capacity.
- (iii) Betting on R & D effort to boost competitive position and profitability and failing to come up with effective innovation.
- (iv) Betting on technological long shot.
- (v) Being too optimistic about the ability to penetrate new markets.
- (vi) Making frequent changes in strategy (because the previous strategy did not work out)

Such organization has been overpowered by the competitive advantages that are enjoyed by their close rivals. According to Chandra (1984), organizations facing financial distress may show the following symptoms:

- i. Delays or default in payments to supplier
- ii. Irregularity in the banks accounts
- iii. Delays or default in payment to banks and financial institutions
- iv. Frequent request to banks for additional credit
- v. Decline in capacity utilization
- vi. Low turnover of assets
- vii. Accumulation of inventories
- viii. Excessive turnover of personnel

### **2.1.1 Theory on Financial Distress**

Modigliani and Miller, (1958), theory, contended that in perfect capital market, the value of a company depended simply on its operating income stream and the degree of business risk attached to this, income regardless of the actual capital structure.

The MM model implies that by including corporate taxation companies should rely on debt finance for nearly 100% of their financing in a perfect capital market. In such a market investors are assumed to be numerous and rational, have homogeneous expectations and plenty of access to information. This means that the resale value of assets, even those being sold in liquidation, will reflect their economic values,( Pike 2002). Investors will therefore recognize the worth of such assets as measured by the present value of their future income flows. They would

be prepared to bid up to this value, so that the price realized by a liquidator should not involve any discount. In other words, the mere event of insolvency is irrelevant, except when it involves a change of ownership.

In effect, liquidation costs and other costs of financial distress introduce a new imperfection into the analysis of capital structure decisions, namely the actual or expected inability to realize “full value “ for assets in a distress sale and the costs of action taken to forestall this contingency. (Pike 2002).

The decision to borrow should not be over influenced by tax consideration. There are other ways of obtaining tax subsidies.

### **2.1.2 Model on financial distress**

Denoting the ‘cost of financial distress’ by FD, the value of a geared company becomes

$$V_g = V_u + [TB - FD]$$

Where,  $V_g$  = value of a geared firm.

$V_u$  = Value of ungeared firm.

T = Tax shield (tax rate-1)

B= Book value of debt

FD= Financial distress

From the above, it may be emphasized that the financial manager should attempt to maximize the gap between tax benefits and financial distress cost i.e. (TB-FD) and that there exist an optimal capital structure where company value is maximized. This occurs where the managerial benefit of further tax savings equal the marginal

cost anticipated financial distress. This occurs at gearing ratio marketed X in figure 1.

The cost of financial distress rises with gearing once the market start to procure substantial in creased risk of financial failure. The likelihood of FD being non-zero depends on the probability distribution of the firms earning profile.

### **Scenario: One**

Assume that a firm has no debt in its capital structure except equity capital of Ksh 100 million: tax rate of 10 % and shareholder-required rate of return of 20%. In this scenario the firm intends to finance a new project with perpetual life by issuing a Ksh 10 million debt at an after tax cost of 6.7% and no impact on the cost of the equity is expected. In this case the firm will have to generate additional annual return of Ksh 670,000 (0.67 million) per annum in order to meet the extra financial cost, associated with the new project so that the hurdle rate for the new project is 6.7 %. But with the explicit assumption that shareholders will not react adversely if the cost of debt is used as the cut –off rate.

### **Scenario: Two**

If the optimal gearing rate involves a capital structure with Ksh 50 millions of each type of capital i.e. Debt and equity, and that the extra Ksh 10 million debt financing will provoke shareholder to demand a return of 24% from 20%. This action would be expressed by downward pressure on share price until the returns on holding shares become 24%. The implication on this is that the project has to

meet both the debt financing cost and the additional returns required by the shareholders. The total additional required income is:

Pre – tax rate 10%

Shareholders required rate of return of 20%

Required extra income = debt financing cost + extra return required on equity

$$= 6.7\% \times \text{Ksh } 10 \text{ million} + (4\% \times \text{Kshs } 50 \text{ million})$$

$$= 0.67\text{m} + 2\text{m}$$

$$= \text{Ksh } 2.67\text{m}$$

Instead of an apparent cost of 6.7% the true cost of using debt to finance the project is actually:

$$\frac{\text{Ksh } 2.67\text{m}}{\text{Kshs } 10\text{m}} \times 100\% = 26.7\%$$

For gearing ratio up to 50% the probability of inability to meet interest payment is zero but would be 0.25 for any higher gearing ratio. For most distress company the distress will increase with the book values of debt B, so that FD function increases with gearing. If d denotes the expected cost of financial distress are:

$$FD = (pd \times V_g)$$

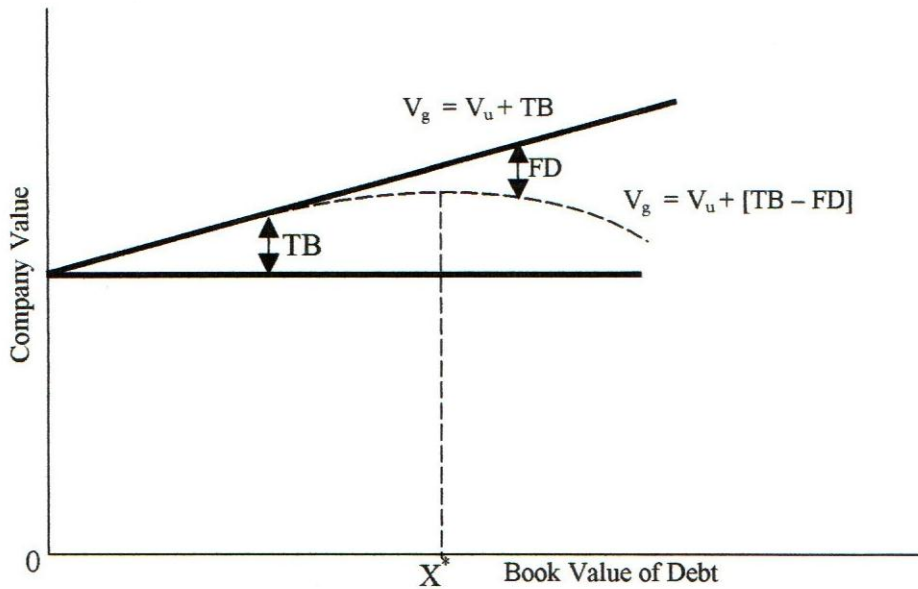
And the value of the geared firm is:  $V_g = V_u + [TB - pdV_g]$

This suggests that market imperfection can be exploited to raise company values so long as TB exceeds  $pdV_g$ . Financial distress will increase with the book values of debt. B, so that the FD function increase with gearing. If d denotes the expected percentage discount on the pre- liquidation value in the event of a forced sale, the expected cost of financial distress are:

$$FD = (pd \times V_g)$$

And the value of the geared firms is  $V_g = V_u + [TB - pdV_g]$

**Figure 1 Optimal gearing with liquidation cost**



Source: Pike (2002), Corporate finance & Investments

Corporate financial manager has therefore the important task of ensuring that there are sufficient funds available to meet all the likely needs of the business. To do this properly, he or she requires both a clear grasp of the future financial requirements of the business and of the financial markets.

## 2.2 Factors influencing the risk of financial Distress

Although most organizations are susceptible to finance distress, the factors that lead to such differ and vary depending on each organization, the most common among these are:

- (i) The sensitivity of the organizations' revenues to the general level of economic activity. If the organization is highly

responsive to the ups and downs in the economy shareholders and lenders may perceive a greater risk of liquidation or distress and demand a higher return compensation, for gearing compared with that demanded for an organization which is less sensitive to economic events

- (ii) The proportion of fixed to variable cost , an organization which is highly operationally geared and which also takes on high borrowing, may find that equity and debt holders demand a high return for the increased risk.
- (iii) The liquidity and marketability of the organizations' investment assets, which can be easily sold at a reasonably high and certain value, should they go into liquidation. This is of benefit to the financial security holders and so they may not demand such a high-risk premium.
- (iv) The cash –generative ability of the organization, some organizations produce a high regular flow of cash and so can reasonably accept a higher gearing level than an organization with lumpy and delayed cash flows.

### **2.2.2 Effect of financial Distress**

When organizations are in financial distress they run the following risks:

- (i) The risk of incurring the cost of financial distress has a negative effect on the organization value. This may offset the tax benefit associated by the use of debt finance

- (ii) If the gearing cost become considerably high, and hoping that the organization manages to avoid liquidation its relationship with suppliers, customers, employee and creditors may be seriously damaged.
- (iii) The suppliers providing goods and services on credit are likely to reduce the generosity of their terms, or even stop supplying altogether.
- (iv) Lack of assurance that the organization may not deliver on its promises may greatly impair its continuity as a going concern.
- (v) Losing key, personnel to rival organizations, as employee become demotivated due to increased job insecurity.
- (vi) Management find that most of their time is spend “ fire fighting” dealing with day-to-day liquidity problems and focusing on short term cash flow rather than long term shareholders wealth.

### **2.2.3 Prediction tools of corporate failure**

The idea here is to develop early warning screens as was developed by William H. Beaver (1966), who used statistical techniques to predict corporate failure. Beaver collected a large sample of firms that failed and compared them with other firms of similar size and in the same industry that did not fail, for the same years. These samples were used to test the predictive ability of 30 financial ratios. The mean values of the ratios for the two samples were compared over 5 –years’ period prior to failure.



The failing company model was constructed with reference to the cash - flow framework, liquidity, profitability and variability. The cash flow framework, describe the business firm as a reservoir of financial resources and its probability of failure in terms of expected flows of those resources. Other things being equal one would expect that the probability of failure is more likely: -

- i. The smaller the reservoir (a large reservoir would be a better buffer against uncertainties)
- ii. The smaller the inflow of resources from operations in both short and long run
- iii. The larger the claims on the resources by creditors,
- iv. The greater the outflow of resources required by the operation of the business
- v. The more highly variable are earning and claims against resources, represented both by outflows to maintain current operation and by obligation to creditors, or

The more failure prone the industry location of a firm's business activities are expected to be. (Obiero, 2002).

Conventionally, excessive level of gearing generally increases the financial risk and often is responsible for corporate failure, due to the company inability to pay the increased level of fixed interest charges. However, very highly geared companies have survived, and conversely some low- geared company has failed. This suggests that there are many other clues to assessing the viability of a company, and it is not enough simply to examine a single balance sheet ratio. In, 1968 Altman in his model to predict financial failure examined the financial characteristic of two samples of failed and surviving United States of American (U.S.A) companies, in order to detect which ratio was most important in discriminating between the two groups. Further studies by Marais (1982),

developed an extension of Altman Z –score model and noted that only four ratios were critical:

$$\text{i) Profitability} = \frac{\text{Pretax profit} + \text{Depreciation}}{\text{Current liabilities}}$$

$$\text{ii) Liquidity} = \frac{\text{Current assets} - \text{stock}}{\text{Current liabilities}}$$

$$\text{iii) Gearing} = \frac{\text{All borrowing}}{\text{Total capital employed} - \text{intangible}}$$

$$\text{iv) Stock turnover sales} = \frac{\text{Stock}}{\text{Sales}}$$

Altman In, (1983), carried out a further extension of his model by employing multiple discriminate analyses to predict bankruptcy, using various financial ratios. He worked with a sample of corporations that filed for bankruptcy. Like Beaver, he collected a paired sample of non-bankrupt firms on a stratified random basis; and selected the 5 ratios that did the best-combined job of predicting bankruptcy. These ratios were used to discriminate between bankrupt and non-bankrupt firms, using data from between 1 to 5 years prior to bankruptcy

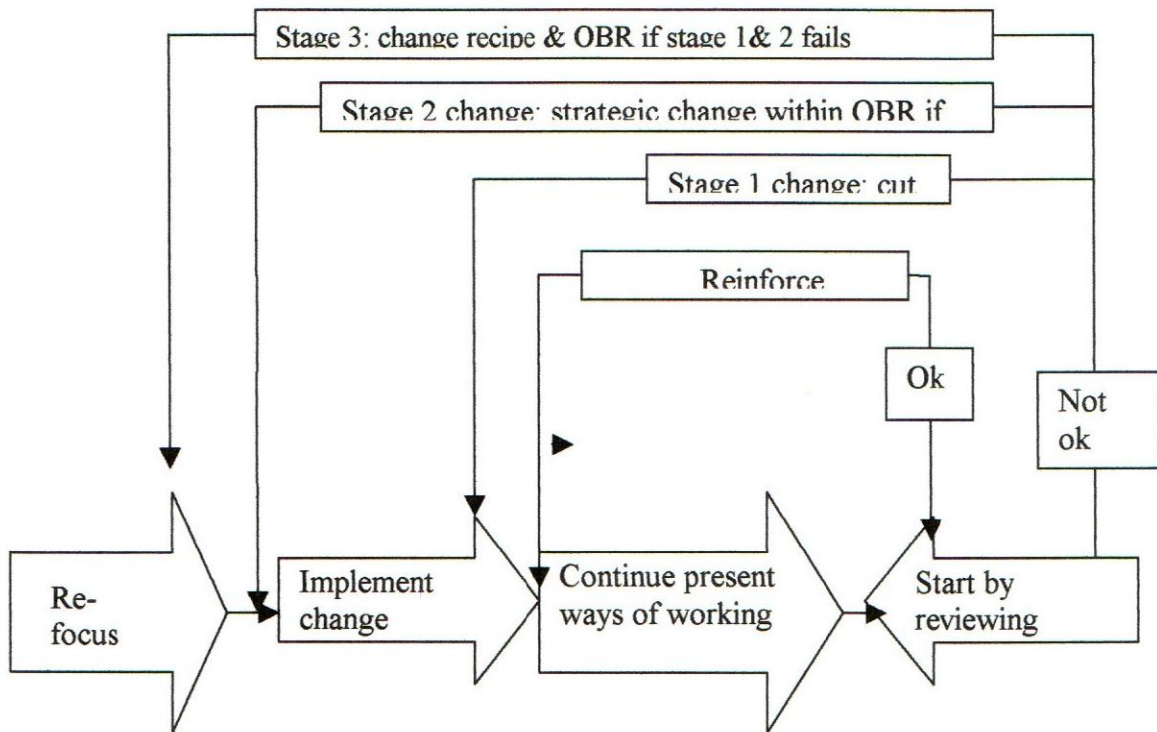
Accordingly, the study by Keige, (1991), on the banking crisis in Kenya in 1986 was a challenge to the Central Bank of Kenya and the Banking industry. They were unable to avert the crisis that resulted in huge losses of customers' deposits, when most banks and financial institutions failed. The current study may help minimize the management dilemma, and could help the Deposit Protection Fund to predict possible failures in

banks and financial institutions. Hence facilitating them to take the necessary precaution to avert losses, and to advise on the appropriate turnaround strategies to adopt, rather than allowing them to be liquidated or to placing them under the Statutory management of Central Bank of Kenya.

### **2.3 Turnaround Strategies**

A turn around strategy is an attempt to reverse a negative trend and get the company back to profitability. Turnaround cover businesses that do manage to change decline into growth (Bibleault 1982). This survey investigated the causes of decline. The conclusion drawn from this survey was that; internal deficiencies were about twice as likely to cause the decline as external causes. A further research study of the phenomenon of turnaround was carried out on 26 United Kingdom manufacturing compared between 1982 and 1987 (Grwiyer et al 1988). This study differentiated between early stage, intermediate stage and late stage turnarounds (sharp benders) and identified differences in the causes trigger and action taken for each of the three stages. The study led to a general model of how enterprises react to unsatisfactory performance as illustrated in the figure 1 below.

**Figure 2 Management model**



Source: Adapted from P. McKiernan strategies of growth, maturity, recovery & Internationalization. (Routledge, 1992)

This research findings tends to support the field observation that organizations change only when they have to and that fundamental change rarely occurs except in due circumstances.

Slatter (1984) updated and reissued as Slatter and Lovett (1999), Provides some general guidance on the issues likely to occur in enterprises, which are facing adverse circumstances and need to recover.

In the last two decades, downsizing has become the strategy favoured by many organization in order to help them cope with fundamental structures changes in the world economy (Mishra, 1998), Increasingly therefore organizations are becoming

mean and lean in their attempt to cut back cost and remain competitive (Armstrong, 2001, Dupuis, Boucherand, 1996, Jepkemboi, 2002.)

Turnaround strategies usually try to:

- (i) Reduce operational costs
- (ii) Have mean and lean operations.
- (iii) Operate more efficiently, or, some specific actions that can be taken to operate more efficiently includes:
  - (i) Eliminating or cutting back employee compensation and /or benefits,
  - (ii) Replacing higher-paid employee with lower-paid employee,
  - (iii) Leasing rather than buying equipment,
  - (iv) Reducing expenses accounts.
  - (v) Cutting back marketing efforts.

Examples of ways to reduce the size of operations include:

- (i) Eliminating low-margin or unprofitable products,
- (ii) Selling buildings or equipment,
- (iii) Laying off employees, and
- (iv) Dropping low margin customers.

Companies that employ turnaround strategies are usually forced into it and do so with the hope that it will be only a temporary measure until things improve. (Byars, Rue and Zahra (1996).

Horne (1986), state that the remedies for saving a failing company vary in harshness and the degree of financial difficulty. If the outlook is sufficiently hopeless, liquidation may be the only feasible alternative. With some hope and

luck, many failing firms can be rehabilitated to the gain of creditors, shareholders and society.

Turnaround effort tends to be high-risk undertaking and often fail. An Oft-cited study of 64 companies found no successful turnaround among the most troubled companies in eight basic industries. Many waited until it was too late to begin a turnaround. And others found themselves short of both cash and entrepreneurial talent needed to compete in a mature industry, characterized by a fierce battle for market share, as better positioned rivals proved too strong to defeat in head-to head combat for the market share in order to survive. This study found that as market maturity approaches, and competitive hostility intensifies, the firm's range of strategic option narrows. For a crisis-ridden firm to be successful in a turnaround effort, its management has to be alert to the signs of an impending competitive shakeout and launch an entry effort to reposition the firm and restore its competitive status. (Chandra 1984)

An attempt on a turnaround necessarily depends on the root of poor profitability and the urgency of any crisis. Depending on the causes, there are six action approaches that can be used singly or in combination to achieve a turnaround in a diversified enterprise:

- (i) Focus mainly on restoring profitability in the money –losing units
- (ii) Implement harvest/divest strategies in poorly performing units and allocate money and resources to expansion of better-performing units.
- (iii) Institutes across-the-board economies in all business units

- (iv) Revamp the composition of the business portfolio by selling off weak business and replacing them with new acquisitions in more attractive industries
- (v) Replace key management personnel at the corporate and/or business levels
- (vi) Launch profit improvement programs in all business units.

### **2.3.2 Portfolio restructuring**

Portfolio restructuring strategies involve radical surgery on the mix and percentage makeup of business in the portfolio. Restructuring can be prompted by any of the following conditions.

- (i) When a strategic review reveals that the long-term performance prospect for the corporation as a whole have become unattractive (because the portfolio contains too many slow-growth, declining, or competitively weak business units
- (ii) When one or more of the firm's key business units fall prey to hard times.
- (iii) When a new chief executive officer takes over the reins and decides that it is time to redirect where the company is headed.
- (iv) When "wave of the future" technology or products emerge and make a series of foothold acquisitions an attractive way to get a position in a potentially big new industry.

- (v) When a "unique opportunity" presents itself make an acquisition so big that several existing business units have to be sold off to raise money to finance the new acquisition. (Karimi, 2002).

### **2.3.3 A Combination of the above**

Combination turnaround strategies are usually essential in grim situations where fast action on a broad front is required. Likewise, combination actions frequently come into play when the rescue effort entails bringing in new managers, and giving them a relatively free hand to make whatever changes they see fit in restoring the business to a good condition, but if the problems, is more complicated, a multiple approach would be adopted, rather than just one turnaround strategy.

## **2.4 Liquidation**

Liquidation is the most unpleasant and painful actions especially for a single enterprise where it means terminating the organization existence. For a multi-industry and multibusiness firm, to liquidate one of its lines of business is less traumatic, because the hardship of suffering (through layoffs, plant closings, etc), It can also mar reputations and ruin management career. Unfortunately, it is seldom simple for management to decide when a cause is lost and when a turnaround is achievable. This is particularly true when emotions and pride get in the way of sound judgment-as they often do.



## **2.5 New Management Concepts**

In order to implement turnaround strategies and to forestall the organization from the risk of business failure, new management concepts are adopted to act as the drive, against which the organization would use, to, steer change, tap staff potential, and strengthen individual beliefs and corporate culture. Examples of such concepts are:

### **2.5.1 Empowerment.**

In the article “ Thriving on chaos” (1987), Tom Peter, stated that the chief reason for failure in any world –class organization is the failure to tap staff potential. Individual employees need to feel as though they are valued members of a team. These will

provides the initiative and vigour that is necessary to serve customers effectively and to create an environment that is stimulating for the staff.

### **2.5.2 Reengineering**

This will involve carrying out dramatic change of the organizational structure, Management system, employment responsibilities and performance measurement, incentive systems, skill development, and the use of information technology.

Successful application of this process can help transform an organization on the verge of bankruptcy into an effective competitor (Hammer and Champy, 1993).

### **2.5.3 Team Building**

In order for any organization survive the increasing environmental pressures, team effort assume greater importance. In team building individuals tend to work independently to satisfy the organizational objectives as well as their own individual objectives.

The value that can be achieved from the team efforts could be critical to successful turnaround strategies (Peter & Waterman, 1982).

### **2.5.4 Value –Based Management (VBM)**

Many of the organizations that have used the VBM concepts have succeeded in improving the organization performance. However, quite a few others have failed, due to lack of vision as a guiding philosophy.

From the past study conducted by, the McKinley Consulting Firm, it was noted that the cause of failure on performance targets was caused by vaguely defined targets that were not properly aligned to Value, Management approach (VBM), since it fails to provide a precise and unambiguous metric upon which an entire organization could be built.

The philosophy behind VBM is that the value of the company is determined by its discounted future cash flow. Value is created only when companies invest capital at returns that exceeds the cost of capital.

### **2.5.5 Retrenchment**

Retrenchment differs from turnaround in that retrenchment is a temporary retreat and trimming back in the face of adverse conditions. The strategic posture of

retrenchment is one of “battering down the hatches and weathering out the storm” Retrenchment is a common short-run defensive strategy for responding to conditions of general economic recession, tight money, periods of economic uncertainty, a storm of public criticism, and /or harsh regulation. Corporate retrenchment also makes sense as a response to internal financial crisis brought about by excessive rapid expansion, strain in financing a major capital investment project, or an unexpected business reversal. Retrenchment strategies are usually dropped as soon as conditions turn favorable enough to resume expansion and other new initiative

## **2.6 Successful Turnaround case**

### **2. 6.1 Turnaround strategy at Cummins Engine**

Cummins Engine was founded in 1919 in Indiana by the Miller family and is the nation’s largest diesel engine manufacturer and the only independent engine maker left in the United States.

By 1994, Cummins had re-established itself as the leading commercial diesel engine producer in the world. The key factor was increased market demand for new Cummins products. Had Cummins not made extensive and early investment in R&E, it would not have been able to supply the medium-duty engines and power generators customer wanted, nor could it have provided the technology for cleaner operating heavy-duty engines as required by new environmental regulations.

The Cummins new technology strategy took longer than expected to show positive result. The company initiated its restructuring plan in 1982 and continued doing so for ten years. During those ten years, there were seven years in which operations

resulted in losses. Cummins was not able to attract private capital, in its quest to reposition and reorganize the company. None of the public domestic capital was available due to a lack of willingness to give up the right to sell shares even if, as in several cases, they had been holding onto their Cummins common share for twenty years. Cummins was eventually able to attract capital from its largest equipment buyers so that it could develop a distinctive competence that made it the leading diesel engine manufacturer.

Several of the European and Japanese producers turned to Cummins for alliances and associations based solely on the products of Cummins' new technology. Is this a reasonable result? And, if so, how do manufacturing companies dependent on the capital markets attract the capital necessary to make the investment needed to advance technologies? Cummins management believed it they made the correct strategic decision, both in terms of positioning of its manufacturing operations in a globally competitive environment and in terms of its responsibility as Managers to stockholders. But only after its R&E program was a success did other manufacturers seek these alliances.

What did Cummins learn about strategy from this experience? First, a company needs a well-defined strategy that shareholders and key stakeholders have bought into it as the strategic vision and its implications for the company. In addition, the company must be positioned to respond to change even with a consensus strategy. Cummins did not anticipate that its strategy was going to take so long to show result; and that it was going to be forced to lower prices halfway through the process. It was able to respond effectively, it had in place a clear strategy, regular

and open communications, and finally, a “share the pain, share the gain ” philosophy with its shareholders.

But fundamentally the key is implementation, and Cummins management had the incentives in the capital market ran counter to competing the Cummins long-term strategy. Indeed, management’s personal incentives were structured such that they did not benefit from the strategy for along time. The company’s shareholders at that time owned stock for long time. The company’s shareholders at that time owned stock to see Cummins strategy carried out over fifteen years. The question for the larger economy is over what timeframe do you maximize gains to the investor? The issue is not whether professional management has the responsibility to maximize return to shareholders, but rather over what period of time. Cummins had that debate in 1980, and decided in favor of the longer timeframe, which was the turning point in its history.

In retrospect, the debate was properly structured. Admittedly, Cummins was influenced by several considerations beyond share price maximization. The company was a famliy company at inception and the Values that it held to be central to the organization were derived from that condition; also, Cummins’ markets were eroding, and to survive it needed to enter new markets, which inevitably required significant capital investment. Additionally, the application of Environmental Protection Agency Standards onto Cummins products, both existing and potential, was going to have significant market impact. But with shrewd research and development program planning this could be taken advantage of. These were important considerations, and the company could not afford to neglect any of them.

A strategy that integrated all of them inevitably required a timeframe longer than the capital markets were prepared to reward. The Cummins experience demonstrates that with imagination and determination, a strategy focused on the long-term will pay-off, nevertheless. (Journal of Strategic Management Education I (I), 2003)

Corporate turnaround, retrenchment and portfolio restructuring strategies come into play when senior management undertakes restoration of an ailing corporate business portfolio to good health. (Chesang, 2002).

Hugh, Macmillan and Tompoe, (2000), stated that turnaround covers, business that does manage to change decline into growth. (Bibleault, 1982). This study investigated the causes of decline in organization, "How managers turned losers into winners". The survey concluded that internal deficiencies were about twice as likely to cause the decline as external causes

The first task is always the diagnosis of the underlying reasons for poor corporate performance, and Formulation of curative strategies that will follow. Poor performance can be caused by large losses in one or more units, which pull overall performance down. /or having a disproportionate number of businesses in unattractive industries, a bad economy which has adversely impacted on many of the firm's business units or having weak management at either the corporate or business levels.

## **2.7 Assumptions**

The study will be based on the following assumptions:

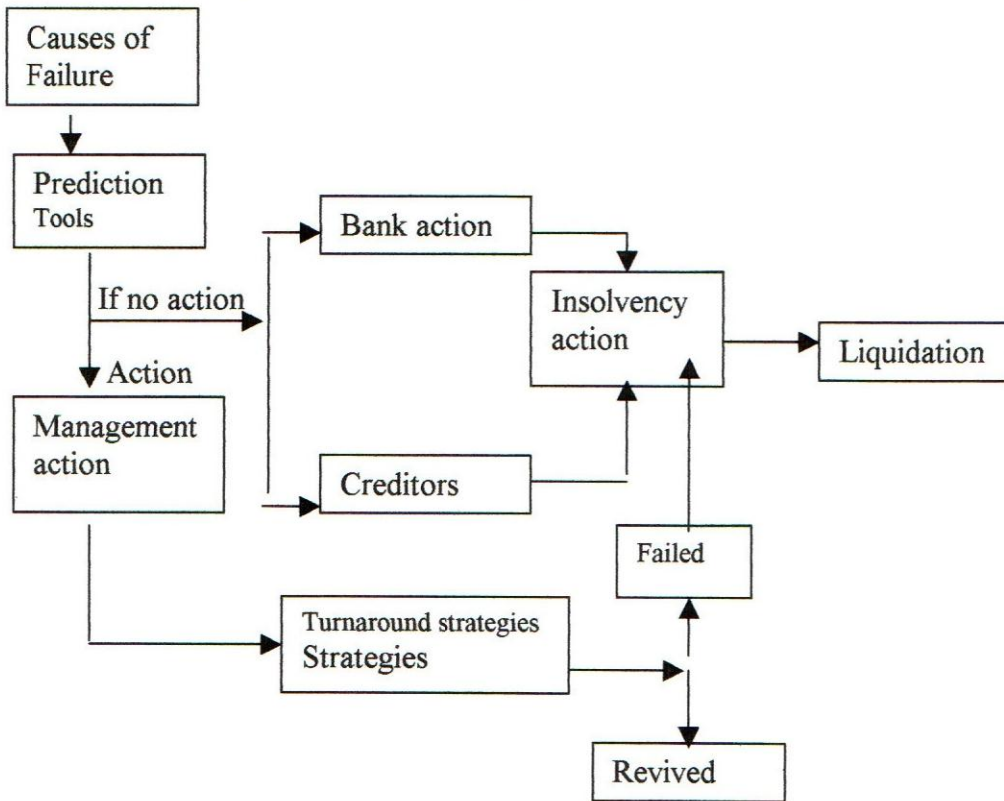
- (i) A Company may under-take several turnaround strategies in a given phase.
- (ii) The turnaround strategies or a combination of them can start and conclude during the period of the study.
- (iii) No none economic variable can significantly affect the implementation of any chosen turnaround strategies
- (iv) The variables from any of the chosen turnaround strategies would be easily testable, from the output achieved.

## **2.8 Conceptual framework**

A turnaround strategy is an attempt by managers to reverse the crisis situations that besiege the organization performance. Managers have the responsible for steering the organizations back to profitability, and may have to undertake turnaround strategies which could either be short or long term. The management is expected to take action and to control the emerging loss making to profitable operations. This means that the organization will have to carry out a radical business transformation, but if no action is taken at this stage, the organization may become technically insolvent and hence fail to service its maturing financial obligations, as and when they fall due. Creditors or /Debenture holder may exercise their statutory right and put the organization into bankruptcy or liquidation, hence bringing the organization to a terminal end. When this

happens, the shareholders and other stakeholders' lose their investment. There is therefore need for managers to act on the crisis befalling the organization rather than leaving it at the hands of the liquidator. This relationship is diagrammed in figure 3

**Figure 3 Corporate Rescue Attempt**



Source: own

Figure.3 above shows how the type of decision that the management may take or not take Depending on what type of decision is taken can affect an organization survival. The. Financial performance can either improve or deteriorate. The organization could go into insolvency, liquidation, or it may adopt turnaround strategies that may steer it to recovery.



## **CHAPTER 3: RESEARCH METHODOLOGY**

### **3.0 Study Area.**

The data was analyzed from financial statements of audited accounts of the organizations under the study to test the impact of turnaround strategies on the financial performance of the selected organizations to reverse the negative effect on their profitability, liquidity and gearing in their endeavour to improve their financial performance. The average financial ratio derived from the computation was compared with the average turnaround strategies adopted, and their critical importance.

This chapter outlines the procedures and method that the researcher considered appropriate in collecting the desired data, recording, analyzing and presenting the information gathered.

### **3.1 Target Population**

The study was based on six Parastatal organizations that undertook turnaround strategies to address their poor financial performance before and after they were privatized. These are Kenya Commercial Bank Limited (KCB), National Bank of Kenya Limited (NBK), Kenya Airways Limited (KQ), East Africa Portland Cement Limited, Kenya Power and Lighting Company (KPLC) and Uchumi Supermarkets Limited.

### **3.2 Data collection**

The Research examined the past audited financial statements of the selected six organizations, and detailed financial statement analysis was carried out to evaluate how those organizations performed, between the periods 1992 to 2002, and how, the turnaround strategies adopted influenced or affected their financial performance. In order to achieve this, ratio analysis of key accounting ratios, derived from audited financial statements of those organizations, was undertaken.. This made it possible to generate several financial scenarios that helped in evaluating how these organizations performed, during the period of the study based on:-Ratios analysis

In order to determine the financial position of these organizations during the period of the study and what was the effect on their financial position, after they pursued certain and adopted turnaround strategies. What types of turnaround strategies were adopted and implemented and which turnaround strategy had the most effect in reversing the negative effect on their profitability, liquidity, and gearing. The study targeted the past eleven years during which various types of turnaround strategies were implemented .It also evaluated the impact of the adopted turnaround strategies on the financial performance of those organizations, over the period of the study. Primary data was collected through the use of questionnaires, which were sent to the Chief Executive Officers of each of the organizations selected.

### **3.3 Data Analysis**

#### **3.3.1 Ratio Analysis**

To accomplish the objectives of this study analytical test of key accounting ratio, was performed From the audited financial statements and computed key financial indicators that may help in enhancing the internal controls efficiency of assets management and for use by various government and regulatory authority and also better understanding of what the capital supplier seek in financial condition and performance from the organization. The needs of various stakeholders differ according to specific need of the party involved. For example; trade creditors are interested primarily in the liquidity. This is because their claims are short term, and the ability of the organization to settle their claims is best judged by means of thorough analysis of its liquidity. The claims of debenture holders, on the other hand, are long term, and accordingly they are more interested in the cash flow ability by analyzing the capital structure of the organization to service its debts over the long run. The Debenture holders may evaluate this ability by analyzing the capital structure, the main sources and uses of funds and its profitability over time and into the future. Shareholders are principally concerned with present and expected future earning and the ability of these earning trends, and as well as their covariance with the earning of other organizations. The investors will ultimately concentrate their analyses on the profitability, and the financial condition in so far as it affects the ability of the firm to pay dividend and to avoid bankruptcy In order to evaluate the financial condition and performance of these organization ratio

analyses was used as the yardstick to help in understanding the financial condition and performance of these organizations. These ratios were arrayed in a spreadsheet covering the period of eleven years, in order to study the composition of change and determine whether there has been an improvement or deterioration in the financial condition and performance of these organizations over time. These results were also plotted using trend graphs to observe the trend.

The result of the questionnaires was also analyzed using frequency tables to determine and to rank each types and the significance of those turnaround strategies that were adopted. Further analysis of the turnaround strategies (A-F) was presented on table showing the number of strategies each organization adopted, and an average number of strategies obtained. Similar analysis of the average turnaround strategies that were considered as critical was also carried out, to determine which strategies were commonly used.

Tabulating the results from he average turnaround strategies adopted and the average financial ratio that may help to measure the profitability, stability, liquidity, and return on investment tested the first hypothesis. Multiple Regression analysis was used to compute and to test the degree of relationship between the turnaround strategies adopted and the level of financial performance that the organizations achieved

## CHAPTER: 4 FINDINGS & DISCUSSIONS

### 4.0 Introduction

The chapter covers the presentation of the secondary data, the primary data and the relationship between the secondary and primary data

### 4.1 General Results

The tables and the figure below, gives the summary of the general findings of the study .The findings are grouped as per the Parastatal and their financial years under the study. They include the details of the financial ratios, and the performance of the respective Parastatal.

**Table 2: Comparison of Earning per share.**

COMPANY	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
KQ	-118.00	-146.30	-.80	4.63	3.07	1.84	2.85	2.61	6.03	2.94	1.88
KPLC	1.03	4.06	7.74	13.70	14.11	18.88	18.50	18.50	-40.00	-38.00	-23.70
EAPC	0.11	0.34	0.90	0.62	0.75	1.01	4.17	-9.76	-4.66	0.82	1.37
KCB	4.27	11.4	15	21.1	22.3	22.9	10	-14	4.14	0.1	-20.1
NBK	0.43	0.45	1.24	1.85	2.51	1.94	-11.00	-12.00	-11.00	1.49	0.99
Uchu mi	1.54	3.17	4.50	3.51	4.33	3.75	5.21	4.07	0.53	1.49	0.83

Source: audited financial statements

### Earning per share.

This ratio expresses the income that belongs to the ordinary shareholders after all other claims have been paid. The shareholders are particularly interested in knowing how much has been earned during the financial year, and what will be distributed as dividend or retained for expansion. The table below examines the trend of the earning per share of the above listed organizations, and what interpretation deduced from the trend.

**Table 3: Interpretation of Earning per Share**

<b>Company</b>	<b>Interpretation of the ratio</b>	<b>Recommendation</b>
<b>KQ</b>	The negative earning per share trend improved in 1995 to 1996, but earning per share declined in 1997, improving marginally in 1998 and 1999, before the best the best performance in earning per share was recording in, 2000. The upward earning per share trend declined in 2001 and 2002	The average earning per share deteriorated to a negative per share Ksh 23.42. If this trend and the inability to generate sufficient profit is not tackled and reversed it could be a major drawback to the Company' success.
<b>KPLC</b>	The earning per share trend improved from Ksh, 1.03 in 1992 to ksh.18.50 in 1999. However it suddenly dropped to a negative per share of ksh.40, in 2000. It improved slightly in 2001 to a negative earning per share of ksh.38, and ksh23.70 in 2002, respectively.	The huge loss the company made in 2000, through 2002, reduced the average earning per share to Ksh 6.28 from Ksh. 18.50, in 1999.

<b>EAPC</b>	The trend in earning per share, increased a steadily from Ksh 0.11 in 1992 to ksh.4.17 in 1998. However this trend declined to a loss in earning per share in 1999, but improved to Ksh 1.37 in 2002.	The average earning per share during the period under the study dropped to a negative per share of ksh1.2.
<b>KCB</b>	The earning per share improved from ksh4.27 in 1992, to ksh.22.9 in 1997. This positive trend in earning subsequently declined to a negative earning per share of ksh.20.1 in 2002.	The average earning per share of Ksh.6.28 could be an indication of the future potential of the Bank to the Investors, who would wish to invest in it.
<b>NBK</b>	The trend in earning per share improved in 1993,from ksh.0.45 to Ksh 2.51 in 1996. However this trend declined to ksh.1.94 in 1997.In 1998 the earning per share declined to negative earning until 2000, when it to improved to ksh, 1.49 in 2001, but again declined to Ksh 0.99 in 2002	The average earning per share during the period of the study was negative earning per of Ksh.2.37.
<b>Uchumi</b>	The trend in earning per share improved from ksh.1.54, in 1992 to ksh.4.50 in 1994, but declined in, 1995, to 1997. However this improved to ksh5.21, but declined in 1998, through, 2000 increasing to Ksh. 1.49 in 2001, but declined to Ksh 0.83,in 2002	The average trend in earning per share was Ksh.2.99 during the period of the study. However the rate of decline in earning per share should be checked.

**Table 4: Comparison of Return on Investment.**

Company	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
KQ	0.09	0.1	0.1	0.27	0.14	0.08	0.1	0.07	0.12	0.06	0.04
KPLC	4.35	-6.59	19.07	31.8	28.19	33.76	27.9	20.9	-43	-64	-13.4
EAPC	0.02	0.04	0.08	0.01	0.01	0.02	0.06	-0.15	-0.05	0.01	0.02
KCB	0.02	0.03	0.03	0.04	0.04	0.04	0.01	0	0	0	-0.05
NBK	0.01	0.01	0.02	0.02	0.01	-0.1	-0.1	-0.1	0.01	0.01	
Uchumi	0.16	0.21	0.24	0.17	0.19	0.14	0.17	0.13	0.01	0.05	0.02

Source: audited financial statements

**Return on investment**

Since income is earned by using the assets of business productivity, therefore the rates of return on total assets will indicate the degree of efficiency, with which management has used the assets of the enterprise, to generate profit. This ratio is important to Investors as they placed funds with the managers of the business to better their returns, but if this is not achieved, the investors would have to invest elsewhere.

The rate of return on such assets should compare favourably, or be higher than the market rate of return on Treasury Bills during the same time period, Table 5 that follows examines the trend on the return on investment of the above listed organizations, and what could possibly be deduced from these results



**Table: 5 Interpretations of Return on investment**

Company	Interpretation of the ratio	Recommendations
KQ	The rate of return on investment improved from 9% in 1992, to 27% in 1995 but to declined to 4% in 2002	Despite the increase in turnover the Airlines' the return on investment continued to decline.
KPLC	The rate of return on investment declined between 1992 and 1993 by 10.94%, but increased in 1997, before it steadily crashed to negative 64% in 2001, the negative trend reversed to negative 13.4%	The sudden negative trend that happened in 1998 to 2001 was so significant and could easily, lead to inability to trade.
EAPC	The rate of return on investment was below 10% during the period 1992 to 1998. 1% in 1995 and 1996. In 1999 the return dropped to negative return of 15%. However the trend reversed in 2000 up to 2002. In term of percentage the most improvement of 299% occurred in 1998 while the worst decline was of 344% in 1999.	The rate of return on investment change was so erratic and therefore unattractive to both the current and future investors
KCB	The rate of return on investment increased from 2% in 1992 to 4% in 1997, before declining in 1998 through 1999 to negative 1%. In 2000 and 2001 the rate improved positively, but slipped to a decline of negative 5% in 2002	The average rate of return on investment was negative 1% during the period covered by the study, the trend though consistent in 1994 to 1997 was reasonably erratic in latter years

NBK	The rate of return on investment, increased from 1% in 1992 to 2% in 1995., This trend continued up to 2000, when the return became negative 1%. The rate steadily rose to 1% in 2001 and 2002	The average rate of return on investment during the period of the study was negative 2%.
UCHUMI	The rate of return on investment improved in 1992 from 16% to 24% in 1994, but started to decline at an increasing rate to 1% in 2000, the rate improved slightly in 2001, only to decline in 2002.	The return on investment generated from the assets declined randomly at an increasing rate. these

**Table 6: Comparison of Return on Equity.**

Company	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
KQ	0.31	0.28	0.02	0.57	0.25	0.14	0.2	0.16	0.37	0.17	0.12
KPLC	4.85	-24	32.21	36.7	28.48	30.77	28.7	22.8	-79	-264	-53.4
EAPC	0.05	0.14	0.28	0.17	0.05	0.06	0.22	-1.07	-0.26	0.04	0.06
KCB	0.22	0.4	0.37	0.37	0.31	0.26	0.11	-0.2	0.06	0	-0.57
NBK	0.06	0.07	0.08	0.12	0.16	0.12	-0.5	-1.2	-1	0.17	0.1
Uchumi	0.38	0.39	0.49	0.37	0.41	0.35	0.42	0.3	0.03	0.1	0.05

Source: audited financial statements

### Return on Equity

In evaluating this return the investor will be trying to evaluate the management performance in generating profit for the shareholders of the company, such return will need to ensure that the owners get sufficient return on their investment. This

however must be higher than the rate of return on the investment. Table 7 examines the trend of return on Equity of the above listed organizations, and what could possibly be deduced from the results.

**Table: 7 Interpretation of Return on Equity**

Company	Interpretation of the ratio	Recommendations
KQ	The return on Equity declined from 31% in 1992, to 28% in 1993, and 2% in 1994. The return rose steadily in 1995 to 57%, before it started to decline up to 1999. This however changed in 2000, but later declined in 2001 and 2002 to reach lower rate of 12% in 2002	Despite the increase in turnover the Airlines' return on Equity continued to decline at an increasing rate.
KPLC	The rate of return on Equity declined between 1992 and 1993 by 28.85% but increased up to 1995, before it declined in 1996 up to 2001, when it crashed to negative 264%, the return however improved by registering negative return of 53.4% in 2002	The sudden negative trend that happened in 1999 to 2001 was so significant and could easily lead to inability to trade.

EAPC	<p>The rate of return on Equity was between 5% in 1992 to 14% in 1993, however 1994 recorded the highest return of 28%. In 1995 the rate was 17%, but dropped in and the lowest in 1996 and 1997. In 1998 the return increased to 22%, before dropping to negative return of 10.7%. However the trend reversed in 2000 up to 2002.. In term of percentage the most improvement of 266 % occurred in 1998 while the worst decline was of 584% in 1999.</p>	<p>The rate of change of the return on Equity was so erratic and therefore unattractive to both the current and future investors</p>
KCB	<p>The rate of return on Equity improved in 1992 from 22% to 40% in 1994, but started to decline at an increasing rate to negative 2% in 1999, the rate improved slightly in 2000 and 2001 before crashing in , in 2002. To negative 57%</p>	<p>The average rate of return on Equity was 11% during the period covered by the study, the trend though consistent in 1994 to 1997 was reasonably erratic in latter years</p>
NBK	<p>The rate of return, increased from 7% in 1992 to 16% in 1995, when it assumed a negative trend up to 1999, registering a return of negative 12%.The rate steadily rose to 17% in 2001 and 10% 2002</p>	<p>The average rate of return during the period of the study was negative 18%.</p>

UCHUMI	The rate of return on Equity improved in 1992 from 38% to 49% in 1994, but declined in 1995. In 1996 it increased slightly to 41%. From 1997 to 2000 it declined at an increasing rate to the lowest level of 3% in 2000, subsequently the rate improved 10% but, declined again in 2002.	The return on Equity generated from the assets declined randomly at an increasing rate, these casts doubt as to the company ability to generate sufficient profit using its available assets.
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**Table 8: Comparison of operating profit**

Company	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
KQ	-0.06	.09)	0	0.01	0.20	0.1	0.12	0.11	0.16	0.09	0.04
KPLC	0.04	-0.05	0.08	0.12	0.10	0.13	0.11	0.09	-0.2	-0.2	-0.11
EAPC	0.03	0.04	0.08	0.06	0.06	0.06	0.23	-0.55	-1.85	0.31	0.07
KCB	0.07	0.17	0.23	0.31	0.25	0.24	0.08	-0.16	-0.06	0.002	-0.47
NBK	0.05	0.05	0.12	0.17	0.15	0.11	-0.1	0.07	0.02	0	0.4
Uchumi	0.12	0.14	0.13	0.09	0.09	0.07	0.08	0.05	0.06	0.02	0.01

Source: audited financial statements

### Operating profit margin

Operating profit margin is the amount of profit that has been generated from each Shillings of sale realized. Table 9 below examines the trend of return on Equity of the above listed organizations, and what could possibly be deduced from the results

**Table: 9 Operating profit margin**

Company	Interpretation of the ratio	Recommendations
KQ	The operating profit margin declined from negative (0.06) in 1992, to (0.09) in 1993, and zero in 1994. The return rose in 1995 to 0.10 and 0.20 in 1996, it started to decline bumpily up to 1999. This decline reversed 2000, but later declined in 2001 and 2002 to reach lower rate, of 0.04 in 2002	Despite of the increase in turnover the Airlines' operating profit margin continued to improve initially in 1993 to 1996, but later started to decline
KPLC	The operating profit margin changed marginally in 1992 to 1998, but started to decline steeply in 1998 to 2000.	The margin was very low as compared to the level of turnover that was realized.
EAPC	The operating profit margin changed moderately during the period 1992 to 1996 and increased in 1997, before the declined become more pronounced.	The rate of change in operating profit margin indicated that the company's resources were not efficiently used
KCB	The profit margin improved slightly in 1992 to 1997 but declined in 1998 and 1999, before it steadily increased in 2000 and 2001, but dropped in 2002.	Although the margin improved in the early years its steady dropped to losses.
NBK	The margin, increased from 5% in 1992 to 17% in 1994, when it assumed a negative trend up to 1997, however the margin gradually improved through, 2002.	The margin was significant low, indicating that the management was not efficient utilizing the assets at their disposal.

UCHUMI	The operating profit margin improved by 17% from 1992 to 1993, and declined by; 2 % in subsequent years. This trend persisted up to 2002, when it dropped by 93%.	The margin continued to decline in spite of the turnaround effort that was made
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**Table 10: Comparison of Debt to Asset Ratio.**

Company	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
KQ	0.85	0.77	0.56	0.14	0.07	0.16	0.23	0.34	0.35	0.37	0.35
KPLC	0.55	0.67	0.52	0.38	0.27	0.21	0.3	0.3	0.58	0.83	0.83
EAPC	0.58	0.7	0.71	0.93	0.76	0.75	0.71	0.86	0.8	0.74	0.74
KCB	0.91	0.92	0.92	0.88	0.88	0.86	0.86	0.88	0.89	0.87	0.91
NBK	0.91	0.89	0.83	0.89	0.86	0.88	0.83	0.91	0.9	0.92	0.92
Uchumi	0.58	0.48	0.51	0.54	0.54	0.6	0.6	0.56	0.59	0.52	0.63

Source: audited financial statements

**Debt to Asset Ratio.**

This ratio examines the extent to which funds are provided on a long-term basis by creditors as compared what the owners have invested. Table 11 below examines the interpretations of Debt to Assets ratio of the above listed organizations, and what could possibly be deduced from the results

**Table: 11 Interpretation of Debt to Asset Ratio**

Company	Interpretation of the ratio	Recommendations
KQ	The debt to asset ratio declined from 0.85 in 1992 to 0.07 in 1996, but started to increase in 1997 by 0.16 to 0.37 in 2001. However this trend started to reverse in to 2002.	The organization reliance on external debt significantly declined up to 1996 and started to increase in 1997 to 2001.
KPLC	The debt to asset ratio increased in 1993, but started to decline in 1997, however it started to increase in 1998 up to 2002.	The increase on the external debt and their subsequent increase subjects the organization to a financial risk..
EAPC	The debt to asset ratio changed between 0.03 in 1992 to 0.06% in 1997, however 1998 recorded the highest return of 0.23, before it started to decline In 1999 and 2000, when it was at a negative margin of 1.85 , improved in 2001 , but declined in 2002.	The rate of change of the debt to asset ratio was so erratic and therefore unattractive to both the current and future investors
KCB	The debt to asset ratio improved in 1992 from 22% to 40% in 1994, but started to decline at an increasing rate to negative 2% in 1999, the rate improved slightly in 2000 and 2001 before crashing in , in 2002. To negative 57%	The average debt to asset ratio was 11% during the period covered by the study, the trend was consistent in 1994 to 1997 and was erratic in latter years
NBK	The debt to asset ratio, increased from 7% in 1992 to 16% in 1995, and declined up to 12% in 1999. The rate steadily rose to 17% in 2001 and 10% in 2002	The average debt to asset ratio during the period of the study was negative 18%.



UCHUMI	The debt to asset ratio declined in 1993 to 1996 before improving in 1997 and 1998 to a ratio of 0.60 and then declining in 2001 to 0.52 before improving again in 2002 to 0.63.	The debt to asset ratio continued to decline in spite of the turnaround effort that was made
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**Table 12: Comparison of Current Ratio.**

Company	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
KQ	0.72	0.78	0.79	1.22	1.42	1.3	1.3	1.53	1.67	1.6	1.19
KPLC	0.99	0.97	0.98	0.99	1.03	0.99	0.97	0.93	0.85	0.68	1.16
EAPC	2.21	1.73	1.38	1.39	1.86	1.02	1.31	1.55	1.93	2.2	2.51
KCB	0.15	0.24	0.25	0.18	0.17	0.13	1.11	1.08	1.06	1.07	1.0
NBK	1.02	1.08	1.07	0.99	1.04	0.98	0.06	0.09	0.13	0.96	0.98
Uchumi	1.37	1.82	1.55	1.45	1.47	1.31	1.2	1.33	1.15	0.98	0.72

Source: audited financial statements

### **Current Ratio**

This ratio expresses the relationship between the organization current assets and its current liabilities. It measures the ability of the organization to meet its short-term debts as and when they fall due. Table 13 examines the trend Current ratio of the above listed organizations, and what could possibly be deduced from the results

**Table 13: Interpretation of Current Ratio**

Company	Interpretation of the ratio	Recommendations
KQ	The current ratio increased by 8.3%, between 1992, and 1993, and by 1.3% 1994. It improved by 54% in 1995 & by 16.4% in 1996, but declined by 8.5% In 1997. In 1998, the level remained constant, but improved by 17.7% in 1999, and 9.2% in, 2000, but dropped by, 4.4% in 2001. In 2002 the upward surge suddenly reversed by 25.6%.	The average level of current ratio was 1.23:1 which is below the recommended level of 2.1. This indicates that the Airline current liabilities are covered, 1.23 times by the available assets.
KPLC	The current ratio was not significantly different between 1992 and 1995, but improved by 4. % Between 1995 and 1996. This however declined by 14.6% between 1996 and 2001, before increasing by 31.8% in 2002.	The organization current assets could not be sufficient to cover the short-term financial obligations as and when they fall due.
EAPC	The current ratio declined by 37% between 1992 and 1995, but improved by 33.8% in 1996 before dropping by 28.4% in 1998. Subsequently the level improved by 91.6% between 1999, to 2002.	The overall level of 1.74: 1 is not materially significant from the recommended level of 2:1.
KCB	The current ratio was materially low at less than 0.12: 1 This is much below the recommended level of 2:1	The average level of current ratio of 0.12:1 is quite low, as it may signify that the Bank cannot meet its short-term financial commitments.

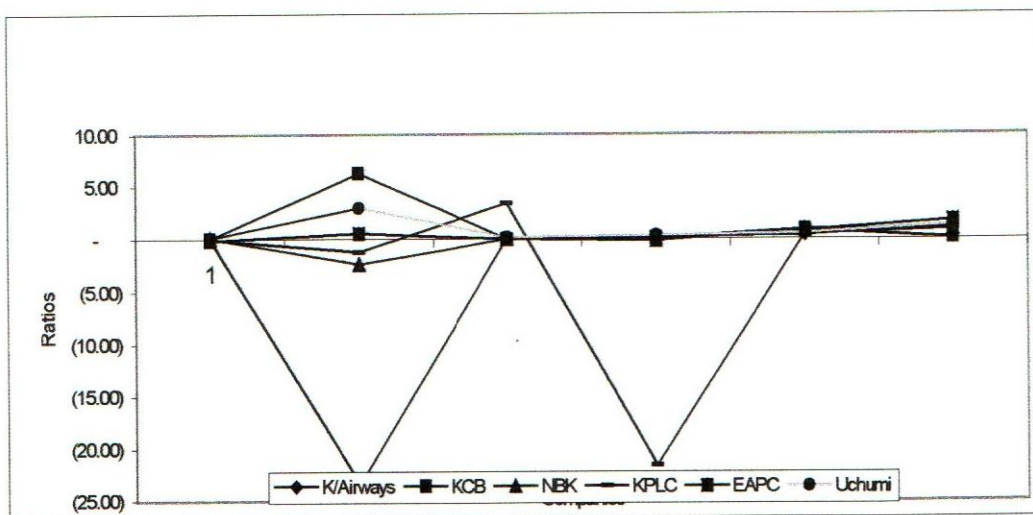
NBK	The current ratio remained substantially constant at 1: 1 through the period of the study.	Probably due to its nature the current liabilities were almost covered by the available current assets
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**Table 14: Comparison of financial ratio**

Ratios	K/Airways	KPLC	EAPC	KCB	NBK	Uchumi
Earning per share	(23.42)	(1.21)	0.57	6.28	(2.37)	2.99
Return on equity	0.23	(21.64)	0.02)	0.11	(0.18)	0.30
Return on investments	0.06	3.44	0.01	0.01	(0.02)	0.13
Operating profit margin	0.07	0.02	0.13)	0.07	0.10	0.08
Debt asset ratio	0.38	0.49	0.75	0.89	0.89	0.56
Current ratio	1.23	0.96	1.74	0.12	0.91	1.30

Source: audited financial statements

**Figure 4 Comparison of the financial Ratios**



Source: audited financial statements

The result shown on table 14 and figure 4 above indicates that although those organizations under took turnaround strategies, their profitability still faced downward trend

### Survey results

The results derived from table 16 above indicates that) NBK, (31) adopted higher number of turnaround strategies, followed by, KQ, (26) EAPC, (26), KCB (21) Uchumi (18) KPLC (16). The turnaround strategies wildly adopted; sections, A (29), D (27), F (25), C (23), B (19), E (15). This result is detailed in table 15 below.

**Table 15: Turnaround Strategies adopted (50% frequency above)**

<b>A</b>	<b>Portfolio restructuring strategies</b>	<b>Frequency</b>	<b>Percentage</b>
2	Payment of principal	4	66.7%
3	Instituting legal	5	83.33%
4	Refinancing and Repackaging of the loan	3	50%
5	Selling of collateral security	3	50%
7	Payment of principal and interest Rescheduled	4	66.7%
9	Payment of arrears by installments	4	66.7%
<b>B</b>	<b>Cost reduction strategies</b>		
10	Cost matched with revenue	6	100%
11	Leasing rather than buying	5	83.33%
13	Instituting budgetary controls	6	100%
<b>C</b>	<b>Assets reduction strategies</b>		
14	Additional capital to enhance modernization	6	100%
15	Divestments of unprofitable investments	3	50%

16	Disposal of slow moving /obsolete stock	5	83.33%
17	Modernization of plant and equipments	4	66.7%
18	Disposal of fixed assets	5	83.33%
<b>D</b>	<b>Revamping the existing strategies</b>		
19	Eliminating low margins products	4	66.7%
20	Diversification of products and services	5	83.33%
21	Product/ service repackaging	4	66.73%
22	Concentration of core business	6	100%
23	System modernization and change	6	100%
<b>E</b>	<b>Retrenchment- floated work force</b>		
25	Salary and benefit reduction	4	66.7
27	Retrenchments	3	50%
28	Voluntary retirement	4	66.7%
29	Natural attrition	3	50%
<b>F</b>	<b>Revenue increasing strategies</b>		
30	Price cuts	4	66.7%
31	Increase promotions	4	66.7%
32	Increase market share	4	66.7%
33	Value adding services	5	83.33%
34	Strengthening liquidity for profitability	6	100%

Source: survey results.

Further analysis of the number of turnaround strategies adopted by each of the organization from sections A-F was tabulated in the table 4.2 below, and averages obtained for;

- (i) Average turnaround strategies adopted by each organization, and
- (ii) Average turnaround strategies by all the organizations from in each of the section A-F.

**Table 16: Strategies adopted by the organization**

<b>Organizations</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	<b>F</b>	<b>Total score</b>	<b>Total possible score</b>
NBK	7	4	5	5	5	5	31	35
Uchumi	3	3	3	4	2	3	18	35
KCB	7	3	2	4	1	4	21	35
EAPC	5	4	5	5	1	6	26	35
KPLC	3	2	4	3	3	1	16	35
KQ	4	3	4	6	3	6	26	35
Total score	29	19	23	27	15	25		
total possible	54	24	30	36	30	36		

Source: survey results

The results derived from table 16 above indicates that) NBK, (31) adopted higher number of turnaround strategies, followed by, KQ, (26) EAPC, (26), KCB (21) Uchumi (18) KPLC (16). The turnaround strategies, mostly adopted were, sections, A (29), D (27), F (25), C (23), B (19), E (15). This result is detailed in table 17 below.

**Table 17: Ranking of the wildly adopted turnaround strategies**

<b>Rank</b>	<b>Strategy</b>	<b>Details of the turnaround strategies</b>
1	A	Portfolio restructuring strategies
2	D	Revamping the existing strategies
3	F	Revenue increasing strategies
4	C	Assets reduction strategies
5	B	Cost reduction strategies
6	E	Retrenchment-floated work force

Source: Survey results:

Results of the data analysis from the questionnaire on the level of importance of the strategies adopted, that were considered as critical by each of the organization under the study was analyzed on frequency table together with their respective percentages as detailed in table 18 below;

**Table 18: Ranking of Critical turnaround strategies adopted .**

<b>A</b>	<b>Portfolio restructuring strategies</b>	<b>Frequency</b>	<b>Percentage</b>
1	Payment of principal + interest	2	33.33%
2	Payment of principal	4	66.7%
3	Instituting legal	5	83.33%
4	Refinancing and Repackaging of the loan	3	50%
5	Selling of collateral security	3	50%
6	Defaulting company placed into receivership	2	33.33%
7	Payment of principal and interest Rescheduled	4	66.7%
8	Debt converted into Equity	2	33.33%
9	Payment of arrears by installments	4	66.7%
<b>B</b>	<b>Cost reduction strategies</b>		
10	Cost matched with revenue	6	100%
11	Leasing rather than buying	5	83.33%
12	Dropping of low margin customers	2	33.33%
13	Instituting budgetary controls	6	100%
<b>C</b>	<b>Assets reduction strategies</b>		
14	Additional capital to enhance modernization	6	100%
15	Divestments of unprofitable investments	3	50%
16	Disposal of slow moving /obsolete stock	5	83.33%
17	Modernization of plant and equipments	4	66.7%
18	Disposal of fixed assets	5	83.33%

D	Revamping the existing strategies		
19	Eliminating low margins products	4	66.7%
20	Diversification of products and services	5	83.33%
21	Product/ service repackaging	4	66.73%
22	Concentration of core business	6	100%
23	System modernization and change	6	100%
24	Strategic alliances	2	33.33%
E	Retrenchment- floated work force		
25	Salary and benefit reduction	4	66.7
26	Highly paid Employees replace with lowly paid	1	16.7%
27	Retrenchments	3	50%
28	Voluntary retirement	4	66.7%
29	Natural attrition	3	50%
F	Revenue increasing strategies		
30	Price cuts	4	66.7%
31	Increase promotions	4	66.7%
32	Increase market share	4	66.7%
33	Value adding services	5	83.33%
34	Strengthening liquidity for profitability	6	100%
35	Price increase based on demand	2	33.33%

The results from table 18 was further summarized in table 20, below which shows the number of critical turnaround strategies selected and adopted by each organization and from each of the classification of the turnaround strategies in section A –F, the results was used to compute the average critical turnaround strategies adopted by each organization and the most commonly adopted turnaround strategies based on the classification A-F by all the organizations.



**Table 19: Critical turnaround strategies adopted by the organizations**

<b>Organizations</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	<b>F</b>	<b>Total score</b>
NBK	4	3	4	5	4	3	23
Uchumi	2	0	2	3	0	0	7
KCB	5	2	1	3	1	4	16
EAPC	2	2	2	0	0	0	6
KPLC	1	3	2	4	2	1	13
KQ	3	2	3	5	1	5	19
Total score	17	12	14	20	8	13	

Source survey results

The respective weight of each of the critical turnaround strategies adopted, was computed to determine which type of strategies was most popular among each of the organization, under the study. The results indicate that;

Revamping the existing strategies (D) was wildly used by the six organization; accordingly this is adopted when the cause of weak performance is diagnosed as bad strategy and therefore an overhaul of the strategy is eminent along any of the several paths (1) shifting to a new competitive approach end thus trying to rebuild the firm’s market position;(2) overhauling internal operations and functional area strategies to produce better support of the same basic overall business strategy;(3) merging with another firm in the industry and converting to its basic, strategy, and (4) retrenching into a reduced core of products and customers more closely matched to the firm’s strengths. But caution is required as the most appealing

choices is dependent upon the conditions prevailing in the industry and the organization's strengths and weaknesses, when compared with rival organizations, and the severity of the crisis. This leaves the organization to do what it can do best. This was followed by portfolio restructuring strategies, (A), which involve radical surgery on the mix and percentage makeup of the types of businesses in the portfolio. This scenario is mostly promoted by any of these conditions (1) when a strategy review reveals that the long-term performance prospects for the organization as a whole have become unattractive, as the portfolio contains so many slow growth, declining or competitively weak business units;(2) when one or more of the firm's key business units fall prey to hard times;(3) when a new chief executive officer (CEO) takes over the reins and decides that it is time to redirect where the company is headed;(4) when "wave of the future" technologies or products emerge and make a series of foothold acquisitions an attractive way to get a position in a potentially big new industry; Or (5) when a "unique opportunity" presents itself to make an acquisition so big that several. Existing business units have to be sold off to raise money to finance the new acquisition.

Portfolio restructuring frequently involves both divestitures and new acquisitions. The candidate business units for divestiture include not only those that may be competitively weak or are up-and-down performers or are in unattractive industries, but also those that no longer fit (even though they may be profitable and in attractive enough industries). Indeed, many broadly diversified corporations, disenchanted with their past experiences and future prospects with unrelated

diversification, have recently gone through the process of revamping their business portfolios. Units found not to be compatible with newly established related diversification themes have been divested. The remaining units realigned to capture more strategic fit benefits and new units acquired to create a stronger mix of related businesses.

The third most popular was; assets addition/reduction strategies (C), this is essential rescue approach, when cash flow is a critical consideration and when the most practical way to generate cash is (1) through the sale of some assets and (2) through pruning of marginal products from the product line, closing or sale of older plants, a reduced work force, withdrawal from outlying markets, cutbacks in customer service etc. The fund generated being used to strengthen the remaining activities.

The fourth most commonly adopted turnaround strategies was; revenue increasing strategies (F) Whose main objective is to generate additional sale volume; the various options are;(1) price cut,(2) increased promotion,(3) a bigger sale force,(4) added customer services ,(5) product improvement,(6) price increase if demand is price inelastic. The attempt to increase sale volume or income is to cut back expenses and still breakeven and to restore profitability by using the existing capacity.

The fifth turnaround strategies commonly adopted was; cost reduction strategies (B) that work best a financially distressed organization's cost structure is flexible enough to permit radical surgery, when operating inefficiencies are identifiable and

readily correctable, and when the organization is relatively close to its break-even point, accompanying this general belt –tightening is an increase in emphasis on;(1) budgeting and cost control, (2) elimination of jobs and hiring, (3) modernization of the existing plant and equipment to gain greater productivity,(4) postponement of capital expenditures.

The least adopted turnaround strategies was retrenchment of bloated workforce, (E) this involve curtailing the hiring of new personnel, trimming the size of corporate staff.

**Table 20 Ranking of critical turnaround strategies**

<b>Rank</b>	<b>Turnaround strategy</b>	<b>Details of the turnaround strategies</b>	<b>%</b>
1	D	Revamping the existing strategies	24%
2	A	Portfolio restructuring strategies	20%
3	C	Assets reduction strategies	17%
4	F	Revenue increasing strategies	15%
5	B	Cost reduction strategies	14%
6	E	Retrenchment-floated work force	10%

Turnaround strategies adopted by each of the organization and chosen from section A-F, including their respective percentages, were ranked as shown in table 4.6 above

comparisons between turnaround strategies adopted and financial performance achieved by the organization The results in table 4.7 below contrast with the commonly held view that financially distressed organizations should always

retrench its floated workforce, as a first step to reverse the negative associated with poor financial performance. This turnaround strategy was found to be the least most adopted strategy, among the six-turnaround strategies that were listed for selection.

National Bank of Kenya Limited and Kenya Airways Limited, adopted specific turnaround strategies that were geared toward, revamping the existing strategies than way than was the case with the other organizations under the study, this may partly explain why NBK, and KQ, has been consistent with the way they have managed their turnaround programme, although in some unusual scenario NBK opened some branches, which were closed a year latter.

**Table 21: Ranking of critical turnaround strategies adopted.**

	NBK	Uchumi	KCB	EAPC	KPLC	KQ
1	D	D	A	A	D	D
2	A	C	F	B	B	F
3	C	A	D	C	C	A
4	E	E	B	D	E	C
5	F	F	E	E	A	B
6	B	B	C	F	F	E

Source: survey results

**Table 22: The most common turnaround strategies.:**

	Organization	Two most highly adopted strategies	EPS	ROE	ROI	OPM	D/A	CR
1	NBK	A and D	-2.37	0.16	0.20	0.10	0.89	0.16
2	KQ	D and F	-22.42	0.23	0.06	0.07	0.38	1.18
3	KCB	A and F	6.28	0.11	0.1	0.07	0.89	0
4	KPLC	B and D	1.21	0.02	0.01	0.02	0.49	0.71
5	Uchumi	A and D	2.99	0.30	0.13	0.08	0.56	0.79
6	EAPC	A and B	0.57	0.02	0.01	0.13	0.75	1.19

**Key**

- A = Portfolio restructuring strategies
- B = Cost reduction strategies
- D = Revamping the existing strategies
- F = Revenue increasing strategies

**Source: survey results:**

**4.2 Test of hypothesis**

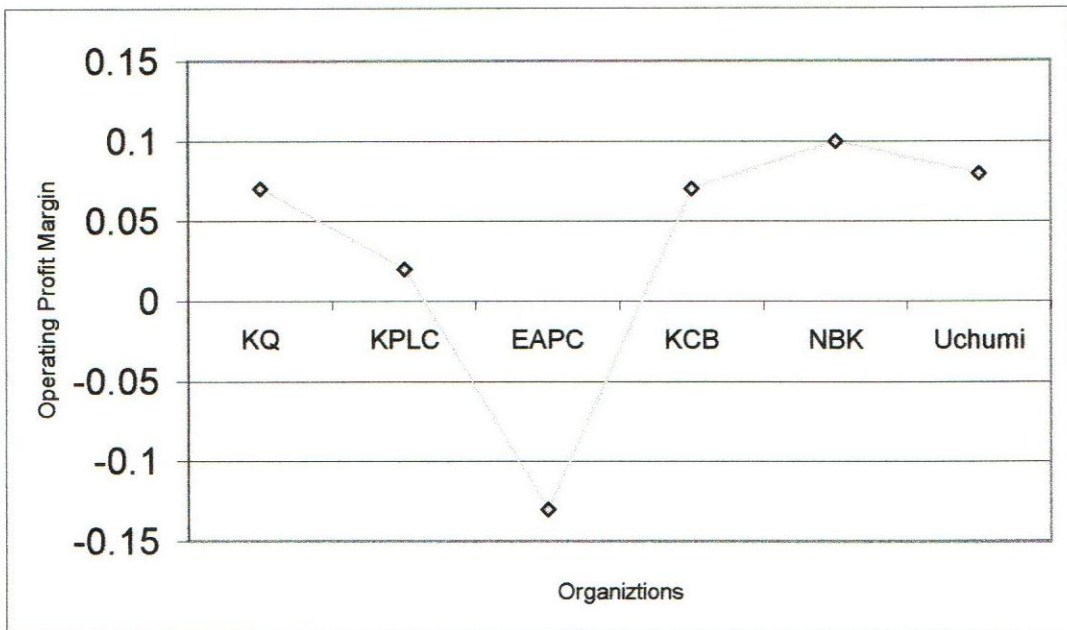
The tables below show how the two hypotheses were tested; the financial ratios were compared with number of Strategies adopted by each of the Parastatal. A t test was used to determine the ratio with the highest level of significance, in order to arrive at the conclusion of the hypothesis test

**Table 23: Summary of average financial ratios**

Organizations	EPS	ROE	ROI	OPM	D/A	CA/CL
KQ	-23.42	0.23	0.06	0.07	0.38	1.23
KPLC	1.21	-21.64	3.44	0.02	0.49	0.96
EAPC	0.57	-0.02	0.01	-0.13	0.75	1.74
KCB	6.28	0.11	0.01	0.07	0.89	0.12
NBK	-2.37	0.18	0.20	0.10	0.89	0.91
Uchumi	2.99	0.30	0.13	0.08	0.56	1.30

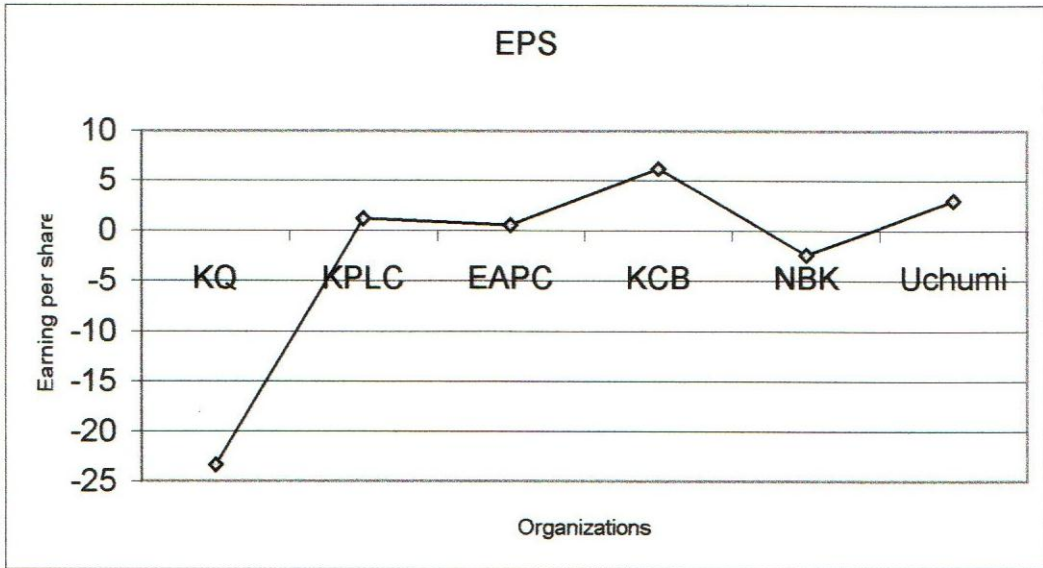
Source: survey results

**Figure 5 Operating Profit Margin Trend**



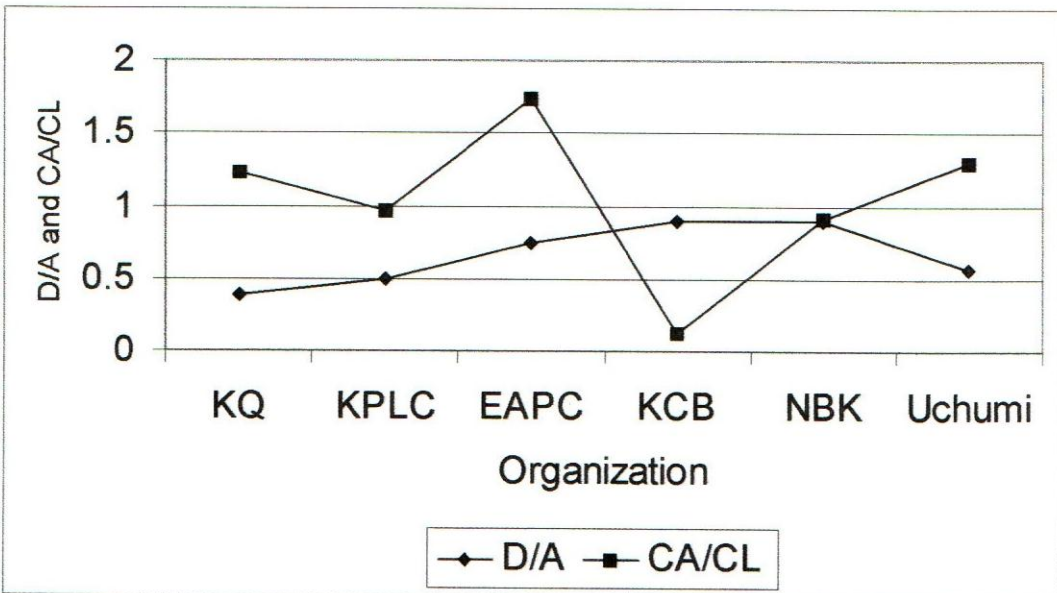
From Fig 5 above, the strategies adopted helped improve the operating profit margin in the following organizations: - KQ, KCB, NBK and Uchumi. The operating profit margin declined tremendously in EAPC.

**Figure 6 Earning Per Share**



From fig 6 above, the strategies adopted improved the earning per share in KCB and Uchumi. There was a tremendous drop in earning per share in KQ, therefore the strategies did not improve the KQ profitability.

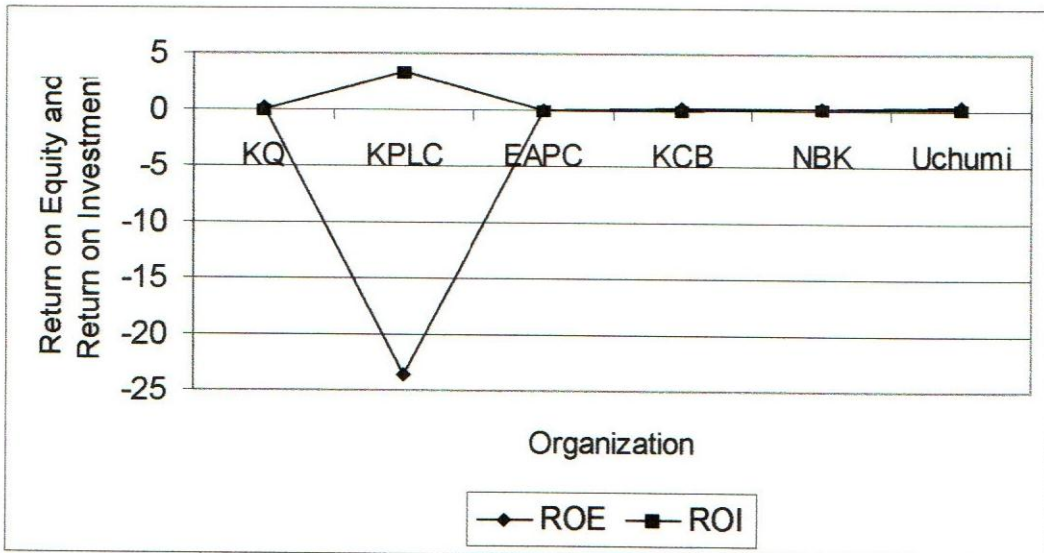
**Figure 7 Comparison of Debt to Asset ratio and Current ratio**





The Debit to Asset ratios and current ratio measures the stability and the liquidity of an organization. From fig. 7 above, the adopted strategies helped to improve the stability of KQ because the total liabilities were lower than the total assets. This was opposite for KCB and NBK which had higher levels of total liabilities compared to total assets. The reverse would be true for the current ratios. The worst case was in NBK where the Assets were almost equal to Liabilities.

**Figure 8 Comparison of Return on Equity and Return on Investment.**



The Return on Equity was comparatively favourable for most organizations, however due to the huge loss that KPLC made, its Return on Equity was very low.

**Table: 24: t-Test of the Financial Ratios**

<b>Variable</b>	<b>Standardized coefficient</b>
EPS	0.385
ROI	0.659
ROE	0.657
OPM	0.31
CR	0.160

Source: survey results

**Key:** **EPS** = Earning per share.

**ROI** =Return on investments

**ROE** =Return on Equity

**OPM** = Operating profit margin

**CR** = Current ratio

How the turnaround has impacted on the financial performance.

The critical turnaround strategies that were adopted impacted highly on the return on investment, 65.9%% as compared with the current ratio, which was 16%. The results of this comparison are shown in figure 4.1 below:

**Key** **EPS** = Earning per share.

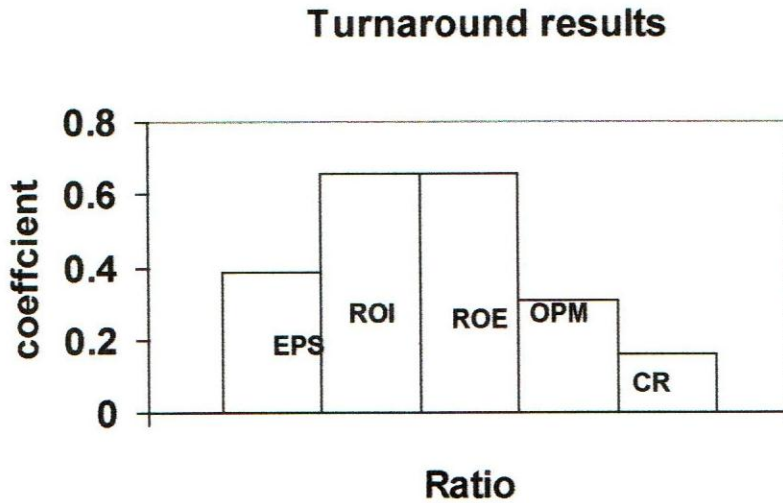
**ROI** =Return on investments

**ROE** =Return on Equity

**OPM** = Operating profit margin

**CR** = Current ratio

**Figure 9 Comparison of t-Test on financials ratios**



Source: survey results

The graph above compares the coefficient correlation among the key financial ratios. The he strategies adopted helped to improve the Return On Investment and Return on Equity were highly revamped by the strategies.

**Table: 25: Critical turnaround strategies and financial performance**

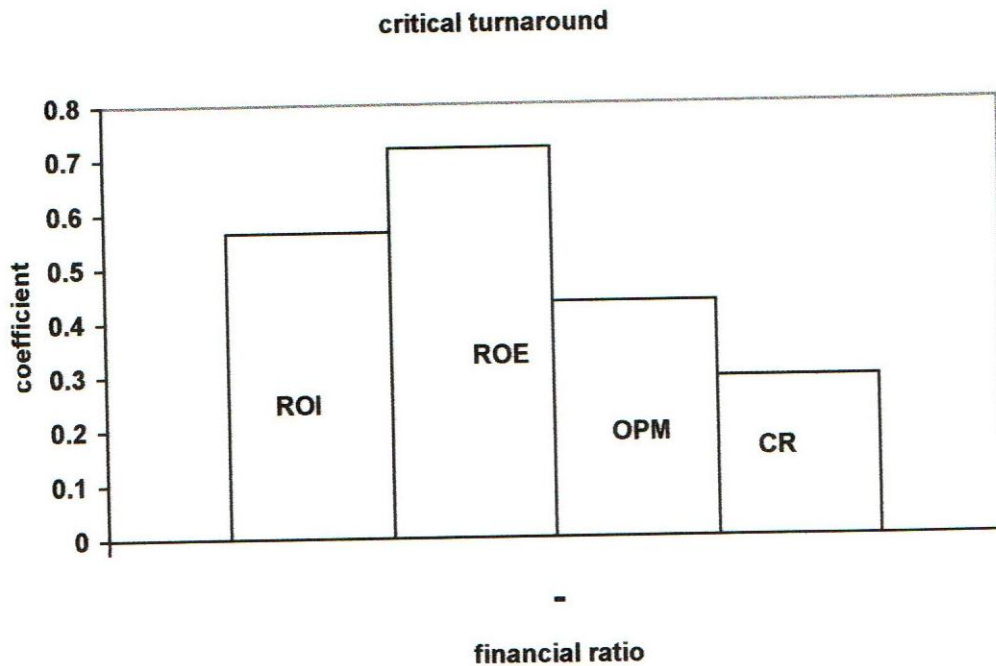
Organizations	Average	EPS	ROE	ROI	OPM	D/A	CA/CL
KQ	3	-23.42	0.23	0.06	0.07	0.38	1.23
KPLC	2	1.21	-21.64	3.44	0.02	0.49	0.96
EAPC	1	0.57	-0.02	0.01	-0.13	0.75	1.74
KCB	3	6.28	0.11	0.01	0.07	0.89	0.12
NBK	4	-2.37	0.18	0.20	0.10	0.89	0.91
Uchumi	1	2.99	0.30	0.13	0.08	0.56	1.30

Source: survey results

**Table: 26: Correlation coefficient of the financial ratios**

Variable	Standardized coefficient
EPS	-
ROI	0.564
ROE	0.72
OPM	0.434
CR	0.294

**Figure 10 Correlation coefficient of the financial ratios**



Source: survey results

**Key:** **EPS** = Earning per share.      **ROI** =Return on investments  
**ROE** =Return on Equity                      **OPM** = Operating profit margin  
**CR** = Current ratio

The graph above shows the summary of the financial ratio how the turnaround impacted on the financial performance.

The critical turnaround strategies that were adopted impacted highly on the return on investment, 72% as compared with the current ratio, which was 29.4%. The results of this analysis are shown in figure 6 above.

There is need to change strategies which will create an impact on the most important financial ratio, EPS, OPM, ROI, AND ROE, ideally to help the investor to favourably compare the results. It would also be appropriate to address such ratios as OPM (operating profit margin, CR (current ratio), in order to avoid financial risk.

## **CHAPTER: 5 SUMMARY AND CONCLUSIONS**

### **5.0 Introduction**

Although each organization's adopted turnaround strategies that were considered suitable to their particular needs, the results of financial performance and especially the earning per share and return on equity of each of these organization did not improve considerably hence continued to decline. The findings do not compare favourably with the return from Treasury Bills and Bond.

### **5.1 Recommendations for further Research**

- i) The companies should develop viable modules to test the viability of the turnaround strategies they are pursuing.
- ii) The companies should carry out an evaluation on its performance based on the turnaround strategies adopted and find out areas of weakness and strength in relation to the model company.
- iii) The companies should develop expert system (artificial intelligence) systems that can detect, deter and trigger courses of action that bring positive results in the turnaround strategies.

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## APPENDIX

### Appendix 1: Questionnaire

#### Part 1: Strategies Adopted

The questions below ask about what kind of turnaround strategies the organization adapted or did not adapt in its endeavour to reverse the negative effect associated with poor financial performances. As the Chief Executive Officer, (C.E.O.), who has been mandated by the Board, how would you rate each of the strategies in their order of importance using the scale below?

Tick in the appropriate column the turnaround Strategies that your Organization adopted: **A** denoting strategy adopted and, **NA** not adopted and then rate their importance on a scale of 1 to 3: **1** Not important: **2** important: **3** critical

<b>FINANCIAL STRATEGIES</b>	<b>A</b>	<b>NA</b>	<b>1</b>	<b>2</b>	<b>3</b>
<b>Portfolio Restructuring strategies</b>					
<b>Non-performing loans or debtors</b>					
Allowing customer to pay the principle plus some negotiated interest					
Allowing the customer to pay the principle only					
Instituted legal action					
Re-financing arrangements and repackaging of the loan facilities					
Selling off the assets charged as security for the loan.					

Tick in the appropriate column the turnaround Strategies that your Organization adopted: **A** denoting strategy adopted and, **NA** not adopt and then rate their importance on a scale of 1 to 3: **1** Not important: **2** important: **3** critical

	<b>FINANCIAL STRATEGIES</b>	<b>A</b>	<b>NA</b>	<b>1</b>	<b>2</b>	<b>3</b>
	Rescheduling of the loan and placing the company into receivership					
	<b>Working out a settlement scheme with creditors so as:</b>					
	◆ To reschedule payment or principal and interest					
	◆ To convert debt into equity					
	◆ To pay arrears in installment					
<b>B</b>	<b>Cost –Reduction Strategies</b>					
	◆ Cutting down on cost to match revenue					
	◆ Leasing rather than buying equipment.					
	◆ Dropping low margin customers					
	◆ Budgetary control					
<b>C</b>	<b>Assets addition/ reduction strategies</b>					
	◆ Provision of additional capital to enhance modernization needed to support a higher level of operations.					

Tick in the appropriate column the turnaround Strategies that your Organization adopted: **A** denoting strategy adopted and, **NA** not adopt and then rate their importance on a scale of 1 to 3: **1** Not important: **2** important: **3** critical

	<b>FINANCIAL STRATEGIES</b>	<b>A</b>	<b>NA</b>	<b>1</b>	<b>2</b>	<b>3</b>
	Divestment of unprofitable plant and operations					
	Disposal of slow moving and obsolete stocks					
	Modernize, renovate and repair plant and machinery to improve efficiency.					
	Disposal of some of the fixed assets to finance the revival program.					
<b>D</b>	<b>Revamping the Existing Strategies</b>					
	Eliminating low-margin or unprofitable products					
	Changing the products or services production to reduce cost and increase efficiency.					
	Changing the quality and appearance of the products or services.					
	Retrenching into a reduced core of products and customers more closely matched to the firm's					

Tick in the appropriate column the turnaround Strategies that your Organization adopted: **A** denoting strategy adopted and, **NA** not adopt and then rate their importance on a scale of 1 to 3: **1** Not important: **2** important: **3** critical

	<b>FINANCIAL STRATEGIES</b>	<b>A</b>	<b>NA</b>	<b>1</b>	<b>2</b>	<b>3</b>
	Overhauling internal operations and functional area strategies to produce better support of the same basic overall business strategy.					
	Merging with another firm in the industry and converting to its basic strategy.					
<b>E</b>	<b>Retrenchment- Floated work force</b>					
	Eliminating or cutting back employee compensation and or benefits.					
	Replacing higher paid employees with lower paid employees.					
	Lying off employees.					
	Voluntary retirement with golden handshake.					
	Retrenching through natural attrition.					
<b>F</b>	<b>Revenue- Increasing Strategies</b>					
	Price cuts.					
	Increased promotion					
	Bigger sales force.					
	Added customer service and quickly achieved product improvements.					

Tick in the appropriate column the turnaround Strategies that your Organization adopted: **A** denoting strategy adopted and, **NA** not adopt and then rate their importance on a scale of 1 to 3: **1** Not important: **2** important: **3** critical

	<b>FINANCIAL STRATEGIES</b>	<b>A</b>	<b>NA</b>	<b>1</b>	<b>2</b>	<b>3</b>
	Strengthen the liquidity of the unit and facilitate reallocation of resources for enhancing the profitability.					
	Price increases when demand happens to be price inelastic.					

## Appendix 2: strategies adopted

A	Portfolio restructuring strategies	Not important	Important	Critical
1	Payment of principal + interest	-	-	33.33%
2	Payment of principal	16.75%	33.33%	16.7%
3	Instituting legal	16.7%	33.33%	33.33%
4	Loan Refinancing and Repackaging	-	-	50%
5	Selling of collateral security	-	16.7%	33.33%
6	Defaulting company placed in receivership	-	16.7%	16.7%
7	Reschedule of payment of principal and interest	-	33.33%	33.33%
8	Debt converted into Equity	-	-	33.33%
9	Payment of arrears by installments	16.7%	16.7%	33.33%
B	Cost reduction strategies	-	-	100%
10	Cost matched with revenue	-	16.7%	83.3%
11	Leasing rather than buying	50%	33.3%	16.7%
12	Dropping of low margin customers	-	33.33%	16.7%
13	Instituting budgetary controls	16.7%	-	83.3%
C	Assets additions/ reduction strategies	2	33.33%	16.7%
14	Additional capital to enhance modernization	-	-	100%
15	Divestments of unprofitable investments	16.7%	16.7%	33.33%
16	Disposal of slow moving /obsolete stock	16.7%	50%	16.7%
17	Modernization of plant and equipments	-	-	100%
18	Disposal of fixed assets	16.7%	50%	16.7%

D	Revamping the existing strategies			
19	Eliminating low margins products	-	16.7%	66.7%
20	Diversification of products and services	-	16.7%	66.7%
21	Product/ service repackaging	-	33.33%	66.7%
22	Concentration of core business	-	50%	50%
23	System modernization and change	16.7%	16.7%	66.7%
24	Strategic alliances	33.33%	-	33.33%
E	Retrenchment-floated work force			
25	Salary and benefit reduction	-	66.7%	16.7%
26	Replacing of highly paid Employee with lowly paid	16.7%	16.7%	16.7%
27	Retrenchments	16.7%	16.7%	33.3%
28	Voluntary retirement	-	16.7%	66.7%
29	Natural attrition	33.33%	33.33%	-
F	<b>Retrenchment-floated work force</b>			
30	Price cuts	16.7%	50%	16.7%
31	Increase promotions	-	50%	33.3%
32	Increased market share	-	50%	33.3%
33	Value adding services	16.7%	33.3%	50%
34	Strengthening of liquidity for profitability	16.7%	16.7%	66.7%
35	Price increase based on demand	-	66.7%	33.3%

Source: survey results

### Appendix 3: computation of ratios

Profitability Ratio	Formula	Meaning	Desired trend
Operating profit margin	$\frac{\text{Operating income} \times 100}{\text{Total sale}}$	The % of the operating Expenses relative to sale. Measure the relative impact of the operating expenses	The lower the ratio, the lower the expenses in relative to sale
Net profit margin	$\frac{\text{Net income After taxes}}{\text{Total sale}}$	% of net income earned for every shilling sale. It measures ultimate profitability	The higher the ratio the more profitable each sale is
Stability			
Total Debt to Total Assets	$\frac{\text{Total Liability}}{\text{Total Assets}}$	What percentage of the business is financed through debt	The lower the ratio the more safe is the organization, but this more impair the profitability, hence a compromise between risk and return is necessary
Liquidity			
Current Ratio	$\frac{\text{Total Current Assets}}{\text{Total Current Liabilities}}$	The number of times short – term assets can cover short term debts	Higher the ratio the more secure the organization is to meet its maturing short term financial obligation .Ratio of 2:1 is recommended, but caution is required as low may leads to insolvency and to high may indicate inefficiency use of capital
Quick ratio/Acid test	$\frac{\text{Cash+marketable securities} + \text{Average Debtors}}{\text{Total Current Liabilities}}$	Indicates the ability to meet short term payment using only the most liquid assets	The most ideal ratio is 1:1, but this however depend on the industry



Working Capital	$\frac{\text{Current Assets}-\text{Current Liabilities}}$	The net amount of money tied up in working capital	The higher the ratio, the safer the organization is, but caution is required to compromise between risk and returns i.e.
Return on investment			
Return on Investment	$\frac{\text{Net income After Taxes}}{\text{Total Assets}}$	Shows the relationship between income and total assets	A higher return indicates better use of the organizations' assets
Return on Equity	$\frac{\text{Net Income After taxes}}{\text{Average shareholder Equity}}$	Shows the maximum return available to shareholders	A high return is an indication that the shareholders will be happy .
Earning Per Share	$\frac{\text{Net income available to ordinary share holders}}{\text{Number of ordinary shares outstanding}}$	Net income per share available to ordinary shareholders	The higher the earning the better it is for the Ordinary Shareholders

#### Appendix 4 : Turnaround strategies adopted

A	Portfolio restructuring strategies	Frequency	Percentage
1	Payment of principal + interest	2	33.33%
2	Payment of principal	4	66.7%
3	Instituting legal	5	83.33%
4	Refinancing and Repackaging of the loan	3	50%
5	Selling of collateral security	3	50%
6	Placing the defaulting company into receivership	2	33.33%
7	Reschedule of payment of principal and interest	4	66.7%
8	Debt converted into Equity	2	33.33%
9	Payment of arrears by installments	4	66.7%
B	Cost reduction strategies		
10	Cost matched with revenue	6	100%
11	Leasing rather than buying	5	83.33%
12	Dropping of low margin customers	2	33.33%
13	Instituting budgetary controls	6	100%
C	Assets reduction strategies		
14	Additional capital to enhance modernization	6	100%
15	Divestments of unprofitable investments	3	50%
16	Disposal of slow moving /obsolete stock	5	83.33%
17	Modernization of plant and equipment	4	66.7%
18	Disposal of fixed assets	5	83.33%
D	Revamping the existing strategies		
19	Eliminating low margins products	4	66.7%
20	Diversification of products and services	5	83.33%
21	Product/ service repackaging	4	66.73%
22	Concentration of core business	6	100%
23	System modernization and change	6	100%
24	Strategic alliances	2	33.33%
E	Retrenchment- floated work force		

25	Salary and benefit reduction	4	66.7
26	Replacing of highly paid Employee with lowly paid	1	16.7%
27	Retrenchments	3	50%
28	Voluntary retirement	4	66.7%
29	Natural attrition	3	50%
F	Revenue increasing strategies		
30	Price cuts	4	66.7%
31	Increase promotions	4	66.7%
32	Increase market share	4	66.7%
33	Value adding services	5	83.33%
34	Strengthening liquidity for profitability	6	100%
35	Price increase based on demand	2	33.33%

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