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THE EFFECT OF ORGANIZATIONAL STRUCTURE ON FINANCIAL PERFORMANCE OF COMMERCIAL STATE CORPORATIONS IN KENYA

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Abstract

Purpose: The main purpose of this study was to determine effect of organizational structure on financial performance of commercial state corporations in Kenya.

Methodology: The study employed a survey research design and targeted all the 34 commercial state corporations in Kenya. The study used both structured / closed ended and unstructured / open ended questionnaires to collect data. Both qualitative and quantitative was analyzed. Inferential statistics was employed whereby correlation and multiple linear regression was used to establish a relation between and among the studied variables. A statistical Package for social sciences (SPSS) was used to analyze data. The analyses data was presented graphically by visual aids such as Figures and Tables.

Results: The findings obtained concluded that, organizational size, structure formalization, structure complexity and structure centralization affected the financial performance of commercial state corporations. Also it was establish that the number of non-executive directors affected the performance of the commercial state corporation is a challenge the board faced. It was further deduced that the organizational structure affected the financial performance of the commercial state corporations.

Unique Contribution to Theory, Policy and Practice: The study recommends that the board size and composition be considered since they affect the financial performance of the commercial state corporations, the number of non-executive directors needs to be selected well, the board needs to comprise of well-educated people since they are actively involved in shaping Commercial state corporations' strategy, on-executive directors be trained on internal corporate governance mechanisms, and also ownership concentration needs to be reduced to avoid few people controlling the financial performance of the organization.

Keywords: *Structure Complexity, Organizational Structure, Financial Performance and Commercial State Corporations*

1.0 INTRODUCTION

Slevin (2007) highlight organizational structure as a critical antecedent to financial performance. These authors indicate that in order to be capable of adequately responding to changes in dynamic environments, organizations often decentralize decision-making authority, have minimal hierarchical levels or structural layers and adopt Free-flow communication channels. These attributes permit flexibility and rapid decision making and thus make a positive impact on an organization's opportunity seeking financial performance. Conceptually, the construct of organizational structure variables against an ultimately on performance in commercial state corporations only deliver better performance if there is a willing to move away from centralized systems that involve higher levels of formality to organizational systems that facilitate higher levels of discretion, Campion (2008). Cohen (2009) hold the similar opinion that interdependence and self-management are the fundamentals of organization's task design, and exert influences on organization effects by means of such interactions as conflicts and communication. Simons (2009), on the other hand, cautions against the attempts to decentralize the decision-making structures in the organizations. This author argues that decentralizing decision making can often lead to a loss of control of employees at the lower levels of organizational hierarchy, resulting in dysfunctional behavior and thus inefficient use of organizational resources.

Financial performance is the level of performance of a business over a specified period of time, expressed in terms of overall profits and losses during that time. Evaluating the financial performance of a business allows decision-makers to judge the results of business strategies and activities in objective monetary terms. One of the most fundamental facts about businesses is that the operating performance of the firm shapes its financial structure. It is true that the financial situation of the firm can also determine its operating performance. The subject of financial performance has received significant attention from scholars in the various areas of business and strategic management. It has also been the primary concern of business practitioners in all types of organizations since financial performance has implications to organization's health and ultimately its survival. High performance reflects management effectiveness and efficiency in making use of company's resources and this in turn contributes to a country's economy at large (Naser and Mokhtar, 2004).

There have been various measures of financial performance. For example return on sales reveals how much a company earns in relation to its sales, return on assets determines an organization's ability to make use of its assets and return on equity reveals what return investors take for their investments. The advantages of financial measures are the easiness of calculation and that definitions are agreed worldwide. Traditionally, the success of a manufacturing system or company has been evaluated by the use of financial measures (Tangen, 2003). Liquidity measures the ability of the business to meet financial obligations as they come due, without disrupting the normal, on-going operations of the business.

A key source of process benefit is improving hand-offs between functions, which can occur only when processes are broadly defined (Oden, 1999). A process orientation leads to cycle time reduction by doing a good job of coordinating work across functions. In addition, some costs are reduced with a process organization. The faster time cycles mean reduced inventories and faster receipt of cash. The reduced working capital translates into reduced costs of carrying inventory and cash. Other costs are reduced because duplication of work across functions is eliminated. A process organization eliminates such redundant activities, verifying input once for all functions (Galbraith, 2002).

State corporations (also government parastatals or public corporations) are quasi government agencies linked to government ministries or departments. Kenyan parastatals are classified into three categories namely class A, class B and class C parastatals. The categories are based on the revenue base, size and the ministry the parastatals falls under. Parastatals are further classifieds in terms of industries they belong to. The sectors include: Financial sector, commercial/manufacturing sector, regulatory sector, public universities, training and research, service corporations, regional development authorities, and finally tertiary education and training, Office of the Prime Minister (DPM, 2006).

The establishment of parastatals was driven by a national desire to: accelerate economic and social development; redress regional and economic imbalances; increase Kenyan citizens' participation in the economy; promote indigenous entrepreneurship; promote foreign direct investments through joint ventures (Sessional Paper No. 10 of 1965). Comprehensive reviews on Public Enterprise Performance were carried in 1979 (the Report on the Review of Statutory Boards), and 1982 (the Report of the Working Party on Government Expenditures).

Statement of the Problem

There is a growing recognition of the importance of organizational structure in aligning the success and financial performance of any organization. Organizational structure of commercially owned State corporations must therefore be aligned to achieve organizational goals and objectives. Individual work needs to be coordinated and managed. Organizations therefore can function within a number of different structures, each possessing distinct advantages and disadvantages (DPM, 2002).

Various empirical studies indicate that better organizational structure guarantee the payback to the customers and limit the risk of the investment. The association between quality of organizational structure and firms' profitability is a main focus in governance studies, but one cannot predict much on the direction due to contrasting views on the results, Jensen and Meckling (1976). Klapper and Love (2003) used return on assets as measure for performance found evidence that firms with better governance have higher operating performance. A well-functioning organizational structure is an indication of the overall effectiveness of operational system. Organizational structure has been largely criticized for the decline in service provision and financial performance (Uadiale, 2010).

Locally, studies on the relationship between organizational structure and firm performance remain inconclusive and contradictory. Ngetich (2005) carried out a study to establish the relationship between, ownership structure, governance structure and performance among the Firms Listed with the Nairobi Stock Exchange. Some of the empirical evidence that supports a negative relationship between firm performance and organizational structure are from studies undertaken by Waiyaki (2006), Ndeto (2007), and Chacha (2005). There studies reported that small size are associated with higher market evaluations, returns on assets (ROA), and returns on sales (ROS), he highlighted that the scale and nature of that impact is actually dependent on the size of a company, and may become different as a structure becomes too large.

2.0 LITERATURE REVIEW

Theories Related to the Study

Agency Theory

Agency theory explains how best the relationship between agents and principals can be utilized with a view to attaining corporate goals. In this kind of relationship principals and agents have clearly defined responsibilities where shareholders expect the agents to act and make decisions in the principal's interest. On the contrary, the agent may not necessarily make decisions in the best interests of the principals (Padilia, 2002) the agent may succumb to self-interest, opportunistic behavior and falling short of balancing between the aspirations of the principal and the agent's pursuits. In such a principal-agent relationship, there is always the potential for conflicts within a firm due to economic incentives faced by the agents which are often different from those faced by the principals, ((ISDA, April 2002). According to ((ISDA, April 2002) all companies are exposed to agency problems, and to some extent develop action plans to deal with them. Although steeped in certain setbacks, agency theory was introduced basically as a separation of ownership and control (Bhimani, 2008).

Stakeholder Theory

Stakeholder theory can be defined as any group or individual who can affect or is affected by the achievement of the organization's objectives. Stakeholders theorists suggest that managers in organizations have a network of relationships to serve this include the suppliers, employees and business partners. And it was argued that this group of network is important other than owner-manager-employee relationship as in agency theory. On the other end, (Inkpen & Sundaram, 2004) contend that stakeholder theory attempts to address the group of stakeholders deserving and requiring management's attention. Current organizational structure arrangements vest excessive power in the hands of management who may abuse it to serve their own interest at the expense of shareholders and society as a whole (Welsbach & Hermalin, 2003).

Stewardship Theory

Stewardship theory assumes that managers are not opportunistic agents, but good stewards of corporations who diligently work towards owners' interests by securing high level of corporate profits and shareholders' returns (Donaldson, 2002) hence, stewardship theory differs from agency theory with respect to the motive of managers. According to (Gay, 2002) stewardship theory is also derived from the economic model of human behavior, classified by McGregor as Theory Y, which assumes that people are inherently motivated to work and perform a good job. Therefore, stewardship theory purports there is no conflict between managers and owners, and the optimum organizational structure allows coordination of the companies to perform most effectively towards the betterment of the owners' interest.

Empirical Review

Various empirical literatures have extensively explored the linkage between organizational structure, its many component and financial performance. Montanari (1978) stated that organization size, technology, or environment was proposed as the single most important determinant of organization structure. Burt, Gabbay, Holt, and Moran (1994) studied corporate culture and firm performance. They viewed culture as a control mechanism in Malasian listed firms. In order to do this, a firm needs to have a strong corporate culture that able to clarify a firm's goals and practices.

They discovered that economic performance can be enhanced by a strong corporate culture, economic success results in a strong corporate culture, culture and performance determined each other, and correlation between performance and culture strength is spurious. Parker, Peters and Turetsky (2002), investigated the influence of various attributes of organizational structure and financial survival of 176 financially stressed firms of the Caribbean nations from 1988-1996 using regression analysis.

Their study findings established that firms that replaced their CEO with an outside director were more than twice as likely to experience bankruptcy larger levels of insider ownership are positively associated with the likelihood of firm survival. Robbins (2003) discussed ways many of those parts are related to one another and therefore affect organizational structure. A complex structure has a greater need for communication across many departments horizontally or between many levels vertically. The more complex an organization is, the greater the need for effective communication, coordination and control (Robbins, 2003).

Locally, scholarly literature divides formalization as high versus low, where a high level of formalization is related to a mechanistic structure and a low level of formalization is related to a flexible organic structure. The fourth variable is the level of process-based. Onyango (2000) undertook a study on the relationship between ownership structure value of firms listed at the Nairobi Stock Exchange and arrive to a conclusion that the relationship between the value of the firm and insider. From the analysis he concluded that the value of the firm increased when insider ownership ranged between 0% and 37% while firm value again increased when the ownership level is more than 50%.

Barako et al (2007) study provides longitudinal examination of voluntary disclosure practices in the annual reports of listed companies in Kenya from 1992 to 2001. Their study investigates the extent to which organizational structure attributes, ownership structure and company characteristics influence voluntary disclosure of various types of information. Due to the panel nature of their data, to estimate the determinants of voluntary disclosure of various types of information, they use pooled Ordinary Least Square (OLS) with Panel-Corrected Standard Errors (PCSEs). The results indicate that, disclosures of all types of information are influenced by organizational structure attributes, ownership structure and corporate characteristics. In particular, the results also suggest that size and companies in the agricultural sector are significantly associated with the voluntary disclosure of all four types of information disclosures.

Ngumi (2008) looked at the survey of the Organizational structure practices in the Housing Finance Company (HFCK) and concluded that good corporate practices are the best for the banking industry. Whereby he come to the clear conclusion that bank and is the level of commitment will ensure that its business and operations are conducted with high integrity and compliance with the law and the accepted practices in accounting. Kiamba (2008) study the effects of Organizational structure on the financial performance of local authorities in Kenya. The study found that financial performance of the local authorities was influenced by political composition in the respective councils and manner in which internal audits are conducted and the managerial approaches applied by the council's chiefs.

Muriithi (2008) documented Organizational structure and Financial performance of state corporations, the case of the New KCC and drawn a conclusion that better Organizational structure will improve financial performance in that respect he identified the following Organizational structure practices; appointment and leadership of the board structure of the organization, purpose and values, balance of power in the board, corporate communication and the assessment of performance of board and its responsibilities.

Ongore (2008) carried out a research on the effects of ownership structure, Board effectiveness and managerial discretion on performance of listed companies in Kenya where the following conclusion was drawn from this study that; ownership concentration is inimical to a manager creativity and innovation and curtains firm performance, also increase in government shareholding of a firm results in negative performance.

3.0 METHODOLOGY

The study employed a survey research design and targeted all the 34 commercial state corporations in Kenya. The study used both structured / closed ended and unstructured / open ended questionnaires to collect data. Both qualitative and quantitative was analyzed. Inferential statistics was employed whereby correlation and multiple linear regression was used to establish a relation between and among the studied variables. A statistical Package for social sciences (SPSS) was used to analyze data.

4.0 RESEARCH FINDINGS AND DISCUSSION

4.1 Demographic Data

4.1.1 Gender of Respondents

The figure below displays demographic information according to gender.

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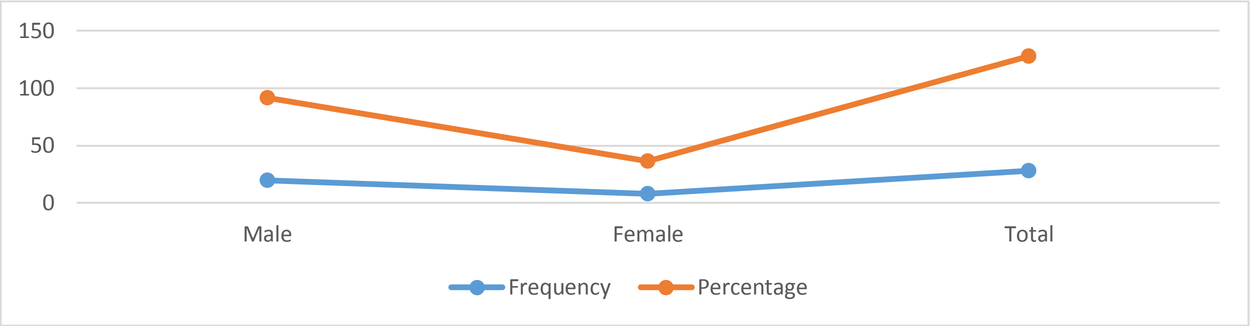

Figure 1: Gender of the Respondents

Source: Research Findings

The study found it paramount to determine the respondents' gender in order to ascertain whether there was gender parity in the positions indicated by the respondents. The findings of the study are as shown in Figure 1. According to the analysis it was evident that majority of the respondents were male which represented 71.43% while 28.57% were female. It can therefore be deduced that males were the most dominant gender in organizations of Kenya.

4.1.2 Age Bracket of the Respondents

The researcher sought to determine if the respondents were old enough to provide valuable responses that pertain to the effect of organizational structure on financial performance of commercial state corporations in Kenya.

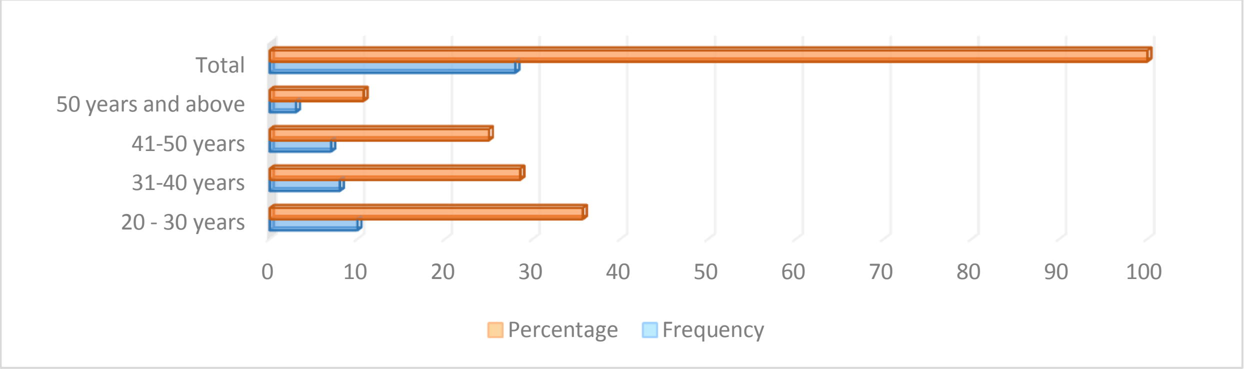

Figure 2: Age Bracket of the Respondents

Source: Research Findings

The respondents were required to indicate their age where the study findings indicated that majority (35.71%) indicated that their age bracket was between 20 and 30 years. Analysis of findings also indicated that 28.57% of the respondents were between 31 and 40 years of age. The findings further indicated that 25.0% were 41 to 50 years and above. While the remaining 10.71% indicated that they were 50 years and above. The finding therefore implies that the

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respondents were old enough to provide valuable responses that pertain to the effect of organizational structure on financial performance of commercial state corporations in Kenya.

4.1.3 Level of Education of the Respondents

The figure shows the respondents level of education.

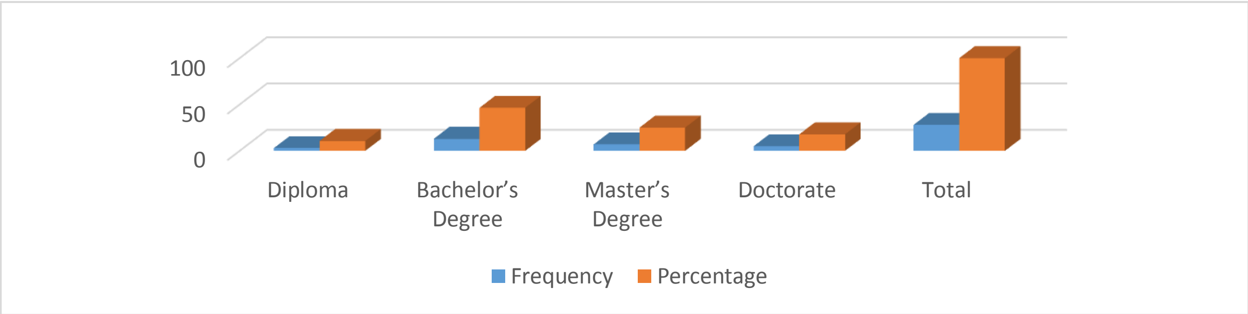

Figure 3: Level of Education of the Respondents

Source: Research Findings

The study sought to find out the respondents level of education. The findings of the study are tabulated as in Figure 3. From the findings, majority (46.43%) had university degrees followed by 25% who indicated that they had master degree, 17.86% indicated that they had doctorates. The remaining 10.71% indicated that they had attained diplomas. Therefore the findings conclude that most respondents had adequate education to execute their pertaining to effect of organizational structure on financial performance of commercial state corporations in Kenya.

4.2 Descriptive Statistics

The researcher sought to find out the extent to which certain factors affect the financial performance of commercial state corporations. The findings are indicated as follows.

Table 1: Structure Formalization

Structure Formalization		Mean	Std. deviation.
(a)	Sections/departments formal meetings/briefings are conducted on a regular basis.	3.891	0.937
(b)	There are formal guidelines on how to deal with every operational activity/situation and the guidelines are available to staff.	4.172	0.815
(c)	Written formal communications through established channels must be used on every engagement to be undertaken by the corporation.	3.997	0.716
(d)	Every position in this corporation has a written job description	4.137	0.798
(e)	There is formal orientation program for new members of staff.	4.123	0.9117
(f)	Policies and procedures manual are readily available to all staff.	3.879	0.892

Table 2: Structure Complexity

Structure Complexity		Mean	Std. deviation
(a)	There are few levels of hierarchy before a decision is made.	3.517	0.637
(b)	For every corporation mandate, there is an established department/division to deal with it.	3.978	0.733
(c)	There is more than one income generating activity/more than one mandate.	3.451	0.914
(d)	Department/divisional decisions are approved by the head of the department/division.	4.089	0.857

Table 3: Structure Centralization

Structure Centralization		**Mean**	**Std. deviation**
(a)	Sub-ordinate staffs participate in decision making on matters relating to day to day operations of the corporation.	4.129	0.995
(b)	All investment decisions must be approved by board of directors before are undertaken the corporation.	3.971	0.925
(c)	All operation activities to be undertaken by the corporation are approved by Chief Executive officer.	3.578	0.841
(d)	Staffs are asked to give their input on the adoption of new policies and procedures.	4.135	0.759
(e)	No or little action can be taken by a staff on any matter without supervisor permission.	3.649	0.999

Source: Research Findings

The researcher found out that the four variables i.e. organizational size, structure formalization, structure complexity and structure centralization affected the financial performance of the commercial state corporations. Under structure formalization the researcher found out that department meetings were conducted on a regular basis, also there was a formal guideline on how to deal with every operational activity. The researcher also found out that policies and procedures manual are readily available to all staff. Under structure complexity, the researcher found out that the respondents agreed that there are few levels of hierarchy before a decision is made, there are established departments to deal with every corporation mandate and that there is more than one income generating activity. Lastly under structural centralization, the study finding indicate that the respondents greatly agreed that the subordinate staff participate in decision making on matters relating to day to day operations of the corporation.

4.3 Inferential Statistics

4.3.1 Correlation Analysis

The Pearson product-moment correlation coefficient (or Pearson correlation coefficient for short) is a measure of the strength of a linear association between two variables and is denoted by r. The Pearson correlation coefficient, r, can take a range of values from +1 to -1. A value of 0 indicates that there is no association between the two variables. A value greater than 0 indicates a positive association, that is, as the value of one variable increases so does the value of the other variable.

Table 4: Correlation Coefficient of Financial Performance.

	organizational size- Turnover & Number of	structure formalization	structure complexity	structure centralization	Return on
Organizational size- Turnover & Number of Staff	1				
Structure formalization	0.1135	1			
Structure complexity	0.1297	0.7914	1		
Structure centralization	0.7612	0.8321	0.7294	1	
Return on assets (ROA)	0.6913	0.8163	0.7568	0.8679	1

Sources: Research data

The study in table 5, show that almost all the predictor variables were shown to have a positive association between them at a significant level of 0.05 and hence included in the analysis. There was strong positive relationship between organizational size- Turnover & Number of Staff and structure centralization (correlation coefficient 0.7612), structure formalization and structure centralization (correlation coefficient 0.8321), structure complexity and structure centralization (correlation coefficient 0.7294), return on assets (ROA) and organizational size- Turnover & Number of Staff (correlation coefficient 0.6913) and return on assets (ROA) and structure formalization (correlation coefficient 0.8163), return on assets (ROA) and structure complexity (correlation coefficient 0.7568), lastly between return on assets (ROA) and structure centralization (correlation coefficient 0.8679).

4.3.2 Regression Analysis

The following are the results of regression analysis.

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.5713[a]	.7685	.7681	.42127

a. *Predictors*: (Constant), organizational size- Turnover & Number of Staff, structure formalization, structure centralization and structure complexity.
b. *Dependent Variable:* Return on assets (ROA)

Source: Research Findings

Analysis in table above shows that the coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables) R square equals 0. 7685, that is, organizational size- Turnover & Number of Staff, structure formalization, structure centralization and structure complexity. The Analysis of Variance (ANOVA) was used to check how well the model fits the data. The results are presented in table 6.

Table 6: ANOVA (Analysis of Variance)

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1.045	3	.123	.678	.000[a]
	Residual	5.102	28	.177		
	Total	5.628	93			

a. *Predictors*: (organizational size- Turnover & Number of Staff, structure formalization, structure centralization and structure complexity)
b. *Dependent Variable*: Return on assets (ROA)

Source: Research Findings

The F statistic is the regression mean square (MSR) divided by the residual mean square (MSE). Since the significance value of the F statistic is small (0.000 smaller than say 0.05) then the predictors' variables i.e. the relationship between organizational size- Turnover & Number of Staff, structure formalization, structure centralization and structure complexity explain the variation in the dependent variable which is return on assets (ROA). Consequently, we accept the Hypothesis that all the population values for the regression coefficients are not 0. Contrary, if the significance value of F was larger than 0.05 then the independent variables would not explain the variation in the dependent variable, and the null hypothesis that all the population values for the regression coefficients are 0 should have been accepted. The regression output of most interest is the following table of coefficients and associated output:

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Table 6: Regression Coefficients Results

Model		Standardized Coefficients Beta	T	Sig.
1	(Constant)	0.954	7.367	0.000
	organizational size	0.971	2.021	0.045
	structure formalization	0.739	1.157	0.210
	structure complexity	0.835	1.194	0.234
	structure centralization	1.271	2.617	0.095

Source: Research Findings

Dependent variable: Return on assets (ROA)

From the Regression results in table below, the multiple linear regression model finally appear as;

$ROA = 0.954 + 0.971SZ + 0.739SF + 0.835SC + 1.271SCE + \varepsilon i$

The multiple linear regression models indicate that all the independent variables have positive coefficient. The regression results above reveal that there is a positive relationship between dependent variable return on assets (ROA) and independent variables (organizational size-Turnover & Number of Staff, structure formalization, structure centralization and structure complexity).

From the findings, one unit change in organizational size results in 0.971 units increase in institutions financial performance. One unit increase in structure formalization results in 0.739 units increase in institutions financial performance. One unit change in the structure centralization results in 1.271 increase in financial performance. One unit change in structure complexity results in 0.835 unit increases in financial performance. The t statistics helps in determining the relative importance of each variable in the model. As a guide regarding useful predictors, we look for t values well below -0.5 or above +0.5. In this case, the most important variable was organizational size- Turnover & Number of Staff, structure formalization, structure centralization and structure complexity.

5.0 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Summary of Findings

The study aimed at investigating the effects of organizational structure on financial performance of commercial state corporations. The study found that the respondents indicated that the organizational size and structure formalization affected the financial performance in the commercial state corporations to a great extent. The structure complexity affected the performance of the commercial state corporations was a challenge the board faced to a great extent as shown by a mean of 3.79. The respondents strongly agreed that the structural centralization played a big role in shaping commercial state corporations strategy as shown by a mean of 3.87.

Conclusion

The study concludes that the organizational size, structure formalization, structure complexity and structure centralization affected the financial performance in the commercial state corporations. The number of non-executive directors affected the performance of the commercial state corporation was a challenge the board faced. The board was actively involved in shaping commercial strategy. From the findings, it was deduced that the organizational structure affected the financial performance of the commercial state corporations. The directors were involved in making the internal corporate governance mechanisms. Reducing ownership concentration affected the financial performance of the commercial state corporation. Employee involvement affected the financial performance of the commercial state corporations. The commercial state corporations' leadership affected the financial performance of the commercial state corporations. Finally, organizational size, structure formalization, structure complexity and structure centralization were also identified as the factors affecting the financial performance of the commercial state corporation.

Recommendations

The study recommends that the board size and composition be considered since they affect the financial performance of the commercial state corporations. The number of non-executive directors needs to be selected well since they affect financial performance of the commercial state corporations. The board needs to comprise of well-educated people since they are actively involved in shaping Commercial state corporations' strategy. The study recommends that non-executive directors be trained on internal corporate governance mechanisms.

Ownership concentration needs to be reduced to avoid few people controlling the financial performance of the organization. Employees should be encouraged to be more active in financial management aspects of the commercial state corporations business. Finally, the study recommends that financial monitoring should be done thoroughly by the board.

A constitution which clearly indicates how to select and replace the CEO and directors need to be adopted. Commercial state corporations should consider adopting conduct of regular Corporate Governance Audits and Evaluations. Good Corporate Governance has a positive economic impact on the institution in question as it saves the organization from various losses for example, those occasioned by frauds, corruption and similar irregularities.

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