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INFLUENCE OF DIVESTMENT STRATEGY ON PERFORMANCE OF LARGE MANUFACTURING FIRMS IN KENYA

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INFLUENCE OF DIVESTMENT STRATEGY ON PERFORMANCE OF LARGE MANUFACTURING FIRMS IN KENYA

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Abstract

Purpose: The study sought to establish the influence of divestment strategy on the performance of manufacturing firms in Kenya. This comes at a time when manufacturing firms in Kenya have been experiencing declining performance in terms of revenue, sales and the profit margins. While the firms have tried to come up with different strategies to salvage their performance, it is not clear whether they have embraced divestment as one of the turnaround strategies, hence the subject of the study.

Methodology: This study was informed by real options theory. Descriptive research design was used in the study. The target population was the 708 large manufacturing firms in Kenya. The sample size for the study was 249 firms selected randomly from all the 14 sub-sectors of the manufacturing industry in Kenya. The data collection instrument was a questionnaire. The collected data was analyzed using descriptive and inferential statistics.

Results: The findings revealed that divestment strategy had a significant and positive influence on the performance of large manufacturing firms in Kenya. The study concluded that through divestment, manufacturing firms are able to save on costs and redirect their revenues to more productive and profitable processes, thus enhancing performance.

Unique Contribution to Theory, Practice and Policy: The management of manufacturing companies should embrace divestment strategy through disposing some of their assets that are not generating profits and exiting any market that is least performing. This way, the companies raise more funds and save on costs used in running less beneficial products or services.

Keywords: *Turnaround Strategies, Divestment strategy, organizational culture, firm performance, manufacturing firms*

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1.0 INTRODUCTION

1.1 Background of the Study

In turbulent times when business and industries are unable to break-even and profit margins seem to decline or losses are increasing, it becomes essential for organizational management to rethink of strategies that can be applied to salvage such situations. One of the strategies is the divestment strategy. This is the decision by an organization to dispose-off a significant portion of its assets as a way of sustaining its profitability state. It is the process by which multi establishment corporations shift or relocate existing capital between their own establishments. Taken together, it can be inferred from these characterizations that divestments concern the voluntary release or shift of capital previously tied up in organizational resources (Mata & Portugal, 2010).

Divestment activities including spinning-off divisions and exiting diversified markets are regarded as part of a firm's corporate restructuring strategy. Spinning-off divisions is the process of removing some product or process divisions that are not accurately and extensively aligned to the business operations and revenue generations. A thorough scanning is required to establish the divisions that contribute little to the revenue kitty of the firm and getting rid of them to minimize the costs. However, firms might restructure their business activities in a variety of ways. Delmar, Davidsson and Gartner (2003) distinguish three categories of restructuring activities: organizational, financial, and portfolio restructuring. Organizational restructuring to remove some passive divisions is intended, as the name implies, to increase the efficiency of management teams through changes in the organizational structure such as team sizes, responsibilities and incentive structure (Flickinger, & Zschoche, 2018).

The other aspect of divestment is exiting from some of the diversified markets. Companies diversify their products and services to other markets as a way of enhancing their competitiveness and revenue generation. However, with time, this diversification might seem to underperform or utilize more revenues in terms of costs than it is generating income for the company. It is therefore necessary to divest through exits in such markets in order to save on operational costs. According to Vargo *et al.* (2017), exiting diversified markets not only enhances the ability of the organizations to save on costs but also to enable the company to concentrate their competencies and skills to their main market.

Divestment of organizational units through assets disposal can lead to various kinds of losses accruing to the parent firm, such as strategic, reputational, financial, or human resource and identity related sacrifices (Brauer, 2006). Thus, the categories of divestment decisions can be expected to differ significantly in their determinants and should be distinguished carefully. To explain why companies, divest, it is frequently assumed that poor financial divestment objective performance is the dominant element to drive the divestment decision (Boddewyn, 2009). However, there is profound evidence that a multitude of factors unrelated to divestment objective performance affect corporate divestment decisions significantly. Divestment decisions typically are impacted by declining profit margins and revenues due to changes in the business environment or other related factors

Manufacturing sector stands to be one of the major economic drivers in both the developing and developed countries across the globe. According to World Bank report (2017), most of the middle-income countries recorded between 10-15% of their GDP to be contributed by manufacturing sector. Moreover, Carlinn (2018) indicated that over 40% of middle-east economies were anchored on manufacturing sector which employed more than 60% of the countries' workforce. In Kenya, manufacturing firms have continuously contributed to the country's economic growth by being key pillars of other important sectors while at the same time providing employment to more than 18% of the country's workforce (KAM, 2017). However, despite the merit that surrounds the manufacturing sector in Kenya, the firms have been facing tremendous challenges most of which have affected their performance and sustainability (KAM, 2017).

1.2 Statement of the Problem

Statistics from World Bank show that a good number of large-scale manufacturers operating in Kenya have been registering stagnation and declining profits and on the whole, manufacturing sector has lost 70 per cent of its market share in East Africa in the last 25 years (RoK, 2016). In the year 2016, manufacturing sector in Kenya contributed barely 10% to the GDP which represented a 2.4% decrease from the previous year (KNBS, 2016). Cadbury Kenya closed down its manufacturing plant in Nairobi after its net profits fell by 58.7 per cent to $493,237 from $784,783 while Eveready Ltd reduced its production capacity to 50 million units annually, down from a previous high of 180 million per year (RoK, 2014). On the other hand, Tata Chemicals Magadi scaled down its operations by closing down its main factory (Kandie, 2014). Despite the contextual differences in the existing studies, there is little effort to link divestment strategy with performance. Moreover, there lacks any evidence on the role played by organizational culture in the relationship between divestment strategy and performance. This study therefore sought to fill the existing gaps by establishing the influence of divestment strategy on performance of large manufacturing firms in Kenya and the moderating effect of organizational culture.

1.3 Study Objectives

i. To determine the influence of divestment strategy on performance of large manufacturing firms in Kenya
ii. To establish the moderating effect of organizational culture on the relationship between divestment strategy and performance of large manufacturing firms in Kenya

1.4 Research Hypotheses

1. **H_{02}** Divestment strategy does not positively and significantly influence the performance of large manufacturing firms in Kenya
2. **H_{02}** Organizational culture does not positively and significantly moderate the relationship between divestment strategy and performance of large manufacturing firms in Kenya

2.0 LITERATURE REVIEW

2.1 Divestment Strategy and Firm Performance

Chen, Yi and Lin (2013) assessed the role played by divestment strategy in promoting business survival. The scholars aimed at establishing the effect of divestment on firm survival with the induction that most organizations divest with the sole aim of prolonging their existence in the market. The study adopted a case study research design and had a sample of 93 respondents drawn from firms in Taiwan. Chen *et al.* (2013) found that as a result of divesting, firms in Taiwan are able to enhance their survival through obtaining more financial capacity to continue their operations.

Zschoche (2016) carried out a study on short-term performance effects of a firm's decision to divest foreign affiliates that are part of an integrated international production network in South Africa. The study evaluated the actual financial consequences of divestments; however, it is unclear whether the benefits of divesting unprofitable production locations will outweigh the costs that arise from withdrawal in the short run. The study findings suggested that withdrawing some investments from a production network leads to an immediate decline in performance. The study findings further revealed that efficiency gains that result from more favorable labor cost conditions across the remaining locations, on the other hand, can mitigate the negative performance effects.

Schoenberg, Collier and Bowman (2013) conducted a study focusing on strategies for business turnaround and focused on divestment as one of the strategies. The study aimed at pointing out the impact of divestment as one of the turnaround strategies in promoting firm growth and performance while basing evidence on previous empirical research. The study findings indicated that indeed divestment played a significant role in promoting firm growth in its dying period. Schoenberg *et al.* (2013) contemplated that through conversion of debt to equity and extending the time of accounts receivables, a firm stands a better chance to raise more revenue for its operations and thus promoting its survival and continued performance.

Locally, Njuguna (2010) carried out a study on the effects of performance on divestiture strategy in the Kenyan oil industry. The study sought to find out whether organizational performance had any direct link with divesture strategy adopted by oil companies in Kenya. Njuguna (2010) used a descriptive research design and targeted oil marketing companies in Kenya. The study established that performance was the strongest predictor of divestiture because of dwindling return on investment, low profit margins and high working capital requirements due to upfront payment of duties and compliance to safety standards. According to Njuguna (2010), as a result of uneven competition, unfavorable regulations and supply constraints, performance of the oil companies is affected thus leading them to adopt divestment as a strategy of prolonging their existence in the market.

2.2 Theoretical Review

The paper has been informed by real options theory. The theory has been widely used to explain divestment decision. The expression "Real Options" was initially introduced by Myers (1977), highlighting that a company's new expansion investments can be interpreted as being similar to call for the available options. Myers (1977) proposed the Options Theory as the best approach to evaluate projects containing significant operating and strategic options, suggesting that the Theory can integrate strategy and finance. According to Myers (1977), the real options theory is used as a risk management tool centered on uncertainty and includes the alternative of executing or not executing the options (Belderbos & Zou, 2009; Keswani & Shackleton, 2006).

According to Myers as cited by Kenny (2014), when an organization realizes that some of its investments/assets are not well performing, it has the option to dispose them off in an attempt to streamline its operations and enhance performance. Myers (1977) states that divestment is not only done in order to raise funds to meet the operational costs through disposing off assets and other investments but also as a way of restraining the company from continued draw of resources to investments that are less profitable. Lambrecht and Myers (2007) indicated that real-options theory can be used to analyze takeovers in the context of declining industries.

Manufacturing firms ought to consider alternatives in decision making when their performance and sustainability are at risk. One of the main ways of turning around as an organization according to the real options theory is through divestment (Driouchi & Bennett, 2011). This could serve a purpose in ensuring that the firm has all its systems put together and the best approach identified to have some disposals done for sustainability. The study adopted the real options theory to infer on the influence of divestment strategy on the performance of large manufacturing firms in Kenya.

2.3 Conceptual Framework

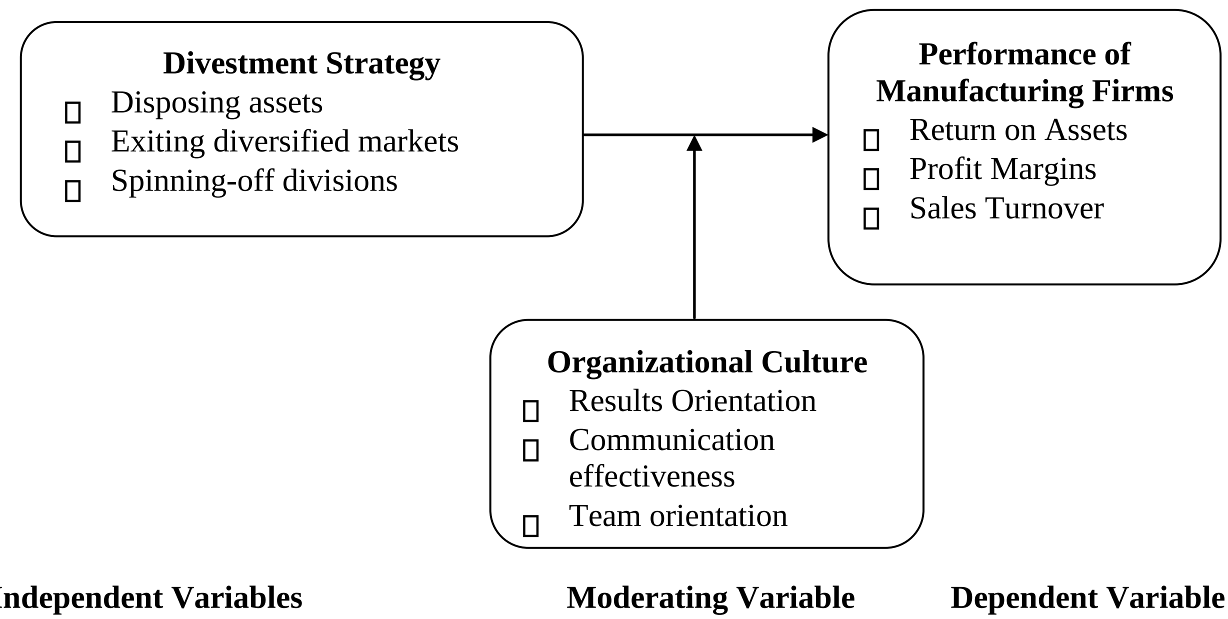

Figure 1: Conceptual Framework

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3.0 METHODOLOGY

The study employed a descriptive survey research design. The target population for this study was the entire population of 708 large manufacturing firms which were registered members of Kenya Association of Manufacturers (KAM, 2017). The firms were stratified into 14 manufacturing sectors and all were considered for this study.

The study used Kothari (2010) formula to determine the sample size as shown below;

$$n = \frac{z^2 \cdot p \cdot q \cdot N}{e^2(N-1) + z^2 \cdot p \cdot q}$$

$$n = \frac{(1.96 \text{ x } 1.96) \text{ x } (0.5 \text{ x } 0.5) \text{ x } 708}{(0.05 \text{ x } 0.05) \text{ x } 708 + (1.96 \text{ x } 1.96 \text{ x } 0.5 \text{ x } 0.5)}$$

$$n = 249.03$$

The sample size therefore comprised of 249 respondents. This represents 35% of the target population. The study then stratified the 249 firms across the 14 sectors so as to reduce sampling bias.

The primary data collection instrument in this study was a questionnaire. This is because questionnaires allow the respondent to present their facts on the subject matter independently enabling a greater depth of response. Questionnaires were administered by the researcher and a research assistant. A total of 249 questionnaires were distributed to the sampled manufacturing entities as per the sampling frame, targeting one respondent in each firm.

Data gathered using the questionnaires was analyzed quantitatively using both descriptive and inferential statistics using SPSS. Descriptive statistics including the mean and standard deviation were used to capture the characteristics of the variables under study. Inferential statistics were also used in the study. Inferential statistics are methods of establishing relationships between variables.

4.0 RESEARCH FINDINGS

4.1 Divestment Strategies

The study sought to determine the influence of divestment strategy on performance of large manufacturing firms in Kenya. The main measures of the variable were; disposing assets, exiting diversified markets and Spinning-off divisions. The respondents were asked specific questions based on these measures and the findings are as herein presented. The respondents were asked to

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indicate their level of agreement based on the statements of divestment strategies. The findings are as shown in table 1.

Table 1: Descriptive Results on Divestment Strategies

Statements	Mean	Std. Dev
The company has considered assets disposal as a way of coming back to business and increasing performance	3.32	1.12
The company focuses on restructuring non-performing assets to turn them into more valuable assets	3.34	1.14
The company has exited some new diversified markets which are less penetrated to save on costs	3.53	1.09
The company spins-off some business divisions and closes down others so as to save on costs	3.02	1.26
The organization has put measures to ensure assets performance and contribution to the firm performance is tracked and those that are less productive are disposed-off	3.33	1.17
The company has previously stopped some projects to save on costs and enhance performance	3.24	1.28
The company has recently undertaken measures to close some product lines that are less performing in the market to save on costs	3.02	1.16
The company has effectively upheld divestment strategy towards enhancing performance	2.63	1.24

The findings imply that divestment is a turnaround strategy adopted by most of the large manufacturing firms in Kenya through assets disposal and exit of lowly penetrated markets so as to tame-down their operational costs and maximize their revenues. The findings gain support from the literature by Hamilton (2011) who found that divestment strategy was a major move by large organizations to pin-down the operations that are draining their revenues and focus on those that maximize the revenues. The scholar stated that for a company to reap the best out of divestment, it is necessary to optimize on the tracking of the assets contribution to the revenues and comparing the contribution to the costs of maintaining the assets so as to identify whether to divest through disposal or not. According to Flickinger and Zschoche (2018), divestment strategy plays a significant role in promoting the performance of the firm by recollecting the invested revenues and channeling them towards a common goal.

4.2 Organization Culture

Table 2: Descriptive Results on Organization Culture

Statements	Mean	Std. Dev.
Employees are frequently Involved in decision making processes in our firm	3.31	1.15
The organizational management is concerned with the relationship among employees and plays its role in promoting the relationship	3.22	1.21
The organizational management encourages cooperation across different departments and groups in the firm	3.09	1.16
The organization has embraced a shared vision of what the organization will be like in the future	3.48	1.12
The firm management encourages teamwork among the employees in carrying out the firm operations	3.38	1.14
The top management frequently delegates duties to employees so as to create a capable team of leaders	2.85	1.29
The company continuously invests in the skills of employees through training and development	2.78	1.26
There are clear and consistent set of values that governs the way business is done in our firm	3.17	1.17
The vision in our organization creates excitement and motivation among the employees	3.14	1.14
The mission statement of the organization is properly constituted, communicated and aligned with the organizational goals	3.12	1.20

The study sought to establish the moderating effect of organizational culture on the relationship between divestment strategy and performance of large manufacturing firms in Kenya. The study aimed at establishing the agreement level of respondents on statements on organization culture as an aspect of performance of large manufacturing firms in Kenya. Organizational culture was operationalized as team orientation, results driven and effective communication.

The findings are as shown in table 2. According to Martins *et al.* (2011), organizational culture relates the employees to Organization's values, norms, stories, beliefs and principles and incorporates these assumptions into them as behavioral set of standards. Őnday (2016) while citing Mayo's theory of human relations argued that the relationships between the workers and management greatly influence productivity

4.3 Performance of Manufacturing Firms in Kenya Sales Turnover

The study sought to find out the sales turnover of the companies as a way of establishing their performance. The findings as shown in Figure 2 revealed that the manufacturing companies recorded varying sales turnover. In 2019, the large manufacturing companies recorded an average sales turnover of Kshs.20.03 billion and in the year 2020, the companies recorded an average of Kshs.20.64 billion in sales turnover. This shows an upward trend in sales volume although the average increase is low as compared to other industries.

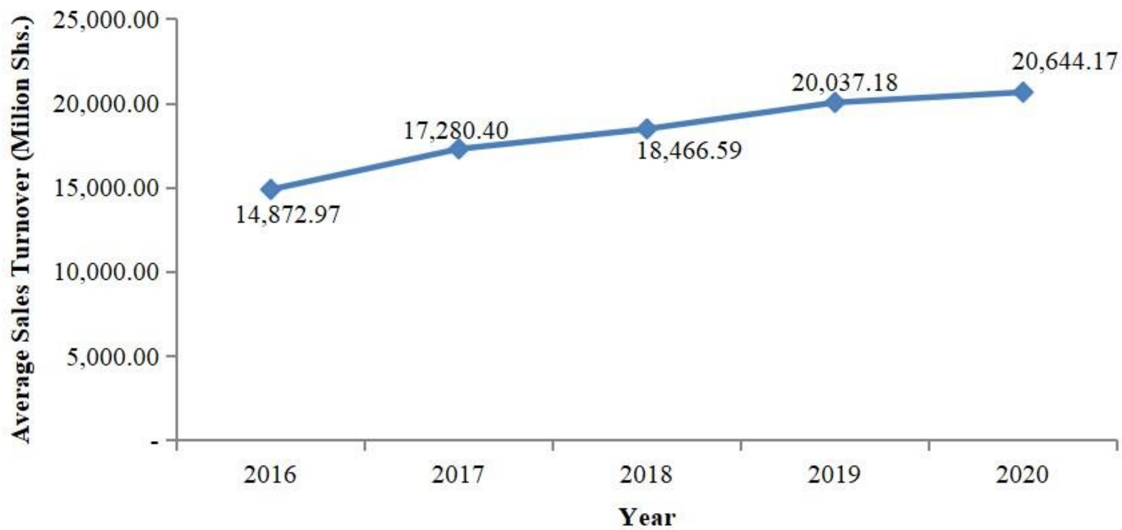

Figure 2: Sales Turnover

4.4 Profit Margin

The study sought to find out the annual profits of the manufacturing companies as one of the measures of performance. The findings as shown in Figure 3 portray that in 2019, the firms recorded a decline in the average net profit to record Kshs.899.49 million and in the year 2020, the average net profit declined to Kshs.394.62 million. The trend in average net profits among the large manufacturing firms is unstable.

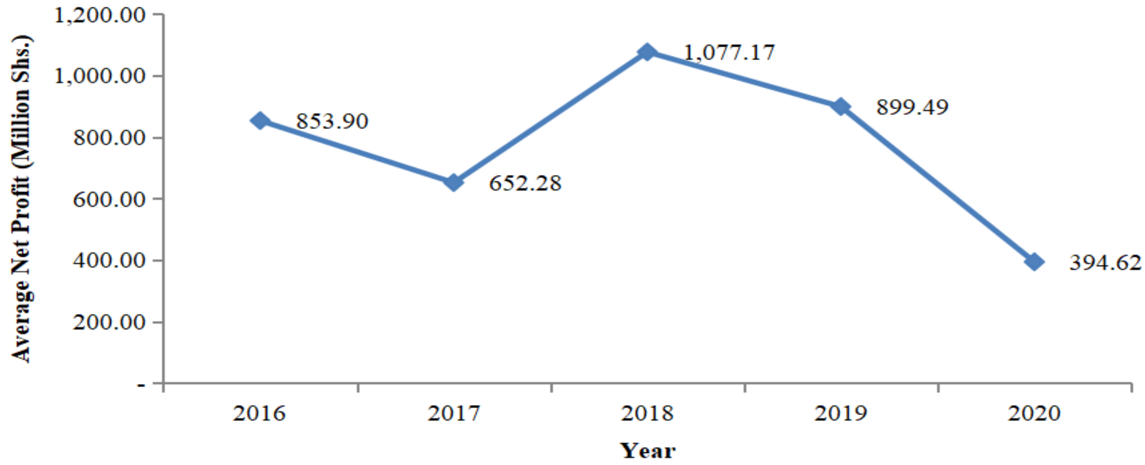

Figure 3: Profits Margin

4.5 Inferential Statistics

4.5.1 Correlation Results

Results of the Pearson correlation, as shown in Table 3, indicate that there is a significant positive correlation between divestment strategies and performance of large manufacturing firms (r=0.628, p value <0.05). The findings indicate that divestment strategy has a strong positive association with the performance of manufacturing firms.

Table 3: Correlation Matrix

		Performance of manufacturing firms	Divestment Strategies
Performance of manufacturing firms	(r)	1	
	Sig. (2-tailed)		
	N	208	
Divestment Strategies	(r)	.628*	1
	Sig. (2-tailed)	.000	
	N	208	208

*Correlation is significant at the 0.05 level (2-tailed)

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4.5.2 Hypothesis Testing

***H_{o1}*:** *Divestment strategy does not positively and significantly influence performance of large manufacturing firms in Kenya.*

$$Y = \beta_0 + \beta_2 X_2 + \mathcal{E}$$

As the model summary results on Table 4 reveal, the value of R square is 0.438 which means that 43.8% variation in performance of manufacturing firms in Kenya was due to divestment strategies.

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.662[a]	.438	.435	.57037

Predictors: (Constant), Divestment Strategies

Analysis of Variance (ANOVA) results are as shown in Table 5. As the results portray, the F-statistic was 160.444 at a significance level of 0.000 which is less than 0.05 thus the model was statistically significant in predicting how divestment strategy influenced performance of manufacturing firms in Kenya.

Table 5: ANOVA (Analysis of Variance)

Model		**Sum of Squares**	**df**	**Mean Square**	**F**	**Sig.**
1	Regression	52.196	1 206	52.196	160.444	.000[b]
	Residual	67.016		.325		
	Total	119.212	207			

a. Predictors: (Constant), divestment strategies

b. Dependent Variable: Performance of Manufacturing Firms

Based on the regression results shown on Table 6, holding divestment strategy constant at zero, performance of manufacturing firms in Kenya would be 0.974. A positive unit change in divestment strategies would lead to a 0.619 increase in performance of manufacturing firms in Kenya. At 5% significance level, divestment strategies had a p=0.0000 which is <0.05, and hence the study rejected the null hypothesis that divestment strategy does not positively and significantly influence performance of large manufacturing firms in Kenya.

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Table 6: Regression Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.974	.156		6.240	.000
Divestment Strategies	.619	.049	.662	12.667	.000

a. Dependent Variable: Performance of Manufacturing Firms

4.5.3 Moderating Effect of Organizational Culture

The regression coefficients results are as shown in Table 7. As the results show, the Beta coefficient for the interaction effect between divestment strategy and organizational culture is 0.045 with a P-value of 0.014<0.05. The findings imply that organizational culture has a significant moderating effect on the relationship between divestment strategy and performance of manufacturing firms in Kenya.

Table 7: Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.351	.094		14.401	.000
1 Divestment Strategy*Organizational Culture	.045	.018	.262	2.468	.014

a. Dependent Variable: Organizational Performance

5.0 CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

The study sought to establish the influence of divestment strategies on the performance of large manufacturing firms in Kenya. The results showed that divestment strategy had positive and significant influence on the performance of large manufacturing companies in Kenya. The analysis further revealed that organizational culture significantly moderated the relationship between divestment strategy and performance of the large manufacturing firms in Kenya.

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The study concluded that through disposal of assets that are not generating profits for the organization and exiting non-performing markets that the organization may have diversified into play a key role in promoting firm performance.

5.2 Recommendations

The management of manufacturing companies should embrace divestment strategy through disposing some of their assets that are not generating profits and exiting any market that is least performing. This way, the companies raise more funds and save on costs used in running less beneficial products or services.

The study recommends that the management of the large manufacturing firms ought to embrace organizational culture as an aspect to control and enhance changes within their organizations. The culture in a given organization plays an essential role in determining the ability of the management to implement new strategies such as the turnaround strategies. It is therefore essential for the management to ensure that the culture exemplified in the organizations aligns to the goals and objectives of the organization.

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