



EFFECTS OF GOVERNANCE STRUCTURE ON SUPPLIER PERFORMANCE IN SERVICE STATE OWNED ENTERPRISES IN KAKAMEGA COUNTY

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ABSTRACT

In Kenya it is estimated that public procurement accounts for over 10% of the Gross Domestic Product (GDP), making it a large market for suppliers and contractors. However, supplier performance has not been impressive in Kenya's public sector to date. Evidence suggests that Kenya's public entities are suffering from long lead times, poor quality of goods and services delivered and high levels of contract violations. PPOA report of 2015, reported that more than \$200 million is lost every year due to suppliers failure to deliver as per terms of the signed contracts, and this is despite the presence of a contract management system. The objective of the study was to investigate the effect of governance structure on supplier performance in service state owned enterprises in Kakamega County. Survey research design was adopted targeting 120 State Owned Enterprises officials from 15 Service State Owned Enterprises in the County using a census survey. The study was quantitative in nature and used questionnaires as research instruments. Data was analyzed using both descriptive and inferential statistical methods with the aid of Statistical Package for Social Sciences (SPSS) version 24 and findings were presented in the form of frequency distribution tables. Governance structure was also found to significantly influence on supplier performance. The study recommended a further study on the effect of contractor-supplier relationship on quality of goods and services supplied. This study would help to shed more light on the lack of consensus on the subject matter as identified in this current study.

Key Words: Governance Structures, Supplier Performance, Kakamega County

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INTRODUCTION

Procurement is the process of acquiring goods, works and services. Public procurement (PP) as a function of government includes decisions about the services that will be delivered to local authorities and the communities they serve (Hughes, 2005). This important function is utilized not only to secure goods and services required by public sector organizations for their missions and to support services provided to taxpayers, but it is also used to implement national policies and to achieve social and other objectives (Thai, 2004). Aketch (2013) says that public procurement plays a significant role in the generation of country's wealth since it accounts for approximately 16% of most countries GDPs. According to Agaba and Shipman (2008), the Organization for Economic Cooperation and Development (OECD) estimates the value of government procurement in the world to be over US\$ 2,000 billion, equivalent to 7% of world GDP and 30% of global merchandise trade on average.

Contract governance is an integral part of the procurement cycle. Contract governance is a value-maximizing model towards which most of businesses has begun to shift. Contract governance consists of having a firm strategy that addresses every aspect of the contract process (Enquist, Johnson & Camén, 2005). That means having oversight over the entire process for every contract from start to finish, transparency into relationships for all the necessary parties and an understanding of where risk may arise in the future. It is drastically more intuitive way to manage all of the contracts that enables the contracting authority not to use the contract merely as a tool to seal the deal, but to help any given partnership grow (Hansson & Longva, 2014). With contract governance, it is no longer just signing off on contracts and waiting for an end date, but one can monitor what is working and what is not and renegotiate accordingly to keep all parties satisfied and increase the productivity of the relationships (Greve, 2008). The need for contract governance as a contract management

model arose out of the weaknesses inherent in the latter that was quite evident during procurement contracts.

A supplier is an entity that supplies goods and services to another organization. This entity is part of the supply chain of a business, which may provide the bulk of the value contained within its products. Some suppliers may even engage in drop shipping, where they ship goods directly to the customers of the buyer (Lysons and Farrinton, 2012). A supplier is usually a manufacturer or a distributor. A distributor buys goods from multiple manufacturers and sells them to its customers (CIPS, 2016). According to The Business Dictionary (2018), a supplier may be distinguished from a contractor or subcontractor, who commonly adds specialized input to deliverables. A supplier is also called vendor.

A company that deploys effective supplier performance management ensures that a supplier's performance meets the expectations defined in the contract and market norms. It includes the management of actual performance, identification of performance gaps and agreement of actions to achieve desired performance levels. SPM not only ensures that those benefits identified in the contracting stage are delivered, but that value delivery continues for the life of the contract (Ryals, & Rogers, 2006). As companies increasingly focus on their core competencies and outsource a greater percentage of work, their success becomes ever more dependent on the performance of strategic suppliers. Ultimately, the objective of SPM is to improve the performance of all parties involved in the contract and Service Level Agreement (SLA) (Gordon, 2005). However, upholding the SLA can only be effective under a contract governance system.

State owned enterprises refer to agencies, companies or intergovernmental organizations that have political influence and are distinct from the government though their activities directly or indirectly serve the state. Such organizations can also be partly or wholly owned by a government.

Under the State Corporations Act, chapter 446 of the constitution, Kenya has established many SOEs, usually referred as Parastatals. These firms have the autonomy of running and concentrating on particular mandates so as to enhance the public service delivery (Government of Kenya, 1986). Even though they have Board of Directors and equivalent governing bodies to supervise their operations, such institutions act within the general supervision of their respective ministries (Government of Kenya, 2004). These organizations are highly indispensable in the Kenya since they provide significant avenues through which the state reaches out to the people and serve them appropriately. These organizations are relevant in the study because they all undertake procurement practices under the PPADA 2015 Act. The country loses a lot of taxpayers' money through poor procurement and contract management practices. Therefore, it would be insightful to discover the extent to which state owned enterprises in Kenya conduct contract management practices. It is also worthwhile to understand how contract management practices affects the overall operational performance particularly the supplier performance of these SOEs. Therefore, the study will gain valuable information from these SOEs in relation to contract management and supplier performance, and that the context forms a fertile ground for the study

Statement of the Problem

Public procurement is the main process through which any government operates and spends public money. Public sector procurement makes up 10-20% of the Gross Domestic Product (GDP) of developed countries and accounts for up to 30-36% of most developing nation's GDP in Sub Saharan Africa (OECD, 2013; Commonwealth secretariat, 2013). In Kenya it is estimated that public procurement accounts for over 10% of the Gross Domestic Product (GDP), making it a large market for suppliers and contractors PPOA (2009). A significant amount of the state's procurement budget is channeled to SOEs for recurrent expenditure, maintenance, operations and capital

improvement so as to enhance service delivery. The country's public sector entities such as ministries, government agencies, state corporations have vastly adopted contracting as model to increase flexibility, access better expertise, improve quality of services, reduced capital investment as well as improved internal user satisfaction

and obtain value for money hence relieving the taxpayer of additional expenses (Ntayi, Namugenyi & Eyaa, 2010). Contracted functions include technology, consultancy, cleaning services, security, waste management, training, roads construction among others to improve supplier performance. However, supplier performance has not been impressive in Kenya's public sector to date. Evidence suggests that Kenya's public entities are suffering from long lead times, poor quality of goods and services delivered and high levels of contract violations (PPOA, 2009). PPDA report of (2015), reported that more than \$200 million is lost every year due to suppliers' failure to deliver as per terms of the signed contracts, and this is despite the presence of a contract management system.

Ordinarily firms use governance mechanisms to structure their relationships in order to mitigate risks arising from contractual relationships (Williamson, 1979). As an emerging practice in contracts management, contract governance gives the contracting authority discretionary powers in overseeing the implementation of the procurement contracts to its satisfaction. This, therefore, led to questions regarding the efficacy of the procurement contract management system and even more importantly on the state of the governance structures in ensuring both parties honor their agreements to the letter. This study, therefore, intended to undertake a critical assessment of the governance structures with respect to supplier performance of service state owned enterprises in Kakamega country.

Research Objectives

The objective of the study was to investigate the effects of governance structure on supplier

performance in service state owned enterprises in Kakamega County. The research hypothesis was:-

- **H₀:** Governance structure does not significantly affect supplier performance in service state owned enterprises in Kakamega County

LITERATURE REVIEW

Theoretical Review

The Principal-Agency theory

According to Chiappori and Salanie (2003) as cited by Salim (2013); and Oluka and Basheka (2012) the underlying principle of the principal-agency theory is that there should be a clear understanding of the needs of the principal and ability of the agent to meet these needs competently. Principal must closely monitor agents' performance; create reward structures that reinforce desired performance (Ketchen and Hult, 2006). Indeed, when procurement contract is well defined and planned, the principal and agents find it easy to meet needs of each other in an efficient way resulting into timely execution of the contract (Oluka and Basheka, 2012). The principal-agent theory can proudly be applied to this study with a case company as a principal and contractors or service providers or suppliers as agents. The theory becomes significant to the study as it highlights the need for robust contract requirements and specifications as well as the objectively process of monitoring contractors' performance. When contract requirements, CM team roles and responsibilities and KPIs are well defined, the principal and agents will find it easy to meet needs of each other in an efficient way resulting into timely execution of the contract in predetermined performance level.

Empirical Review

Governance Structure and Supplier Performance

Good governance is measured around four key pillars: accountability, transparency, predictability, and participation. None of the four pillars and their constituent components can stand alone without the other because the public sector operates like a system. A mistake or weakness in one part of the

public sector is felt by other components of the public sector (PPOA 2009). Launching effective supply governance is vital to unravelling SRM value, particularly for partner suppliers (Anderson, 2002). To achieve this, the internal governance processes must be aligned to the organizational structure and assigned teams ownership (Shin, Collier & Wilson, 2000). It is essential to encompass the right stakeholders from the business in the process as well as ownership from procurement department in supplier relationships (Archer, 2003). These stakeholders are part of a recognized supplier governance committee for each category of suppliers.

A governance committee describes and pushes the strategic roadmap together with the supplier (Choy, Lee & Lo, 2002). These committees are indispensable for a steady and reliable interface with suppliers to identify and sustain long-term value, for example, IBM has sourcing committees especially liable for the strategic supplier relationships for each category of spend (Li, Ragu-Nathan, Ragu-Nathan & Rao, 2006). The committees devote time developing, mentoring and working with suppliers to increase their business so firms can in return gain some benefit (Shin, Collier & Wilson, 2000). Sourcing committees proactively engage with suppliers in discovery of the best value in terms of quality, pricing and overall relationship at all levels within the supply network (Li, Ragu-Nathan, Ragu-Nathan & Rao, 2006).

Comprehensive SRM method produces fruitful relationships from organization wide ranging commitments united with a well-defined process (Moorman, Zaltman & Deshpande, 1993). The configuration of supplier relationships across the organization needs an energetic governance structure, both within the organization and towards their strategic suppliers, consistent performance measurements and corporate supplier strategies (Bovet, David, Martha & Joseph, 2000). A flawless framework to manage supplier relationships at various levels reduces the level of intricacy and

increases transparency internally as well as externally (Nyaga, Whipple & Lynch, 2010).

Many organizations struggle to manage their supplier relationships methodically (Zimmermann, et al 2015). The main reason behind this is lack of a clear structure with aligned guidelines on supplier management. In traditional supplier relationships, the interface between different functions of an organization and its suppliers can be termed as tactical and operational (Lysons and Farrington 2012). As a result relationships are wanting in transparency not only from an external perspective, but also with reverence to internal governance and ownership of interactions (Ghijsen, Semeijn & Ernstson, 2010). This outcome is further augmented by the organizations' development and acquisition strategies, which may lead to a growing supply system, progressive global operations and increases the level of organizational intricacy and risk (Kannan & Choon, 2003).

Basheka, Tumutegereize and Sabiiti (2013) analyzed the implications of public procurement governance within the context of structures, mechanisms, values and processes on administrative efficiency in Uganda's public sector; but with a rejoinder that our findings may be applicable in other polities. The results confirmed that improvements in public procurement governance is likely to contribute to 45% in improvements on administrative efficiency; an indeed significant percentage especially when comparison is directed to the number of functions performed by public organizations. While all the procurement governance dimensions post a statistically significant positive association with administrative efficiency, governance values and processes emerge as the most central procurement governance issues.

A study by Muema (2016) on supplier relationship management strategies and procurement performance of Sports Kenya revealed that Sports Kenya has a structure of internal governance and assigned ownerships of supplier relationships and that the organization supplier governance

committee are actively involved with supplier. The study also established that the organization had internal control processes on supplier relationships, supplier governance committees are engaged with suppliers. Further, the organization has supplier governance committee/councils, supplier governance committee/councils spend time developing, mentoring and working with suppliers, and that the organization supplier governance committees weigh such elements as cost and supply to determine where the best value lies. This indicates that Sports Kenya has supplier control processes and clearly assigned rights of supplier relationships and that the organizations supplier governance committees are engaged with the suppliers.

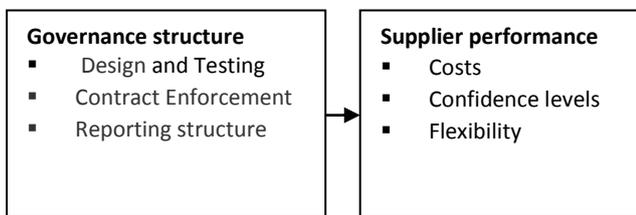
Kemunto and Ngugi (2014) studied the influence of strategic buyer supplier alliance on procurement performance in private manufacturing organizations using Glaxo Smithkline as a case study. The specific objectives of the study were: to assess the effects of governance structure on the procurement performance of the firm; to find out how technology impacts on the procurement performance of Glaxo Smithkline; to establish how top management support affects the procurement performance of the pharmaceutical giant and to establish the effect of awareness of procurement policy and legal framework on the procurement performance of the organization. The study findings revealed that governance structure was the main factor in the relationship between procurement performance and strategic buyer supplier alliance. Governance Structure coefficient of 0.799 was found to be positive at significant level of 0.004 and this indicates that Governance Structure has a positive influence on procurement performance.

Jeptoo and Karanja (2017) examined the effect of governance structure on e-procurement implementation by state corporations in Kenya. The study established that governance structure had an effect on implementation of e-procurement in state corporations in Kenya. This was also supported by the inferential statistics later on in the study that

statistically predicted existence of a positive relationship between governance structure and implementation of e-procurement. In this case, a unit increase in governance structure was observed to likely result to a 0.338 increase in e-procurement implementation.

Kingoo (2013) also studied supply chain governance and organizational performance among parastatals in Kenya. The study objectives were; to determine the effect of supply chain planning on organization performance, to establish the effect of supply chain and disposal procedure on organization performance, to evaluate the effect supply chain record management on organization performance, to analyze effect of supply chain code of ethics on organization performance and, to determine the effect of market price index on organization performance. The study used an exploratory research design targeting 96 parastatals. The study findings showed that there was significant correlation between supply chain governance and organization performance.

Conceptual Framework



Independent variables

Dependent variable

Figure 1: Conceptual Framework

Source: Author (2019)

METHODOLOGY

The research design that was adopted in this study was the descriptive survey research design. Descriptive survey research design is an efficient method for systematically collecting data from a broad spectrum of individuals. The study was both qualitative and quantitative in nature. Kombo and Tromp (2006) explain that qualitative research is a

form of research that emphasizes description. There were 184 State Owned Enterprises in Kenya (Government of Kenya, 2016). Of these, 15 service SOEs were based in Kakamega County. The target population of this study, therefore comprised of; the Center Directors, Supply chain officers, Human Resource Officers, Finance Officers, Procurement officers, Inventory Officers, Procurement Assistants and ICT officers. Hence, the accessible population was 120 members. This population was chosen because it was deemed that they could give reliable information for the study and they were highly accessible within the area as most of them had their premises within Kakamega town and its outskirts. Since the target population was small the whole population was surveyed through the use of a census technique. A total of 120 officials were surveyed consistent with the recommendations of Kathuri and Pals (1993). The study used primary data which was collected directly from the respondents using the research instruments while secondary data was collected in form of records from reports and other relevant publications. They were then entered into the Statistical Package for Social Sciences (SPSS) version 24.0 computer program.

FINDINGS

Governance Structure and Supplier Performance

The study sought to determine the effects of governance structure on supplier performance in service SOE’s in Kakamega County as its second objective. This objective was determined on the basis of three constructs; organization values, contract enforcement and reporting structure. A 5 point Likert scale was used to rate responses of this variable and it ranged from; 1 = strongly disagree to 5 = strongly agree. The findings were presented in Table 1.

Table 1: Governance Structure and Supplier Performance

Statement	1 Freq(%)	2 Freq(%)	3 Freq(%)	4 Freq(%)	5 Freq(%)	Mean	Std. Dev
Our contract governance structure is designed around the organization's values	1(1)	6(5)	10(9)	61(55)	33(30)	4.07	0.83
Our contract governance system comprises of all stakeholders in our procurement system	0	6(5)	11(10)	42(38)	51(47)	4.25	0.85
Our contract governance system enables us to enforce the terms of our contracts with our suppliers effectively	1(1)	4(4)	28(25)	50(45)	29(26)	3.92	0.86
Through our contract governance structure, we can easily report on developments affecting us and our suppliers	1(1)	6(5)	11(10)	61(55)	32(29)	4.07	0.83
We also have an ICT based governance system that aids us in reporting	0	8(7)	13(12)	40(36)	50(45)	4.18	0.91
Our reporting system is easily verifiable due to our governance structures	1(1)	4(4)	23(21)	57(52)	25(23)	3.92	0.81
Aggregate Score						4.06	0.848

The results in Table 1 suggested that contract governance structures in the state corporations were designed around the organization's values as indicated by most respondents (85%). There was also a strong perception among the respondents that the contract governance system comprised of all stakeholders in their procurement system (85%). Most were of the view that their contract governance systems enable them to enforce the terms of their contracts with their suppliers effectively (71%). Further, through the organizations' contract governance structure, it was easy to report on developments affecting the organizations and their suppliers (84%). Majority reported that their organizations had ICT based governance systems that aided them in reporting (81%). The reporting systems were also easily verifiable due to their governance structures (75%). The aggregated mean (Mean = 4.06) indicated that there was high concurrence with the statements

implying that there was strong confidence in the contract governance structures in the organizations. The findings agreed with Basheka *et al.*, (2013) who found that improvements in public procurement governance is likely to contribute to improvements on administrative efficiency; an indeed significant percentage especially when comparison is directed to the number of functions performed by public organizations.

Supplier Performance in State Corporations

The study sought to determine the status of supplier performance in service SOE's in Kakamega County. The constructs used to rate supplier performance included quantity, timeliness, completeness, quality, innovation and regulatory compliance. The responses to this constructs were rated on a 5 point Likert scale ranging from; 1 = strongly disagree to 5 = strongly agree. The results were as shown by Table 2.

Table 2: Supplier Performance in State Corporations

Statement	1 Freq(%)	2 Freq(%)	3 Freq(%)	4 Freq(%)	5 Freq(%)	Mean	Std. Dev
Our suppliers supply goods in the quantity ordered for in the purchase orders	5(4)	45(41)	10(9)	36(33)	14(13)	3.21	0.94
Our suppliers deliver in full all procured goods or service as agreed in the contracts	17(15)	33(30)	2(2)	49(44)	9(8)	3.3	0.94
Our suppliers strictly observe timelines for delivery of goods or services ordered for	20(18)	31(28)	21(19)	23(21)	15(14)	3.48	0.85
Our suppliers deliver high quality goods or services as contracted	22(20)	25(23)	20(18)	29(26)	14(13)	3.14	0.96
Our suppliers often come up with new products or services resulting in better outcomes	12(11)	46(42)	9(8)	26(24)	17(15)	3.4	0.9
Our suppliers work within legal standards, health and safety protocols and organizational guidelines	12(11)	23(21)	38(35)	25(23)	11(10)	3.3	0.86
Aggregate Score						3.28	0.908

The results in Table 2 suggested that the suppliers contracted by the state firms often supplied goods in the quantity ordered for in the purchase orders as indicated by most respondents (46%). The suppliers delivered in full all procured goods or service as agreed in the contracts (52%). However, most of them did not strictly observe timelines for delivery of goods or services ordered for (35%). Most suppliers also failed to deliver high quality goods or services as contracted (39 %). The respondents were also of the opinion that their suppliers seldom came up with new products or services resulting in better outcomes (53%). There were also doubts on whether the suppliers were working within legal standards, health and safety protocols and organizational guidelines (35%). The aggregated mean score (Mean = 3.28) suggests that the respondents did not agree with most of the statements describing the status of supplier performance in their organizations. These results echo those of Wanyonyi and Muturi (2015) who found that since procurement tasks demand professionals with high-level strategic, tactical as

well as operational skills which are needed to improve performance of the procurement function.

Inferential Statistics

Hypothesis Testing

H₀:The null hypothesis stated that Governance structure does not significantly affect supplier performance in service SOE's in Kakamega County.

It was evident from the results that the relationship between governance structure and supplier performance significantly affect supplier performance in service SOE's in Kakamega County. ($\beta = 0.191, p \leq 0.05$). This led to the rejection of the null hypothesis which implied that the governance structure does not significantly affect supplier performance in service SOE's in Kakamega County. The results agreed with those of previous studies, for example, Naomi and Karanja (2017) who established that governance structure had significant effect on implementation of e-procurement in state corporations in Kenya. In this case, a unit increase in governance structure was observed to likely result to a 0.338 increase in e-procurement implementation. Kingoo (2013) also

found that there was significant relationship between supply chain governance and organization performance.

SUMMARY

The findings on this objective revealed that contract governance structures in the state corporations were designed around the organization's values. There was also a strong perception among the respondents that the contract governance system comprised of all stakeholders in their procurement system. Most were of the view that their contract governance systems enable them to enforce the terms of their contracts with their suppliers effectively. Further, through the organizations' contract governance structure, it was easy to report on developments affecting the organizations and their suppliers. The organizations had ICT based governance systems that aided them in reporting. The reporting systems were also easily verifiable due to their governance structures. These results indicate that there was high concurrence with the statements implying that there was strong confidence in the contract governance structures in the organizations.

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CONCLUSION

From the summary of the findings, governance structure significantly affect supplier performance in service SOE's in Kakamega County. SOE's with good contract governance system, their suppliers performed better.

RECOMMENDATIONS

This study also recommends SOE's to use contract governance system to enforce the terms of contracts with their suppliers. This contract governance system should also be verifiable. This will help in keeping the suppliers on tract and avoid violation of contract terms. This will play a big role in improving supplier performance.

Recommendation for further studies

The study recommended a further study on the effect of contractor-supplier relationship on quality of goods and services supplied. This study would help to shed more light on the lack of consensus on the subject matter as identified in this current study. Also, since this study was done within Kakamega County which limited the generalization of study findings to other parts of the country, a further research can be done on other parts of the country to ascertain if the results would be comparable.

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