International Journal of Economics, Commerce and Management
United Kingdom Vol. III, Issue 5, May 2015
http://ijecm.co.uk/ ISSN 2348 0386

ASSESSMENT OF FINANCIAL CONSTRAINTS ON OPERATIONS OF COUNTY GOVERNMENTS IN KENYA: A CASE OF NAKURU COUNTY

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Abstract

Since the inception of devolution in Kenya, there are many functions under the national government that have been devolved to the 47 County governments. The Council of Governors has claimed that the funds disbursed to Counties are insufficient to ensure effective running of operations at county levels. It is also alleged that there exists other constraints that have been hampering county operations. It is against this backdrop that this study was conducted, specifically to establish how financial management skills affect operations of county governments. The study was conducted in Nakuru County Government, Kenya. A descriptive cross-sectional census design was adopted. The target population comprised of all the 46 accounting/finance staff working with Nakuru County Government. A structured questionnaire was first pilot tested to assess its reliability and validity before its administration in the main study. Both descriptive and inferential data analyses were conducted using SPSS. The findings indicated that there exists a positive, strong and statistically significant relationship between financial management skills and County Government operations. It is recommended that the County Governments should organize seminars and workshops for their staff in order to enhance their financial management skills.

Keywords: Counties, Devolution, Financial management skills, County governments, Kenya

INTRODUCTION

The county governments (otherwise called local authorities or regional governments) all over the world operate under the purview of public finance. According to Gruber (2005), the purview of public finance entails effects of government on efficient allocation of resources, distribution of income, and macroeconomic stabilization. It is further noted that, the government expenditures comprise of government operations and income distribution (such as catering for the remuneration of public employees). There are four major ways of financing the government expenditures including taxation, debt, seigniorage, and also public finance through state enterprises. Notably, when a government fails to raise funds through any or all of the aforementioned avenues, then, it results in constrains in financing the government operations. It is rather impractical for county governments to raise funds through seigniorage, since they are not involved in issuance of currency as the same is a preserve of the national government.

Mejda and Mustapha (2005) assessed the impact of financial liberalization and financing constraints on the corporate sector in Tunisia. They found that, there were several firm characteristics which meant there were significantly different financing constraints such as government ownership, trade orientation, and size of firm. They further established that, there exists a string, positive effect of financial liberalization on the economic performance and financing behaviour of Tunisian corporations. Their study results indicated that, the public sector is less constrained in the access of long-term financing. Furthermore, it was opined that, debt ratios decline significantly for both public and private sector after financial liberalization, yet the former (public sector) remains twice more indebted in terms of long-term debt than the private sector.

Kenya is considered to have the largest, most diversified and innovative economy in East Africa region. The country has made significant strides in enhancing the overall economic environment with a performance index always above that of the sub-Saharan Africa (SSA) average. It is observed that, the Government of Kenya (GoK, 2014) plans to continue the growth trajectory and has as such prioritized among others, governance and public finance management reforms to enhance transparency, accountability, service delivery and cost efficiency. It is further indicate that, Kenya is in the critical process of implementing the devolved governance as espoused in the Constitution of Kenya of 2010. It is pinpointed that, with the object of meeting the enlarged financing demands of both the national and the 47 county governments, there is a dire need of for increased efficiency and effectiveness in utilization and management of scarce public resources both at the national and county levels.

According to the National Council for Law Reporting (2012), County governments in Kenya were established as stipulated in the County Governments Act No. 17 of 2012. The Act

stipulates that, a county government shall be responsible for any function assigned to it under the Constitution or by an Act of Parliament. The Act further states that, a county government shall be responsible for among others, exercising executive functions, functions provided for in Article 186 of the Constitution, any other function that may be transferred to county governments from the national government, any functions agreed upon with any other county governments; and establishment and staffing of county public service. Needless to say, therefore, there are many operations under county governments which demand for massive financing.

It is lamented that, in Kenyan context, influence of financing constraints on operations has not been adequately studied (Karanga, 2013). Opano (2013) when investigating strategic planning and implementation practices at the Kisii county government, Kenya established that, besides human resources, financial resources were required in the implementation of the strategic plan. The scholar, nevertheless, noted that, the main challenge in strategic planning implementation is financial constraints. As exemplified by the case of Busia County, the devolved governments are facing bottlenecks in financing their operations and other expenditures due to scarcity of resources. It is also averred that, the county government would go an extra mile and utilize the contingency emergency funds but within the stipulations of the Public Financial Management (PFM) law. It is clear that, indeed county governments just like the national government operate in environment devoid of key resources which would otherwise be employed to finance requisite operations and expenditures. It was, therefore, rational to investigate financial constraints especially bordering on financial management skills and how they affect operations of county governments in Kenya.

Statement of the Problem

Virtually all counties in Kenya are hampered by inadequacy of vital financial resources. This is in spite of many government functions having already been devolved to the county governments by the national government. Indeed, there are authenticated allegations that the larger percentage of the monies disbursed to the county governments is employed in the recurrent expenditure to the detriment of development projects such as infrastructure (GoK, 2014) which begs the question of financial management skills amongst the staff entrusted to manage those funds.

In the face of the foregoing, there are several counties that have been slammed with labour strikes and go-slows among their workforce due to delayed salaries and/or poor remuneration of employees working under the county governments. The foregoing, as argued by the management of affected county governments, stem from inadequate funds to finance all

county operations and expenditures. Inadequacy of finances is bound to affect delivery of services to the public and also derail development at county levels. The situation is not only detrimental to the citizenry at county levels who lack the requisite services and also complain of among others, over-taxation, but also the county leadership is likely to be voted out of their positions due to perception in the public eye of mismanagement of public funds. The aforementioned factors indeed necessitated this study which sought to determine how the financial constraints particularly financial management skills influence operations of county governments in Kenya.

Research Objective

To determine the implication of financial management skills on the operations of Nakuru county government, Kenya

Research Hypothesis

H_{01}:μ_1=μ_1: There is no significant relationship between financial management skills and the operations of Nakuru county government, Kenya

THEORETICAL FRAMEWORK

The following section reviews both the free cash flow theory and REMM theory of human behaviour, economic value added theory, and institutional-centric theory of finances. The four theories are argued to be very pertinent to the study objectives that revolve around financial constraints that affect operations of county governments.

Free Cash Flow Theory

This theory was proposed by Jensen (1986) and built upon the Jensen and Meckling's 2001) theory of the agency. FCF is "the cash flow in excess of that required to fund all projects that have positive net present values when discounted at the relevant cost of capital" (Stewart, 2001). FCF is the sum of the cash flow to equity and cash flow to debt-holders after interest-tax-shield (Shrieves & Wachovicz, 2001). The theory contends that by relying on debt to finance projects, managers will be obliged to transfer excessive cash flows to investors and limit the allocation of resources to low return projects (Miller, 2001).

This theory, argues Miller (2001), justified the massive substitution of debt for equity in 1980's where it was argued that, cash flow was going to pay interests and principal and not to "investment ratholes". Relative to this theory, leveraged buyouts (LBOs) provide additional benefits to reduce the agency costs of an organization or institution. Chew (2001) observed that,

the media failed to bring out the real impact of LBOs as being advantageous. In context of financing constraints and operations of county governments, this theory can be employed to illustrate how the aforementioned governments can balance between debt and equity to finance public projects and operations within their jurisdiction.

Institutional-centric Theory of Finances

This theory was proposed by Arestis, Nissanke and Stein (2005) as an option to the flawed financial liberalization theory that increased the instability of developing countries in 1990s. This theory acknowledges the existence of imperfect information and informal and formal institutions, which are essentially the engine of development (Dornbusch & Reynoso, 2003; Arestis et al., 2005). It is argued that incentives, norms, regulations, capacities and organizations are the institutions that comprise any financial system whose risks have to be socialized. The foregoing concurs with the financial situation of County Governments. These governments are built around institutions whose functionalities determine the success of the governments in offering requisite services to the societies within their jurisdictions.

In tandem with institutional-centric theory, Demaestri and Guerrero (2003) indicated that financial regulations indeed mitigate moral hazard, and as such address the issues of transparency and accountability. The scholars further opined that, theoretically, effectiveness and efficacy are achieved when regulatory institutions are integrated into one. The foregoing can be employed to explain the rationale of having an integrated financial system in County Governments such as the Integrated Financial Information Management System.

EMPIRICAL REVIEW

Studies bordering on financial management skills and operations of County governments are reviewed in this section.

Financial Management Skills

Studies by the World Bank (2012) and Manuel et al. (2012) postulated that, ODI's (Overseas Development Institute) experiences with the implementation of public sector institutional and financial management reforms in fragile governments, acknowledges the detrimental effects of these governance constraints in practice, and in tandem, points out to the essence of innovative, responsive and flexible financing and approaches to assist in enhancing the incentive structures faced by government officials and service providers. Tavakoli et al. (2013) looked into the aspect of using aid to address governance constraints in public service delivery. They further sought to determine the degree of coherence between sector policies and institutional set ups. They noted that, indeed weakly-aligned financing frameworks are

correlated with poor outcomes. The authors exemplified two relatively dependent agencies (finance and procurement) by arguing if and when they happen to pull in different directions by, for instance, issuing contradicting guidelines, the resultant confusion may occasion to stalling or interference of government operations.

An empirical study on revenue allocation and economic development in Nigeria (Dagwom, 2013) recommended that, there ought to be more financial control and value for money audit should be carried out to reduce wastage and corruption in the Nigerian states. This initiative would change the direction of influence of states' revenue allocation on economic development.

Kiwanuka (2009) assessed the theme of decentralization and good governance in Africa by specifically analyzing institutional challenges affecting local governments in Uganda. The author noted that, local governments lack the requisite capacity to recruit or hire and retain competent and skilled personnel. The foregoing issue has been detrimental to the performance of sub-national governments in the country. Indeed, the study findings indicated that, there exists a shortage of officials with the requisite technical and financial skills in local governments. About 77 per cent of the study's respondents believed that this challenge was occasioned by lack of sufficient financial resources to attract and retain skilled human resource. In Uganda, the study established that, the remuneration levels for local government staff are only a proportion of what employees earn in the private sector.

Tewfik (2010) established that Ethiopia faced several challenges at the outset of the implementation of the devolved governments. During the transitional period, in spite of the significant redeployment of civil servants from the central government to regional governments, all the regional governments suffered a scarcity of skilled personnel and poor capacity for the implementation of their policies and programmes. Therefore, the public service delivery was largely inadequate and civil service performance continued to be constrained by a lack of skilled and qualified personnel.

Mwohe (2013) examined the influence of financial management skills on operation of small and micro enterprises (SMEs). It was established that, poor financial management of lack of financial management altogether are the primary genesis of the problems in SMEs' financial management. The study revealed that, firm operations are affected by financial management. Keraro et al. (2014) in their empirical study on devolved public sector in Kenya observed that, it is imperative for county governance systems to put in place early establishment of training institutions in order to fill indentified skill gaps.

County Governments' Operations

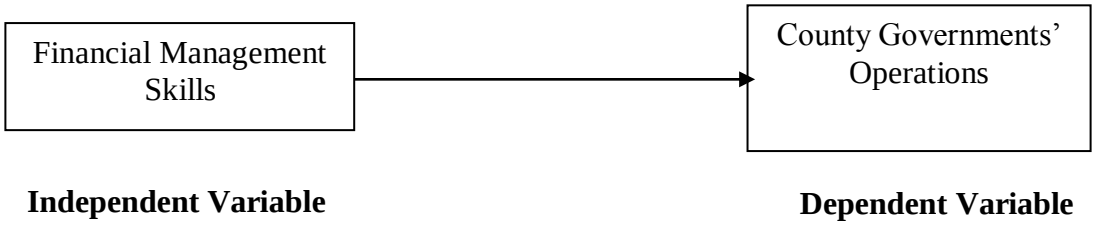
It is noted that, many African countries were centralized during the colonial era. On the other hand, local authorities were inspired local government systems in operation at the time (Olowu, 2004). Golola (2003) argued that in some instances some powerful politicians refuse to detach themselves from the operations of the local government. In an empirical analysis of Budget transparency in local governments, Caamano-Alegre, Lago-Penas, Reyes-Santias, and Santiago-Boubeta (2011) asserted that, the reinforcing of local governments along with substantial changes in the ways those governments operate has roused the interest of stakeholders in understanding what governments do, how and at what price.

De Villiers (2008) reviewed provinces and local governments in South Africa. The author noted that, local governments just like public institutions are required to operate in tandem with stringently defined financial processes and practices. In South Africa, the scholars observed that, the Local Government: Municipal Finance Act, 2003 was passed with the object of regulating financial affairs of municipalities. The Act ensures securing of the financial and sustainable financial affairs of the aforementioned jurisdictions. In Kenya, operations of the County Governments are duly regulated by the County Government Act, 2012. It was noted that, the formative years of the County Government operations in Kenya 2012 – 2015 would be for laying foundation by laying down the best management and leadership practices (Burugu, 2010). The author further posits that, both the National and County Governments are anticipated to work in consultation and also exchange pertinent information. The foregoing cooperation is bound to enhance coordination of socio-economic policies, enhancing capacity and facilitation of County and Senate Government operations.

Conceptual Framework

The conceptual framework (Figure 1) shows that financial management skills represent the independent variables while the dependent variable is the operations of the County governments. Hypothetically, the operations of Nakuru County Government are influenced by the financial management skills of its employees.

Figure 1: Conceptual Framework



METHODOLOGY

Research Design

Research design is the roadmap that guided the entire research work (Rajasekar, Philominathan, & Chinnathambi, 2006). In the context of the current study, a mix of descriptive and cross-sectional survey research designs was adopted. As Kothari (2009) asserted descriptive research attempts to answer the "what" kind of questions in addition to describing the various opinions of the respondents in respect of the theme(s) being studied. The foregoing conforms to this study. The aspect of cross-sectional survey is brought out by the fact that, besides the study being conducted at a specific point in time (January to March, 2015); respondents were drawn from all the 11 sub-Counties of Nakuru County, Kenya.

Target Population

The target population, otherwise referred to as accessible population is the population to which the study findings will be applicable. The target population of this study comprised of all the 46 accounting/finance staff working with Nakuru County Government.

Census Design

A census method was adopted due to the relatively small size of the target population (46 members). This implies that all the members of the target population participated in the study. In other words, both the sample and the target population were similar in size and composition. This method was also highly recommended due to the fact that it not only eliminates the sampling error but also the sampling bias. The foregoing enhanced the reliability and generalizability of the study findings.

Research Instrument

A structured questionnaire with close-ended questions was employed to collect primary data from the respondents. Mugenda and Mugenda (2009) observed that questionnaires are appropriate data collection tools in survey research where respondents are located in different geographical locations as it is the case with this study. For consistency purposes, the questions captured in the questionnaire were on a 5-point Likert scale.

Reliability of the Research Instrument

Reliability is the degree to which a measurement technique can be depended upon to secure consistent results upon repeated application (Weiner, 2007). A reliable instrument is that, which

can be used to collect consistent data. That is, for the research questionnaire to be reliable, then it ought to return consistent data as long as the target population is similar. In this study, reliability was tested using the Cronbach alpha (α) coefficient which is the most widely employed test of reliability. The reliability threshold was $\alpha \geq 0.7$. The financial management skills variable returned $\alpha = 0.704$ while operations of County governments variable returned $\alpha = 0.761$. The findings indicated that the two variables were reliable.

Validity of the Research Instrument

Validity is the degree of measure to which any measurement approach or instrument succeeds in describing or quantifying what it is designed to measure (Wenier, 2007). A valid instrument measures what it purports to measure (Kimberlin & Winterstein, 2008). It is asserted that an instrument can be reliable but not valid; but in order for an instrument to be valid, it must be reliable. In light of the foregoing, having determined the reliability, it was rational to assess the instrument's validity. There are several types of validity, but in the context of this study, content validity was determined. Kimberlin and Winterstein (2008) argued that this type of validity cannot statistically be determined. In this regard, the expert opinion of the university supervisors regarding validity of the research instrument was sought

Data Analysis

The collected quantitative data was cleaned by ensuring only the questionnaires filled appropriately were part of the study. The data was edited before analysis. The Statistical Package for Social Sciences (SPSS) software was employed to conduct data analysis. Both descriptive and inferential analyses were conducted on the collected data. Descriptive analysis was in form of frequencies, percentages, means, and standard deviations. Descriptive analyses aimed to establish the opinions of the respondents regarding the various constructs being studied. On the other hand, Pearson's correlation analysis was employed to explain the relationship between financial management skills and operations of County governments. The findings of the study were presented in form of statistical tables.

ANALYSIS & FINDINGS

For drawing empirical findings, both descriptive and inferential statistics were used.

Financial Management Skills

Table 1 outlines the views of the respondents on financial management skills among the employees of Nakuru County Government.

Table 1: Financial Management Skills

		N	Min	Max	Mean	Std. Dev
i.	County finance officers and accountants receive lower pay and benefits than their counterparts in private sector	34	1	5	3.79	1.095
ii.	The county lacks capacity to attract and retain high cadre of skilled accountants and financial officers	34	1	5	3.50	1.108
iii.	the county governments does not adequately organize for training of its finance/accounts officers	34	1	5	3.50	1.261
iv.	County lacks funds to remunerate its staff competitively	34	1	5	3.35	1.228
v.	Nakuru county government lacks sufficient financial personnel	34	1	5	3.18	1.114
vi.	The employees in accounts/finance sections are not skilled and competent enough to manage county finances.	34	1	4	2.18	1.167

Respondents agreed (mean ≈ 4.00) that County Government finance officers and accountants receive lower pay and benefits than their counterparts in private sector; The County Government lacks capacity to attract and retain high cadre of skilled accountants and financial officers; and that the County Governments does not adequately organize for training of its finance/accounts officers. It was, nonetheless, disagreed (mean = 2.18) that the employees in accounts/finance sections are not skilled and competent enough to manage County Government finances. It was not clear (mean ≈ 4.00) whether the County Government lacks funds to remunerate its staff competitively, or if the County Government lacks sufficient financial personnel.

County Government's Operations

Furthermore, the study sought the views of the respondents regarding the operations of County Governments. The relevant findings are as outlined in 2.

Table 2: County Government's Operations

		N	Min	Max	Mean	Std. Dev
i.	National government financing influences County Government's Operations	34	2	5	4.24	.987
ii.	Lack of sufficient financial management skills negates the County governments operations	34	1	5	3.56	1.160
iii.	Limited revenue hinders county government operations.	34	1	5	3.41	1.258
iv.	Minimal access to credit facilities is an impediment of county Governments operations.	34	1	5	3.21	1.175

The respondents opined that National Government financing influences County Government's Operations (mean = 4.24), and that lack of sufficient financial management skills negates the County Governments' operations (mean = 3.56). Yet, it was unclear whether limited revenue hinders County Government operations (mean = 3.41) or if minimal access to credit facilities is an impediment of County Governments' operations (mean = 3.21).

Correlation Analysis

Below, the findings of the correlation analysis between the financial management skills and operations of County Governments. Table 3 outlines the pertinent correlation findings.

Table 3: Relationship between Financial Management Skills and County Government Operations

		County Government Operations
Financial Management Skills	Pearson Correlation	.741**
	Sig. (2-tailed)	.000
	N	34

***. Correlation is significant at the 0.01 level (2-tailed).*

It was established that there exists a positive, strong and statistically significant relationship between financial management skills and County Government operations ($r = 0.741$; $p < 0.01$). Therefore, the second null hypothesis that stated is no significant relationship between financial management skills and the operations of Nakuru county government was also rejected.

Summary of the Findings

Respondents agreed that County Government finance officers and accountants receive lower pay and benefits than their counterparts in private sector; The County Government lacks capacity to attract and retain high cadre of skilled accountants and financial officers; and that the County Governments does not adequately organize for training of its finance/accounts officers. It was, nonetheless, disagreed that the employees in accounts/finance sections are not skilled and competent enough to manage County Government finances. It was not clear whether the County Government lacks funds to remunerate its staff competitively, or if the County Government lacks sufficient financial personnel. It was established that there exists a positive, strong and statistically significant relationship between financial management skills and County Government operations ($r = 0.741$; $p < 0.01$). It was noted that lack of sufficient financial management skills negates the County Governments' operations.

CONCLUSIONS AND RECOMMENDATIONS

According to the study findings it is concluded that the employees of county governments receive lower pay than their counterparts in the private sector. More so, it is inferred that county governments lack capacity to attract and retain high cadre of skilled accountants and financial officers. The findings led to the conclusion that financial management skills are important in county government operations. On the basis of above, following recommendations are made:

i. The County Governments ought to prudently manage whatever amounts of financing channeled to them by the National Government.
ii. The County Governments should organize seminars and workshops for their staff in order to enhance their financial management skills.

SUGGESTIONS FOR FURTHER STUDIES

Future studies could explore following areas:

i. The challenges that limit County Governments from financing their operations
ii. The role of politics in the National Government financing of County Governments
iii. Financial factors influencing attraction and retention of employees in County Governments
iv. Assessment of factors that influence revenue collection in County Governments.

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