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ABSTRACT

This study determined the effect of supplier selection on the procurement performance of government parastatals in the Lake Region. The study used a descriptive research design and the target population was the three government parastatals in the Lake Region of Migori, Kisumu, Homabay, and Siaya Counties. The study collected data using questionnaires which had five sections with section one seeking to collect information on the respondents' biodata while the subsequent sections collected data based on the study objectives. The findings were presented in tables, charts, and figures. The study found that most government parastatals evaluated the suppliers based on quality commitment including quality standards, quality inspections, and quality control techniques. The supplier quality commitment exhibited a positive and significant influence on the procurement performance of the government parastatals. A majority of the government parastatals employed financial capacity criteria in the evaluation of their suppliers which included: the ability to pay off short-term debt obligations and, the ability to convert assets to cash among others. The supplier's financial capacity had a direct influence on the procurement performance of the government parastatals. The organizations evaluated their suppliers based on their technical capabilities, such as labor force skills, etc. According to the results, the supplier's technical capability had a positive and significant effect on the procurement of the government parastatals. Finally, most government parastatals used supplier capacity criteria to evaluate their suppliers. The study thus recommends that the management of the government parastatals should employ more supplier quality commitment during the supplier evaluation process. Further, the government parastatals should employ more of the financial capacity aspects in the evaluation of the suppliers to achieve more procurement performance in the government parastatals in Kenya. The study recommends that the management of the government parastatals should employ more of the technical capabilities to enhance the procurement performance of the government parastatals in Kenya. The management of government parastatals should more of the supplier capacity aspects in the evaluation process to enhance the procurement performance of the organizations.

Keywords: *Supplies Selection, Criteria, Procurement Performance*

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INTRODUCTION

Organizations must adapt to several changes in the business environment in the modern global economy (Amino, 2018; Kivite, 2015; Pal et al.,. 2013). Organizations are under increasing pressure to reinvent themselves on a nearly constant basis as a result of the dynamics of the current competitive environment (McAdam & McCormack 2017). Businesses seek to invest in new technology and skills to strengthen their competitive position to overcome the difficulties given by the tumultuous economic conditions and intense competition (Krop & Iravo, 2016). According to Swiss Re Institute (2022) the total insurance premium is about 7.5% of global domestic product accentuating the important role insurance play in the global economy.

Supplier chains, which were once classified as having inefficiencies as a result of cost-related quality to unreliable, constrained quality, and delivery, now play a significant role in helping firms gain a competitive edge. Supply chain management helps to save costs, boost product quality, and enhance the production of goods and services. The procurement process depends on choosing the correct suppliers, which also presents a significant cost-cutting opportunity for businesses. The majority of research in the literature (Dimas-Skari, 2019; Gold, 2017; Tütüncü, ve Küçükusta, 2018) highlight the impact of supplier selection on productivity. As a result, choosing a supplier is crucial for all firms. Supplier selection gives the business a strategic edge in attaining its long-term objective and lowering risks. When the purchasing organization tries to build a long-term and mutually beneficial commercial relationship with its suppliers, supplier selection has been defined as a strategic choice.The moral hazard arising from the principal agent relationship according to Ain et al. (2021) can make an agent to engage in risky underwriting and management behaviors to the detriment of the principal (policyholders or shareholders) who bear economic and financial consequences of their behavior. The moral hazard can significantly result to heightened agency costs that can subsequently impact on the general operation of the insurance business. This study therefore investigated whether these agency costs have a relationship with financial performance of insurance firms (Einav & Finkelstein, 2018).

Businesses choose their suppliers primarily to improve quality, boost customer happiness, and expand market share while keeping costs as low as possible. Communication with the supplier is essential to successfully and efficiently provide the input that the firms require (Aykut, Mahmoud & Fatih, 2019). The best results for corporations come from supplier selection (Scott et al., 2018). According to Annan and Haq (2017), when a purchaser (procuring entity) successfully selects suppliers, it lays the groundwork for future development and improvement of both supplier and buyer performance. The supplier selection process is a crucial component of buying management operations because it guarantees that the company gets the goods and services it needs in the proper quality and on time, especially in the event of an unanticipated rise in demand for a particular good. Additionally, given that the supplier appears to be a strategic partner and a source of competitive advantage, at a price that is competitive and aids in boosting the firm's competitive position and earnings.

Statement of Problem

Persistent worries surround the effectiveness of government attempts to enhance the procurement system despite recurring issues. Commercial government parastatal losses reached 21% in 2011-12, totaling Ksh. 2 billion lost in fraudulent supplier payments during 2015-2016. Shoddy workmanship, inferior goods, and services continue to tarnish the system, causing additional concern. Problems intensified in 2018-2019, with public procurement malpractices amounting to USD 8.24 billion due to faulty supplies, inflated pricing, and inadequate supplier selection.

Transparency International (2022) reveals that government parastatals face severe struggles, especially in procurement, with shadowy vendors obtaining substantial amounts. Reports expose persistent procurement irregularities, including price inflation, flawed approval systems, and insufficient bidder transparency, draining public finances. Instances include the infamous Anglo Leasing Scandal of 1997 and the National Youth Service corruption scandal of 2018. Several agencies experienced negative impacts, notably Kenya Pipeline Company, National Cereals and Produce Board (NCPB), and National Hospital Insurance Fund (NHIF).

To address this pressing concern, the study concentrates on the impact of supplier selection criteria on the procurement performance of government parastatals in Kenya, targeting the Lake Region counties of Homa Bay, Kisumu, Migori, and Siaya. Despite existing scholarship exploring the connection between procurement selection and corporate performance, past studies often concentrate on private manufacturers or regional governments. A knowledge gap exists, considering the scarcity of comparable research on the national level within parastatal sectors. Bridging this divide, the current study aims to shed light on the effect of supplier selection criteria on procurement performance in governmental parastatals in Kenya. Researchers like Naobor and Moronge (2017), Ogendo (2018), and Mutuku, Ochieng, and Sung (2021) have contributed valuable insights, helping shape the current investigation.

Objectives of the Study

- To assess the influence of monitoring costs on procurement performance of Government parastatals in the Lake region, Kenya.
- To examine the influence of bonding costs on procurement performance of Government parastatals in the Lake region, Kenya

Theoretical Framework

Jensen and Meckling Theory of Agency Costs

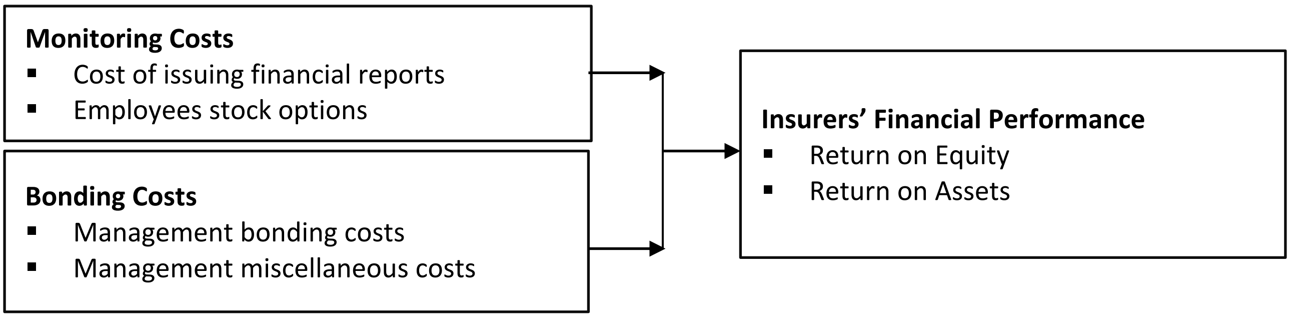
Jensen and Mecking are the known proponents of the agency theory in 1976; they observed that a major weakness with majority of public companies lies in the inactivity of the shareholders in running of the company, which give leeway to management to abandon the interests of shareholders for their own selfish interest, giving rise to agency problems (Vitolla, Raimo, & Rubino, 2020; Marashdeh et al., 2021). According to this theory the managers are the agents and shareholders are principal. Both the agent and principal are utility maximizer, implying that as much as the managers are supposed to act at the best interest of the shareholders at times, they may choose to advance their selfish interests. The core aim of the shareholders is to maximize the net present value of the company while the main interest of the managers is to maximize utility, this results into a conflict of interest (Naz et al., 2022).

This theory argues that for shareholders to compel the management to act in their best interests they come up with various incentives that could be in the form of monitoring, bonding costs, to monitor the activities of the managers. These give rise to the agency costs incurred on monitoring, and bonding expenditures, as well as the residual losses. This theory often tries to describe and resolve the agency problems that tend to occur in most companies. This is because the shareholders often rely on managers to manage the affairs of the company. As such the management and directors of the companies are under a duty of care to make optimal decisions that are geared towards shareholders' value creation. The primary foundation of agency theory is that managers are constantly seeking ways to act in their own best interest even if it disadvantages the shareholders. This often happen due to information asymmetry arising from the fact that managers have superior information with regard to the day-to-day activities of the companies (Tijjani & Bello, 2020)

This theory is of importance to this study as it expounds on the factors influencing the relationship between the agents and shareholders, which in this case are managers and shareholders. This theory explains how the misalignment of corporate interests between the managers and shareholders can be addressed to maximize the value of a company. Also, it provides an understanding on the key indicators of agency costs that are central to this study (Laher & Proffitt, 2020).

Conceptual Framework

The illustrative interconnection of independent variables and dependent variables is illustrated in figure 1.



Independent Variables **Dependent Variable**

Figure 1: Conceptual Framework

Empirical Review

The study on the influence of agency costs on financial performance is increasingly attracting considerable interest among scholars, with the most conspicuous one being that of Ain et al. (2021) on female directors and agency costs in listed firms in China Securities Exchange. The study found out that agency costs strongly influenced the performance of most state-owned corporations with gender-diverse boards. The study establishes the agency costs were more severe in those state-owned corporations highly characterized with agency problems. It also noted that those boards with more female directors had reduced agency costs as compared to those with most men.

Bitti et al. (2019) work on agency costs and scarce resources in Brazil, after evaluating a panel data of 270 franchised companies for the duration 2011-2016; recognized that agency costs of monitoring influence the scarcity of resources available in a given company. This study however did not dig dipper into the link that exist between agency costs and company's performance, it only assessed the impact of agency costs on scarcity of resources available in a given company. The study also relies on outdated panel data of 2011-2016, as opposed to the present study that aimed in probing the association that exist between agency costs and financial performance of insurance companies, as well as evaluating latest data.

In Rizwan and Akhtar (2022), research on exploring effect of agency costs on competitive advantage of Banks and Small and Medium Enterprises in Pakistan, which used dyadic questionnaires issued to branch managers, found out that proof exist on the link that exist between agency monitoring costs and the competitive advantage. It noted that for banks to achieve competitive advantage there must be a decline in the level of agency costs. Despite this, the research does not comprehensively quantify the size of the relationship that exist. The present research studies the various agency costs and how they influence company's performance in Kenya, as there are limited research done, to bring on board new perspectives on the interaction that exists.

A review of most recent literature such as that of Sapuan et al. (2021) has shown that the burden of agency problems has resulted to remarkable agency monitoring costs. The study which focused on impacts of agency costs on financial performance of

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350 listed firms in Malaysia for the duration 2005 - 2016 observed that that monitoring agency costs negatively influenced the return on asset of a company. However, the limitation of this study is that it placed much emphasis on free cash flow instead of agency costs as it is the case in the present research that studies it thoroughly using current data in different country to see whether the results obtained align with those of the appraised study.

There is a growing body of literature that acknowledges the influence of bonding costs on financial performance, specifically that of Abdulrahman (2014), that while evaluating the link between agency costs and financial performance of listed firms in Nairobi Securities Exchange for the duration 2008-2012 and using multiple regression found out that bonding expenditures incurred by a company have a mild influence on the financial performance. However, in contrast with the present research, it evaluated only listed firms and relied on data from 2008 to 2012. The present research expanded the scope of the research to non-listed insurance companies and rely on current data providing mew perspectives.

The other prominent study is that of Baykara and Baykara (2021) who while researching on the impact of agency costs on financial performance in 38 firms listed in Istanbul Stock Exchange, and using regression found out that there is a negative influence of bonding agency costs on performance was insignificant in listed small and medium enterprises. The study used data from 2017 to 20220 and only focused on small and medium enterprise firms it did not evaluate listed and non-listed big companies making it difficult to recast its findings within a wider context.

METHODOLOGY

The study used explanatory study design that is appropriate when probing for cause-effect relationship where the study variables are not adequately studied by previous research. The study targeted all the 56 insurers in Kenya offering both life assurance and general insurance that are licensed by Insurance Regulatory Authority of Kenya. The researcher used census technique to sample all the 56 insurers offering general insurance and life assurance. In an effort to collect the data this study relied on secondary data obtained from insurers' financial reports, Association of Kenya Insurer's reports and Insurance Regulatory Authority's statistical reports. The study relied on secondary data on monitoring costs, bonding costs and residual losses and financial performance for the period ranging from 2018 to 2022. The assembled information from the field was checked for accuracy, completeness, coded and analysed using Stata statistical application version 17; which is suitable when handling panel data. The assembled data was presented on charts and tables, the information deduced there interpreted and discussed as per the variables under study. A multiple regression was utilized to assess the nature of the influence of each type of agency cost on financial performance.

FINDINGS AND DISCUSSION

Descriptive Analysis of Research Variables

The descriptive statistics used in this research include maximum, minimum, mean, and standard deviation. The results yielded from the descriptive analysis of monitoring costs, bonding costs, Return on Equity (ROE) and Return on Assets (ROA) are depicted in the following table.

Table 1: Summary of the Descriptive Analysis

Variable/Statistics	Obs	Mean	SD	Maximum	Minimum
Monitoring Costs	280	0.512	0.24	0.81	0.01
Bonding Costs	280	0.48	0.34	2.37	0.01
ROE	280	0.47	0.21	0.71	0.12
ROA	280	2.21	0.85	4.8	0.89

Key: Obs: observations; Sample Size; SD = Standard deviation; ROE = return on equity; ROA = return on assets

The results from the descriptive analysis show that monitoring costs had a mean of 0.512 and standard deviation of 0.24 with the highest and lowest value being 0.81 and 0.01 respectively. This is suggestive that most insurers bear high monitoring costs in an effort to deter undesirable management behavior. The constant monitoring of management activities compels them to stay in line or face consequences from their erratic management behaviors.

The results further depict that bonding costs had a mean of 0.48 and a standard deviation of 0.34 with the highest and lowest value being 2.37 and 0.01. Overall, it can be deduced that there exists a relationship between bonding costs and financial performance of licensed insurers in Kenya. The findings were in partly in agreement with Abdulrahman (2017) study that established that bonding expenditures incurred by a company influenced its financial performance. Nonetheless, they were in disagreement with Baykara and Baykara (2021) study that found that bonding agency costs negatively influenced performance of listed small and medium enterprises in Istanbul Stock Exchange.

On the other hand, the mean and standard deviation of financial performance measured by return on equity is 0.47 and 0.21 with a high and low of 0.71 and 0.12 respectively. Moreover, the mean and standard deviation of financial performance expressed as return on assets is 2.21 and 0.85 respectively; its highest value was 4.8 with the lowest value of 0.89. The descriptive analysis shows that financial performance measured by ROA and monitoring costs had the highest mean while return on equity and monitoring costs had the least standard deviation, which meant that dispersion from the mean was relatively lower compared to other items. These findings are in agreement with Tripathi (2019) that had found that monitoring costs had a high influence on the profitability and financial performance of an entity.

Correlation Analysis

Correlation between Monitoring Costs and Financial Performance

The results from the correlation of monitoring costs and financial performance measured by Return on Equity and Return on Assets are summarized in the following table.

Table 2: Correlation between Monitoring Costs and Financial Performance

	Monitoring Costs	ROE	ROA
Monitoring Costs	1.000	0.323	0.112
ROE	0.323	1.000	0.745
ROA	0.105	0.814	1.000

The results show that there exists a positive relationship between monitoring costs and financial performance as estimated by both measures (ROE and ROA). More precisely, the relationship between monitoring costs and ROE was found to be positive with a correlation coefficient of 0.323.

On the other hand, the relationship between monitoring costs and ROA was found to be positive with a correlation coefficient of 0.105. This means that as monitoring costs increase so does return on assets.

Table 3: Correlation between Bonding Costs and Financial Performance

	Bonding Costs	ROE	ROA
Bonding Costs	1.000	-0.15	-0.12
ROE	-0.157	1.000	0.812
ROA	-0.108	0.842	1.000

The table shows that bonding costs negatively influence financial performance of licensed insurers in Kenya. It was observed that bonding costs negatively influenced ROE and ROA with correlation coefficient of -0.157 and -0.108 respectively.

Regression Analysis

Influence of Monitoring Costs and Financial Performance

The results from the regression analysis of monitoring costs and financial performance measured through ROE and ROA is summarized in the following two tables.

Table 4: Influence of Monitoring Costs on ROE

Variable	Beta Coefficient	Std Error	t-Statistic	Probability
Constant	0.455	0.023	19.78	0.000
Monitoring Costs	0.131	0.002	65.50	0.032
Root MSE	0.198			
R-Squared = 0.71.8				
Adjusted R^2 = 0.71.6				

The result from the regression analysis indicate that monitoring costs has a positive and significant relationship on financial performance as estimated using ROE (β =0.131, P = 0.032); implying that for every unit rise in monitoring costs results to a 13.1 unit increase in return on equity.

Table 5: Influence of Monitoring Costs on ROA

Variable	Beta Coefficient	Std Error	t-Statistic	Probability
Constant	2.124	0.098	21.67	0.000
Monitoring Costs	0.384	0.155	2.48	0.010
Root MSE	0.869			
R-Squared = 0.684				
Adjusted R^2 = 0.677				

The results shows that monitoring costs has a positive and significant influence on financial performance estimated through ROA (β =0.384, P = 0.010); this means that in every unit rise in monitoring costs it results to a 38.4 unit rise in ROA (financial performance). This resulted to rejection of the hypothesis that monitoring costs have no significant influence on financial performance of insurance firms licensed Insurers in Kenya. This finding is in line with Tripathi (2019) study that also established that monitoring costs has a significant relationship on not only the firms' value but also on financial performance.

The finding on monitoring costs espoused with Tripathi (2019) study that discovered that monitoring costs had a positive influence on the value of the firm; as monitoring expenditures are necessary to align the interests of the managers with that of the shareholders.

Influence of Bonding Costs on Financial Performance

The regression result assessing the influence of bonding costs on financial performance of insurance firms licensed Insurers in Kenya is highlighted in the following tables.

Table 6: Influence of Bonding Costs on ROE

Variable	Beta Coefficient	Std Error	t-Statistic	Probability
Constant	0.512	0.013	39.38	0.000
Monitoring Costs	-0.128	0.018	-7.11	0.012
Root MSE	0.198			
R-Squared = 0.112				
Adjusted R^2 = 0.204				

The result indicates that bonding costs has a negatively significant influence on financial performance as measured through return on equity (β = -0.128, P = 0.012). This means that a unit rise in bonding costs causes a 12.8-unit decline in financial performance. The influence of bonding costs on the second measure of financial performance is illustrated in the following table.

Table 7: Influence of Bonding Costs on ROA

Variable	Beta Coefficient	Std Error	t-Statistic	Probability
Constant	2.375	0.0711	33.40	0.000
Bonding Costs	-0.134	0.085	-1.58	0.026
Root MSE	0.926			
R-Squared = 0.808				
Adjusted R^2 = 0.802				

The results also indicate that bonding costs has a negative and significant influence on financial performance as estimated by return on asset (β = -0.134, P = 0.026); this means that a unit rise in bonding costs result to a 13.4 unit decline in financial performance as estimated by ROA. This led to rejection of the hypothesis that bonding costs have no significant influence on financial performance of insurance firms licensed Insurers in Kenya.

The finding on bonding costs was in disagreement with Abdulrahman (2014) study that found out that bonding expenditure had mild positive influence of financial performance of listed firms in Nairobi Securities Exchange.

CONCLUSIONS

The result indicated that monitoring costs had a significant positive influence on financial performance measured by both ROE and ROA. This implied that increased monitoring expenses correlate with improved financial performance of licensed insurers in Kenya. Effective oversight seems to bolster not only profitability but also shareholders value; emphasizing the importance of diligent supervision within these insurers.

The result indicates that bonding costs had a negatively significant influence on financial performance as measured by both ROE and ROA. This implies that increased bonding expenses are linked to decreased financial performance. This finding therefore suggests that reducing bonding costs may result to high profitability and shareholders returns.

RECOMMENDATION

In order to lower the monitoring costs, the study recommends the introduction of management incentives and welfare schemes that will provide both financial and non-financial incentives to management in an effort to motivate them to act at the best interest of the shareholders. The incentives can be based on various performance indicators like monthly or annual sales and profits targets. Financial incentives pegged on financial performance tend to align the interests of management with those of the shareholders. There should be enhanced oversight mechanisms through regular audits to optimize monitoring efficiency, therefore enhancing financial performance.

In order to lower the bonding costs that have been found to have a negative influence on financial performance, the study recommends the use of stock options and policies on profit sharing that will see management become part of the company and receive a certain percentage of company annual profits; motivating them to maximize shareholder's value. Also, the management should be provided with a conducive working environment, provided with training opportunities and their effort acknowledged. Though the agency costs rampant in the insurance sector cannot be fully done away with, it can be lowered and therefore bolstering financial performance of insurers.

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