To Investigate the Cost Implication of Short-Term Contracts in the Banking Sector in Kenya

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Abstract: ***As a break from the past where organizations employed most of its personnel on a permanent basis, there have been a sharp rise in the use of short-term employment contracts within the Kenyan Banking Industry In The Recent Past. The objective of this study was to Investigate the Cost Implication of Short-Term Contracts in the Banking Sector in Kenya.The study employed a census of the entire 45 registered commercial banks in Kenya, based in Nairobi city. The Human Resource department was the unit under observation. Questionnaires were handed to the human resources officers of each of the registered commercial bank.Out of these, 39 responded for the study. It was found that the main motives for hiring employees on short-term basis were related with saving on wage costs: on fringe-benefit ,matching staff to numbers to workload fluctuation, having personnel for unusual working hours without necessary paying overtime, and when there is business uncertainty.***

Keywords: Short-term contract, Labour flexibility. Employee screening, Adjustment costs

1. Introduction

Houseman, (2001) defined short-term contracting as a contract which terminates on a specified date or on the occurrence of an event which is certain to occur on a particular date. Short-term contracts may be used to cover sickness; maternity leave where the date that the substantive post holder will return is not known; other period of paid/unpaid leave where the end date is not known; cover a temporary reduction in the hours of a member of staff; cover a short-term temporary increase in workload (Abowd et al, 1999). Rationalization of the growing share of these temporary work arrangements has been offered within an adjustment cost framework. In this context, firms hire contingent workers because they want to save on future dismissal costs. Notwithstanding, the focus on adjustment costs alone may be too narrow.

1.1 Statement of the Problem

In the last decade, there has been a sharp rise in the use of short-term contracts among corporate organizations in Kenya. In consequence, the banks have increasingly employed workers on short-term contracts. According to a study by Matindni, (2006) in 32 corporate firms, 9.2% of all employees were temporary. The study also found that 67% of the firms surveyed use temporary workers. However, it did not investigate the cost implications.

Short term contract employment is a practice in which organizations employ workers on temporary terms. The short-term contracts contain no incentives for initiation or continuation of employment that translates to job security. Many researchers (Guell and Petrongolo, 2003; Houseman, 2001; and Autor, 2001) seek to re-balance the debate on temporary employment which they consider to have been distorted by unfounded assertions. The view that short-term is of some economical advantage; to employers at least, is commonplace. For example, it is believed to increase short term employment practices cut costs on employees' long term benefits as well as widen the scope for employers to screen possible long-term recruits while they are temporarily employed. The larger question, however, is whether these advantages to employers should be allowed to outweigh the drawbacks on the side of employees. If all the drawbacks were suffered only by employers it might make sense to leave them to make up their own minds without regulation. However, despite efforts to minimize the disadvantages for workers, these are far from negligible. This study therefore, seeks to investigate the purpose of this study was to investigate the cost implication of short-term contracts in the banking sector in Kenya.

1.2 Objective of study

The purpose of this study was to investigate the cost implication of short-term contracts in the banking sector in Kenya.

1.3 Research Hypothesis

In the light of the above objective, and in view of previous studies in this subject matter, the following research hypothesis was formulated:

$H_{1:}$ Cost implication has a significant effect on short-term contracts in the banking sector in Kenya.

Limitations of the Study

Some of banks did not respond fully to some of the critical questions; hence this was anticipated to be one limitation to this study since most of information required for this study relied on their responses and incase data collected was insufficient, then generalization of the finding may not be representative of the actual scenario in the real corporate world. Secondly, inadequate financial resources actually hampered the researcher from obtaining all required information for the study, thus possibility of not having enough data to meet the objectives of the study.Thirdly,the extensive number of commercial banks and their locations made it quite time consuming for the researcher and her assistants.

2. Theoretical

The study will be grounded on two major theories namely: Principal and Agent Theory and Equity theory.

2.1 Principal and Social exchange theory

The principal and agent theory emerged in the 1970s from the combined disciplines of economics and institutional theory. Its proponents were theorists Stephen Ross and Barry Mitnick .It states that in designing either managerial or non-managerial compensation, the key question is, "How can such agency costs be minimized?" Agency theory says that the principal must choose a contracting scheme that helps align the interests of the agent with the principal's own. These contracts can be classified as either behavior or outcome oriented such as stock options, profit sharing, commissions. If profits are high, compensation goes up. If profits go down, compensation goes down. The interests of "the firm" and employees are aligned. An important drawback, however, is that such contracts increase the amount of risk borne by the agent. Furthermore, because agents are averse to risk, they may require higher pay ,a compensating wage differential to make up for it. Behavior-based contracts, on the other hand, do not transfer risk to the agent, and thus do not require a compensating wage differential. However, the principal must be able to monitor with little cost what the agent has done. Otherwise, the principal must either invest in monitoring/information or structure the contract so that pay is linked at least partly to outcomes. This is related to cost implications of hiring on contract where employers seek to cut costs.

2.2 Social exchange theory

Major proponent of Social exchange theory was Humans in 1961. Social exchange theory proposes that social behavior is the result of an exchange process. The purpose of this exchange is to maximize benefits and minimize costs. According to this theory, people weigh the potential benefits and risks of social relationships. When the risks outweigh the rewards, people will terminate or abandon that relationship. Its assumptions are that people who are involved in the interaction are rationally seeking to maximize their profits; People have access to information about social, economic, and psychological aspects of their interactions that allows them to consider alternative, more profitable situations relative to their present situation. People are rational and calculate the best possible means to compete in rewarding situations. Employees will enter into a contractual employment since they want to meet their immediate needs .Contract employment pays better than permanent employment. On the other hand employers will enter into a contract arrangement to minimize on costs

2.3 Empirical Review

Autor, (2001) contends that firms employ short-term workers so as to avoid firing costs. According to Booth *et al* (2000), it is costly to discharge long-serving employees. Workers with sufficient length of service are entitled to statutory redundancy pay and can claim unfair dismissal. Insofar as these are simple transfers from the firm to the separating worker, there is no particular reason to avoid permanent appointments. A worker on a short-term contract will, in a competitive labour market, receive a higher wage that just offsets the loss of the expected value of redundancy pay. However, severance costs can contain a deadweight element.

Houseman, (2001) observe that there is a considerable cost in time and expense to a firm in being brought before an industrial tribunal to defend an unfair dismissal claim. For these reasons, firms might prefer to have a cushion of workers without employment rights who can be freely discharged in the event of adverse market conditions, even if the firm must pay a wage premium to these workers.

According to Booth et al (2000) there are a number of reasons why short-term workers may not in practice receive a compensating differential in the form of a higher wage than permanent workers. It is not efficient for workers in short-term contracts to invest heavily in specific human capital. This leads to a lower wage.

In another contribution, Autor (2001) says that short-term work arrangements offer potential ways to avoid adjustment costs and as such represent an option value to the firm. Severance payments are nonexistent for short-term contracts. A firm’s adjustment costs consist of hiring costs, firing costs and quit costs. The total costs are determined by the amount of turnover and the (hiring, firing and quit) costs per worker (Maurin, 2000).

Autor, (2000) states that the term of notice for employees influences quit costs. The shorter the employees’ term of notice is, the higher is the probability that the firm experiences decreased productivity in the period between one worker quitting and the arrival of a new worker. This means that the implicit costs of quitting rise. Therefore, employers prefer longer terms of notice for their employees, so they can reduce the period of reduced productivity due to labour shortage.

Nevertheless, the period during which a firm experiences decreased productivity because one worker quits and another has not yet arrived can be considerably shorter if a replacement worker is provided. If an external party provides immediate replacement when an employee quits, quit and hiring costs decrease. This might be quite valuable to a firm, which accordingly is willing to pay for immediate replacement. The term of notice for employers is related to firing costs. The longer employers’ term of notice, the higher the indirect costs of (reduced productivity during) dismissal procedures. So firing costs are higher, the longer the employers’ term of notice is. Obviously, the same holds for the amount of severance payments, since these make up the direct cost element of firing costs. Not surprisingly, Autor, (2000) states that employers prefer shorter notice periods and lower severance payments and are willing to pay for that.

Kalleberg, (2000) reaffirms that lower firing costs are the reasons why these contracts are used, either for screening purposes or to absorb shocks in workload. As a result, it is unsurprising that fixed-term contracts are valued highest in industries that are sensitive to business cycle fluctuations such as manufacturing, for production, administrative and management personnel.

3. Methods

This study adopted a descriptive survey design. The core advantage of descriptive design is that it seeks to establish factors associated with certain occurrences, outcomes, conditions or types of behavior(Mugenda & Mugenda 2001) .This method was preferred because it allowed an in-depth study of the subject matter. The other advantage was that descriptive studies make use of questionnaires with which is easier to collect and analyze data.

3.1 Sampling Techniques and Sample Size

The study employed a census of the entire 45 registered commercial banks in Kenya, based in Nairobi city. Since information on Human Resource Procurement is available in Human Resource Department, the Human resource manager was the respondent. The Human Resource department was the unit under observation. A purposive kind of sampling where the structured questionnaires were handed to the human resources officers of each of the registered commercial bank. A complete enumeration of the listed commercial banks was used for collection of data to meet the research objectives.

3.2 Sample Description

The sampling Frame constituted a list of commercial banks obtained from Central Bank of Kenya. Then for data collection, structured questionnaires were targeted to be distributed to the human resource managers of the banking institutions as the respondents. The data collected was assumed to take care of both primary and secondary information.

4. Findings

4.1 Cost Implication of Short- Term Contracts

Most respondents agreed that the banks' practice of short-term employment saved on wage costs. Majority, (90.9%) of the respondents felt that the practice saves on wage cost while a paltry (9.1%) of the respondents felt otherwise as shown in table 4.2. short term contracting is an organizations human resource strategy which must be aligned with other business strategies. This is therefore expected since the main objective is to save cost and increase profit.

On whether short term contract saves on the cost incurred by the organization on training. Majority, (63.6%) thought the contract it doesn't saves training cost while the rest (36.4%) believe this can saves on the training expenses. This is expected since it is for short terms only but other full time employees are still required to go for various training to up grade their skills. It is not a wonder such contracting is even necessary when other employees go for training.

Respondents were also asked to indicate whether short-term employment saves on fringe-benefit costs. Majority, (81.8%) of the respondents agreed that short-term employment saves on fringe-benefit costs while (18.2%) felt that short-term employment saved on fringe-benefit costs. This shows that short term employment saved on employee fringe-benefit costs incurred by the organizations since employees contracted on such terms automatically don't qualify for this benefit.

4.3 Hypothesis Testing

The hypothesis of the study stated that Cost implication has a significant effect on short-term contracts in the banking sector in Kenya. Results of the study revealed a positive and significant relationship between cost and short term contracting (β=0.080, p value <0.05). This implies a unit change in cost increases employers' potential to hire in short term contracts by 0.080 units.

5. Discussion

Cost Implication of Short- Term Employment

The study found that the cost implication of short-term contracts is less severe than permanent employment contracts. Out of the firms surveyed 91% indicated that short-term contracts save d on their wage costs, while 82% indicated that it saved on fringe-benefit costs paid to employees with the same proportion saying that short term employment saved on firing costs. However, 64% did not think that short-term employment helped them save on training costs.

5.1 Conclusions

As indicated in the findings, short-term contracts were found to save wage costs, fringe-benefits and costs of firing employees for most of the firms. Based on the findings, it can be concluded that short-term employments contracts are effective in saving costs; they can be used to match staff numbers to workload fluctuation ; they are suitable when there is business uncertainty.

5.2 Recommendations

The study suggest that companies can hire temporary workers mainly for coping with flexibility needs such as covering long absences, matching peaks on demands and trial periods before offering permanent contracts. The short-term contracts also provide cost saving benefits in paying wages, allowances and benefits to employees. However, firms should employ on short-term basis with caution because of the job insecurity that this arrangement signal to the employees. In this regard they may feel de-motivated and spend most of their time searching for the next job.

Area for Further Research

This study could be a rung in the ladder to deeper studies that include more samples of forms. It would be of great significance to categorize the various motives of using temporary employment contracts by firms of different industries. Another dimension would be to study the short-term workers themselves to understand why they accept the short-term employment arrangement. This study could be conducted among all temporary employees with different types of contracts (fixed-term, daily/on call, on probation, training, seasonal, contractors, etc.).

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