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East Africa's Hub

The Experience of South African Firms Doing Business in Kenya

Judi Hudson

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About the Author

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About the SAIIA Business in Africa project

This is the eighth country case study in a comprehensive examination of business conditions prevailing in Africa, conducted by SAIIA's Business in Africa project. The report forms part of a series of country and sectoral studies undertaken with a view to extrapolating specific policy recommendations for African governments on how to create a more supportive business environment in Africa.

The New Partnership for Africa's Development (Nepad) initiative emphasises the critical importance of the private sector to the continent's economic development. South Africa's expanding track record as a significant and, even more important, a fellow African investor is a notable indicator of business confidence in the future of the continent. It is also paving the way for the private sector to play a stronger role in Africa's advancement.

Although it is generally assumed that South African investors are less averse than others to taking risks, in view of their knowledge of, and proximity to, the African market in terms of appropriate technology and products, the SAIIA Business in Africa project aims to establish whether this is indeed the case. Moreover, an aim of this research is to identify critical areas in which reform is essential if Africa's private sector is to contribute to growth.

The Business in Africa project is headed by Neuma Grobbelaar, the Director of Studies at SAIIA.

The following reports have been published by the project thus far.

Games D, *A Preliminary Survey: The Experience of South African Business in Africa*, Business in Africa Report 1, SAIIA, 2003.

Grobbelaar N, '*Every Continent Needs an America': The Experience of South African Firms doing Business in Mozambique*, Business in Africa Report 2, SAIIA, 2004.

Games D, *An Oil Giant Reforms: The Experience of South African Firms doing Business in Nigeria*, Business in Africa Report 3, SAIIA, 2004.

Besada H, *Glimpse of Hope in West Africa: The Experience of South African Firms doing Business in Ghana*, Business in Africa Report 4, SAIIA, 2005.

Grobbelaar N & K Tsotetsi, *Africa's first Welfare State: The Experience of South African Firms doing Business in Botswana*, Business in Africa Report 5, SAIIA, 2005.

Sayagues M, *Golden road to Timbuktu: The Experience of South African Firms doing Business in Mali*, Business in Africa Report 6, SAIIA, 2005.

Besada H, *Meeting the Sphinx: The Experience of South African Firms doing Business in Egypt*, Business in Africa Report 7, SAIIA, 2006.

Games D, A *Nation in Turmoil: The Experience of South African Firms Doing Business in Zimbabwe*, Business in Africa Report 8, SAIIA, 2006.

Methodology and Rationale

The World Development Report 2005 defines *the investment climate* as 'the many location specific factors that shape the opportunities and incentives for firms to invest productively, create jobs and expand'. Within this context, the experiences of companies become pivotal to an understanding of the investment opportunities and challenges and the related government policies and actions of a country. This view is taken as the point of departure for the report.

The researcher's findings are based on in-depth interviews with representatives of 21 South African companies that are currently doing business in Kenya, or contemplating it, or have recently closed down their operations in that country. The objective of the interviews was to elicit information on their experiences of the Kenyan business environment. Follow-up interviews were also conducted in South Africa with some businesspeople working in the head offices of those subsidiaries. The interviews, which lasted approximately an hour each, were based on a semi-structured questionnaire that had been designed in consultation with the management team at the South African Institute of International Affairs (SAIIA).

The range of companies approached included firms in the financial services, retail, franchising, insurance, telecommunications, services and tourism industry sectors. The in-depth discussion covered a wide spectrum of subjects, ranging from general perceptions of the investment climate in Kenya and the types of investment made, to what were perceived as the main constraints in the operating environment, to interviewees' opinions on the major challenges and opportunities connected with doing business there. The interviewees were also asked for general recommendations to both the Kenyan and South African governments on how to boost private sector development in Kenya specifically, and on the continent in general. The respondents were also invited to discuss their perspectives and experiences in terms of South African companies operating in Kenya, and to impart the key lessons learned.

The views of a number of Kenyan policy analysts and business association members were also canvassed, in order to explore their views of South Africa's expansion into Kenya — the strengths, weaknesses and areas of concern. It was also considered necessary to consult important members of the business community and commentators in Kenya whose opinions are not shaped by the South African corporate perspective. These interviews were supplemented by others conducted with a range of representatives of government departments and donors involved in this field. Overall approximately 41 interviews were carried out. The research interviews for this report started in the first half of 2005 and work was completed on this report by mid-2007.

No agency in Kenya has a mandate to collect data on foreign direct investment (FDI), although the Investment Promotion Centre, Central Bank of Kenya and Central Bureau of Statistics can provide some information. Kenya does not keep comprehensive records of the value of FDI by sector and industry, and investors are not required to liaise with the Investment Promotion Centre. As a result, this report is of an exploratory nature.

Additional information was obtained through semi-structured detailed interviews, combined with a literature review. The latter included material provided by the Kenya Institute for Public Policy Research and Analysis (Kippra), Transparency International–Kenya, the Investment Promotion Centre in Kenya, the World Bank's *Investment Climate Assessment*, the

UNCTAD *Investment Policy Review*, and the Economist Intelligence Unit.

The overall objective of the study was to locate some of the challenges and opportunities related to doing business in Kenya for South African companies, to identify some of the mistakes made and to convey the key lessons these firms have learnt. It is also intended to make both the Kenyan and South African governments more cognisant of the nature of the investment environment, and in this way to contribute to improved policies and more active dialogue among the parties concerned.

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Executive Summary

Few could have predicted the speed with which South Africa has become the largest investor in the rest of Africa, eclipsing even the recent increased interest shown by investors from other continents. This 'rush' to expand into African countries has been described as 'one of the biggest economic phenomena of the last decade'.[1] Once a pariah state, South Africa now 'seems poised to dominate the continent that once shunned its products and leaders'.[2]

The situation is somewhat different in Kenya. In effect, that country has managed to keep the South African business heavyweights at arm's length. The experiences of South African companies doing business in Kenya show us that we cannot separate the successes from the problems of doing business in Africa. Indeed, some Kenyans have perceived some of the efforts at economic penetration made by South African corporations as aggressive. The clash between local and South African firms reached its peak in the widely reported 'beer wars', in which South African Breweries eventually lost out to Kenya Breweries. South Africa's Metro Cash and Carry outlet in Kenya closed its doors in March 2005 after eight years of failing to make a profit. The more than 120 stores Shoprite Checkers has in 15 African countries outside South Africa do business that accounts for only 12% of the group's turnover.[3] But while this chain has registered a company in Kenya, strong levels of competition from established local businesses in a market that is smaller than South Africa's have reportedly

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1 Quoted in Christianson D, 'South Africans doing business in Africa: The new imperialists', *Enterprise*, December 2004, p.78.

2 *New York Times*, 17 February 2002.

3 Quoted in Christianson D, *op. cit.*, and *Business Day*, 25 August 2005.

prevented it from opening any stores there. Again, while MTN International's returns from its operations in Africa overall entered the profit column in 2002, a full two years ahead of schedule,[4] it did not succeed in Kenya.

Despite these setbacks, Kenya remains an attractive investment destination for many South African companies. Interviewees pointed to a range of factors that encourage investment into Kenya. These include saturation in the local market; the desire to 'extend our African footprint'; strategic positioning for further expansion into Africa; and improving brand recognition. Some investors wanted to improve their capacity to serve their South African clients with operations in East Africa; some pointed to a market of an appropriate size for their products in Kenya; others wished to take advantage of the well-established industrial base and high level of skills which make Kenya more attractive than its neighbours.

Moreover, Kenya was seen as a springboard into the East African region. Especially from an education, skills and labour point of view, Kenya was regarded as the 'natural entry point' to the markets of its landlocked neighbours. Business investors were also attracted by the availability of educated and enterprising people in Kenya. Another advantage was the fact that Kenya had never been through a socialist phase and therefore was not anti-capitalist, but markedly business-friendly. Some interviewees also pointed to Kenya's topographical beauty and climate as factors that have great commercial potential, particularly to investors in the agriculture and tourism sectors.

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4 Daniel J, Naidoo V & S Naidu, 'The South Africans have arrived: Post-apartheid corporate expansion into Africa', in *State of the Nation: South Africa 2003–2004*, Daniel J, Habib A & R Southall, Human Sciences Research Council, 2003, p.385.

However, Kenya presents a number of logistical challenges that act as constraints on investor enthusiasm. It is important to recognise, however, that not all businesses are affected in the same ways. The type of sector, the size of the firm, how long it has been in operation in the Kenyan environment, whether or not it has a local partner all affect the way a South African enterprise experiences the Kenyan environment. Notwithstanding these differences, the representatives of companies who were consulted during the course of this research study raised the following areas of concern.

- Infrastructure, particularly the poor condition of roads, the inadequacy of the energy supply and the sluggish pace at which goods were processed through the main port, was seen as the most troublesome obstacle to doing business in Kenya. The cost of electricity in Kenya is reportedly four times that of electricity in South Africa.
- The next most common criticisms concerned the high cost of duties and a difficult administrative environment as far as businesses are concerned. The greatest frustrations in the latter were excessive red tape, vague regulations that are open to varying interpretation, and their by-product, corruption.
- Crime had escalated, although not to the same extent as in SA, and had become a cause for concern.
- Apart from the 'hardware' component of the investment climate, there is also the 'software' (the human element). Wrangling in the political arena and political uncertainty (both of which can affect regulatory arrangements) were raised as areas that were troublesome, given that they hamper long-term planning and can alter the viability of projects without warning.

- While the involvement of South Africa's business sector in the Kenyan economy is desirable, and may well assist the private sector to play a more significant role in the continent's economic development, several instances of blatantly anti-South African sentiment were reported. Kenyans resent what they perceive as the excessive volume of South African investment. They have accused South African companies of being patronising, even arrogant, and of not wanting to work with local partners.
- Some South African companies reported having encountered difficulties with Kenyan partners who let them down at the last minute.

On the last two of the above points, while there is the uncomfortable possibility that competitors in Kenya might have been tempted to promote their own interests by exaggerating what South African companies are doing, there may also be room for improvement in the way South African enterprises operate in Kenya, and perhaps elsewhere in the rest of Africa. They need to make a greater effort to understand and accommodate local sensitivities, and take cognisance of local customs and business practices. South Africa could be in danger of acquiring an image similar to that of the 'ugly American' that Uncle Sam continues to project in Latin America and the Caribbean.[5]

As the stronger economy, South Africa has a complex economic role in East Africa, and on the continent as a whole. The experience of South African firms doing business in other African countries raises a number of fundamental questions. To what extent has South Africa become an economic hegemon

[5] See Hudson J, 'Neo-colonialism or development? South Africa's economic role in Africa', article in forthcoming book by the Centre for Conflict Resolution, Cape Town.

in Africa? Are South African companies taking out more than they put into other African countries, dominating markets to the detriment of local industries? How can positive rather than exploitative outcomes of this expansion into the continent be maximised?

There is little strong research-based evidence on which to draw firm conclusions. Evidence is often patchy, contradictory and over-reliant on anecdote and reported 'perceptions'. Nevertheless, sufficient data have been generated to justify the drawing of some tentative conclusions. This report attempts to answer these complicated and far-ranging questions from the perspective of South African firms doing business in Kenya. The findings inform the policy recommendations made in the report to help shape a more positive relationship between South Africa and Kenya, while also proposing key recommendations for improving the business environment in Kenya.

Introduction

Although its citizens have become poorer over the decades, Kenya remains East Africa's second-largest economy after Sudan. It has the most developed and diverse industrial base in East Africa, a sophisticated banking and financial sector, a high-quality service industry, and good management and labour skills. In 2002, Kenya's economy was 30% larger than Tanzania's and twice as big as Uganda's,[6] with a gross national income (GNI) of $12.2 billion.

Bounded by Tanzania to the south, Uganda to the west, Sudan to the northwest, Ethiopia to the north, Somalia to the northeast and the Indian Ocean to the east, Kenya is well situated. Its strategic geographical location and well-developed airport, deep sea port and coastal access have made it the logistical hub of the East African region, and a leading player in its trade, investment, and general economic growth. As one of the persons interviewed explained,[7]

> Location, location, location — this is where the investment's game's at…Africa's development will take place along the coastal areas, by the sea, in the places that are in touch with the world. The African continent is 'fat' — transport costs into the interior are very high.

Also, because it is free of violent conflict, Kenya remains an anchor in an unstable region.[8]

However, Kenya is lagging behind some of its neighbours in terms of trade and its ability to attract foreign direct investment

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[6] United Nations *Investment Policy Review: Kenya*, Unedited advance copy, 2005, p.5.

[7] Interview, March 2005.

[8] Kenya experienced the spillover effects of conflicts in Sudan and Somalia in the form of 213,000 refugees by the end of 2001: 145,000 from Somalia and 68,000 from Sudan.

(FDI). Investor confidence in Kenya has shown a downward trend. The delays in implementing economic reforms, corruption and political fractiousness have created a weak investment climate and increased uncertainty in the business environment. The number of investment inquiries declined between January and June 2004, according to Kenya's Investment Promotion Centre. This was attributed to 'concerns about political in-fighting and corruption'.[9]

Despite Kenya's initial advantage, the economies of Uganda and Tanzania have been recording faster growth in recent years. Competition from Tanzania is on the increase, particularly for shipments being sent to and from Rwanda and Burundi. This has weakened Kenya's geographical competitive advantage.

While the main countries investing in Kenya have traditionally been the United Kingdom (UK), Germany and the United States (US), South Africa is increasingly making investments in diverse sectors. Kenya is of strategic interest to South Africa. Its location, access to the Eastern seaboard, and the size of its economy combine to make it an attractive destination for South African products.

While Kenya has not taken full advantage of its regional economic leadership to attract significant flows of FDI, it remains strategically positioned as a springboard into East Africa, and is well placed to resume its earlier role as its engine of economic growth. An interviewee argued,[10]

> Kenya is a politically stable country, it has demonstrated that it has the ability to change power peacefully, there is a

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[9] Economist Intelligence Unit, *Kenya Country Report* November 2004, p.32.

[10] Interview, March 2005.

pragmatism and stability in the system which are very good signs in terms of attracting investment.

Socio-Economic Overview of Kenya

At the start of 2003, following the landslide election victory of Mwai Kibaki's National Rainbow Coalition (NARC), which ousted Daniel Arap Moi and his Kenya African National Union (KANU) regime, Kenyans were — according to a Gallup poll of 65 nationalities — the world's most optimistic nation.[11] While many had feared that the elections would be accompanied by violence, Kenya's peaceful and democratic change of government became yet another beacon for democracy in Africa. The country seemed to be turning its back on its earlier history of political oppression, rising ethnic tension, corruption and mismanagement.[12]

Some four years later, however, the picture appears somewhat different. Economic and political reforms have sputtered and come to a halt; optimism has largely dissipated; and the tide of goodwill on which NARC rose to power has ebbed. President Kibaki's authority was weakened by the 'no' vote in the 2005 constitutional referendum, and allegations of corruption have been levelled against some of his senior ministers. Moreover, President Kibaki has found it difficult to maintain the confidence of the Kenyan parliament, the citizens of his country, and foreign donors.[13]

The political situation

Kenya is undergoing a fundamental transformation as it moves from presidential to coalition politics. Because the transition has

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[11] 'Going wrong?' *The Economist*, 9 October 2003.

[12] 'Making progress on a long, hard road', *Financial Times*, 5 April 2004.

[13] The next of these is currently scheduled for December 2007.

been disrupted, the political stability of Kenya has been placed in jeopardy. In the words of a Kenyan analyst[14],

> Kenya is in a transitional mode politically. This brings uncertainty in the environment and makes it very difficult to predict what's going to happen next. Investment is all about stability. Kenya is floundering for lack of direction, for indecisive leadership and unfocused objectives.

During the administration of Daniel Arap Moi (1978–2002), political power was vested in the position and person of the president. Government decisions were reportedly driven by personal relationships and patronage. Currently, the political system is characterised by greater openness. It is not uncommon, for example, for Kenyan ministers to quarrel in public, and for Kenyan newspapers to express criticism of government policy and actions freely.

The dictates of coalition politics and the attendant diffusion of power relationships, combined with the challenge of overcoming the ingrained political influence-peddling left over from the Moi era, have restricted the new president's room to manoeuvre. A number of NARC members were, according to a Kenyan analyst, [15]

> faithful Moi courtiers only a few months before the election. NARC is a diverse mix of personalities, agendas, parties and egos, whose only common ground seems to have been the elimination of Moi and [the] Kenya African National Union stranglehold on Kenyan politics.

Indeed, 12 ministers from the Moi government joined the coalition and were given places in the cabinet, largely to retain their support for the coalition. This, however, meant that the coalition had to serve a broad range of interests.

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[14] Interview, March 2005.

[15] 'A second independence?' *Mail&Guardian*, 21 February 2003.

The two main players in NARC were the National Alliance of Kenya (NAK), which backs President Kibaki, and the Liberal Democratic Party (LDP), under its de facto leader, Raila Odinga. The two factions have been at loggerheads since the coalition came to power in December 2002, and remain divided over the new constitution. The LDP has grumbled that an understanding reached with the NAK before the election, in which it was promised a share in power, has not been honoured. Early in 2004 the LDP sided with the opposition KANU party, and in so doing 'brought parliament to an effective standstill'. In June 2004, President Kibaki responded by demoting most of the LDP ministers in a cabinet reshuffle, and bringing in the leader of the Forum for the Restoration of Democracy–People (FORD) and several members of KANU to replace them.[16]

Mired in political infighting, Kibaki's government has, in the words of Gladwell Otieno, previously of Transparency International–Kenya, 'lost momentum and credibility'.[17] Newspaper reports claim that President Kibaki has allowed 'ethnic squabbling to stall reforms aimed at ending a long era of Big Man rule, hindering economic recovery'.[18] Several interviewees, both Kenyans and South Africans, noted that President Kibaki has seemed 'aloof' since he took office. Members of the 'Mount Kenya Mafia', a cabal of controversial politicians from the president's Kikuyu tribe, are said to control the cabinet, and to be reluctant to share power with members of any other tribe.

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[16] *Kenya Country Report*, *op. cit.*, p.13.

[17] 'Kenya's anti-graft drive dismal — Survey', *The Star*, 10 December 2004.

[18] 'Ethnic squabbles stall Kenyan reforms', *This Day*, 9 June 2004.

Even when Kenya gained independence in 1963, there was social stratification, particularly amongst the Kikuyu, the largest ethnic group, which consisted mainly of cash-crop farmers. Today, ethnicity retains a pull on Kenyan political, economic and social life, since political loyalties tend to follow ethnic lines.

Kenya has a long history of encouraging business, which started with Jomo Kenyatta's first independent government. Kenyatta and his party, KANU, unlike many other new African administrations, were supportive of business development. But the Kenyan private sector was dependent on maintaining a close relationship with Kenyatta's government. This sowed the seeds of the patronage system which has put a brake on Kenya's growth. Kenyatta's vice-president was Oginga Odinga, a Luo, and the Kenyan government's economic development programme at that time reportedly favoured Kikuyu and Luo business leaders. Its perceived neglect of the Kikuyu poor prompted Odinga to leave the government three years later to form his own party, the Kenya People's Unioin (KPU), which represented those who had not benefited from the government's programmes.

In 1969, Kenyatta banned Odinga's party and Kenya became a de facto one-party state. (A multiparty system was reintroduced only in December 1991, while elections were resumed in 1992.) As Kenyatta attempted to elicit support from other ethnic groups, namely the Kalenjin, he appointed Daniel arap Moi as his vice-president. Twelve years later, Moi had amassed sufficient backing from Kenyatta's disaffected supporters to succeed to the presidency when Kenyatta died. Moi's subsequent strategy was to entrench the interests of the Kalenjin elite whilst simultaneously undermining those of the Kikuyu. He used state resources and his presidential powers to bring this about, appointing his supporters to positions in the cabinet and (of importance to this analysis), as the heads of parastatal institutions. In March 1991 the editor of the *Nairobi Law Monthly* was arrested for suggesting that members of Moi's Kalenjin tribe were being appointed to a disproportionately large number of public offices. While Moi was able to retain power during the 1992 and 1997 elections, the economy began to show signs of strain.

In the first decade after independence Kenya registered growth in real GDP of about 6%, while per capita income increased at about 4% per annum. When it became independent, Kenya inherited a relatively diversified economic structure, in which agriculture and tourism were predominant. Independence provided greater opportunities for Africans who had been involved in agricultural production to acquire large farms from departing 'settlers'. This resulted in the rapid expansion of smallholder agriculture. However, 'success flagged in the 1970s, dwindled in the 1980s, and — after a brief rally in the early 1990s following reforms — [growth] has since stagnated'.[19] According to the Kenya Institute for Public Policy Research and Analysis (Kippra): 'during a period of 40 years, Kenya moved from one of the most promising developing countries in sub-Saharan Africa, both in terms of growth and social development, to a stagnated economy struggling to find a new path of sustained growth'.'[20]

Kenya's growing economic difficulties opened the way for political change. Oginga Odinga's son Raila, leader of the Luo faction, crossed the floor in 2002 to join Mwai Kibaki in the

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[19] Regional Programme on Enterprise Development, *Enhancing the competitiveness of Kenya's manufacturing sector: The role of the investment climate*, November 2004, p.14.

[20] Kippra, *Improving the enabling environment for business in Kenya: Reducing the costs of doing business*, 20 January 2005, p.25.

NARC coalition. Its successful election campaign in 2003 was financed in large part by Kikuyu and business leaders from the central highlands.

Today Kenya has a unicameral National Assembly consisting of 210 elected plus 12 nominated members, the attorney-general and the Speaker. The president is directly elected by simple majority and at least 25% of the vote in five of Kenya's eight provinces. The representation of political parties in parliament is as set out in the table below.

Table 1: Political Representation in Parliament

Political party	***Number of seats in parliament***
National Rainbow Coalition	132
Kenya African National Union	68
Forum for the Restoration of Democracy-People	15
Safina	2
Ford-Asili	2
Sisi Kwa Sisi	2
Shirikisho Party of Kenya	1
Ex officio members 2	
Total (turnout 56.1%) 224	
Source: *www.electionguide.org*	

At the time of his election in 2003, Kibaki promised to curb corruption, which was entrenched in the political system. The problem has, however, proved to be stubborn. In mid-2004 (apparently disregarding his training in diplomacy), Edward Clay, the British high commissioner to Kenya, said,[21]

> Evidently the practitioners now in government have the arrogance, greed and perhaps a desperate sense of panic to lead them to eat like gluttons. But they can hardly expect us not to care when their gluttony causes them to vomit all over our

[21] 'UK envoy lashes out at Kenyans for greed', *Business Day*, 15 July 2004

shoes. The facts are that the new corruption entered into by this government may involve around 15-billion shillings.

The fight against corruption was dealt a significant blow in February 2005, when the chief official involved in anti-corruption activities, the internationally respected John Githongo, resigned. The statement he made on this occasion simply said, 'I am no longer able to continue serving the government of Kenya'. Gladwell Otieno, the head of Transparency International–Kenya, described Githongo's resignation as 'the nail in the coffin of people's hopes in Kenya'.[22] In April 2005, Otieno herself resigned.

Kenya's political landscape altered dramatically once again after the referendum held on 21 November 2005, when the country's voters rejected by 57% to 43% the new constitution proposed by President Kibaki. (The voter turnout was 54%.) The 'no' camp included several former cabinet ministers from the LDP, Kibaki's erstwhile partner in the NARC. The chief opposition party, KANU, also campaigned for the 'no' vote under the banner of the Orange Democratic Movement (ODM), and used the orange as its symbol. (The 'yes' camp was represented by a banana.) Kenya thus retains the original constitution it adopted at independence in 1963. This provided for a constitutional monarchy, but has been extensively amended since to grant considerable power to the president. The result of the referendum means that a pledge made by Kibaki during his election campaign in 2002 to give Kenyans a new constitution (initially within a 100-day deadline) remains unfulfilled. Kibaki's response to the referendum defeat was to dismiss his entire cabinet. He took more than two weeks to name a new one. This delay exacerbated feelings of instability in the general public. It also meant that the

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[22] Interview, March 2005.

paperwork necessary for the release of International Monetary Fund (IMF) grants (a letter of intent and a memorandum of economic and financial policy) could not be submitted on time.

Notable features of the cabinet reshuffle were the reappointment of several senior ministers from the 'banana' camp to their former portfolios, and the failure to reinstate all seven LDP ministers who had aligned themselves with the ODM. Among them were prominent figures such as Raila Odinga and Kalonzo Musyoka. 'The reshuffle confirms what had been suspected for some time: that the alliance between the Kibaki camp and the LDP is now wholly defunct'.[23] Indeed, the exclusion of the 'orange' ministers made it clear that the NARC coalition was a thing of the past.

In 2005 the Kibaki government was embroiled in a new corruption furore within a few days of his having been sworn into office. A dossier prepared by John Githongo in exile suggested that various senior members of the administration were implicated in the awarding of a series of dubious state contracts involving commitments of KSh7 billion ($97 million), known as the Anglo Leading scandal. Githongo alleged that four ministers as well as President Kibaki had at least been aware that the contracts had been arranged, but had done nothing to prevent them. As a result of pressure from the parliamentary opposition, donors and civil society, the finance minister, David Mwiraria, resigned on 1 February 2006.

Foreign donors, who initially welcomed the advent of President Kibaki, now feel uneasy. Business confidence and investment have declined. Kenya has received negative press coverage, mainly in the international media. It seems unlikely

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[23] Economist Intelligence Unit, *Kenya Country Report*, 2006–2007, p.7.

that a new constitution will be adopted before the next election which is due before the end of 2007.

It is worth noting, however, that the high level of optimism captured in the Gallup survey at the time of Kibaki's election was unsustainable, whatever the circumstances that followed. In the words of one interviewee,[24] Kenya had just

> come out of 24 years of plundering and decay. Decay of infrastructure is visible, but there is also the decay of the social fabric, of social trust, the deliberate hollowing out of institutions and subverting of procedures over decades.

This is not to deny that there have been gains in recent years, for example improvements in budget balancing and tax collection. Many people who were formally or informally employed who were not submitting tax returns are apparently now registered taxpayers as a result of a campaign by the Kenya Revenue Authority that used the rubric 'pay your taxes, defend your freedom'. At the local government level, the Local Authority Transfer Fund legislation passed in 1998 replaced linked local government grants with others not attached to specific lines of expenditure. This means that councils now work out how they will spend the money allotted them. Budgets linked to proposed service outputs are required before the funds are released. The sums allocated to particular purposes are published, and local communities are encouraged to scrutinise the performance of their councils. This scheme in part explains why the number of councils who 'lost' money, dropped from 40% to 18%.

The most important positive indicator is that economic recovery is afoot.

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[24] Interview, March 2005.

The economic situation

Economic growth has begun to accelerate dramatically, after a period of sluggish growth. Real GDP grew by an estimated 5,2% in 2005 and 5.8% in 2006, the best performance Kenya has recorded for several years, and is projected to grow by over 6% in 2007.[25] This improvement is largely attributable to strong results in the trade, tourism and communications sectors. Tourism grew by 52% in 2004; horticulture by 25%; and the dairy sector by 35%. The reason for the rise in the latter was largely the revival of Kenya Co-operative Creameries, which succeeded in almost doubling the incomes of smallholder dairy farmers. The Kenyan shilling averaged Ksh75.6: $1 in 2005, 4,6% stronger than in 2004. The exchange rate continued to strengthen in January 2006, averaging Ksh72.2: $1.

Poor growth in 2004 was the result of a variety of adverse factors. These included a drought early in the growing season, delays in the disbursement of donor funds, and a spike in world oil prices, which pushed up freight costs *inter alia*. Because it imports 100% of its petroleum requirements and holds scant reserves, Kenya is vulnerable to shifts in oil prices.[26] After the strong performance of the economy in 2005, projections of real GDP growth in 2006 were lower than might have been expected. The reasons are the drought, which poses a number of threats, including a decline in the production of tea (Kenya's number one export); the diversion of public funds from capital projects to emergency relief assistance; and rising food prices.[27] According to the Economist Intelligence Unit, the

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[25] See *www.kaplanstratton.com*, and Statement by IMF Staff Mission to Kenya, Press Release No. 07/115, 30 May 2007.

[26] *Kenya Country report*, 2004, *op. cit.*, p.23.

[27] *Ibid*, p.23.

drought has produced an overall livestock death rate of between 10% and 30% — rising to 70% in some cases — which is 'devastating' the pastoral economy, while migration in search of water and grazing is apparently causing conflict between competing communities. Farm production is threatened, and the falling levels of water in dams could cause power shortages. This in turn could affect the production of hydroelectricity, which could lead to power rationing and/or a switch to more expensive thermal generation. Other constraints on growth are a deterioration of relations between the government and donors because of corruption, which has led to the suspension of project funding; and political instability as the country prepares for the next general election.

The proportion of the Kenyan population that live in poverty increased from 51% in 1997 to approximately 56.8% in 2002.[28] According to World Bank data, 23% of Kenyans subsist on less than a dollar a day.[29] Kenya was ranked 154th out of a total of 177 countries on the *UNDP Development Index* in 2005, between Haiti and Gambia, and was characterised as a country with low human development. (In comparison, Egypt stood at 119th, South Africa 120th, and Tanzania at 164th.)

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[28] Kippra, *op. cit.*,p.25.

[29] World Bank, *World Development Report 2005: A Better Investment Climate for Everyone*, A co-publication of the World Bank and Oxford University Press, 2005, p.258.

Table 2: Key social and economic indicators

Indicator	*1970*	*1980*	*1990*	*1995*
Population (m)	11.5	16.6	23.4	26.7
GDP at market prices $ bn	1.6	7.3	8.6	8.1
GDP per capita ($)	139.5	436.8	365.4	339.0
Annual GDP growth (%)	-4.7	5.6	4.3	4.4
Inflation (%)	2.2	13.9	17.8	1.6
Exports (% of GDP)	29.8	28.0	25.9	32.6
Imports (% of GDP)	30.7	39.1	31.2	38.8
Gross capital Formation (% of GDP)	24.4	24.5	19.7	17.5
FDI Inflows ($m)	13.8	19.0	57.1	33.0

Table 2: Key social and economic indicators (continued)

Indicator	2000	2001	2002	2003
Population (m)	30.1	30.7	31.3	31.9
GDP at market prices $ bn	10.4	11.2	12.3	13.8
GDP per capita ($)	347.2	370.8	393.0	432.6
Annual GDP growth (%)	-0.2	1.1	1.0	1.3
Inflation (%)	10.0	5.7	2.0	9.8
Exports (% of GDP)	26.3	26.4	26.6	26.5
Imports (% of GDP)	36.0	35.6	29.8	31.1
Gross capital Formation (% of GDP)	15.4	14.7	13.6	15.6
FDI Inflows ($m)	110.9	5.3	27.6	81.7
Source: UNCTAD, FDI/TNC database, World Bank, World Investment Report 2004				

Donors

In 1997 no aid was given to Kenya, because donors had reportedly run out of patience with what they perceived as 'one of the most corrupt and careless governments in Africa'.[30] In 2004 a three-year $253 million facility granted by the IMF led donors to pledge $41 billion for the same period, to support the government's economic recovery strategy. However, endemic corruption, weak management of public spending and the resignation of Githongo in February 2005, followed by Otieno a little later, have caused a resurgence of concern in Western donors. The disbursement of budgetary support has been delayed, although project funding is going ahead. In 2006 the World Bank withheld $265 million in loans that had been agreed in 2004 because Kenya had failed to satisfy an 'integrity' test. The IMF is also delaying a decision to pay out the fourth and fifth tranches of the country's Poverty Reduction and Growth Facility (PRGF) loan, which is worth $73 million. Both institutions are demanding proof that the Kenyan government is committed to eradicating corruption. However, the World Bank approved two new loans for Kenya in January 2006 — $25 million for institutional reform and capacity building, and $120 million to foster trade within the East African Community (EAC).

Donors are especially critical of corruption in state officials and the government's inability to manage aid disbursements. The US government suspended its assistance to Kenya's anti-corruption programme after Githongo's resignation. In October 2004, the second Public Expenditure Management assessment was released. Of the 16 indicators evaluated,

30 'Dancing in Kenya to the donor's tune' *The Economist*, 3 August 2000.

Kenya complied with only four during the 2003–2004 fiscal year. The review made particular mention of the government's failure to reform its public procurement mechanism,[31] which remains largely unregulated and unmonitored, and its accumulation of serious arrears in payment of bills.[32] Donors also complain that the government is dithering over cutting the amount it spends on civil service wages, and carrying out the privatisation of parastatals too slowly.

The Privatisation Bill apparently met with stiff resistance in parliament. Some members accused the government of 'trying to sell the family silver to foreigners for a song'. The Bill, which was adopted in 2005, provides the legal and institutional framework for the divestiture of state assets. It has however, been criticised because it does not set a timetable or list the enterprises to be sold. It seems that the reluctance to privatise is connected with the complex political environment in Kenya.

According to a report by the Economist Intelligence Unit, [33]

> the most politically challenging aspect of fiscal policy is the need to reduce the government's massive wage bill which accounted for 8,7% of GDP in 2003–2004 (or 9,6% of GDP if parastatals are included), while also meeting demands for wage rises among key workers. The government earlier pledged to cut the civil service wage bill to 8.1% of GDP in 2004–2005 and 7.6% of GDP in 2005–2006…However, although retrenchment is not an explicit donor condition, it will be virtually impossible for the government to meet its targets without laying off some 30,000–40,000 staff over the next two years, which risks sparking industrial action.

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[31] In October 2005 the Public Procurement and Disposal Act was enacted. Its objectives are to maximise efficiency and promote competition. It is designed to promote fairness in procurement, increase transparency and accountability, and raise public confidence.

[32] *Kenya Country Report*, 2004, *op. cit.*, p.19.

[33] *Ibid*, p.9.

Kenyan ministers and members of parliament are reportedly among the best-paid in the world.[34] One interviewee noted that 'government effectively has Kibaki's head and Moi's body', meaning that the bulk of those in government service are people who served and benefited from the previous regime. Many of these were reportedly not chosen for their efficiency. Since 1992, the government has imposed a moratorium on hiring new civil servants. As a result, the culture and practices of state employees under Kibaki's administration are similar if not identical with those who served the previous government. The present regime will have to proceed cautiously with its reduction in the wage bill if it wants to avoid strike action in the run-up to the 2007 election.

In addition, bickering within the NARC coalition has alienated donors. Because it failed to meet the stipulated conditions, Kenya was not one of the eight African countries chosen to apply for a new set of development grants offered by the $1 billion Millennium Challenge Accounts.[35] To pass muster with the donors, the Kenyan government needs to trim the civil service — one of the largest in Africa; cut public spending; and adopt more rigorous and sustained measures against corruption. It is not just the donors who need reassurance, says David Kabaara, a Kenyan policy analyst, 'The government will have to convince Kenyans that it can borrow from donors to build roads and beef up education and health, not just to pay for a bloated civil service'.[36]

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[34] 'Dirt out, cash in', *The Economist*, 27 November 2003.

[35] South African Department of Foreign Affairs, *Kenya Country Profile*, 19 January 2005, p.16.

[36] 'Kenyan budget will feature heavy reliance on donor aid', *ThisDay*, 10 June 2004.

One of those interviewed said, [37]

> Donors were chased away by Kenya's perceived corruption which has had an adverse impact on the country's GDP. But the country has survived and is still relatively strong. This shows the underlying potential of Kenya's private sector. Donor funding would be the icing on the cake.

Indeed, '[w]hat is striking about Kenya', said another interviewee, 'is that it has had much less donor aid than its neighbours and yet the economy has kept on going'.[38]

The structure of the economy and the business class

Kenya's private sector accounts for 80% of GDP. Firms come in a range of different sizes. Put differently, the Kenyan business class, according to an interviewee, consists of three distinct layers:

- ***big businesses***, which employ about one-third of workers not involved in agriculture, and are predominantly based in the urban centres;
- ***small and medium-sized enterprises***, which account for about two-thirds of employment not related to agriculture, as much as 20% of GDP, and are concentrated in cities and towns but are also spread across rural Kenya; and
- ***smallholdings*** belonging to farmers working as part of larger agricultural enterprises, which are ubiquitous in rural areas and contribute some 70% to all marketed agricultural products.

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[37] Interview, March 2005.

[38] Interview, March 2005.

One interviewee mentioned the dominance of the Kenyan Asians or 'Kenasians' in the private sector, describing them as 'wielding significant financial clout, playing a very astute game'.[39] However, a Kenyan analyst argued that while this was a common perception, the reality was somewhat different. He did not deny the distinctive entrepreneurialism of the Kenasians and the strength of their networks, but suggested that their power was less extensive than most people assumed. Another person noted that Kenasians 'suffer with the stigma of not being patriotic',[40] which suggests they are still regarded by most Kenyans as foreigners. He argued that the Kenyan private sector has a 'thin line at the top made up of multinationals and very few local African-owned businesses and a massive informal sector.'[41] There are few large firms, and of these many are subsidiaries of multinational corporations (MNCs) that have been attracted to Kenya by the investment incentives offered by the government. These large enterprises are active in business associations and lobby the government directly. As far as the informal sector is concerned, by the 1990s there were more people working in this part of the economy than in formal employment. In 2003, when the country experienced a moderate economic recovery, the informal economy created 458 800 new jobs (that is, 94.3% of the overall total). The informal sector is the main source of employment for women.[42]

Increasingly, Kenyan businesses operate independently of the government. There appears to have been a corresponding

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[39] Interview, March 2005.

[40] Interview, March 2005.

[41] Interview, March 2005.

[42] Investment Programme for the Economic Recovery Strategy for Wealth and Employment Creation 2003-2007, Ministry of Planning and Development, July 2005. p.3.

shift in the administration's policies towards considering the private sector as the main actor in the economic development of Kenya, so although there is interaction between state officials and businesspeople, the government no longer attempts to control all commercial activity. There are now a number of business associations in Kenya. The Kenya Association of Manufacturers is the oldest and most well-established. Its access to government officials is described as 'good and getting better'. The Kenya Private Sector Alliance was established as an umbrella body to provide a single, unified voice for Kenyan businesses. However it is encountering difficulties in defining itself and finding ways to develop cross-cutting principles that will be binding on both big and small enterprises in the future. Its efficacy has been threatened by fragmentation, the politics of group interests, and the relative novelty in Kenya of public/private sector dialogue on issues of policy formulation, implementation, monitoring and evaluation.

It is noteworthy that Kenya's private sector has limited faith in the country's economic growth, given the difficulties outlined above. As a result, business planning tends to focus on the short term. Again, enterprises are inclined to adopt a zero-sum approach that reflects the feeling that the economic pie in Kenya is not big enough for all participants. This attitude leads to hostility, particularly towards certain newcomers. As a Kenyan interviewee commented, 'Local businesses complain that foreign businesses are treated better than Kenyan businesses'.[43] Recent expressions of concern about 'financial colonisation' of Kenya's economy by South African companies are discussed in greater detail in a later section of this report.

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[43] Interview, March 2005.

The feelings of resentment entertained by local members of the private sector towards foreign investors raise a political dimension. Andrea Goldstein of the Organisation of Economic Co-operation and Development (OECD), points to the broader possibility of[44]

> manipulation of public opinion by groups that [are] exploiting to their advantage the rents created by autarchic economic policies and [that are] obviously threatened by the emerging competition from more efficient foreign producers.

Table 3: Structure of GDP by Economic Activity	
Origins of gross domestic product 2004	***% of total***
Agriculture, forestry and fishing	27.5
Manufacturing	13.3
Trade, restaurants and hotels	11.2
Transport, storage and communications	10.5
Government services	14.8
Others (net)	22.7
Source: *Economist Intelligence Unit Country report: Kenya 2006–2007*	

Agriculture

Agriculture remains the single largest sector of the economy, and therefore its mainstay. With fishing and forestry, it accounted for 24% of GDP in 2002. Around 80% of Kenyans are employed in this sector.

[44] Goldstein A E ,'Regional integration, FDI and competitiveness: The case of SADC', paper delivered at the Africa Investment Roundtable hosted by the government of South Africa, Johannesburg, 19 November 2003, p.3.

New sources of production that are more closely linked to Kenya's climate and transport infrastructure have emerged over the last couple of years. Horticulture has become a major source of agricultural exports, on a par with tea and coffee. Kenya now accounts for 25% of European flower imports from countries outside the EU, a share significantly higher than that of the next largest suppliers — Colombia (17%) and Israel (16%).[45]

Agriculture is predominantly small-scale. Farmers on smallholdings that average 2–3 hectares in extent produce 75% of the total agricultural output, and 70% of marketed agricultural goods. They also produce 70% of maize, 65% of coffee, 50% of tea, 80% of milk, 85% of fish and 70% of beef and related outputs. Large-scale plantation and estate agriculture, which account for 30% of marketed agricultural produce, focus on tea, coffee, flower, maize, wheat and livestock farming.

Table 4: Cash crop production (‘000 tons unless otherwise stated)

	2003	***2004***	***Jan–Oct 2004***	***Jan–Oct 2005***	***% change 2004–2005***
Sugarcane	4,184.5	4,654.0	3,789.6	3,813.9	0.6
Tea	293.7	324.6	257.9	268.6	4.2
Horticulture	133.2	166.1	133.4	140.0	4.9
Coffee	61.2	49.9	44.4	43.6	-1.7

Source: Central Bureau of Statistics, Kenya Sugar Authority, Horticulture Crops Development Association, Kenya Tea

45 Quoted in United Nations *Investment Policy Review: Kenya*, *op. cit.*, p.21.

Manufacturing

The share of manufacturing in total production has fluctuated during the last two decades. It stood at about 13% of GDP in 2002. According to the UN, 'The manufacturing sector has been in difficulty in recent years as it has not been able to compete in global markets, [and] has lost market shares in its traditional export markets within the region'.[46] The exception is the garment industry, which has grown considerably owing to the access provided to the US market through America's Africa Growth and Opportunity Act (AGOA). Overall, however, manufacturing has 'largely stagnated in terms of output, productivity and employment'.[47]

Tourism

The beauty of Kenya's landscapes, and particularly its wilderness areas, is the country's most obvious asset. Tourism remains the cornerstone of the Kenyan economy, and its leading earner of foreign exchange. Official data indicate that tourism receipts reached a record Ksh48.9 billion ($647 million) in 2005, 16% higher than in 2004.

The UK was Kenya's leading source of foreign tourists, with 138,000 (up by 24%), followed by Germany, with 75,557 (an increase of 15%). The number of visitors from North America increased by 47% to 73,574, despite the US travel warning that was issued in 2003 and renewed at the start of 2006.

[46] *Ibid*, p.3.

[47] Regional Programme on Enterprise Development, *op. cit.*, p.7.

Table 5: Visitor Arrivals in Kenya			
	2004	***2005***	***%change***
By air and sea	668,134	832,299	24.6
Across borders	690,000	848,200	22.9
Total visitors	1,358,134	1,680,499	23.7
Source*:* Kenya Tourist Board			

Tourism recorded another year of rapid growth in 2006, despite warnings issued by the US about the ongoing threat of terrorist incidents.

Box 1: The Impact of Terrorist activities on Tourism

The security risks faced by tourists are illustrated by the terrorist incidents that took place in 1998 and 2002. In the 1998 attack, a car bomb exploded at the US embassy in central Nairobi, simultaneously with a similar assault on the US mission in Dar es Salaam, Tanzania. Some 254 people were killed in Nairobi, and more than 5,000 people suffered injuries. In 2002, two surface-to-air missiles narrowly missed an Israeli charter aircraft as it took off from Mombasa airport, while in a nearby tourist resort suicide bombers struck at an Israeli-owned hotel, killing 18 people and injuring many more. What British Airways perceived as a terrorist threat resulted in the cancellation of international flights and the issuing of travel warnings by several countries. It is particularly noteworthy that Kenya's capacity to deal with the threat of terrorist attack has strengthened. The Institute for Security Studies listed Kenya, along with Algeria, Uganda, Ethiopia and South Africa, as the countries in Africa best equipped to deal with terrorism, because they had improved both their intelligence-gathering measures and their internal security systems.[48]

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[48] *Kenya Country Report* 2004, p.17.

Transport

Kenya has one major seaport and eight minor ones, all managed by the Kenya Ports Authority, a parastatal. Mombasa is the main port of entry, and has served the shipping needs of its neighbours Uganda, Rwanda, Burundi and parts of Sudan and Tanzania for many years. However, as the main regional seaport it faces increasing competition from Dar es Salaam, particularly for shipments to and from Rwanda and Burundi. One of the persons interviewed said, 'Kenya is losing its comparative advantage in relation to geography to Tanzania. Fundamentally you won't be in the ballgame of exporting and manufacturing unless you're by the sea. In the East African sense, Dar es Salaam is growing very fast.'[49] Indeed, the costs of handling by the terminals and of storage are a third lower in Dar es Salaam than in Kenya's Mombasa; and there is a rail line from Dar es Salaam to Lake Tanganyika which adds to the advantages enjoyed by the Tanzanian port.[50]

Again, Tanzania Railways has already captured much of the Burundi market, a substantial part of Rwanda's, and is actively pursuing Uganda's.[51] The Kenyan railway service, which once carried the dominant share of freight between Mombasa and Nairobi (and almost all goods traffic into Uganda) is now transporting roughly a fifth of Ugandan cargo and the goods handled by Mombasa port. The current prices charged for

[49] Interview, March 2005.

[50] Joint publication of the World Bank and International Bank for Reconstruction and Development, *Doing business in 2006: Creating jobs*, Washington, 2006, p.53.

[51] Regional Programme on Enterprise Development, *op. cit.*, p.61.

moving containers by rail can be as much as double those charged for road transport. [52]

However, Kenya has a good airline. Since Kenya Airways was privatised in 1996 and became associated with KLM of the Netherlands, it has flourished. Kenya Airways currently offers direct passenger flights to Amsterdam, London, Bangkok, Dubai, Hong Kong and Mumbai, and to 21 destinations in Africa. More than a dozen major European and Asian airlines also operate direct flights to Nairobi.[53]

Mining

Mining makes a small contribution to Kenya's GDP, estimated by Mbendi to be less than 1% in 2000. Whereas soda ash is Kenya's principal mineral export, other minerals being mined include fluorspar and kaolin, as well as gemstones. Gold is mined mainly by artisanal miners.[54]

After 10 years of settling land claims with local residents and introducing environmental safeguards, a Canadian firm, Tiomin, has launched a $170 million venture to mine titanium at Kwale in the Coast province. Construction of the mining facilities was supposed to begin in 2006, but after a year's delay, suffered another setback when the company's finance and country directors resigned in early September 2007. Tiomin has acquired the 100 acres of land that it needs for a mineral reprocessing plant, but still face a court injunction brought by

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[52] *Ibid*.

[53] United Nations *Investment Policy Review*, *op. cit.*, p.54.

[54] See *www.mbendi.co.za*.

farmers who believe that they were not adequately compensated for their land. [55]

Trade

Kenya has a 'relatively open' economy. Over the past few years its total trade in goods and services (exports and imports) has represented around 60% of GDP.[56] It is a founding member of the World Trade Organisation (WTO), a member of the Common Market for Eastern and Southern Africa (Comesa), the EAC and the African Caribbean Pacific (ACP) grouping. However, some problems have surfaced relating to the number of trade organisations with which it is affiliated. According to one interviewee, Kenya's being party to multiple trading regimes such as Comesa and the EAC has resulted in conflicts of interest and created duplication of activities, for example in tariff design and regulation.

The potential of trade to drive and sustain growth has not been achieved in Kenya. Kenya's share of world trade has steadily declined, and is now less than half of what it was in the mid-1980s.

Kenya's economic environment could be made more conducive to trade. For example, the regulatory environment is unnecessarily complicated. According to *Doing business in 2007*, in Germany one needs a single signature to ship goods abroad, while in Denmark one requires 5 days and 3 documents to import or export. In Kenya, one has to obtain 11 documents taking 25 days, to export goods; and 9 documents

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[55] See 'New blow to Tiomin and officials quit', *Business Daily*, 11 September 2007.

[56] *Ibid*, p.19.

taking 45 days, to import items. South Africa's trading environment, like Tanzania's, is more friendly than Kenya's, as the table below demonstrates. However, Uganda, while lagging behind other countries, has made significant progress by introducing electronic filing for trading.

Table 6: Trading across borders

Countries	*Kenya*	*Tanzania*	*Uganda*	*Rwanda*	*South Africa*
Documents for export (number)	11	3	12	7	5
Time to export (days)	25	24	42	15	31
Cost to export ($ per container)	1,980	822	1,050	1,120	850
Documents to import (number)	9	10	19	8	9
Time for import (days)	45	39	67	19	34
Cost to import ($ per container)	2,325	917	2,945	1,265	850

Source: Doing business in 2007, World Bank, 2006.

According to the World Bank's *Investment Climate Assessment* (ICA),[57] the openness of trade in Kenya has prompted the rapid growth of a few internationally competitive firms. The report points out, however, that the 'average firm is less internationally competitive and is now less likely to export'. With a slight economic recovery and access to new markets through AGOA, Comesa and the EAC, total

[57] The sample was drawn by the Central Bureau of Statistics from a census of nearly 2,000 formal manufacturing firms with more than 250,000 full-time employees, conducted in 2002–2003. It incorporated 282 formal manufacturing firms, and a sample of 1,922 employees in manufacturing, .

exports have grown in the last few years. But data obtained from businesses show that since 1999 the average firm has become less likely to export, which suggests that such an enterprise is 'unable to compete internationally, and the rise in exports is being driven by a few firms'. Only companies in the textile sector have on average shown growth in exports, most probably because of AGOA.[58] The ICA is of the opinion that 'in other sectors Kenya will have to continue to compete against China and India'.[59]

Box 2: Kenya and the East African Community

Regional unity under the auspices of the East African Community (EAC) is a central tenet of Kenya's foreign policy. The East African Customs Union came into force on 1 January 2005. It aims to stimulate trade, attract investors to the region and reduce or eliminate tariffs between member states. Common external tariffs with a minimum rate of 0%, a middle rate of 10% and a maximum rate of 25% have been established. Free trade in goods among the three member countries will be phased in over a period of five years. Goods traded between Tanzania and Uganda, and goods exported from Tanzania and Uganda to Kenya will be exempt from duties with immediate effect, while levies on certain categories of goods (manufactured items) exported from Kenya to Tanzania and Uganda will be phased out over a period of five years. Differentiated schedules and sets of tariffs will be applied to the two countries. The UN *Investment Policy Review* warns, however, that '[g]iven the free movement of goods between Tanzania and Uganda, this differentiated approach in phasing out tariffs on Kenyan exports to the two countries will require a high administrative burden to enforce rules of origin'.[60]

[58] Regional Programme on Enterprise Development, *op. cit*., p.iv.

[59] Ibid, p.2.

[60] United Nations *Investment Policy Review: Kenya*, *op. cit*., p.59.

Kenya's *Economic Survey 2004* pointed to a widening of the trade deficit compared with the figures recorded for the previous year, with imports outstripping exports. Kenyan exports grew by 4% in 2003, compared with an increase of 8.2% in 2002. Imports rose by 9.3% in the same period. Subsequently the trade deficit grew by 11.6% from Ksh88 427 million in 2002 to Ksh98 690 million in 2003.[61] Kenya's current account deficit widened to $211 million in the year June 2003–2004 as imports, particularly of oil (24% of the total) surged, despite 'solid growth' in horticultural exports and tourism.[62]

An interviewee consulted during the course of this research commented,[63]

> There will now be far more stability and predictability in terms of tariffs with this five year plan. Whereas before, individual governments used to change their budgets each fiscal year, this new union provides the region with an enormous opportunity. The general reaction of Kenyan business is that this is a price worth paying for the eventual establishment of a customs union and access to a bigger East African market.

In January 2006 the World Bank approved three loans to the value of $199 million, as well as $60 million of partial risk guarantees, to the three member states of the EAC and to a prospective member, Rwanda. These loans are intended to foster regional trade by improving transportation services and reducing transport costs. The largest proportion ($120 million) of the money advanced is for projects in Kenya. This bears testimony to the World Bank's recognition of the country's key role in regional trade, especially its importance to land-locked countries such as Uganda and Rwanda.

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[61] Central Bureau of Statistics, Ministry of Planning and Development, *Economic Survey 2004*, The Government Printer, Nairobi, 2004, p.16.

[62] *Kenya Country report*, 2004, *op. cit.*, p.3.

[63] Interview, March 2005.

According to the World Bank's ICA, Kenya's export markets have become more diversified. East African markets have become more prominent than those of Europe in Kenya's trade profile, and its US market has expanded substantially since 1999–2000. Put differently, Kenya's trading patterns have shifted away from the EU. Other African countries, especially those of the Comesa region, are currently the most important destinations for Kenyan exports. Recently, there has been another change. Kenya's share of imports from the EAC and Comesa, which accounted for 8.5% in 1994–1996, declined to 7.7% in 2002. Food-related processed goods decreased most dramatically, from 9% of the region's imports to 2.1%. Exports to the Comesa market accounted for 73% of total exports to other African countries. Most of these were manufactured consumer goods. In contrast, Kenya's exports to Europe are mainly agricultural produce, while those to the US are predominantly garments. The value of the latter increased more than 300% to $200 million in 2000–2003.[64] Uganda, the UK and the US were the main recipients of Kenya's exports in 2004, whereas Kenya's major sources of imports were the United Arab Emirates, Saudi Arabia and (significant in terms of this study) South Africa. (See the table below.) Industrial supplies such as machinery, equipment and fuels make up about 90% of Kenya's total imports.[65]

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[64] United Nations *Investment Policy Review: Kenya*, *op. cit.*, p.20.

[65] Regional Programme on Enterprise Development, *op. cit.*, p.13.

Table 7: Kenya's exports and imports by destination and origin, 2004	
Main destinations of exports 2004	***% of total***
Uganda	13.1
UK	11.3
US	10.4
Netherlands	8.0
Main origins of imports	**% of total**
United Arab Emirates	12.7
Saudi Arabia	9.8
South Africa	6.5
US	4.4
Source: *Economist Intelligence Unit Country Report Kenya 2006–2007*	

Trade and Business Linkages Between South Africa and Kenya

Following a suspension of formal ties that lasted 29 years, South Africa re-established diplomatic relations with Kenya in 1992. The South African mission, which arrived in November 1991, was accorded diplomatic privileges and immunities in May 1992. Relations were upgraded to full diplomatic status on 12 April 1994, and South Africa's first fully accredited High Commissioner to Kenya presented his credentials to President Moi on 11 December 1996.

An Agreement on the Establishment of Representative Offices was signed in 1992. A Declaration of Intent on Co-operation, outlining the need to agree a framework for collaboration in the economic, political, technical, scientific, security and cultural fields, and based on the principles of equality and reciprocal advantages, followed in 2003. A proposed Joint Commission of Co-operation between South Africa and Kenya, designed to boost bilateral trade and originally scheduled to be signed in 2006, is still unsigned.

In 2003, President Mbeki said that South Africa valued the important role that Kenya plays in the affairs of the continent and the East African region. Representatives of the Department of Foreign Affairs confirmed that Kenya's geographic location, its role as the economic powerhouse of East Africa, and its use as a base by a large number of international organisations combine to make the country of strategic interest to South Africa. Especially in the areas of peace and security, President Mbeki reportedly said that South Africa could learn much from Kenya about the deployment of peacekeeping missions, referring to the pivotal role the government of Kenya played in the peace processes in

Somalia and Sudan. These reached successful conclusions with the signing of the Naivasha protocols for Sudan and the relocation of the Somali Transitional Federal Institutions to Somalia. (Kenya had a mandate from the Inter-Governmental Association on Development — IGAD — to mediate in the South Sudan and Somalia conflicts.) South African military personnel are now deployed to a defence college in Kenya on a yearly basis, to facilitate co-operation in peacekeeping. In return, Kenya is looking to South Africa's military organisation to provide a model for its own reform programmes. In May 2005, *The Star* reported that 'Kenya is copying and customising South African defence reforms, policy and planning to suit its circumstances in a bid to stamp out corruption'.[66] Apparently, bribery and influence-peddling are rife in the Kenyan military, which was allowed to operate unchecked for decades under KANU.

President Moi was the first African head of state to visit South Africa in 21 years when he attended President Mbeki's inauguration in 1999. The victory of the NARC coalition in the 2002 elections and the accession of President Kibaki was followed by a significant amount of high-level interaction. Shortly after taking office, and at the invitation of Mbeki, Kibaki made a visit to South Africa. Talks between the two countries revolved around harmonising tariffs between the two regional bodies, the Southern African Development Community (SADC), of which South Africa is a member, and Comesa, to which Kenya belongs. In October 2004, then deputy president Zuma visited Kenya en route to the swearing-in of the president-elect of the Somali Republic, His Excellency Abudullahi Ahmed. This was followed by a visit of Foreign

[66] Quoted in 'Kenyan military looks to SA for anti-corruption policy', *The Star*, 3 May 2005.

Minister Dlamini Zuma to her counterpart in November 2006 to discuss the establishment of a joint bilateral commission and a trade agreement. Almost one year later the agreements remain unsigned.

Despite several moves towards interaction at a high political level, one of the persons interviewed described the relationship between Kenya and South Africa as 'cool', and a newspaper editorial referred to an 'edgy distance between the two countries'.[67] This is partly explained by the fact that the previous Kenyan administration recognised Pretoria before the 1994 elections brought democratic rule to South Africa. At that time, the relationship between the Kenyan opposition (as it was then) and the African National Congress (ANC) was reportedly not 'particularly good'.[68] Kenya did not play a role as a frontline state.

A certain discomfort concerning South Africa's perceived economic dominance in the region is felt in Kenya. For a country that is a powerhouse in East Africa, South Africa's growth in influence is disconcerting. Relations between democratic South Africa and the rest of Africa are now both constructive and competitive, but new tensions and differences have emerged. These tensions have been exacerbated by South Africa's becoming a favoured emerging market for international investors abroad.[69] Many multinationals are now establishing their African head offices in South Africa. The pill is made even more bitter, according to some analysts, by the circumstance that 'South African FDI is not combined with the sweetener of donor assistance that

[67] 'The Kenyan shield', *Business Day*, 8 August 2003.

[68] *Ibid.*

[69] Gelb S, 'South Africa, Africa and the New Partnership for Africa's development', The Edge Institute, September 2002, p.23.

other investors are able to offer African governments, contributing to accusations of neo-colonialism'.[70]

South Africa also competes strongly with Kenya for tourists. After the security threats outlined earlier in this report, Kenya reportedly received a tenth of the number of tourists that visited South Africa in 2004. [71]

In the words of one respondent, [72]

> Before 1994 when South Africa came out of isolation, Kenya was obviously a fairly major powerhouse in the southern part of Africa. Kenya probably sees South Africa [as] starting to muscle its way in. There have been some very bad examples of South African companies venturing into Africa full of arrogance — 'we know best, we'll tell you how to do things'. This is feedback that is coming through very strongly and is a factor in the relationship.

Another interviewee put it differently: 'Many Kenyans see themselves as the heavyweights and consider South Africa a young democracy. There was a view of: "what is this young boy down south doing?"'[73] Speaking in the Kenyan parliament in 2001, an opposition legislator lamented the 'bulldozing' attitude of South African corporations, saying, 'It seems like they still have the attitudes of the old South Africa'.[74] This animosity is fuelled by the trade dominance of South Africa in the region, and its substantial trade surplus with Kenya.

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[70] Grobbelaar, N 'Investing in Africa: SA's influence a mixed blessing', *Business Day*, 1 June 2005.

[71] 'Travel warnings hit Africa's flagship', *Financial Times*, 5 April 2004.

[72] Interview, March 2005.

[73] Interview, March 2006.

[74] *New York Times*, 17 February 2002, quoted in Daniel *et al*, *op. cit.*, p.387.

Table 8: South Africa's trade with Kenya, 1992-2006, ZAR

Year	*Exports*	*Imports*	*Total trade*	*Surplus (%)*
1992	144,848,885	24,004,464	168,853,349	86
1993	233,685,633	31,296,181	264,981,814	88
1994	716,969,040	28,798,476	745,767,516	96
1995	879,946,808	112,775,490	992,722,298	89
1996	945,106,757	124,652,389	1,069,759,146	88
1997	1,580,589,505	90,743,737	1,671,333,242	95
1998	1,258,041,446	63,885,778	1,321,927,224	95
1999	1,244,159,773	38,538,045	1,282,697,818	97
2000	1,505,301,515	44,181,599	1,549,483,114	97
2001	1,806,923,406	89,626,382	1,896,549,788	95
2002	2,318,346,640	110,135,947	2,428,482,587	95
2003	2,214,105,515	106,588,266	2,320,693,781	95
2004	2,961,124,434	329,237,810	3,290,362,244	90
2005	2,976,694,772	203,565,365	3,180,260,137	94
2006	3,244,035,539	171,684,045	3,415,719,584	95

Source: www.thedti.gov.za

Kenya, however, is also one of South Africa's largest trading partners on the continent outside SADC.

Table 9: South Africa's 10 Largest African trading partners (excluding BLNS) — 2006		
Country		***Total trade ZAR millions***
1	Nigeria	13,287,023,000
2	Zimbabwe	12,043,970,000
3	Zambia*	9,827,214,000
4	Angola*	7,225,300,000
5	Mozambique*	6,559,035,000
6	**Kenya**	**3,415,720,000**
7	Tanzania*	3,070,613,000
8	Malawi*	2,217,627,000
9	Ghana	1,818,607,000
10	Gabon	1,460,361,000

* SADC member states
\# BLNS states (Botswana, Lesotho, Namibia and Swaziland)
Source: *www.thedti.gov.za*

Kenyans feel 'aggrieved' at the trade imbalance between South Africa and Kenya, and complain that while they are not given greater access to the South African market, South African firms keep exporting goods to Kenya.[75] Indeed, some Kenyans accuse South Africa of flooding its market with cheap goods, while imposing tariffs and other barriers that prevent Kenyan products from entering South Africa. One of the people interviewed noted, 'South Africa should take a good look at its trade relations with Kenya. Specifically, they should talk to Kenya about tea and stop acting like the European

[75] Interview, February 2005.

Union. We have to open up our barriers to trade on this continent'.[76]

The trade imbalance between South Africa and Kenya is merely part of a concern shared by many countries in the rest of Africa about South Africa's economic pre-eminence. Daniel, Naidoo and Naidu point out that 'of South Africa's R20,3 billion trade with the member states of SADC in 1999, R17,7 billion were exports to the region. This is an imbalance of almost 7:1'.[77] South Africa's total trade with the rest of Africa in 2001, excluding the South African Customs Union (SACU) countries, amounted to $856 million in imports and $3,7 billion in exports, an imbalance of nearly 5:1.[78] But while South Africa enjoys a trade surplus with most African countries, and most trade balances remain in South Africa's favour, it is important to note that the gap is narrowing. After 2001 the balance in South Africa's favour dropped from 5:1 to 4:1 in 2003, and 3:1 in 2004.[79] The influx of goods from Asia and the strengthening rand have also contributed to a decline in exports to the rest of the continent. This shrinking trade imbalance, however, does not apply to Kenya.

The situation is made more complex because Kenya lies just outside the ambit of the trading blocs that South Africa favours. For example, should South Africa import its soda ash

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[76] Interview, March 2005.

[77] Daniel *et al*, *op. cit.*, p.376.

[78] *Business Day*, 17 April 2002, quoted in Daniel *et al*, *ibid*.

[79] Daniel, J & J Lutchman, 'South Africa in Africa: Scrambling for energy', in *State of the nation: South Africa 2005–2006*, Buhlungu, S, Daniel, J, Lutchman J & R Southall (eds), Human Sciences Research Council, 2005, p.487. This downward trend continued in 2005. South Africa exported goods to the value of R46 billion to the rest of Africa, and imported goods worth R16 billion from Africa. Source: *www.dti.gov.za*.

from Kenya, when it can get it from Botswana? During a three-day visit to South Africa in 2003, the Kenyan minister of trade, Mukhisa Kituyi, was quoted in the South African media as having said:[80]

> we are all hostage to regional trade blocs. Preferential market access by the other SADC countries is an inhibition to the growth of bilateral trade between Kenya and South Africa…There are limits to how much preferential market access you can negotiate when you're in rigid trade blocs.

The existence of different regional trade groupings can indeed complicate trading relations. However, it seems that South Africa may choose to import soda ash from Kenya, given that this country is a large consumer, and Botswana cannot produce sufficient of this commodity to meet South Africa's needs. It is possible that soda ash may provide the stimulus to regularise trade relations between Kenya and South Africa.

A specific worry for Kenya is that South Africa is emerging as 'supplier of choice'[81] to Kenya's neighbours, as the table below shows. This competition for markets in East Africa has been driven by trade liberalisation in SADC. The Community's 14 members include South Africa, the Democratic Republic of Congo (DRC), Tanzania and Zambia. However, Kenya also faces competition from global players.

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[80] Quoted in 'Kenya calls on South Africa to lower its tariffs', *Business Report*, 7 August 2003.

[81] United Nations *Investment Policy Review: Kenya*, *op. cit.*, p.20.

Table 10: Market share in the imports of seven of Kenya's neighbours: Congo, Ethiopia, Rwanda, Sudan, Tanzania, Uganda, Zambia (% of imports originating from the listed country, period average)			
Country	***1994–1996***	***1997–1999***	***2000–2002***
Kenya	8.5	7.9	7.7
China	2.2	4.4	5.5
Egypt	1.8	0.9	1.2
India	4.2	4.6	4.7
South Africa	6.2	11.7	14.5
Source: UN COMTRADE, data from importing countries			

Box 3: South Africa's trade with the rest of Africa: How East Africa fits in

South Africa's economy is inextricably linked with that of Africa as a whole. Prosperity and stability in the rest of Africa is in South Africa's own national interests. Establishing regional linkages might also contribute to an overall strategy of building greater strength to counter Africa's economic marginalisation in the global economy. This is important since, as Stephen Gelb points out, 'most African states are ill-equipped to address the particular challenges posed by globalisation, making a strong case for collective action by states'.[82]

In terms of trade, South Africa and Kenya are apparently 'warming' towards each other. This is a positive development. Africa's share of global trade is smaller today than it was 25 years ago. The IMF notes that[83]

> during 1994–2002, the average share of South Africa in the rest of Africa's external trade rose to three times its 1970–1993 average, but it was still only 2% of the total. As a percentage of GDP, the rest of Africa's trade with South Africa during 1994–2002 rose to four times its 1970–1993 level, but was only equivalent to 0,5–1% (of Africa's) GDP.

The share of South Africa's intra-African trade stood at 9.6% in 2003, which, 'though an improvement from previous years, is a meagre figure'.[84] A stronger emphasis should be placed on greater intra-African trade, as a way of driving sustainable economic growth on the continent.

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82 Gelb S, *op. cit.*, p.3.

83 Quoted in Stoddard E, 'SA's economic growth shows way for the rest of Africa', *Business Day*, 11 May 2005.

84 Quoted in *What Zimbabwe's continuing crisis means for South African Business*, Map Foundation, 24 June 2005.

Box 3: South Africa's trade with the rest of Africa: How East Africa fits in (continued)

South Africa would do well to follow this principle by improving its relationship with Kenya. The focus has to be on partnership rather than economic competition between these two relatively big economies in Africa. Greater engagement between Kenya and South Africa should be promoted, and the nuisance factors ameliorated. Better terms of trade and greater volumes of Kenyan–South African transactions are in the continent's interest, and should be embraced energetically by South Africa.

However, some repair work may be necessary. One interviewee reported his impression that Mbeki tended to ignore East Africa and that he seemed more inclined to concentrate on Nigeria. Several others recalled that in 1999 Mbeki had landed at Jomo Kenyatta airport because the aeroplane carrying him to another destination had been diverted there. When members of the Kenyan parliament heard he was at the airport, they went there to meet him. However, since President Mbeki had not been scheduled to visit that country, he remained on board the aeroplane, a move that was seen as an affront by some Kenyans. 'The Kenyans felt slighted',[85] commented an interviewee.

Foreign direct investment: On the 'moving out' side of the equation

For years, Kenya was the model of a market- and business-friendly African environment, one in which investors' money was safe. The principal regulations were contained in the Trade Licensing Act of 1968 and its subsequent amendments. Apart

[85] Interview, March 2005.

from this, the only formal limits on foreign ownership were in the telecommunications and insurance sectors (in which the foreign share of a business was limited to 70% and 77% respectively), and for companies listed on the Nairobi Stock Exchange, which required that for a firm to be listed, Kenyans should own at least 25%.[86]

During the 1970s FDI grew steadily, because Kenya was a prime choice for foreign investors seeking to establish a presence in Eastern and Southern Africa. Kenya has attracted foreign investors in banking and professional services in particular. Companies such as Deloitte and Touche, Ernst and Young and KPMG have based their main East African operations in Kenya. The country often serves as the regional hub or services centre of multinationals. Many maintain the head offices of their East African operations in Kenya, even when they move their production lines elsewhere. This is the case with Colgate-Palmolive, Old Mutual, and Deloitte.

According to data supplied by the United Nations Conference on Trade and Development (UNCTAD), more than 200 transnational corporations (TNCs) are represented in Kenya. British firms constitute the largest group. The most long-standing of these investors include Barclays, Standard Chartered, BAT, and CDC Capital Partners. The market value of US investment, which focuses primarily on commerce, light manufacturing and the tourism industry, is estimated at around $285 million. Major US investors are General Motors, Eveready Batteries, Colgate Palmolive, Sara Lee and Wrigley. Although participation from Far Eastern countries, including China and Japan, is currently small, it is increasing.

Thirteen of the 43 banks in Kenya are foreign, and control 51% of the total banking assets in the country. The largest are

[86] United Nations *Investment Policy Review: Kenya*, *op. cit.*, p.24.

Barclays (UK, 21%), Standard Chartered (UK, 14%), Citibank (US, 7%), and Stanbic (South Africa, 2%). Forty percent of Safaricom is owned by Vodafone of the UK, and 60% of Kencel is currently held by Celtel of the Netherlands (which purchased Vivendi's participation in 2004).

FDI into Kenya was approximately $10 million a year in the early 1970s, before peaking at $80 million in 1979–1980. Inflows in the period 1981–1999 averaged $22 million a year. The sale of mobile telephone licences to Kenyan–foreign joint ventures pushed FDI to over $100 million in 2000, but investment fell down to the average of the 1980s and 1990s ($22 million) before rising again in 2003 on the back of textile investments in export processing zones (EPZs). However, according to the UN *Investment Policy Review*, these gains 'may not prove sustainable'. [87]

An overview of recent FDI trends and performance makes some critical challenges clear. The stock of FDI into Kenya, says UNCTAD, was only 7,5% of GDP in 2003, compared with 25.3% for Africa as a whole, and 31.5% for developing countries.[88] FDI inflows represented only 2.4% of gross fixed capital formation, compared with 11.4% for Africa and 12% for all developing countries.[89] In 1996–2003 FDI averaged $39 million a year, while in comparison inflows into Tanzania and Uganda jumped to $280 million and $220 million respectively, after having maintained negligible levels in the 1980s.

[87] *Ibid*, p.5.

[88] *Ibid*.

[89] *Ibid*, p.15.

Table 11: Comparative performance of Kenya with selected countries, 2003		
Country	***FDI stock- Per capita (dollars)***	***Percent of GDP***
Kenya	31.7	7.5
Botswana	540.0	14.6
Lesotho	213.5	38.0
Mozambique	96.9	42.6
Namibia	587.8	39.1
South Africa	675.0	18.5
Uganda	78.5	32.9
U.R. of Tanzania	68.0	26.8
Zambia	212.9	55.2
Comesa	136.7	29.4
Africa	196.5	25.3
Africa excl South Africa	169.8	27.6
Developing countries	449.7	31.4
Source: UNCTAD FDI/TNC Database		

Overall, Kenya ranked 129th out of 140 countries on UNCTAD's FDI performance index in 2001–2003, representing a slight slippage from its 126th listing in 2000–2002. It is sandwiched between Rwanda and Nepal on the index, and is some way behind the rankings for Uganda (35th) and Tanzania (47th). (The performance index is calculated as the ratio of a country's share of global FDI flows to its share in global GDP.) Kenya has not done better than 111th at any time since 1990.[90] Although its average annual level of FDI inflows doubled between 1981–1985 and 1996–2003, the average influx to African countries was multiplied by six, while the mean for developing countries as a whole increased to almost tenfold.[91] The decline in FDI

[90] *Ibid*, p.5 and World Investment Report 2006, FDI from Developing Countries and Transition Economies: Implications for development, UNCTAD, Geneva, 2006.

[91] *Ibid*, p.6.

inflows into Kenya continued from 2003 onwards, registering $82 million (2003), $46 million (2004) and $21 million (2005).

Despite having a relatively small share in the country's economy, foreign investors have played an important role in Kenya, most significantly in horticulture, the airline industry and mobile telephony.[92] The auction of two mobile telephone licences in 1999 and 2000 led to the rapid build-up of the necessary infrastructure, which was financed in part by foreign investors. The auctions and the competition they generated in mobile telephony generated a dramatic increase in the availability and quality of telecommunication services. The number of users reached 3 million in 2003, when mobile phone subscriptions outnumbered those for fixed line connections by six to one.[93] Again, foreign banks were instrumental in reducing the financial burdens faced by local corporate and retail borrowers. In addition, the rise in foreign investment in labour-intensive garment production has boosted employment in Export Processing Zones to 35,000 jobs, counting the nearly 12,000 additional ones created indirectly by sub-contracting.[94]

It is problematic that investor perceptions of Kenya have become negative. The World Economic Forum's *African Competitiveness Index* places Kenya near the bottom of its list in terms of economic governance and country risk rating. The country's *Institutional Investor Index* ratings have fallen nearly 50% since the end of the 1980s,[95] and MNCs reported a 25%

[92] *Ibid*, p.24.

[93] *Ibid*, p.15.

[94] Ibid, p.17.

[95] Quoted in Regional Programme on Enterprise Development, *op. cit.*, p.3.

decrease in turnover in 2003.[96] It is fair to say, as UNCTAD has done, [97]

> By and large, Kenya has been left out of the global surge in FDI flows that started in the mid and late 1990s and benefited its neighbours in the East African Community, as well as much of Africa and the developing world…. While Kenya was a prime choice for foreign investors seeking to establish a presence in Eastern or Southern Africa in the 1960s and 1970s, poor economic policies or inconsistent efforts at structural reforms, rising problems of corruption and governance, and the deterioration of public services have discouraged FDI since the 1980s.

The table below shows a perception that Kenya is performing poorly on a number of indicators relative to its neighbours. It is paying more bribes and is hobbled by more restrictive regulations.

[96] 'Dirt out, cash in', *The Economist*, 27 November 2003.

[97] United Nations *Investment Policy Review: Kenya*, *op. cit.*, p.1.

Table 12: Perceptions of barriers to investment in selected countries*

Indicator	*Kenya*	*Tanzania*	*Uganda*	*India*
Corruption	73.8	51.0	38.2	37.4
High cost of finance	73.3	57.8	60.3	20.2
High crime level	69.8	25.4	26.8	15.6
High tax rates	68.2	73.4	48.3	27.9
Anti-competition	65.3	24.3	31.1	17.5
Policy uncertainty	51.5	31.4	27.5	20.9
Macroeconomic instability	51.3	42.9	45.4	16.1
Poor tax administration	50.9	55.7	36.1	26.3
Unreliable electricity supply	48.1	58.8	44.5	28.9
Inadequate telecommunications	44.1	11.8	5.2	5.3
Lack of access to finance	44.1	48.3	45.0	18.3
Poor/corrupt customs administration	39.9	31.4	27.4	14.0
Deficient transportation	37.4	22.8	22.9	12.4
Low skills in workers	27.6	25.0	30.8	12.4
Insufficient access to land	24.6	24.6	17.3	9.0
Inadequate/restrictive labour regulations	22.5	12.1	10.8	16.7
Delays in business licensing	15.2	27.4	10.1	13.4

* *Percentages refer to proportions of firms indicating severity of problem*

Source: World Bank Investment Climate Surveys, 2004

Tanzania and Uganda, two of Kenya's neighbours, started to reform their economies and open them up to foreigners in the 1990s, and have been engaged in progressive catch-up operations. UNCTAD argues that developments in South Africa have also prompted competition to attract large TNCs seeking to establish a single production base or headquarters in Anglophone Africa.[98] Manufacturing groups have consolidated their production centres. For example, Procter and Gamble moved its detergent production line to Egypt in 1999, and Johnson and Johnson transferred its factory to Zimbabwe in 2000. Colgate Palmolive has been gradually phasing down its operation in Kenya while maintaining support services for the region in Nairobi. Other reasons for the outflow of FDI may have been that investors were no longer influenced by the political dynamics of the Cold War, which encouraged a corporate presence in Africa; or that investors had become disillusioned with the poor state of infrastructure and high levels of corruption in Kenya.

The UNCTAD review notes that Kenya has in general featured on the 'moving out' side of the equation rather than the 'moving in' side, as a result of its relatively high operation costs.[99] There is a 'worrying trend of foreign investors moving out…of Kenya, with few new investors coming in or existing investors planning significant expansion'.[100] South African investors were and are among the new entries, even though many South African firms are still investing predominantly in Europe, the US and Asia.

It is possible that South African expansion into Kenya appeared more threatening to the Kenyans than it really was,

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[98] *Ibid*, p.5.

[99] *Ibid*, p.6.

[100] *Ibid*.

perhaps because this expansion happened against the backdrop of disengagement on the part of many other investors. John Daniel and Jessica Lutcham note, [101]

> This Western withdrawal from Africa coincided with South Africa's post-1990s 'discovery' of the African market… What this meant is that for the best part of the decade 1994–2004 not only was South Africa the 'new kid on the block' in the African marketplace, it was also frequently the 'only show in town'.

While Kenya has not attracted the share of global FDI that it might have, the *Economist Intelligence Unit* describes Kenya as 'one of the most rapid improvers, although absolute levels of FDI remain low'.[102] This view is based on the swift increase in FDI inflows into Kenya recently, from a low of $5 million in 2002 to $82 million in 2003 (apparently figures that both UNCTAD and IMF agree on). Kenya cut duties on all soft drinks from 15% to 10% in its 2004–2005 budget, and in 2006 it was reported that Coca Cola plans to invest $135 million in Kenya over the next five years, although the full details have not yet been revealed. Also, Coca Cola apparently plans to transfer its East and Central African headquarters from London to Nairobi, which is a positive move for Kenya.

This ability to bounce back, combined with the robustness of the Kenyan private sector, is an important attribute. While performance in terms of attracting investment has been below its potential, Kenya still has considerable strengths as an investment destination. These include its human resource base; being party to various preferential trade agreements; location; its land; and its climate. The last two features offer decisive advantages in certain agricultural sectors and in tourism.[103]

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[101] Daniel & Lutchman, *op. cit*., p.492.

[102] *Kenya Country Report:*, 2004, *op. cit.*, p.32.

[103] United Nations *Investment Policy Review*, *op. cit*., p.23.

Box 4: Investment Promotion Bill

At the end of 2004 a restriction was introduced into one of the most open FDI regimes in Africa when Kenya imposed a minimum capital requirement on all foreign investors by passing the Investment Promotion Bill, which had been in preparation for several years, and had involved substantial negotiations. As an interviewee said, [104]

> It was important to pass a law so that investors know what is expected of them, to create a conducive environment for FDI. There are so many regulators in different sectors, they give licences and approvals. They have their own rules and regulations, they might not necessarily have the interests of investors at heart and act in a manner contrary to the spirit of attracting investment. We needed to harmonise our rules and regulations.

This sounds sensible, but the Bill in its original form also introduced a mandatory investment threshold and a strict screening procedure for all foreign investments.

The proposed Act also made a formal distinction between domestic and foreign investors, and required the latter to apply to the newly-established Kenya Investment Authority (KIA) for an Investment Certificate.[105] Conditions that had to be met before such a certificate was granted were:

- the amount invested must be at least $500,000, or the equivalent in another currency; and
- the investment must be deemed by KIA to be to the benefit of Kenya. The criteria in this category are the creation of employment for Kenyans; the transfer of new skills or technology to Kenyans; and the prospect that the investment will make a substantial contribution to Government revenues.

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[104] Interview, March 2005.

[105] The mandatory Investment certificates and minimum capital requirements for foreign investors and reporting obligations for domestic investors serve two main purposes. These are to improve weak data collection on domestic and foreign investment, and to ensure that entitlement to work permits for foreigners, granted as an incentives to holders of Investment Certificates, is not used to bring in foreign workers illegitimately.

Box 4: Investment Promotion Bill (continued)

Other factors, such as the contribution an enterprise can make to foreign exchange earnings or its utilisation of domestic inputs, were also taken into account, but were not essential requirements.

A minimum capital investment for domestic companies seeking an Investment Certificate was introduced at $65,000. They were expected to fulfil the same requirements as foreign firms to be deemed 'beneficial to Kenya'. Under the Act, an Investment Certificate entitles the holder to be issued a wide range of licences for an initial period not to exceed 12 months, pending the acquisition of actual licences within 12 months. Holders of Investment Certificates are also allowed six work permits for expatriates.

The Investment Promotion Act transformed the Investment Promotion Centre into the KIA, and instituted the National Investment Council (NIC) as an advisory body. The latter will be chaired by the president (or a designated minister) and is to comprise 23 members, 11 of whom will be government appointees and 12 representatives of the private sector. The objectives of the NIC include:

- identifying areas of impediment to economic development and investment;
- reviewing the economic environment and proposing incentives for investment;
- monitoring industrial development; and
- promoting co-operation between the public and private sectors in the formulation and implementation of economic policy.

According to the UN *Investment Policy Review*, however, FDI projects registered by the Investment Promotion Centre between 2000–2004 show that 74% of all projects, representing 21% of foreign capital investment, were valued at less than $500,000. Under the proposed Investment Promotion Act, these projects would not meet the legal conditions.[106] The authors pointed out that the minimum capital requirement was likely to put a brake on Kenya's ability to attract small-scale

[106] United Nations *Investment Policy Review*, *op. cit.*, p.26.

investment, for example in the services sector. This made the government's reasoning difficult to understand as it also seemed to contradict the Economic Recovery Strategy of 2003, a key principle of which was improving the investment climate. ('We are determined to create a friendly affordable environment for investment and doing business in Kenya.') After much lobbying by the business community the Kenyan Parliament amended the act doing away with the requirement that foreign investors required a certificate before investing and also reducing the minimum amount for foreign investment.[107]

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[107] See 'Kenya amends act in favour of foreign investors', *The Nation*, 7 November 2005.

South African Companies in Kenya — Challenges and Experiences

While the main sources of FDI into Kenya continue to be the country's traditional partners (the UK, Germany and the US), South Africa has begun to compete for a larger share of investment in the country. According to the South African Department of Foreign Affairs, South Africa invested approximately $450 million in Kenya in 2001–2002.[108] Standard Bank has a strong presence there with four branches and four outlets nationwide. The life assurance companies Old Mutual and African Life are also well-established in Kenya. Some of the South African companies currently operating in the country include include Nandos, Holiday Inn, Protea Hotels, Alexander Forbes, Bell Equipment, Multichoice, Nampak, Media 24, Woolworths, Truworths and Engen. There are seven Steers and four Debonairs outlets; and South Africa's wine and fruit juice industry has also made its presence felt.

South African companies have expanded into Kenya for strategic reasons, and because it offers favourable profit margins. Given the existing saturation in the local market, firms based in South Africa were eager to use their operations in Kenya to expand into the larger markets offered by not only that country but other parts of East Africa. Equally important to most South African investors is Kenya's strategic location on the tip of East Africa. As one interviewee remarked: 'If you want to be in East Africa, you have to have a presence in Kenya. It is still the leading economy in that region.'[109] It is regarded as, a 'stepping stone' or 'huge springboard' to other countries in the

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[108] South African Department of Foreign Affairs, *Kenya Country Profile*, 19 January 2005, p.16.

[109] Interview, March 2005.

region, particularly Tanzania and Uganda given its close proximity to both countries. Other advantages are Kenya's deep-sea port and well-developed airport.

One company representative regarded expansion from Kenya into neighbouring countries as attractive not only because it would increase the market for the firm's products, but because a single senior staff member could co-ordinate all the personnel training in skills and management required by their operations in East Africa, from Kenya. Both pooling of resources and cross-selling were considered by this company to be very important success factors.[110]

However, many businesses have entered Kenya following their clients. A representative of a South African bank pointed out the importance of developing a broad retail depositor base that could meet the needs of corporate borrowers.

South African companies face stiff competition in Kenya's relatively developed market. However, many interviewees in the insurance broking and financial services fields noted that their major competitors were international, not Kenyan, businesses. One South African company that deals in pension schemes, a specialised area of insurance, did enjoy a competitive edge over other international players. Most South African companies outside this sector, however, see other South African companies as rivals, but three of the businesses from this country identified their major source of competition as coming from Kenya's informal sector. But at least two of the companies consulted in the course of this research reported that it is the high level of competition from established local businesses in a smaller market than South Africa's that are the strongest deterrent to starting operations in Kenya.

[110] Interview, March 2005.

The majority of South African investments in Kenya are the result of acquisitions and mergers, but franchises offered another convenient investment vehicle for six of the companies consulted. Only two South African firms who participated in the interviews were greenfield operations.

As far as the relative profitability of investments in Kenya were concerned, most of the business representatives interviewed reported that the contribution made by their Kenyan operations to their parent company's earnings was small — no larger than 10% on average. Queries as to the expansion plans of firms with a foothold in Kenya tended to elicit a wide range of responses. One company had recently shut up shop; another had reduced its share to a passive 20% share, with the remainder held by a Kenyan 'partner'. Two investors said they would not consider expansion at this point, while three were in a phase of consolidation or refurbishment rather than expansion. In contrast, the majority of those interviewed stated that their firms were considering expanding their operations in the near future, as they become more familiar with, and confident about, operating in Kenya. They stressed that with the right approach and products, doing business in Kenya could be a fruitful and rewarding experience for any foreign investor. This last group also said that their companies intended to use the country as an entry-point to the rest of region.

How investor-friendly is Kenya?

The overall findings reflect a mixed set of responses and experiences on the subject of doing business in Kenya. The majority of interviewees felt that Kenya was 'reasonably' welcoming to foreign investors. Among the individual comments were that Kenya was more investment-friendly, had a more open market and was generally more accessible than most countries in East, West and North Africa (excluding Zimbabwe and Botswana) in terms of the logistics of setting up and opening their stores. For example, three to four months on average were needed to obtain council approval for land and buildings, whereas in Nigeria these processes can take up to two years.[111]

Whereas a Ugandan businessman about to invest in Kenya saw the country as very investor-friendly, a Kenyan interviewee cautioned that South African companies are not particularly welcome in his country. The context of this observation is that Kenya is accustomed to being the dominant business force in East Africa, and some Kenyans suspect that South African companies intend to usurp this role. This may explain why one South African interviewee described the investment environment as somewhat bruising, even 'shocking', leading to the conclusion that 'foreign business is definitely not welcome in Kenya'. Another respondent commented that although the Kenyan government encourages foreign investment, the way that officialdom treats visitors undercuts this and is not desirable.[112]

There was a wide discrepancy in the views respondents expressed on whether or not Kenya is friendly to foreign investors. One analyst pointed out that the country is not as accessible to foreign investors in general as Tanzania and Uganda; some interviewees noted that British investors are more welcome than South Africans. Others emphasised that

[111] Interview, March 2005.

[112] One interviewee also pointed to an unfortunate tendency to xenophobia, which was also to be found in Kenya. Interview, March 2005.

foreign investors are well received as long as they have Kenyan partners and show respect for the locals.

Those surveyed expressed a variety of views on whether South African products were faring well in Kenya. There was a marked difference between the opinions of competitors and those of consumers. A Kenyan analyst noted that the typical Kenyan consumer does not mind the increased choice and competition that South African goods (and indeed those of investors from other countries) bring into the Kenyan market. The hostility that South African firms encountered stemmed largely from local competitors in the same field or entrenched interests.[113]

However, some South African companies have been sufficiently discouraged to throw in the towel. An interviewee explained, [114]

> we shut up shop because we did not make money, we were unsuccessful. We found Kenya an extremely hostile environment in which to operate, blatantly anti-South African. There wasn't any real commitment to help the new entrant in Kenya, in fact the opposite.

On the other hand, this respondent admitted that the reason for closing down its operations fell very squarely on the company's business model, which had not been adapted sufficiently to the Kenyan market, and unwise business decisions. The interviewee also made it clear that the enterprise he represented was withdrawing from Kenya in such a way that it would be well-positioned to re-enter that country's market if it chose to do so at some time in the future.

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[113] Interview, March 2005

[114] Interview, February 2005

Unpacking some of the negative perceptions on both sides

While Kenyans are ready to admit that South Africans are seen as 'good at business', the majority of Kenyan interviewees objected to both the South African business approach and the way in which South African companies tend to sideline local players. They described South Africans as brash, arrogant and selfish, with their eyes fixed only on the bottom line. On the other side, a South African interviewee conceded that perhaps companies from this country are overzealous about the South African brand.[115]

However, several South Africans also complained that they had been badly let down by local players, often at the last minute, quoting as an example that MTN's negotiations with Vivendi regarding its buyout of its shares were conducted in ignorance of the fact that a different company, Sameer, had a pre-emptive option on those shares. The Celtell people continued their secret dealings with the Sameer group. MTN realised they were talking to the wrong people only shortly before the deal was finalised.

Interviewees from both countries also referred to Kenyan pride. A Kenyan interviewee summed it up: 'Kenya is a very patriotic nation despite tribal differences.

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[115] These references to the engagement of South African companies in Kenya are somewhat unfairly coloured by the unceremonious departure of SAB from Kenya after four years, following its bitter clash (known as the beer wars) with East Africa Breweries for market share. Billboards were blacked out and Kenyans pushed the slogan 'my country, my beer'. When Kenya Breweries tried to establish their beer in South Africa under the Tusker brand they encountered all sorts of legal obstacles preventing them from selling their product.

We're basically arrogant.'[116] This characteristic entails a clear attitude toward entrants into the Kenyan market: they should not behave as though they have all the answers. 'There's a lot of pride in Kenya, they will follow a principle even if it brings with it financial ruin.'[117]

What emerges from the series of interviews is that a significant mistake made by those South African companies that have encountered resistance in Kenya was that they misunderstood the depth of the market, the business acumen of Kenyan companies, the loyalty to local brands and the level of competition. South African firms have to accept that in many respects they are coming into an economy where businesspeople are just as knowledgeable as they are.

One South African noted that although doing business in Kenya is challenging, it is also rewarding if the enterprise concerned maintains a low profile. 'If you're too successful here, you get nailed. The key to success is to look for the right kind of partnerships and people. Most important here is that you respect the locals.'[118]

Some of the more successful South African companies have chosen to partner with local firms, and tend to operate in sectors where Kenyan competition is not strong. One company pointed to the importance of having the right management team in place. Other factors that were identified as important to success in the Kenyan business environment were for a company to have a sophisticated corporate social investment programme, and for it to employ local sources to supply, service and repair its equipment, rather than look to South Africa to meet these needs.

[116] Interview, March 2005.

[117] Interview, March 2005.

[118] Interview, March 2005.

Several South African businesses, however, have opted to choose Tanzania over Kenya. According to one interviewee, over the last five years, at least, Tanzania has won the lion's share of investment into East Africa.[119] Many Kenyans refer to neighbouring Tanzania as 'little Jo'burg' because of the predominance of South African companies there. Indeed, in view of more attractive options elsewhere on the continent, many South African companies may look outside the Kenyan market towards more investment-friendly destinations.

Main constraints on doing business

South African companies entering Kenya, in common with other foreign investors, face a number of hurdles. These include an ineffective civil service, corruption, high crime levels – although not as high as in South Africa - and insecurity, and over-regulation of business. Although some of the members of South African firms consulted in the course of this study pointed to political instability and fragmentation along tribal lines as causes for concern, most of them readily admitted that Kenya has not yet seen the political turmoil prevalent in other African states, especially those in the East Africa region.

However, the South African respondents concurred that the main factor retarding investment and the development of the private sector in Kenya is the failure of the Kenyan government to improve key infrastructure. Investor surveys consistently draw attention to the poor and deteriorating quality and high cost of backbone services, including telecommunications, electricity and transport. These constitute major obstacles to the country's international competitiveness.

[119] Interview, March 2005.

Backbone services

Infrastructure is one of the Kenyan government Economic Recovery Strategy's (ERS) priority areas. The ERS outlines concrete plans to improve road and rail transport, maritime and inland waterways, telecommunications and the energy supply. Funding is not the problem; the government announced in its 2005–2006 budget speech that resources allocated to physical infrastructure will increase by 86% over the next three years.

The ICA survey found that Kenyan firms' opinion of infrastructure services was extremely low. Roughly half of all firms rated the poor quality of electricity, transport, water and telecommunications provision as a major constraint on their business operations. The number of firms dissatisfied is higher than that recorded for Uganda and Tanzania.[120] There is also evidence that the state of infrastructure services contributes significantly to the high cost of doing business in Kenya.

Kenyan firms move goods by road because the state-owned railways, though cheaper, invariably deliver late, if at all.[121] The principal source of discontent with transport infrastructure appears to be the dramatic deterioration in road quality.[122] About 90% of the investors who participated in the World Bank's investment climate survey in 2004 rated the quality of roads and public works as 'bad' or 'very bad', placing Kenya in a much poorer position than Tanzania and Uganda, and dramatically worse than Egypt and South

120 Regional Programme on Enterprise Development, *op. cit.*, p.60.

121 'Where graft is merely rampant', *The Economist* 16 December 2004.

122 Regional Programme on Enterprise Development *Enhancing the competitiveness of Kenya's manufacturing sector: The role of the investment climate* November 2004, p.60.

Africa.[123] In 2002–2003, 2.5% of the country's export cargo was rejected or discounted owing to spoilage attributable to transport delays.[124] The shoddy condition of roads (the result of lack of repairs) increases vehicle costs and wastage of fresh produce. The ICA survey found that 24% of firms reported spending resources on improving roads surrounding their operations.

Improvement in the road system in Kenya is made particularly important by the need its landlocked neighbours have for easier access to its ports. Another reason for upgrading roads and building new ones is that the livelihoods of the rural poor could be made more secure, for example by enabling smallholders to get their produce to markets more efficiently. Another difficulty pertinent to the question of roads is the problem of traffic congestion in the urban centres, especially Nairobi. One South African interviewee reported that a journey of only 20 kilometres from the airport to the nearest hotel could take as long as two hours.[125] The *Urban Public Transport Survey*, which analysed 16 key intersections in Nairobi based on traffic counts, found that the costs of the inefficient operation of the intersections amounted to approximately 5% and 20% of the annual recurrent and development expenditures respectively, and 1.8% of Kenya's GDP.[126]

The Mombasa port also requires upgrading. According to the *United Nations Investment Policy Review*, the port's facilities are not capable of keeping up with the rapidly growing

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[123] Quoted in United Nations *Investment Policy Review: Kenya* Unedited advance copy, 2005, p.69.

[124] Regional Programme on Enterprise Development , *op. cit.*, p.v.

[125] Interview, March 2005.

[126] Kippra, *op. cit.*, p.73.

demands placed on them by international companies. Garment producers, for example, report that a three-day advance notice is required to secure export handling. Investors also expressed concerns about delays in clearing customs and the integrity of the process. However, respondents reported that the majority of delays occur in the import process, which currently requires 10–15 days.[127] Port productivity is estimated at a third or a half of the international norm, and perhaps six times as costly,[128] given that unloading a shipment at Mombasa is likely to be six times that charged at Felixstowe in the UK. While customs clearances were reduced to roughly 10 days in 2003 (as compared with over 20 in the mid-1990s), the management of the port authority estimates that the process could be retarded by up to six days by time required for clearances and paperwork.[129] The paper-based system in current use also leaves openings for officials to exercise discretion, which opens opportunities for extortion.

There is little doubt that electricity supply is one of the most problematic infrastructure-related issues in Kenya, not only for foreign investors but also for Kenyan businesspeople and entrepreneurs. Ageing equipment results in power outages and surges, which create not only uncertainty but quite specific damage in a number of cases. The existing electric supply network is predominantly hydro-based, which exposes Kenya to power shortages in times of drought. According to the ICS, on average 21% of total energy produced is wasted through failures in transmission and distribution.[130] The ICA study also notes that firms lost nearly 10% of sales to power outages,

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[127] United Nations *Investment Policy Review: Kenya*, op. cit., pp.52–53.

[128] Regional Programme on Enterprise Development, *op. cit*., p.v.

[129] *Ibid*, p.62.

[130] *Ibid*, p.63.

and surges had caused irreparable damage to capital equipment in two-thirds of companies. This is relatively high in regional terms. Comparable figures (for sales and equipment losses owing to electrical problems) stand at 5% in Tanzania and zero in Uganda.[131] Further, the average manufacturing firm in Kenya lost more than 9% of output because of power failures, experienced 33 outages per year, and also suffered from high voltage fluctuations.[132] Electricity hook-ups and usage charges are also very costly relative to those prevalent in other parts of the region,[133] The cost of electricity is apparently four times that of South Africa.[134] Again, Kenyan firms report that it takes more than two months to obtain a new electricity connection, roughly twice the time required in Uganda. Seventy percent of firms own one or more generators, a higher number than those required in the other countries listed in the ICA survey.

The country is also poorly served as far as fixed line telecommunications are concerned. Foreign investors frequently complain about the low density of landlines, insufficient distribution of coverage, over-pricing of telephone calls and excessive delays in having telephones installed (which the ICA estimates as taking on average 124 days).

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[131] *Ibid*,

[132] *Ibid*, p.3.

[133] *Ibid*, p.vi.

[134] Kippra, *op. cit*, p.70.

Table 13: The cost of Telkom Kenya services in 2002		
	Telkom Kenya	***OECD average***
Monthly rent	$3.64	$15-20
Local call per minute	0.7cents	3-5 cents
Long distance call per minute	40 cents	10 cents
International call per minute	$2.50	10–30 cents
Source: Country Economic Memorandum, from World Bank database		

In Kenya Internet access is relatively costly and of poor quality, owing to the inadequate performance of Telkom Kenya. Moreover, broadband Internet access is reported as being limited and highly priced, with a 1 024 bps (downstream) ASDL connection costing around $500 per month. (Rates for comparable services are charged at about $100 per month in South Africa, $30 in the US and $20 in France.)[135] Mobile telephones offer better telecommunication services, but continue to be expensive, especially for local entrepreneurs.

More than half of all firms surveyed in the ICA study rated water services as poor, very poor or not available. Extending lines from the main water distribution grid to the development site is currently the responsibility of the company, which is required to pay a connection deposit that may cost as much as $3 850.[136] Another source of concern is that water pollution has increased. A South African firm in the fast food industry reported that filtering water — a key requirement for the

[135] United Nations *Investment Policy Review: Kenya*, *op. cit.*, p.49.

[136] Regional Programme on Enterprise Development, *op. cit.*, p.66.

operation of his company — cost his operation between $4,000–5,000 per month.[137]

Many firms also reported having had to dig their own wells apart from repairing the roads adjacent to their operations, as the provision of public services like roads, water and electricity have been poor or unpredictable.[138]

Table 14: Infrastructure indicators

	Kenya	**Uganda**	**Tanzania**	**S. Africa**
Telecommunications				
• Cost to USA per 3 minutes ($)	3.75	3.51	5.28	0.58
• Tel faults per 100 mainlines per year	220.90	-	24.00	48.20
• Prepaid cellular tariff per minute (local call peak, $)	0.20	0.19	0.25	0.27
Utilities				
• Electricity charge per kwh (business use, $)	0.08	0.08	0.06	0.03
• % of production lost to power outage (survey of investors	9.30	6.30	9.20	-
• Transmission and distribution losses (%)	21.30	-	25.00	8.20
• Water charge (per cubic metre, $)	0.51	0.93	-	0.72
Source: UNCTAD, *Investment Policy Review, Kenya, 2005*				

[137] Interview, March 2005.

[138] Regional Programme on Enterprise Development, *op. cit.*, p.3.

Part of the inefficiency encountered in Kenya's provision of infrastructure services is attributable to poor control by the government of the approximately 140 parastatal organisations that are responsible for these functions. Many of these bodies are bloated and inefficient reportedly because of biased ethnic staff appointments made under the patronage system that flourished under the Moi regime.[139] The many manifestations of the low level of basic services add significantly to the cost of doing business for foreign and local investors.

Red tape

The third annual report of the World Bank and the International Finance Corporation (IFC), *Doing Business in 2007: How to reform*, provides a ranking of 175 countries, from Afghanistan to Zimbabwe, in terms of the ease of doing business in their markets. The study considers how easy it is to: start a business; obtain licences; hire and fire workers; register properties; obtain access to credit; trade across borders; enforce contracts; and close a business. It assesses how well investors are protected, and describes the characteristics of each economy. It is important to bear in mind that the ease of doing business ranking, which is outlined below, does not take into account a country's proximity to large markets, the quality of basic infrastructure and services, the level of crime and macroeconomic imbalances, threats to the security of property from theft or looting, or the strength of each country's institutions. Nevertheless, it provides an interesting indicator in

[139] The staff of Kenya Telecom is predominantly made up of Kalenjin, for example.

terms of assessing regulatory environments, which are capable of stimulating or constraining business activity. Kenya was ranked at 83 in terms of the index, behind South Africa (29), Namibia (42), Botswana (48) and Swaziland (76) but ahead of Ghana (94), Ethiopia (97), Zambia (102), Uganda (107), Nigeria (108), Mozambique (140) and Tanzania (142) and Sudan (154). According to the World Bank's study, Singapore came first and the Democratic Republic of Congo (DRC) last.

Table 15: Cost of doing business in selected countries

Indicator	*Kenya*	*Tanzania*	*Uganda*	*Ghana*	*South Africa*
1. Starting a business					
Procedures	13	13	17	12	9
Number of days	54	35	36	81	38
Cost (% of income per capita)	48.2	161.3	117.8	78.6	8.6
2. Dealing with licences					
Procedures	11	26	19	16	18
Time (days)	170	313	155	127	176
Cost (% of income per capita)	40	4110.2	861.8	1549.7	38.0
3. Hiring and firing workers					
Difficulty of hiring index	33	67	0	11	56
Rigidity of hours index	20	80	20	40	40
Difficulty of firing index	30	60	20	50	60
Rigidity of employment index	28	69	13	34	52
Hiring cost (%of salary)	5	16	22	13	3
Firing cost (weeks of salary)	47	38	112	25	38

Table 15: Cost of doing business in selected countries (continued)					
Indicator	***Kenya***	***Tanzania***	***Uganda***	***Ghana***	***South Africa***
4. Registering property					
Number of procedures	8	12	8	7	6
Time (days)	73	61	48	382	23
Cost (% of property value)	4.1	12.2	5.1	3.7	11.0
5. Protecting investors					
Extent of disclosure index (0-10)	4	3	7	7	8
Extent of director liability index (0-10)	2	3	5	7	8
Ease of shareholder suits index (0-10)	10	0	4	4	8
Strength of investor protection index (0-10)	5.3	2.0	5.3	6.0	8
6. Paying taxes					
Payments (number)	17	48	31	35	32
Time (hours per year)	372	248	237	305	350
Total tax payable (% of gross profit)	68.2	51.3	42.9	45.3	43.8
7. Closing a business					
Time (years)	4.5	3.0	2.2	1.9	2.0
Cost (% of estate)	18	22.0	29.5	22.0	18.0
Recovery rate (cents on the dollar)	14.7	22.3	39.8	23.7	33.9
Source: *Doing business in 2007*, World Bank, 2006.					

The 54 days needed to start a business Kenya is certainly less time-consuming than in Haiti, which at 203 days comes last in the World Bank's report. However, for business entry only two procedures — registering for statistical purposes, and for tax and social security — are necessary to fulfil the social functions of the process, and these are all that is required in Australia, New Zealand and Canada. It would be advantageous to investors if Kenya could follow this example. Afghanistan cut the number of mandatory procedures from 28 to 1 in 2004, whereas Kenya, by adding a separate procedure for paying stamp duty, seemed to go backwards

Three hundred and sixty-three days are needed to register property in Bangladesh, as compared with one in Norway and two in Sweden. The eight procedures necessary in Kenya take 73 days, slower than in Tanzania and Uganda. Kenya has made it harder to register property by imposing an official requirement that property should be valued before transfer, increasing the time delay from 39 to 73 days.

Where credit registers and collateral laws are effective and good credit information is available, bankers make more loans and provide better terms of credit. According to *Doing Business*, Kenya is identified (along with Chad, Rwanda, and Mauritania) as one of the countries with poorly developed systems of credit information on companies and individuals,.

Another finance-related factor in which Kenya lags behind is the bankruptcy process. If ‘good’ bankruptcy laws allow entrepreneurs to learn from their mistakes and try again with relative ease, ‘bad’ bankruptcy laws quench the spark of a country’s entrepreneurial spirit. A typical business bankruptcy process might take four months in Ireland and six in Japan; but can last 4.5 years in Kenya and more than 10 in India and Brazil. In Kenya the debt recovery rate is low, at 15%.

As far as the regulatory environment in Kenya is concerned, it is important to point out that investors are constrained not only by the burden of numerous regulations, but also by the amount of discretionary power exercised by the civil service in administering and enforcing them which means that investors are at the mercy of unpredictable decisions. [140] Also, the manner in which the regulations are phrased leaves latitude for interpretation by officials that can be used to obstruct investors.[141] The lack of transparency, clarity and consistency in administrative procedures opens up space for rent-seeking. An analyst in Kenya went as far as to suggest that many laws and regulations had been passed to create opportunities for extortion.[142] However, even when bureaucrats are not soliciting bribes, they often carry out their duties in a generally hostile and fault-finding manner.

Suggesting that there is room for Kenya to engage in further regulatory reform is not to recommend that it follow a deregulation agenda. The objective must be 'smart' regulation, better enforcement of a simplified regulatory structure, and improved performance by government services. Essentially, the regulatory burden on the private sector should be as modest as possible, even though it should remain mindful of the purposes of regulation: to collect taxes; protect citizens and consumers from unsafe products; safeguard employees from unfair employment practices; and conserve the environment for current and future generations. However, a regulatory system should be matched by sufficient capacity in the state to implement it fairly and consistently.[143]

There is a further advantage to adopting regulatory reform. International research conducted in 10 countries including Kenya by Bannock Consulting, which is based in London,

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[140] United Nations *Investment Policy Review: Kenya*, *op. cit.*, p.1.

[141] Interview, March 2005.

[142] Interview, March 2005.

[143] See Hudson, J, 'Regulation and the small firm' in *Global Entrepreneurship Monitor 2005*, published by the, Graduate School of Business and Centre for Innovation and Entrepreneurship, University of Cape Town, February 2005.

shows that getting rid of inappropriate regulations is the most important contribution a government can make to stimulating the growth of small and medium enterprises.[144] (The only other factor that is anywhere near as closely correlated with per capita economic growth is a country's level of skills, especially technical expertise.) Efforts to improve the regulatory and institutional environment within which businesses operate are much more likely to result in rapid improvements than concentrating on education and skills, which by their nature are long-term strategies, because the relative costs of compliance depend on the size of a firm.[145] Many small or medium-sized enterprises (SMEs) do not have dedicated in-house tax specialists or human resources staff to help them navigate 'red tape'; whereas large corporations may well be able to do so (and to absorb any penalties).

An OECD report examining the costs of administrative compliance in almost 8,000 SMEs in 11 OECD countries found that compliance costs per employee were over five times higher for the smallest firms than for the largest. A South African study found that complying with regulations costs 8,3% of turnover for enterprises with annual sales of less than R1 million, as against 0,2% of turnover for corporations with sales of R1 billion or more. Average compliance costs per person employed for firms with fewer than five employees are

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[144] Bannock G *et al Indigenous private sector development in African and Central Europe* Bannock Consulting, August 2002. See *www.sbp.org.za*.

[145] See articles written by the author and published by the Small Business Project (SBP), for example, 'An enabling environment for private sector growth: Lessons from the international experience', November 2002; 'Understanding *regulatory impact assessments*: Key issues from the international experience, January 2003; 'A small business perspective on tax compliance', October 2003.

apparently 10 times higher than for a firm with between 200–499 employees.[146] While no such study has been done in Kenya, it is probable that the effect of its regulations on small enterprises would be equally disproportionate.

If it is easy to start a business, more businesses will be set up. On the other hand, in a country with cumbersome entry regulations some businesses fail to register, opting to operate in the informal economy instead, where they remain unregulated and untaxed. It is worth noting that there is scant job security in the informal sector, wages tend to be low, and less concern is shown for safety. Entrepreneurial activity might be promoted in this sector, but non-compliance with tax and other regulations has disadvantages. Firms remain geographically dispersed, and seldom grow to an efficient size. This in turn reduces the number of productive jobs and diminishes opportunities for economic prosperity.[147]

However, an expanding informal sector represents a potential resource that could be harnessed to assist the country's growth and development. It suggests that governments should pay attention to removing some of the barriers to entry of the formal sector. Kenya's economy would grow faster and more equitably if the most successful elements of the informal sector could be brought into the formal economy. Part of the challenge is in making the process of

[146] SBP, *Counting the cost of red tape for business in South Africa: Headline report*, November 2004, p.2.

[147] For a fuller treatment of this argument see Hudson J, 'Regulation and small business', *Global Entrepreneurship Monitor 2005*, Graduate School of Business, University of Cape Town, February 2005.

formalising easier, so that informal enterprises do not become trapped in sub-scale activities.[148]

Courts

The ability of courts to deliver commercial justice impartially, promptly and consistently is a critical element of an environment friendly to investors. Most investors take a dim view of the court system in Kenya. A study by the World Bank found that 74% of investors rated the overall quality of the court system as 'slightly bad', 'bad' or 'very bad'. They indicated a similar level of dissatisfaction with respect to impartiality, honesty (or absence of corruption), the rapidity with which judgements were made, consistency, and the enforceability of judgments. On all of these criteria Kenya compared poorly with the ratings of its EAC partners, and of Egypt and South Africa.[149]

The ICA found that judges and government officials appeared to be the most open to bribes. Twenty-eight percent of firms felt that they were able to use bribes to influence the outcome of commercial cases that directly affected their businesses.[150] However, it must be noted that the government has suspended judges who are alleged to have been involved in corruption, so steps are being taken to improve the court system.

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[148] See also SBP, 'An enabling environment for private sector growth: Lessons from the international experience', *SME Alert*, November 2002.

[149] United Nations *Investment Policy Review: Kenya*, *op. cit.*, p.43.

[150] Regional Programme on Enterprise Development, op. cit., p.57.

Table 16: Enforcing contracts in a number of countries					
Enforcing contracts	***Kenya***	***Tanzania***	***Uganda***	***Ghana***	***South Africa***
Number of procedures	25	21	19	29	26
Time (days)	360	393	484	552	600
Cost (% of claim)	41.3	51.5	35.2	13.0	11.5
Source: *Doing business in 2007*, World Bank, 2006.					

Enforcement of legislation frequently fails to carry out the desired monitoring and identification of persons and companies in breach of Kenya's laws. For example, because the copyright laws are not followed up, pirated goods, especially music and software, are commonly available. These undercut the products of legally registered firms. Another cause for concern is the enforcement of contracts. Although *Doing Business in 2007* notes that Kenya performs significantly worse than Tanzania and Uganda in this regard, the Kenyan court system has reduced the time needed to resolve a dispute to approximately 25 days. (This can be compared with the 1 459 days taken by a Guatemalan court.) A significant advantage is that as confidence in dispute resolution in Kenya rises, entrepreneurs become more willing to enter into contracts beyond their narrow circle of known business partners.

Corruption

According to Transparency International, at the end of 2004 corruption in Kenya was found to have reduced from 'highly acute' to merely 'rampant'.[151] In its Corruption Perception

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[151] 'Where graft is merely rampant', *The Economist*, *op. cit.*

Index (CPI), in which 10 represents 'least corrupt', in 2004 Kenya was ranked 129th out of 146 countries, with a score of 2.1 out of 10. This puts it among the most corrupt countries in Africa, and below its neighbours in East Africa. The table below captures Transparency International's corruption rankings, including those of 2003, which were based on 133 countries.

Table 17: Corruption Perception Index 2004: Selected countries in sub-Saharan Africa

Country	*2004 ranking*	*2004 score*	*2003 score*	*% change*
Botswana	31	6.0	5.7	5.3
South Africa	44	4.6	4.4	4.5
Ghana	64	3.6	3.3	9.1
Tanzania	90	2.8	2.5	12.0
Ethiopia	114	2.3	2.5	8.0
Zimbabwe	114	2.3	2.3	0.0
Uganda	102	2.6	2.2	18.2
Kenya	**129**	**2.1**	**1.9**	**10.5**
Nigeria	144	1.6	1.4	14.3

Source: *Transparency International*

Corruption is perceived as a major impediment to investment because it is not solely an ethical issue. It increases the costs of doing business, and diverts resources from the development agenda. In 2004 the Global Corruption Barometer of Transparency International surveyed Kenya for the first time. It found that ordinary Kenyans continued to be forced to pay bribes on a daily basis. Approximately 36% of respondents reported having paid some form of bribe during the 12 months preceding the survey. The police service was rated the most corrupt institution in Kenya. Political parties and parliament were next on the 'list of shame', that is rated as having the second-highest incidence of corruption.

In the ICA survey 74% of the firms sampled saw corruption as a major obstacle for foreign firms. Another 7% rated it as a severe problem.[152] More than half of the 282 firms that participated reported having to make regular unofficial payments worth more than 6% of revenues over the previous year. Two-thirds felt that there was a culture of bribery; for example that a gift or informal payment was often required to secure government contracts or facilitate payments.

According to the ICA, some of the worst offenders were officials from the taxation authority, the health inspectorate, the municipalities and employees of utility companies. Data provided by the ICA show that 55% of firms that required a telephone connection in Kenya were asked for an informal payment, as compared with less than 20% in Tanzania and Uganda. The median payment made by firms was Ksh5,000 ($43). Again, 38% of firms that sought a construction permit were also asked to pay a bribe. The median payment was Ksh30,000 ($440). The size of the payments extorted by officials averaged 3.8% of annual sales revenue (compared with 2.4% in Uganda and 1.8% in China). Those companies that felt it necessary to pay a bribe to secure a government contract were typically asked for 10% of the value of the service.[153]

The majority of South African businesses consulted for this Business in Africa project indicated that they were stanch opponents of bribes. One respondent said, [154]

> we don't pay bribes. Our staff knows exactly how we respond, we issue warning letters and withdraw from deals if we're not comfortable. Business has to be above board. Our approach is

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[152] Regional Programme on Enterprise Development, *op. cit.*, p.55.

[153] *Ibid*, p.v.

[154] Interview, March 2005.

> to do very little business with the public sector as a result of [the] high levels of corruption.

Another said he had not paid a bribe in Kenya because he had done so in Ghana and found that it had exposed him to repeated extortions from officials who had the power to close his business down on a number of pretexts if he did not comply.[155]

However, a small number of companies, one of which is run by a Kenyan citizen, reported that they had paid bribes because they found it too difficult to get anything done unless they were prepared 'to push some money under the table'.[156]

As noted earlier, the Kenyan government has attempted to prune back corruption. President Kibaki's government rushed through legislation to form an anti-corruption commission and to force public servants, including politicians, to declare their wealth. Kibaki came down hard on police corruption and a 'radical surgery' of the judiciary took place. Six of the 11 judges of the Court of Appeal, 17 of the 36 high court judges and 82 out of the 252 magistrates were suspended on allegations of corruption.[157] The Anti-Corruption and Economic Crimes Act, which was passed by parliament in May 2002/03 forms the centrepiece of government's reform programme. The Act also established the Kenyan Anti-corruption Commission. In the same month, the legislature also adopted the Public Officer Ethics Act, which demands that all public officials and employees declare their family's income, assets and liabilities. The post of Permanent Secretary for Governance and Ethics was also created during this period.

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[155] Interview, March 2005.

[156] Interview, March 2005.

[157] Kariuki M, 'The fight against corruption: Bringing the UN and AU Convention home' in *Adili*, *op. cit.*, p.10.

However, these promising signs of taking the fight against corruption seriously have not been followed through. Enforcement of the anti-corruption measures the government has undertaken remains a critical challenge.

Tax

In the previously mentioned UNCTAD report, investor concerns over taxation are less on the structure of the tax regime or the level of taxation than on what is seen as an aggressive and fault-finding attitude towards taxpayers on the part of the Kenya Revenue Authority. Even compliant taxpayers are faced with 'punitive' penalties if payments are delayed or minor mistakes are made in reporting.[158] It seems easy to make a mistake. Many South African companies pointed out that it was difficult to keep track of the tax system in Kenya because not only is it unclear but applications are subject to change. For example, the tax obligations relating to salary structures are impenetrably complex and required all sorts of funds, contributions, additions and subtractions to be taken into account. These firms advised new entrants to employ good tax and human resource professionals to guide them through the intricacies of Kenya's tax regime.[159]

The corporate tax structure in Kenya imposes higher rates than Tanzania and Uganda.[160] Resident companies are taxed at 30% of earnings, regardless of sector and ownership, while local branches of non-resident companies pay 37.5%. VAT is levied on both goods and services, whether produced

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158 United Nations *Investment Policy Review: Kenya*, *op. cit.*, p.28.
159 Interview, March 2005.
160 Interview, March 2005.

domestically or imported, while exports are zero-rated. A large number of the firms interviewed for the survey pointed out that duties, particularly on imports, are so high that their profit margins are drastically curtailed. The 'prohibitive' cost of importing items that cannot be sourced locally, for example packaging, which carries an 80% duty, was described by one interviewee as equivalent to protectionism, even though these items are not produced locally and so do not require protection. A company representative endorsed this opinion, and pointed out that importing packaging on smaller utilities such as utensils, stainless steel containers, and so on, translated into a 100% duty levy. Thus, a branded product bought for R34 when leaving South Africa, ends up costing approximately R100 in Kenya when the duties, the Clean Report of Inspection (CRI) and so on have been added.[161] Another pointed out that the ability of companies to import raw materials is constrained by duties.

Goods and services subject to VAT are taxed at 0% (for foodstuffs, medicines and agricultural inputs) and 14% (for hotels and restaurants) or 16%. The VAT Act imposes penalties of 2% per month compounded on late payments, and allows the VAT Commissioner to recover unpaid tax liabilities by seizing assets instead of suing the taxable person or entity.

Crime and security

Since the 1980s, violent crime and insecurity have become common in Kenya, especially in the capital city.[162] According to official statistics, crime in Kenya rose by 51% between 1994–

[161] Interview, March 2005.

[162] Regional Programme on Enterprise Development, *op. cit.*, p.13.

2000.[163] Kenya's *Economic Survey 2004* states that crimes reported to the police went up from 70 423 crimes committed in 2002 to 77 430 in 2003 (that is, by 9.8%). Reported cases of rape rose by 14.4%, from 984 in 2002 to 1 126 in 2003. Violence against women increased by 9,6% from 9 901 cases in 2002 to 10 852 cases in 2003.[164] Banditry is common in rural areas, and housebreaking and violent car robbery have become a feature of living in Nairobi.

The United Nations has given Kenya a security rating below that of Jerusalem and Bogota. One consequence is that many businesses close their doors earlier, because their customers tend to return to their homes early to avoid becoming victims of crime.[165]

The ICA notes that a third of the firms surveyed reported the occurrence of a crime in 2002.[166] The direct loss to companies attributable to crime is estimated at 4% of annual sales revenue, and the indirect cost of prevention in the form of security measures is 2.7% of sales. (Most firms contracted private security services.)[167] The average number of crimes per firm was five in 2002. Three times as many firms in Kenya report that crime and theft are major impediments to business than in Tanzania and Uganda.

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163 *Ibid.*, p.58.

164 Central Bureau of Statistics, Ministry of Planning and Development *Economic Survey 2004*, The Government Printer, Nairobi, 2004, p.2.

165 Interview, March 2005.

166 Regional Programme on Enterprise Development, *op. cit.*, p.3.

167 *Ibid*,, p.vi.

Table 18: Incidence of crime and cost of security in Kenya	
Firms perceiving the official provision of security (police) as poor or very poor	51.0%
Percentage of firms that lost sales to theft, robbery or arson	34.0%
Those firms that had been victims of a crime:	
Average sales loss as a percentage of total sales	4.0%
Average number of incidents reported	4.8%
Percentage of incidents reported to the police	79.0%
Percentage of incidents solved	18.0%
Source: Kenya Investment Climate Assessment, 2004	

A survey carried out by Kippra found that 41% of the companies sampled faced their greatest security problems during times when goods and services were being distributed. The majority of these firms (94%) had lost goods in transit through theft or robbery, 90% of them through attacks on personnel in distribution. Eighty percent had lost goods caused by delays due to security checks.[168]

While Kenya's population increased from 28.6 million in 1999 to 32.2 million in 2003, the number of police personnel has not risen in parallel. The ratio of police to population declined from 1:850 in 1999 to 1:908 in year 2003, far below the United Nations standard of 1:450.[169] The inadequacy of the state's provision of normal security affects the freedom and safety of its own citizens as well as tarnishing Kenya's image in the eyes of the international investment community. Kippra argues that Kenya is estimated as losing as much as 40% of FDI because of insecurity.[170]

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[168] Kippra, *op. cit.*, p.91.

[169] *Ibid*, p.95.

[170] *Ibid*,, p.17.

Competitiveness of the Kenyan workforce

South African companies consistently noted their appreciation of the well- educated, industrious and hardworking workforce that Kenya offers. The country's literacy rate is 85.1%, one of the highest on the continent; there is a good strong work ethic; and Kenyans have a passion for learning. All of these make the Kenyan workforce a major plus. An interviewee noted that because of the high level of skills in Kenya his company paid 'above average wages for above average performance'. Another advantage of employing Kenyans is that their way of doing business is synchronous with Western practices: for example correspondence by email and the use of business cards are common.

However, although Kenyan education and labour skills are well regarded, the level and quality of production and technical training is reportedly low. South African companies reported that whereas skills in terms of reading, planning and processing were much better in Kenya than in South Africa, technical skills training in the former was not as good. In other words, the emphasis seems to be on managerial and professional training rather than developing production skills. According to the ICA, Kenya's formal training institutions have 'little orientation toward the practical needs of the enterprise sector, and firms cannot use the funds they pay into the training levy to obtain productivity-enhancing training for their manufacturing workers'.[171] Other sources confirm this diagnosis. The 2003 *Country Economic Memorandum* for Kenya notes that the highest priority for the further development of the textile industry will be skills improvement. A 2004 report, *Growth and Competitiveness in Kenya*, argues

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[171] Regional Programme on Enterprise Development, op. cit., p.3.

that 'current training curricula are obsolete, and that major deficiencies are observed in public training facilities and instructional capacities'. These are problems which lead to a 'mismatch' between the supply and quality of skills in the market and the demands of the growth sectors of the economy.[172]

Labour

The wages of unskilled production workers at spot exchange rates are higher in Kenya than in all its neighbours and strategic competitors, at about $99.20 per month. Unit labour costs in Kenya rose by 20% for the manufacturing sector and 45% for the transport and communications sector over the period 1990–2001. While the better wages paid in Kenya appear justified when compared to those of the less labour-productive workers of Tanzania or Uganda, they are high relative to those paid in the highly-productive countries of Asia.[173] This makes Kenya's labour costs uncompetitive, because the unit cost is about 12% higher than in India and 33% higher than in China, according to Kippra. This makes Kenya less attractive to investors.[174] Another concern for companies is that real wages appear to have been rising rapidly for a decade, while productivity has not shown a commensurate increase.[175] An interviewee also reported that it is more expensive to retrench people in Kenya than in South Africa.[176]

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[172] *Ibid*, p.34.

[173] Ibid,, p.iv.

[174] Kippra, *op. cit.*, p.54.

[175] Regional Programme on Enterprise Development, *op. cit.*, p.31.

[176] Interview, March 2005.

It is important to retain perspective, however. About 66% of investors canvassed by the World Bank in 2000 in the *World Business Environment Survey* stated that labour regulations in Kenya were 'no obstacle' or a 'minor obstacle' to either their operations or the growth of their businesses. This contrasts favourably with the evaluations of South Africa's and Tanzania's labour regulations, which 85% and 55% of investors respectively rated as a 'moderate' or 'major' obstacle.[177]

Nevertheless, it is interesting to note that the number of strikes in Kenya rose from 22 in 2001 to 47 in 2002, even though these numbers are insignificant when compared with the 105 strikes reported in 1998. What is worth noting, however, is the growth in the number of workers taking part in these strikes, as is shown in the table below. This factor could act as a potential discouragement to investment, as mass strikes lead to loss in production and generally raise the costs of doing business. However, strike action does not appear to be a significant concern for investors in Kenya.

Table 19: Collective agreements and industries unrest registered by the Industrial Court 1998-2003

	Number of agreements	**Number of unionisable employees covered by agreement**	**Number of strikes**	**Number of workers involved**
1998	349	138,147	105	214,867
1999	328	113,758	38	9,094
2000	316	71,586	41	17,794
2001	247	43,031	22	4,5632
2002	304	78,254	47	258,788
2003	290	50,839	n/a	n/a

Source: Economic Survey, 2003.

[177] Quoted in United Nations *Investment Policy Review: Kenya*, op. cit., p.36.

The impact of the South African business presence in Kenya

Although South African investment appears to be of marginal importance in comparison with the more established players in the Kenyan market, it has had a considerable impact on that country's economy. However, assessing the effects of South African investment into Kenya is a complex undertaking, owing to the limited availability of baseline data. Therefore the researcher has had to rely on reports issued by global institutions and evidence gleaned from the survey.

This report has already mentioned the resentment that South Africa's economic expansion is causing in some quarters in Kenya. However, there is another side to the story. Although in a number of instances foreign entrants into markets (not only South African firms) have displaced local businesses, this phenomenon is not unique to the Kenyan context. As far as Kenya's feeling a particular aversion to South African enterprises is concerned, various counter-arguments have been put forward by investors from this country. South African companies with a presence in Kenya argue that they are breaking local monopolies, bringing down the prices of goods, and creating much-needed employment. (The unemployment rate in Kenya was estimated at 40% in 2001.[178]) Independent confirmation of the role of South African businesses in providing jobs came from a number of respondents: the majority reported that well over 80% of their companies' employees were Kenyan: some said the figure was closer to 98% in their operations, because of the high levels of education and skills available locally.

[178] CIA, World Factbook: Kenya, *www.cia.gov*, 17 April 2007.

Another contribution South African investors can claim to have made to the Kenyan economy is in establishing reliable supply chains. One interviewee summarised this argument as follows: [179]

> We've forced a standard on suppliers, helped them develop products specific for our industry, set up supply chains from Europe and South Africa to bring in products. In so doing, we've been a conduit to growth in this sector.

Another important advantage, although an unintended one, is that the entrance of South African companies into Kenya has also created a heightened awareness of business opportunities in that country's private sector. A South African respondent described the effect of the arrival of South African enterprises in Kenya as a 'wake-up call' for the local business community.[180] A further positive effect, according to a Kenyan policy analyst, is that Kenyan businesspeople have[181]

> adopted the standards and approach of some South African companies and become powerful competitors in their own right, over the years. In many areas, the moment South Africans came into a sector offering better quality and better service. In a very short time, many Kenyans were able to copy this, incorporate that, and become significant competitors.

The increased competition has thus far generated imitation rather than innovation. For example, when Ceres fruit juice first appeared in Kenya, it was both popular and well-priced. This led local suppliers to experiment with producing packaged juice themselves. Kenyans responded quickly; Ceres now has only a small share of the juice market.[182] A Ceres

[179] Interview, March 2005.

[180] Interview, March 2005.

[181] Interview, March 2005.

[182] Interview, March 2005.

representative confirmed that 'Kenya [now] has one of the most competitive fruit juice markets in Africa.'[183]

The impact of South African companies on environmental and operational standards has also been positive. For example, a Kenyan analyst commented that before the entry of various fast-food chains from South Africa, the local fast food industry was underdeveloped, and had very low standards of hygiene. Within a few years, Kenyan food outlets improved their standards and competitiveness significantly so as to match the products offered by incoming South African companies.[184]

Advertising demonstrates another positive aspect of the impact of South African investment. South African companies are seen as particularly good at marketing, a skill that has not received much attention in Kenya in the past. It is interesting to note that the marketing strategy adopted by Kenya Breweries is being supervised by a marketing manager who previously worked for SABMiller. Kenya Breweries is now using billboards to advertise its products. Apparently spurred by the success of Brand South Africa, Kenya has even launched a Brand Kenya campaign.

Time for a code of conduct for firms?

The negative perception caused by the behaviour of some South African companies in Kenya suggests that there is room for improvement in terms of the quality of South African investment and the management of local sensitivities. Fraught business relationships are problematic for both South African

[183] Interview, March 2005.

[184] Interview, March 2005.

investors and for the private sectors of host countries. Business is about interactions between humans, not just transactions; and relationships are most durably built up over the longer term. This goal has to be kept firmly in sight if South Africa wants to establish long-term investment and a good reputation on the continent as a whole.

South Africa is being called upon with increasing frequency to regulate the corporate behaviour of its nationals, and thus promote ethical corporate citizenship. South Africa's new role in the international, and particularly the African, arena is complicated. Philip Armstrong, convenor of South Africa's King Committee on Corporate Governance, noted: [185]

> I believe that given the proliferation of South African business in Africa, … some form of integrated and substantive guidelines could be useful… Given the role of South Africa in Nepad and its own acknowledged record of democracy and governance, we would not want to see our national reputation or stature compromised by irresponsible conduct.

The following are some of the questions confronting policymakers in South Africa and on the continent: Is it time to put pressure on South African companies? Would regulation stifle the development aspects of FDI? Should certain businesses be persuaded or compelled to act contrary to their own perceptions of short-run profit? Pressure is already being put on South African corporations to look beyond the factory gate when they engage with countries north of the Limpopo. Careful management of local sensitivities combined with good corporate practices are as critical in Kenya (and other African markets) as they have proved to be in South Africa. The OECD

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[185] Quoted in African Institute of Corporate Citizenship, *Promoting South African companies' corporate responsibility in Africa* Workshop proceedings, Sunnyside Park Hotel, Parktown, 27 May 2005, p.1.

guidelines could provide a useful point of departure and should be embraced by South African corporations in their own interest, with adaptations to accommodate the African context.

It is easy to imagine howls of protest coming from businesses already feeling weighed down by overregulation. However, it is in the best interests of South African firms to reflect on these issues, since in the longer term the competitiveness and success of this country's private sector in the rest of Africa could be undermined if 'unhelpful' activities for short-term gain are allowed to continue unchecked. Bad behaviour on the part of one South African company could well muddy the waters for others in their expansion into the continent. These are good grounds for the voluntary adoption of a more socially responsible attitude and/or a code of conduct by South African corporations in other African countries.

If a code of conduct for businesses were to be adopted, there are already a number of initiatives that might provide a blueprint: the King II report; the UN Global Compact; and the Johannesburg Stock Exchange's Social Responsibility Index (SRI). However, the benchmark instrument for promoting corporate responsibility is the Guidelines for Multinational Enterprises, which forms part of the Declaration on International Investment and Multinational Enterprises published by the Paris-based Organisation for Economic Co-operation and Development. Under this mechanism, governments that choose to comply with the Guidelines establish a National Contact Point (NCP) — a government office, or (increasingly often) a collaborative structure involving representatives of labour, business and civil society organisations. The NCP's mandate is to clarify and publicise the Guidelines, and promote compliance with them in the private sector.[186] Accusations that a multinational corporation (MNC) has contravened the guidelines are brought to the attention either of the NCP in the host country or the NCP in the company's country of domicile. The interested party must substantiate its claim against the MNC before the matter is taken up by the NCP.

As noted earlier, NCPs played an important role in investigating allegedly irresponsible business practices by companies operating in the DRC, including some South African companies. De Beers, which is registered in London, was asked by Britain's NCP to respond to allegations of contravention of the OECD Guidelines. After all the parties concerned had been given the opportunity to present their evidence, the African Institute of Corporate Citizenship (AICC) issued a statement exonerating De Beers from any contravention of the Guidelines, adding .[187]

> this experience illustrates that a transparent and formal process for querying concerns about responsible conduct can be in the company's interest, in that De Beers was spared [a potentially] damaging media campaign.

Suitable adaptations of the OECD Guidelines to the African context could focus on specific priority areas, such as community reinvestment requirements, local procurement, and an emphasis on HIV/Aids.[188]

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[186] OECD, quoted in *Promoting South African companies' corporate responsibility in Africa*, African Institute of Corporate Citizenship May 2004, p.28.

[187] *Ibid*, p.29.

[188] *Ibid*, p.27.

Some Policy Recommendations

Responsibility for minimising the 'down side' that South African FDI into Kenya may have cuts both ways. Some South African companies may well need to modify their behaviour, but Kenyan authorities might also provide a more appropriate regulatory framework to attract, promote and retain local and international business confidence.

The study identified a number of issues and areas of concern relating to Kenya's investment climate. (Many of these are common to other African countries.) These have been incorporated in the recommendations below.

Recommendations to the Kenyan government

- The drive to root out corruption will continue to top the development agenda, as Kenya seeks to increase its share of the FDI trickling into the continent. But the requisite investments will not be forthcoming unless the good governance needed to tackle corruption is displayed and followed through. This requires that much more aggressive implementation of legislation is practised, and that attention be paid not only to the bribe-takers but the bribe-givers.
- There is a clear need for a stronger focus on the development and maintenance of Kenya's roads, railways and ports. Policy-makers need to find ways to improve the quality of infrastructure and basic services in general, but particularly the viability of the transport sector and the costs of moving goods. In this way, investment into the country would be encouraged, international competitiveness promoted and profits increased.

- Although not on the scale of South Africa, escalating crime and insecurity are beginning to worry foreign investors, and threaten to tarnish the country's image as an investor-friendly destination. The Kenyan government would do well to reform the police service and upgrade other security measures.
- Kenya's continued dependence on hydropower to provide its electricity must be addressed. Policy-makers in Kenya should be encouraged to look for alternative (and possibly more reliable) sources of energy.
- The regulatory environment needs to be streamlined, made more clear and consistent, and rendered more practicable in general. For example, the Kenyan government could make application forms available online to speed up the bureaucratic process and minimise direct contact between officials and applicants, whether members of the public or businesspeople. This would not only help improve the investment climate for South African and other international companies, but foster entrepreneurship in Kenya itself. However, implementing a regulatory reform agenda will require a pruning of procedures and of the bureaucracy, which could be a politically unpopular move that requires high-level backing.[189]

  Changes to certain laws and policies may improve the investment climate, but they require not only implementation and enforcement but consistency of application. Currently, many laws leave room for interpretation by officials, giving them discretionary powers which increases the level of uncertainty for businesses and open the way to corruption for public servants.

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[189] See Hudson J, 'Understanding regulatory impact assessments', *op. cit*.

- Informal businesses should be nurtured, and ways found to accommodate them in the formal sector, which offers benefits like access to capital. These could be used as incentives to persuade informal traders to enter the mainstream economy. Reducing the burden of compliance with regulations is likely to be an additional inducement. Another argument that could be used to encourage informal traders to convert is that over the long term, businesses in the formal sector find it easier to grow.
- Strengthening, speeding up and modernising Kenya's legal system would be beneficial to the investment environment. Court procedures could be simplified, and court recording and the management of records improved.
- Investors would prefer to see the distinction between domestic and foreign investors done away with arguing for national treatment. They also express concern about the government's failure to collect and publish accurate statistics.
- There is a need to strengthen the link between education and industry, between labour market needs and education and training outputs. Closer co-operation and dialogue between business and government in order to accommodate better technical training is needed, if the high regard in which Kenyan skills and education is held by investors is to be sustained.
- Kenya's government needs to strengthen the country's institutional capacity to use donor aid effectively and transparently. Unless Kenya can demonstrate good governance by improving the performance of institutions and eradicating corruption within them, it will not qualify for aid, which tends to be linked to issues of governance. Kenya needs an injection of donor money to help it address some

of its socio-economic and infrastructural challenges. An improvement in institutional performance would also ignite an injection of FDI.

Recommendations to the South African government

- South African policy-makers should place greater emphasis on strengthening intra-African trade. They could do this by allowing better terms for trade to not only Kenya but to other countries in the rest of Africa. For example, South Africa could open its borders to Kenyan exports more fully, and drop visa requirements for Kenyan traders and visitors.
- South African policymakers should push energetically for the signing of the Joint Commission of Co-operation between the two countries.
- South African companies should consider acceding to voluntary corporate codes of conduct, as preferable to having a regulatory regime enforced on them. While this study did not uncover any episodes of exploitation and expropriation in Kenya by South African firms operating there, relations between some South African corporations and the private sectors of some host African countries are strained. This situation should be ameliorated by greater sensitivity on the South African side to conditions and perceptions in the countries they target for investment.

Conclusion

South Africa's economic expansion into Kenya has created a sense of competitiveness between the two countries that is not entirely friendly. South African firms have come off second best in certain instances. There is a general acknowledgement on both sides that economic and trade relations between them have yet to reach their full potential. Yet a number of South African firms consulted for this study are already doing good business in East Africa's hub, and have plans to expand their operations. It seems that with the right approach, good returns can be made in this competitive market.

Closer collaboration, combined with a judicious harnessing of the strengths and resources each of these countries have to offer would work to help realise that promise. The most fruitful approach would be to adopt a pragmatic view that enables investors to learn from their mistakes and difficult experiences, and seek solutions by analysing the approaches of those foreign enterprises that have been successful in Kenya. An essential component is that companies entering Kenya are capable of recognising and adapting to the local social context and sensitivities as well as domestic business practices.

Other promising avenues to improve trade relations between the two countries would be the signing of a free trade agreement between the two countries, and greater efforts on the part of Kenya to attract different forms of economic interaction with South Africa, which could be underpinned by the formation of a business council and/or joint chamber of commerce. The work of these could be supplemented by fact-finding missions and trade shows.