INVESTMENT CLIMATE IN KENYA

John W. Nguri
CDC International Consultants LLC.
jnguri@cdcdlconsult.com

Charles M. Onchoke
CDC International Consultants LLC.
conchoke@cdclconsult.com

Abstract

This paper reviews Kenya's investment climate ranking based mainly on the 2016 World Bank Doing Business model as well as the OECD Policy Framework for Investment User's Toolkit. Kenya is ranked 108 out of 189 economies globally and 8.5% better than Sub-Sahara African average in terms of ease of doing business (World Bank, 2016a) despite the country's generally positive investment environment. We discuss key factors underlying this dichotomy as the basis for making recommendations to improve Kenya's business environment. Based on extant literature, the paper reviews the policies implemented so far to ameliorate the existing weaknesses and suggest a framework for continued improvement. We further explore opportunities available for investment in the country. We conclude that further to the Constitution of Kenya 2010, more legal, regulatory, and institutional reforms are necessary in order to improve Kenya's investment climate.

Keywords: investment climate, business environment

Introduction

Kenya, through its major long-term development agenda blueprint, Vision 2030, underscores the importance of investment as a springboard for transforming into a faster developing country by 2030. In order to realize this objective, Kenya must develop measures conducive for attracting investors to supplement the often inadequate public resources.

Therefore, Kenya needs to nurture an attractive and competitive investment climate in order to develop.

Investment climate has assumed a broad definition embracing constraints to the effective functioning of markets, and infrastructure services, including, weaknesses associated with an economy's legal, regulatory and institutional landscape (World Bank, 2013a). The U.S. Department of State (2016) has expanded the definition to include openness to investment, legal and regulatory systems, dispute resolution, intellectual property rights, transparency, performance requirements, responsible business conduct, and corruption. Investment climate may also be construed as the ease or difficulty of doing business.

Investment plays a significant role in economic growth. According to Wiboyo and Alfen (2014), investment focusing on infrastructure development stimulates economic growth. The success of private investment through private public partnership (PPP) in infrastructure development which largely explains the meteoric growth of East Asia and the Pacific region (World Bank, 2013b) is backed with a conducive investment climate. Legislative and regulatory business landscape impacts investment decisions; positive polices are more likely to foster investment growth while negative policies will tend to stifle investment.

Most countries are implementing new investment policy measures geared toward good investment climate characterized mainly by liberalization and promotion (United Nations Trade and Development [UNCTAD], 2016). It is against this backdrop that global investment is growing albeit sluggishly after the 2009 economic and financial crisis translating to a projected economic growth of 2.4 percent in 2016 and 3.0 percent by 2018.

Kenya's country profile

Kenya has a generally favorable investment climate that has made it attractive to international investors seeking a location for their regional or African operations (Deloitte, 2016; World Bank, 2016b). The positive environment has been created, in part, by the recent steady economic growth experienced in the county and the policy reforms undertaken. However, corruption, infrastructural deficits, sporadic political tensions, and an untapped informal sector are pervasive challenges that undermine private sector investment in the country. Kenya, the largest economy in East Africa, is a regional financial, communications, and transportation hub. Kenya's economy is market-based, with a few state-owned infrastructure enterprises, and maintains a liberalized external trade system (Deloitte, 2016). Since independence, Kenya's market structure has transformed from tighter government control to a freer market economy.

During the early years of independence from British colonial rule in 1963, Kenya pursued economic growth through such strategies as public investment, smallholder agricultural production, and private industrial investment (Deloitte, 2016). Gross Domestic Product (GDP) grew at a yearly average of 6.6 percent from 1963 to 1973. Between 1991 and 2002, growth stagnated while inflation soared to an all-time high. Between 2003 and 2007, the country embarked on elaborate economic reforms leading to growth ranging from 2.8 percent to 7.0 percent. However, post-election violence of 2008, compounded by drought and the global financial crisis, slowed the momentum. Between 2010 and 2014 the economy had mixed results with a general growth trajectory. GDP grew by 5.6 percent in 2015. Overall, inflation in the country declined from 6.9 percent in 2014 to 6.6 percent in 2015 (Kenya National Bureau of Standards [KNBS], 2016). The Kenyan Shilling depreciated against major trading currencies in 2015 but appreciated against the Euro, South African Rand, and the Yen.

Kenya’s positive economic outlook is founded on the country’s ability to stimulate economic demand through infrastructure investments, sound fiscal and monetary policies, regulatory reforms, and government divestiture in state enterprises (World Bank, 2016b). Furthermore, Kenya has a fairly broad-based and expansionary economy built on a stable macro-environment. Foreign direct investment flows to Kenya stood at USD 1.4 billion in 2015 and are projected to increase in the years ahead. On the social scene, Kenya has enjoyed relative political tranquility rooted on a generally consistent ideology of capitalism and multi-party democracy. Concomitantly, the Constitution of Kenya 2010 has ushered in a new political and economic governance system with key objectives of deepening political democracy; strengthening governance; and fostering regional development through equitable distribution of the national resources (Kenya Law, 2016a). Furthermore, devolution, a key tenet of the constitution, engenders 47 county governments through which substantial investment opportunities are expected to emerge.

Weak institutional capacity, however, undermines efforts to achieve the country’s socio-economic development objectives. Corruption, poor infrastructure, and deteriorating security have been highlighted as the key vulnerabilities that the government has failed to effectively control (Economist Intelligence Unit, 2015). The level of accountability and transparency in the Kenyan public service is often viewed to be below par and divergent with best practices. In 2015, Kenya was ranked 139 out of 168 most corrupt countries (Transparency International, 2016).

Key reforms recently implemented by Kenya include a new competition framework; modernization of tax administration; simplification of business licensing; revision of the companies’ law; PPP policy framework; and an overall improved investment environment (KPMG, 2016a). The counter-terrorism strategies undertaken have improved security (Kawanja, 2016). Other areas of reform include the judiciary, crime control (KNBS, 2016), and the electoral process. The electoral reforms suggested by the Kiraitu-Orengo Parliamentary Select Committee, are seen as a significant step toward ensuring peaceful elections in 2017.

Kenya's Investment Climate Ranking and the Reforms Undertaken

Overall general investment environment in Kenya is characterized by stable monetary and fiscal conditions and a sound legal environment (KNBS, 2016). However, Kenya's public debt is persistently high with debt service taking disproportionately more economic resources than development programs. It noteworthy that the rate of interest in Kenya has been capped through legislation (Kenya Law, 2016b) thus improving access to credit.

Kenya is becoming a preferred regional business hub, not only for oil and gas exploration but also for manufacturing and transport (UNCTAD, 2016). It is further noted that Kenya has a strong telecommunications infrastructure, a robust financial sector, port services, and solid aviation connections both within Africa and to Europe and Asia (Deloitte, 2016). Furthermore, Kenya has a well-educated population and a growing urban middle class. Kenya's increasing integration within the East African Community as well other regional trade blocks provides enhanced access to large regional markets.

Continued prominence of Kenya in the regional geopolitics has a great bearing in the country's overall development and investment attractiveness. For example, the recent international conferences and dignitaries hosted by Kenya which include the Tokyo International Conference on African Development VI; the 2016 World Trade Organization Conference; President Barrack Obama; Pope Francis; and Benjamin Netanyahu, Prime Minister Narendra Modi signify strong confidence in the country by the international community. A rank of 108 out of 189 countries in ease of doing business in 2016 (World Bank, 2016a), suggests that the investment climate in Kenya is still mediocre. However, this performance is against the relatively positive investment climate prevailing in the country. Furthermore, Kenya was ranked as one of the most improved countries to do business.

Kenya is ranked poorly by *2016 Doing Business* in starting a business (151); dealing with construction permits (149); resolving insolvency (144); trading across boarder (131); getting connected to electricity (127); registering properties (115); protecting minority investments (115); enforcing contracts (102); and paying taxes (101) (World Bank, 2016a). However, the country performed favorably in getting credit (28) and stamp duty processing.

As part of the reforms to improve registering businesses, Kenya has, among other things, introduced “Huduma” centers and revamped the Kenya Investment Authority. The “Huduma” program aims to make public service delivery more efficient through integrated technology platforms (Huduma Kenya, 2016). The services provided through the centers include applications for registration of business names. Kenya allows a wide variety of business organizations including registered companies; partnerships; sole proprietorships; and societies. The Companies Act of 2015 provides substantial reforms on business registration (Kenya Law, 2016a) thus fostering a more positive business climate.

While access to utilities was improved, dealing with construction permits in Kenya is still a cumbersome, time-consuming and costly process (World Bank, 2016a). Prior to the Companies Act of 2015, insolvency and bankruptcy in Kenya was governed by several different statutes (Kenya Law, 2016d). According to 2016 *Doing Business*, Kenya fared poorly in resolving insolvency. However, the new law consolidates the previous plethora of legislation into one statute making insolvency and bankruptcy management more efficient.

On trading across borders, Kenya has been rated as performing dismally (World Bank, 2016a). However, a number of trade reforms have recently been implemented. For example, Kenya is implementing the Kenya National Electronic Single Window System to facilitate trade by reducing duel time of imports (Kentrade, 2014). Despite government efforts to develop infrastructure, inefficient transportation services continue to pose a major challenge. Road transportation still remains grossly inadequate while railway services have deteriorated significantly. To ameliorate the infrastructure deficits noted, the government has embarked on various initiatives including the trunk road network development and rehabilitation; construction of the Standard Gauge Railway, and the implementation of the Lamu Port Southern Sudan Ethiopia Transport Corridor Development Authority (LAPSSET).

Access to reliable and affordable electricity is still a major problem (World Bank, 2016a) in spite of some improvement achieved so far. Connections within 600 meters of a transformer now cost much less and take a shorter period. Also, worthy noting is the fact that the government provides substantial subsidies for electricity connections. Moreover, Kenya is committed to exploit other forms of energy like geothermal, wind, and solar.

Kenya made property transfers faster by improving electronic document management and introducing a unified form for registration (World Bank, 2016a). However, registering properties in Kenya is still a sticky issue despite the considerable land reforms undertaken since 2010. Major challenges beyond registration of titles abound. For example, a nagging problem of authenticating source documents lingers.

Protecting minority investors in Kenya was rated poorly. To bar the board and dominant shareholders from making decisions that would otherwise imperil minority investors' interests, some measures have been implemented. For example, the Capital Markets Authority, Kenya's capital market regulator, has provided guidelines for protecting minority investors. Furthermore, the Companies Act 2015 protects minority investors by affording them an opportunity to petition the courts for equitable reliefs in the event of oppression (Kenya Law, 2016a).

In Kenya, courts take long to adjudicate disputes and it is costly to enforce contracts (World Bank, 2016a). However, the judiciary is undergoing reforms by enhancing capacity as well as introducing alternative dispute resolution methods (KNBS, 2016) in a bid to improve administration of justice. Save for stamp duty, paying taxes in Kenya is ranked poorly with minimal improvement (World Bank, 2016a). However, various reforms have been undertaken by the Kenya Revenue Authority (KRA) to improve tax administration (KPMG, 2016b).

Investment Opportunities and Risks in Kenya

The Second Medium Term Plan of the Vision 2030 focuses on infrastructure development and driving growth through public private partnership arrangements. Together with the prevailing favorable investment environment, this development agenda creates an elaborate menu for investment opportunities. However, investment decisions almost always entail some form of risks which should be critically analyzed and effectively managed.

Key sectors to invest in Kenya include manufacturing, agriculture, infrastructure, technology, tourism, real estate, and financial services. It is estimated that in the next 10 years, Kenya has an infrastructure funding gap of approximately USD 3 billion per year (PPP, 2016). It is noted that Kenya intends to bridge the current development funding gap through PPP deals.

The recent focus on extractive resources, including oil, gas, and minerals, is creating a paradigm shift in the types of investments moving into Kenya. Furthermore, the Special Economic and Export Processing Zones offer special incentives and opportunities in various sectors. KRA also fosters manufacturing for exports by providing tax incentives on imported plant, equipment, raw materials, and other inputs (KenInvest, 2016).

Financial intermediation and insurance services in Kenya has continued to record high growth rates. This signifies immense opportunities in the banking, financial, and insurance sub-sectors. Tourism, which is Kenya's third largest foreign exchange earner has significant investment opportunities too (KenInvest, 2016). Generous tax benefits are extended to the hotel sector targeting buildings and capital machinery (US Department of State, 2016).

Available opportunities in the agricultural sector include food processing, irrigation, technological infrastructure, tools and equipment, value addition, marketing and promotional services, and transport (KenInvest, 2016). The size of the local ICT market is estimated at USD 500 million providing business opportunities in the provision of IT and related services. Furthermore, as a sporting nation, Kenya offers potential for investment in athletics through setting up centers for training.

The demand for housing in Kenya is largely unmet. Establishment of county governments creates more demand for housing and related infrastructure. Therefore, numerous opportunities exist in this sub-sector. Renewable energy projects too provide investment opportunities for private investors (KenInvest, 2016). Kenya's privatization program which covers a wide range of sectors provides further opportunities (Privatization Commission, 2016).

The opportunities discussed above carry varying risks. As part of investment decision making, it is important to asses associated risks and employ mitigation strategies to reduce the extent of exposure to the risks and the likelihood of their occurrence.

Kenya's economy remains vulnerable to both endogenous and exogenous risk factors that could temper the growth prospects (Deloitte, 2016; World Bank, 2016b). Corruption, infrastructural deficits, and an untapped informal sector are pervasive challenges that undermine private investment. Equally worrying is the large public sector wage bill, which denies the capital budget necessary funds. Furthermore, the investment environment weaknesses identified in Kenya are susceptible to general risks and vagaries. Some measures commonly employed to mitigate risks include taking investment insurance covers, incorporating risk into the company's financial management strategy, conducting due diligence, and portfolio diversification (Multilateral Investment Guarantee Agency [MIGA], 2016).

Conclusion

Kenya is a favorable investment destination. Investment opportunities in the country include agriculture, manufacturing, tourism, ICT, energy, infrastructure, real estate, oil and mining, and banking and other financial services. However, the economic reforms implemented, thus far, should go deeper. For example, Kenya should strive to improve the areas where performance has been poor by adopting best practices gleaned from other countries. In particular more work is needed in starting a business, obtaining construction permits, controlling corruption and registering property including intellectual property rights. The executive should enforce the law without fear or favor; parliament should make laws; and the judiciary should interpret the law and settle disputes according to the constitution. No one branch should wield or exercise power as to undermine the authority of the other branches.

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