

DECLARATION

11 THE IMPACT OF KENYA PIPELINE COMPANY ON
EXPORTS OF THE MULTINATIONAL OIL COMPANIES
OPERATING IN KENYA 11

Date November 2 2006

BY:

GRACE MUMO

Date 2nd Nov. 2006

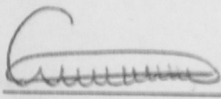
A management Research Project Report Submitted in Partial fulfillment of
the Requirements for the Degree of Master of Business Administration
(MBA), School of Business, University of Nairobi

September 2006

DECLARATION

In memory of Kaka, for whom he meant to me, and the entire family.

This project is my original work and has not been presented for a degree in any other University.

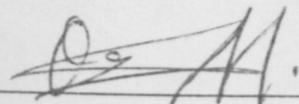
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DEDICATION

In memory of Ken; for whom he meant to me, and the entire family. support and contribution from a number of people whom I am deeply indebted.

I owe very special thanks to Mr. P. Nduu, an invaluable expert in the oil industry. He gave me ideas that became extremely useful within the academic scope of this work. His advice was practical, anything I did with it was my mistake. Further, I am grateful that he allowed me to use him as a reference in contacting respondents in the industry. I am grateful to those managers of the Oil companies, who made time for me to interview them. This was despite their extremely busy schedules.

To my family members, Mum, Mama Bill, Bill, Karuthie, Greg, Ken (for his inspiration, right from the start. He always believed I could do it), his family, Faith, Victor, Mwanzia, Kioko's family, Hellen's family, Sophie's family, Uncle Spoor's family, My grandmother Rebecca (for all the prayers). Thank you all for believing in me.

Finally, I want to thank my friend Judy Oduer who has stood with me through many storms, and my classmates who also became my very good friends, Nancy, Susan, Kinywa, Mwikali, Sarah and John – for their invaluable support throughout the programme. And to Mnyanga, for his support.

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This project has been accomplished with the encouragement, support and contribution from a number of people whom I am deeply indebted.

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Above all, to God. For His provision of finances and safety as I got home late from school on many occasions. For His grace, as I went through very hard accounting courses. And for practically seeing me through this programme; every step of the way.

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LIST OF ABBREVIATIONS

FDI	-	Foreign Direct Investment
IB	-	International Business
KOSF	-	Kipevu Oil Storage Facility
KPC	-	Kenya Pipeline Company
MNCS	-	Multinational Corporations
NEPAD	-	New Partnership for Africa's Development
ODI	-	Outward Direct investment
OPEC	-	Organization of Petroleum Exporting Countries
US	-	United States
WW	-	World War

ABSTRACT

The Kenya Pipeline system is the both the legal and more cost effective way of storing and transporting petroleum products in Kenya. The five major oil companies and the rest of the oil industry rely on the Kenya Pipeline Company to store and transport their fuel stocks to the western Kenya depots for export to the great lakes region. However, KPC's inadequate capacity to store and transport as much fuel as the market demands has been a big hindrance to the realization of these major companies' export potential to the region.

The study sought to determine the magnitude of lost export business and how the oil Multinational Companies have responded to this challenge of inadequate transportation and storage capacity at KPC.

The study was based on primary data, which was collected using a questionnaire and personal interviews. The data obtained was then analyzed and interpreted using content analysis and descriptive statistics.

The findings of this study revealed that the oil companies lose out an average of 53% of their export business due to KPC related problems. Thus KPC does not avail all the volume that the oil companies need to export and the oil companies rated their performance as poor. The oil companies indicated that they are now operating a suppressed demand and customers have had to condition themselves to the volumes they can provide.

In response to this, they have had to rethink alternative storage and transport modes of rail and road. However, the cost implication of these alternative modes far outweighs the use of the Kenya pipeline system. Were the KPC system reliable, it would be the Oil Companies' preferred mode of transportation.

It is thus recommended that the Kenya Pipeline Company would address the current capacity crisis with speed, and proactively anticipate similar challenges that may be faced in the future in view of the fact that the demand in the region is still expected to grow as the various governments continue to reconstruct the economies.

There is a shift from organizing the logistics function on a country to country basis to developing a coordinated international regional strategy (Ellis and Williams, 1996). Despite the seeming popularity of utilizing strategic alliance based sourcing among firms, alliances were reported to have failure rates as high as 70% with many not achieving the intended outcomes (Das and Teng, 2002).

The Kenya Pipeline Company's efforts to create ullage at the Kipevu Oil Storage Facility (KOSF), has been constrained by the under capacity of the existing pumping system which regrettably was not upgraded when due (KPC press release on products supply, February 2006). This translated to several litres of products undelivered to Western Kenya Depots of Nakuru, Eldoret and Kcumu; the east coast for exports to the region.

CHAPTER ONE: INTRODUCTION

1.1 Background

Many firms are consolidating their supplier base and developing strategic alliances with key suppliers to achieve strategic goals that range from cost and risk reduction to new skills or knowledge acquisition. Alliances are expected to create more value than 'go – it – alone' approaches, especially when the capabilities of the partners are combined in such a way that the competitive advantage of either alliance or one or more of the partners is improved (Borys and Jemison, 1989).

There is a shift from organizing the logistics function on a country to country basis to developing a coordinated international regional strategy (Ellis and Williams, 1995). Despite the seeming popularity of utilizing strategic alliance based sourcing among firms, alliances were reported to have failure rates as high as 70% with many not achieving the intended outcomes (Das and Teng, 2000).

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The inconsistent view of the performance implications of strategic alliance based sourcing suggests that its relationship with performance is made more complex by the existence of some key moderating factors than has been theoretically argued and empirically tested before (Kotabe, 1992; Murray et al., 1995). According to Murray et al., 2005, SA sourcing of major components is not an effective strategy in all instances, even in a transitional economy.

1.1.1 The Role of Kenya Pipeline Company (KPC)

The Kenya Pipeline Company owns and operates the white petroleum products pipeline from Mombasa to Nairobi and onwards to Nakuru, Kisumu and Eldoret. This pipeline system is also the only legal means of storing and transporting petroleum products in Kenya. KPC operates the only white oil products pipeline within East and Central Africa. These products include Premium Motor Spirit (Super), Regular Motor Spirit (Regular), Aviation turbine Fuel (Jet A-1), Illuminating kerosene and Diesel (KPC handbook, 2004).

KPC was established by the Kenya government in 1973, and its task was to construct a pipeline system to transport refined petroleum products from the coastal port of Mombasa to the hinterland. Its construction of Line 1 commenced in October 1976 and was completed in December 1977. The government allowed KPC in 1992 to undertake an expansion program. Line 2 was then constructed and it extended from Nairobi to Western Kenya towns of Nakuru, Eldoret and Kisumu and this was commissioned in 1994 (KPC handbook, 2004).

The oil industry relies on KPC to store and pump over petroleum products to these Western Kenya depots where they are normally loaded and transported by road for export to the region. The capacity of the pumping system of the Kenya pipeline company (KPC), constrains its efforts to meet the increasing demand to supply petroleum products in the country and the region at large.

The petroleum industry in Kenya mainly consists of upstream and downstream. The width of line 1 which stretches from Mombasa to Nairobi is 14 inches, and has a pumping capacity of 440m³ per hour. But line II, which pumps product for western Kenya and for exports is much smaller and has a pumping rate of 160m³ per hour. It measures 8 inches between Nairobi – Nakuru – Sinendet, and 6 inches from Sinendet to Eldoret. This line branches off from Sinendet to Kisumu (MOE statistics, 2005).

Petroleum products in Kenya are imported either as crude oil or as refined. All the oil companies licensed to operate in Kenya sign a Transport and Storage (TS) agreement with KPC. Deliveries of fuel from the various KPC terminals are made to the oil companies' depots in accordance with the TS agreement. The entire oil industry thus relies on KPC to store and pump over petroleum products for sale at Nairobi, Nakuru, Kisumu and Eldoret. All export products are then loaded at Kisumu and Eldoret depots and transported by road to Uganda, Rwanda, Burundi, Eastern DRC and South Sudan (KPC Handbook, 2004).

The industry was liberalized in 1994. After this, many new companies have entered. As Kenya does not have its own crude oil at present, it imports the bulk of it from the Middle East. At Mombasa, the crude oil is received and stored in Kenya

Petroleum Refineries Ltd tanks at Changamwe and the Kipevu Oil Storage (KOSF) facility which is owned by the government of Kenya and operated by Kenya Pipeline Company (KPC Handbook, 2004).

1.1.2 The Oil Industry in Kenya

The petroleum industry in Kenya mainly consists of upstream and downstream segments. The upstream segment involves the exploration and production of oil. It ends at the point where the crude product is delivered to an export terminal in the country of production. The downstream segment begins at the loading port and ends at the point where the consumer purchases petroleum products at the retail outlet. It includes shipping, refining, pipeline transport and retail stations.

Petroleum products in Kenya are imported either as crude oil or as refined products. From January 1, 2004, all the crude oil is imported through an Open Tender System (OTS) coordinated by the Ministry of Energy on behalf of all the companies licensed to import petroleum products. The crude is refined at Kenya Petroleum Refineries Ltd (KPRL) to meet 70 percent of the country's requirements. The balance 30 percent of the demand is met by importation of refined products (MOE Statistics, 2005).

The industry was liberalized in 1994. After this, many new companies have entered into importation, distribution and retail marketing activities. Liberalization also enabled many independent businesspersons to construct retail outlets of

their own all over the country. Although many of these outlets do not conform to the minimum conditions as set out in various regulations and bylaws there are some independent stations, which offer facilities equal to those of major companies.

The five biggest oil companies are Shell/BP, Total, Kenol/Kobil, Caltex and Mobil in terms of total sales and percentage market share. In 2003, Total had 16.7% of the market, which went up to 20.6 % in 2004 at the expense of Shell/Bp which dropped from 20.6 per cent to 18.5 % during the same period. Kenol Kobil moved from 14.8% to 18.3%. Caltex moved from 15.1% in 2003 to 13.6% in 2004. And Mobil, from 12.2% in 2003 to 12.3% in 2004. While in 2003, the five largest oil marketers controlled 79.4% of the market, in 2004, they controlled a larger share of 83.1 % (MOE Statistics, 2005).

These major oil companies also rely on KPC for the storage and transportation of their product to western Kenya so that it can in turn be transported by road for exports to the region. The high demand for petroleum products in western Kenya and beyond has stretched the capacity of Kenya pipeline due to fast economic growth rates of the neighboring countries served by KPC. This demand also escalated with the liberalization of the oil industry in 1994 which saw the major oil companies sharing the KPC system with many more users (MOE Statistics, 2005).

The high demand has stretched the state corporation's ability to meet its export obligations. This has remained a big challenge to the major oil companies to realize their market share and exploit the market potential in the region. Since the KPC system only extends up to western Kenya as of now, these major oil companies also face a major health and safety challenge as the fuel for export must be transported by road from these depots.

1.2 The Research Problem

The five major oil companies rely on the Kenya Pipeline Company to store and transport their fuel stocks to the western Kenya depots for export to the great lakes region. However, KPC's inadequate capacity to store and transport as much fuel as the market demands has been a big hindrance to the realization of these major companies' export potential to the region.

In spite of this important role that KPC plays in the industry, and the problem it poses to the major oil companies' export business, scholars seem to have focused on other aspects of the oil industry in their research efforts.

These include Strategic Responses of Petroleum Firms in Kenya to challenges of increased competition in the industry (Chepkwony, 2001), An Investigation of the Strategic responses by Major Oil Companies in Kenya to the threat of New Entrants (Isaboke, 2001), Marketing in a liberalized Petroleum Industry. A study on Changes in Marketing Mix of Oil Companies in Kenya (Wairachu, 2001).

An Investigation into the retail network planning Strategies among Major Petroleum marketers in Kenya (Koech, 2002), A Survey of the operations of service Stations in the Oil Industry using Terry hills framework models (Muthaura, 2002), A survey of the Practices of Staff Downsizing among the Major Oil Firms in Kenya (Huko, 2003), Customer's perceptions of the Differentiating Features of fuel Cards offered by Firms in the Kenyan oil Industry (Munuve, 2003), An analysis of the Application of Unrelated Diversification Strategy by the major Oil Companies in Kenya (Mwindi, 2003) **and** Strategic alliances & Competitive advantage; The case of Major Oil companies in Kenya(Owuor,2004).

challenges they may encounter.

As can be seen, different aspects have been studied, but no research work was found to address the problem this study seeks to investigate. This study seeks to address this knowledge gap by answering the following research question,' What is the Impact of Kenya Pipeline Company on Exports of the Multinational Oil Companies operating in Kenya?

1.3 The Research Objective

The aim of this study is to

- (a) Determine the magnitude of lost export business for the selected oil companies that can be attributed to Kenya Pipeline Company and
- (b) Determine the MNC's response to the growth in demand for exports and resulting challenges of capacity posed by KPC.

1.4 Importance of the Study

The findings of this study will be of benefit to various stakeholders. The various government ministries of energy in the region would get a fair understanding of the operations of the Kenya Pipeline Company on whom they rely for the supply of their country stocks. Development agencies such as NEPAD, interested in funding infrastructural development efforts would also benefit from this information. In particular, it would highlight the urgency with which the Kenya Pipeline should be extended to the region. And finally, international oil companies with intentions of investing in the region would know and appreciate the supply challenges they may encounter.

2.2 The Multinational Corporation

A multinational corporation (MNC) is an enterprise that engages in foreign direct investment (FDI) and that owns or controls value-added activities in more than one country (Hart and Esperto, 2000). A firm is not really multinational if it just engages in overseas trade or serves as a contractor to foreign firms. There are a number of ways of assessing the degree of multinationality of a specific firm. For example, firms are considered to be more multinational if they have the following characteristics. They have many foreign affiliates or subsidiaries in foreign countries. They operate in a wide variety of countries around the globe. The proportion of assets, revenues or profits accounted for by overseas operations

CHAPTER TWO: LITERATURE REVIEW

2.1 INTRODUCTION

Companies may be attracted to cross border markets because of strong pull or push factors or a combination of both. Pull factors entice companies away from their existing local or regional markets because of the perceived attractiveness of a cross border market (Ellis and Williams 1995). This results in to an internationalization process of increasing involvement in international operations across borders. However, MNCs must be aware of any explicit and implicit incentives and barriers to FDI in the host countries. Further, they must strategically manage their relationship to host government controlled means of supply and logistics of the products they trade which would immensely impact on their performance in international business.

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relative to total assets, revenues or profits accounted for by overseas operations relative to total assets, revenues or profits is high. Their employees, stockholders, owners and managers are from many different countries; and their overseas operations are much more ambitious than just sales offices, including a full range of manufacturing, research and development activities.

Multinational Corporations (MNCs) are also referred to as Multinational Enterprises (MNEs), Transnational Corporations (TNCs) and Transnational Enterprises.

2.2.1 The Theory of International Investment

This theory seeks to answer what motivates a firm to go beyond exporting or licensing and what benefits the multinational expects to achieve by establishing a physical presence in other countries. According to this theory, a firm may want to invest in another country for various reasons. The reasons may not necessarily be those of cheapest country of production or country of sale. They may be classified in to three categories, namely those that view firms as seekers, those that view firms as exploiters of imperfections and those that view firms as internalizers.

The top five MNCs in Kenya, by investing in the region, would be according to this theory, exploiters of imperfections. Firms may invest in other countries in order to exploit the imperfections in factor and product markets created by

governments. Many of the policies of governments, especially in developing countries, create imperfections by preventing perfect competition among firms.

Firms are thus compelled to invest in countries with imperfect markets because of the opportunity to earn economic rents or profit that such markets offer, and the fact that it may be difficult to exploit such benefits unless the firm operates from within the market. Operating from within a foreign market enables a firm to bypass the tariff and other restrictions imposed by foreign government. At the same time, the firm also fulfills the foreign government's desire to stimulate domestic industrial production.

2.2.2 The Theory of Competitive Advantage of Nations

In his theory of the competitive advantage of nations, Porter (1990), argues that national prosperity is created and not inherited. According to Porter, a nation's competitiveness depends on the capacity of its industry to innovate and upgrade. KPC operates the only white oil products pipeline within East and Central Africa. This gives Kenya as a country and the MNCs in the oil industry, a competitive advantage that far outweighs that of its neighbors. But it appears that KPC's capacity, unless upgraded, is not adequate to exploit the market imperfections and opportunities in the postwar region.

Porter, (1990) contends that companies develop international competitiveness from having strong domestic rivals, aggressive home base suppliers and

demanding local customers. And that in addition, differences in economic structures, institutions and histories all contribute to competitive success. Porter argued that a firm must avail itself of all dimensions of competitiveness, which he categorized into four major components of what he calls 'the diamond of national advantage'. These components include appropriateness of the nation's factor conditions, demand conditions, related and supporting industries and firm strategy, structure and rivalry.

2.2.3 Regional, rather than 'Single – Country' Location and Competitive Advantage

With globalization, a modern new 'geography' of manufacturing and related industrial innovation seems to have emerged. Science based inventions and high – tech innovations are shaped by business firms increasingly involved in world-wide competition. Yet, many of the industrial and other capabilities that influence new technology-based innovations seem localized to particular geographic areas. In short, innovative capabilities seem to be anchored and shaped in particular areas where the new products are born and nurtured before being launched on the global market.

Dunning, (1980, 1998) posits that an MNC invests in the most advantageous location. They often evaluate prospective FDI destinations on a regional, rather than single – country basis. Geographically contiguous countries are likely to have similar cultures, political and economic systems and development levels. Such countries often constitute a regional economic grouping with considerable

uniformity in their trade and investment policies. Numerous benefits accrue to MNCs from operating in such unified markets, with common communication infrastructure, intra-regional trade without barriers and networking opportunities. The oil Mncs in Kenya have crossed borders to the great lakes region because they have acquired comparative advantages in terms of resource and location.

2.2.4 Exporting as an Entry and Operation Mode for MNCs

There are various modes that a firm can use to enter and operate in foreign markets. For a given foreign market, a firm can use different modes for different products, depending on competitive advantages that may be gained. Exporting may be done directly or indirectly. In indirect exporting, the firm does not need to undertake operations such as documentation and freighting within its organization. The export operations are carried out by others and in many instances they take place without the knowledge of the firm.

In direct exporting, the firm performs the export task by itself rather than delegating it to others. Such a firm will find it necessary to set up an export department within its organization to carry out the tasks of: market contact, market research, physical distribution, export documentation, pricing and other marketing activities. Direct exporting may be done through sales subsidiary abroad and local representatives abroad. The top five oil MNCs operating in Kenya export directly to their sales subsidiaries in the region.

The degree of control the organization has over its sales in cross border markets increases as it moves away from indirect exporting. As export volumes increase, the potential loss of earnings to the company becomes more pronounced. In such circumstances the company may contemplate sizeable fixed investment in market infrastructure, so as to be able to secure a net profit margin similar to that enjoyed in its domestic market. For a manufacturing company, the next stage using direct agents is often to market its products using a direct branch or subsidiary.

In addition to gaining direct control of marketing and being able to set its own selling price, the company retains the large margin taken by the intermediary. The firm may also be better informed and responsive to market changes since it can directly monitor customer and sales responses. Where this method is used for manufacturing goods being imported into the market, the direct subsidiary or branch will focus primarily on sales and marketing in the export market.

Prerequisites for Export (in Kenya)

- Port entry point
- TSS agreement with KPC
- Appropriate KRA export product procedures

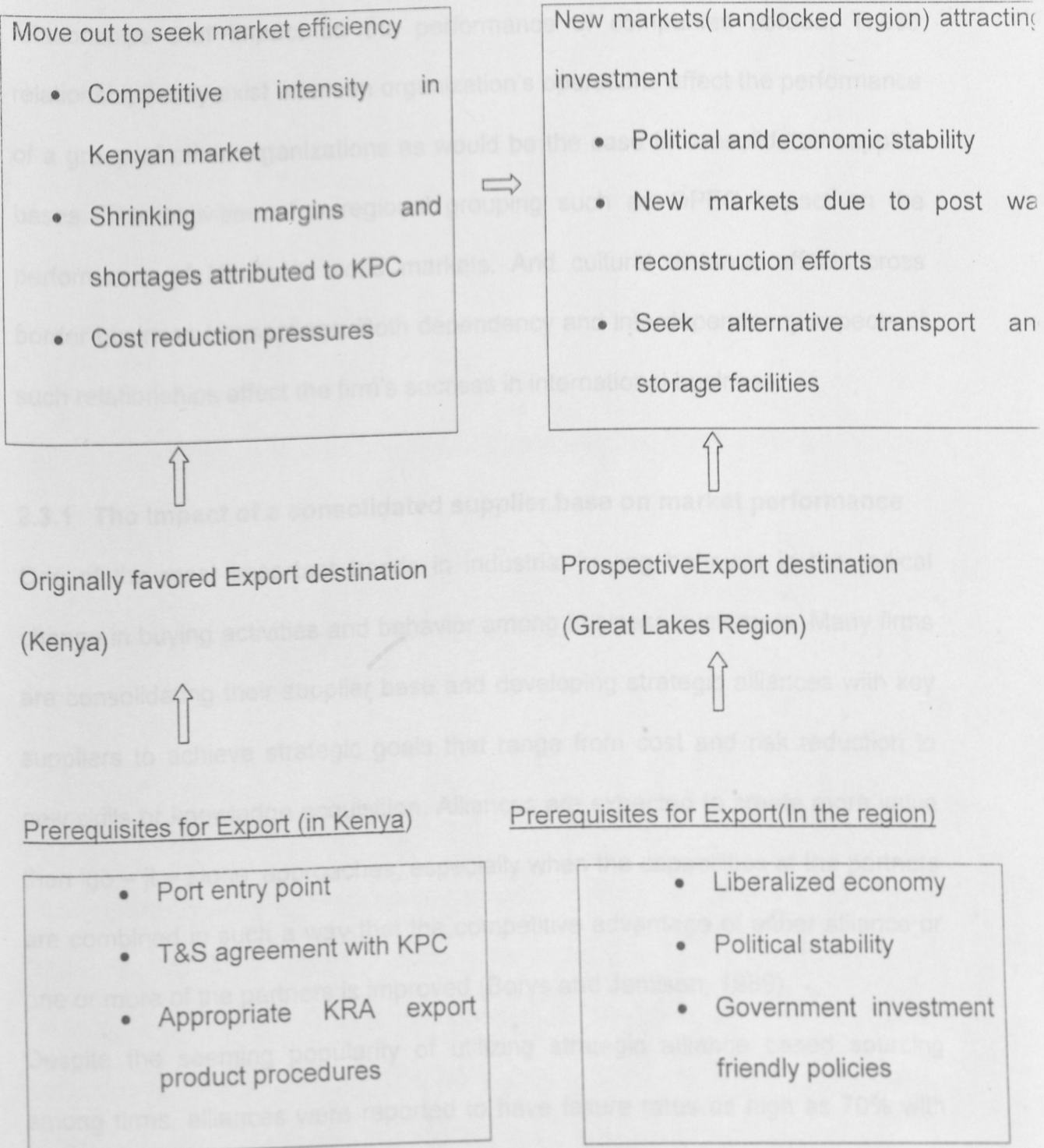
Prerequisites for Export (in the region)

- Liberalized economy
- Political stability
- Government investment friendly policies

Source: Project Author

Figure 1: Factors Impacting on Export trends

Firm Strategy and macro-Economic Factors



Source: Project Author

2.3 A framework of Dependency Relationships in IB

The process of internationalization involves the formation of strategic relationships that impact on the performance of companies abroad. These relationships may exist when an organization's operations affect the performance of a group of other organizations as would be the case in consolidated supplier bases. The activities of a regional grouping such as OPEC impact on the performance of MNCs in world markets. And cultural distance affects cross border business transactions. Both dependency and interdependency aspects of such relationships affect the firm's success in international business.

2.3.1 The Impact of a consolidated supplier base on market performance

One of the most important trends in industrial buying behavior is the radical change in buying activities and behavior among business customers. Many firms are consolidating their supplier base and developing strategic alliances with key suppliers to achieve strategic goals that range from cost and risk reduction to new skills or knowledge acquisition. Alliances are expected to create more value than 'go – it – alone' approaches, especially when the capabilities of the partners are combined in such a way that the competitive advantage of either alliance or one or more of the partners is improved (Borys and Jemison, 1989). Despite the seeming popularity of utilizing strategic alliance based sourcing among firms, alliances were reported to have failure rates as high as 70% with many not achieving the intended outcomes (Das and Teng, 2000). Even more puzzling is the fact that if strategic alliance based sourcing (SA) were significantly

related to higher firm performance, then one should question why all firms would not elect to use such structures to improve their performance (Ahuja, 2000).

The inconsistent view of the performance implications of strategic alliance based sourcing suggests that its relationship with performance is made more complex by the existence of some key moderating factors than has been theoretically argued and empirically tested before(Kotabe, 1992; Murray et al., 1995). According to Murray et al., 2005, SA sourcing of major components is not an effective strategy in all instances, even in a transitional economy like China. They further found that when technological uncertainty is high, increases in SA sourcing of major components by the sourcing firm will negatively influence its market performance. They hypothesized that when demand uncertainty is low, increases in SA sourcing of major components by the sourcing firm will negatively influence its market performance.

2.3.2 The Impact of the Relations between Host Governments and MNCs on FDI and ODI.

Host governments are rarely neutral towards inward foreign direct investment (FDI). Virtually all host governments have barriers to FDI of greater or lesser formality, and greater or lesser transparency. At the same time, many of those governments offer explicit and implicit incentives to foreign-owned multinational companies (MNCs) to establish affiliates in their host markets.

Some prominent direct barriers include limitations on foreign ownership levels, approval procedures that are linked to performance requirements such as

increasing exports from the host country and failure to extend national treatment to foreign investors.

Brewer, (1993) identifies the numerous and diverse types of government policies that might affect FDI, either directly or indirectly. These policies encompass regulations targeted at the operations of MNCs, changes in tariff and non-tariff barriers and monetary and exchange rate regimes.

Public policies designed to limit inflows may as an unintended consequence cause an outflow of FDI. Like was the case in Canada, the passage of the Investment Canada act (1985) marked a significant policy shift in the direction of encouraging FDI. The subsequent implementation of the Canada-US Free Trade Agreement (FTA) and the North American Free Trade Agreement (NAFTA) further liberalizes the environment for FDI in Canada. Globerman and Shapiro, (1999) found that the trade liberalization agreements had statistically significant impacts on gross FDI and ODI (Outward Foreign Direct Investment) flows with a net bias toward ODI.

A major determinant of FDI and ODI is rapid economic growth. It may also generate rapid growth in net cash flows which encourage firms to invest abroad (Grosse and Trevino, 1996). Emerging markets have been dramatically liberalized over the past decade, opening once closed markets to trade and FDI (Doh et al., 2004). One way in which states signal their commitment to market

reform and a positive business climate is through broad liberalization efforts. We would expect countries that have undertaken such reforms to support higher private ownership of infrastructure projects. States committed to a more open trade environment through formal trade and investment obligations can better assure investors of a lower – risk environment (Ramamurti, 2001).

2.3.3 The Impact of Cultural Distance on MNC performance

The study of principal differences in national cultures between the home country of MNCs and their host country operations, that is, cultural distance, has gained a broad interest in international business research (Ricks et al., 1990). Cross – border business transactions involve interaction with different societal value systems. Although national boundaries do not always correspond with homogeneous value systems, there are strong forces within nations to create and maintain a shared culture (Rokeach, 1973; Hofstede, 1980). Adapting to local cultural values that are transmitted through nations' political economy, education, religion and language may create an additional burden of MNCs operating in different countries (Schwartz, 1999).

Underlying the employment of cultural distance in international business research is the assumption that differences between foreign and home country cultures increase the cost of entry, decrease operational benefits and hamper the firm's ability to transfer core competencies to foreign markets (Bartlett and Ghoshal, 1989; Palich and Gomez – Mejia, 1999).

Whereas some studies have indicated a negative relationship between cultural distance and MNC performance (e.g. Luo and Peng, 1999), other studies have found a positive effect (e.g., Morosini et al., 1998). Further managing portfolios of foreign operations with greater cultural distance has been found to increase transaction and operating costs resulting in an increased survival hazard among MNCs (Li, 1995; Park and Ungson, 1997). Meanwhile, high cultural distance has been associated with low rates of joint venture failure.

Hofstede (2001) identifies five dimensions along which countries can be distinguished. Luo and Peng, (1999) argue that incongruence in national cultures results in lower performance when MNCs enter new markets. High cultural differences tend to lead to intra – organizational conflicts and poor implementation of organizational actions, given inconsistencies in values and institutions between home and foreign market operations. MNC managers in culturally distant markets are also less able to take advantage of economies of scale and scope in relation to technology development, joint production, advertising and distribution. Further, high cultural distance can limit MNC performance owing to increased training, monitoring and control costs as well as differences in managerial cognition of environmental and organizational issues (Egelhoff, 1982; Schneider and deMeyer, 1992). At the extreme, cultural differences may lead to differences in investment preferences between partners resulting in the failure of foreign operations of MNCs (Li and Guisinger, 1992).

Individuals operate based upon their cultural orientation when engaging in business practices (e.g. Brett and Okumura, 1998). Culture is the homogeneity of characteristics that separates one human group from another and provides a society's characteristic profile with respect to norms and values that affords understanding of how societies manage relations (Triandis, 1987; Hofstede, 2001; Bhawuk, 2001). Alternately, for Japanese managers, relational norm flexibility in governance contrasts with their cultural orientation (Hofstede, 2001) identifies five dimensions along which countries can be classified: Individualism, Power distance, Uncertainty avoidance, Masculinity and Long term orientation. He argues that national cultures can be positioned along these five dimensions to provide an overall summary of a country's cultural type. When categorizing countries, the general pattern across these five dimensions for each country is used. Japan and the United States clearly differ along four of Hofstede's dimensions (Individualism, Uncertainty avoidance, Power distance and Long term orientation).Further, although both would be classified as masculine, the United States is more feminine than Japan. Relationships that are congruent with the culturally founded normative expectations of each of its (Griffith and Meyers, 2005) postulate that US firm performance will be greatest when the relational norm of information exchange is high in relation to its primary Japanese partner. US firm performance will also be greatest when the relational norm of flexibility is low in relation to its Japanese partner. The concept of flexibility is consistent with USD managers' cultural dimensions of weak uncertainty avoidance and short term orientation (Hofstede,1991). US managers

thus tend to believe that the future is uncertain and therefore they must adapt to changing conditions (Hofstede 2001).

From this perspective, it is believed that flexibility enables a firm to easily adjust to changing environmental conditions allowing it to reap above-normal returns (Noordeweir et al., 1990, Lusch and Brown, 1996). Alternately, for Japanese managers, relational norm flexibility in governance contrasts with their cultural dimensions of strong uncertainty avoidance and Long term orientation which suggest that the future can and should be controlled through effective planning and perseverance (Hofstede, 1991, 2001).

Given the finite nature of resources necessary to engage in flexibility with a firm's global supply chain partners, and the cultural foundation of information change, it is theorized that a US firm managing a global supply chain inclusive of both US and Japanese partners would benefit most by working towards the establishment of relational norm flexibility within its supply chain relationships that are congruent with the culturally founded normative expectations of each of its partners simultaneously.

2.3.4 The Dependency System of International Oil: Impact of OPEC on the World's Oil Markets.

The most successful effort of Southern countries to alter their dependent relationship with the North was the common action of OPEC in seizing control over the world's oil markets (Hart and Espero, 1997). By acting together in a

producer cartel, the southern oil-exporting states were able to increase not only their economic rewards, but also their political power.

For most of the twentieth century, the international oil system was controlled by a producer cartel. Until 1973, that cartel consisted of an oligopoly of international oil companies. The 'seven sisters' – five American (Standard Oil of New Jersey, now known as Exxon, Standard Oil of California, now known as Chevron; Gulf, now part of Chevron; Mobil and Texaco. Chevron and Texaco have since merged.), one British (British Petroleum) and one Anglo-Dutch (Royal Dutch-Shell) – first gained control of their domestic oil industries through vertical integration, that is, by controlling all supply, transportation, refining, marketing operations, as well as exploration and refining technologies (Hart and Espero, 1997).

After WW II, the seven sisters formed joint ventures to explore foreign oil fields and eventually in the 1920's they began to divide up sources of supply by explicit agreements. They were thus able to divide markets, fix world prices and discriminate against outsiders. There was northern political dominance of the oil-producing regions-the Middle East, Indonesia and Latin America who facilitated the activities of the oil companies. Changes in the system began to emerge in the decade following WWII. In the 1950s relatively inexpensive imported oil became the primary source of energy for the developed world. The US oil consumption

outdistanced its vast domestic production, and the US became a net importer of oil. (Hart and Espero, 1997).

In the 1950's and 60's, the seven sisters controlled supply by keeping out competitors and by a series of cooperative ventures: joint production and refining arrangements, long term purchase and supply agreements and joint ownership of pipelines. Over time, changes in the international oil industry, the oil producing states and the oil consuming developed countries undermined the dominance of the seven sisters.

In 1960, five of the major petroleum-exporting countries-Iran, Iraq, Kuwait, Saudi Arabia and Venezuela met to form OPEC in order to protect the price of oil and the revenues of their governments. In its first decade, OPEC expanded from 5 to 13 members, accounting for 85% of the world's oil exports. As oil became the primary source of energy and as US supplies diminished, the developed market economies became increasingly dependent on foreign oil especially from the Middle East and North Africa (Hamilton, 1983, 2003).

The event that created a world shortage of oil and disorder in world oil markets was the 1978 revolution in Iran. At the beginning of 1978, Iran exported 5.4 million barrels of oil a day about 17% of total OPEC exports. As part of a successful effort to dispose the Shah, oil workers cut off all oil exports from that country. The crisis led to a shortage of supply and greater demand for oil as

consumers tried to augment stocks to protect against anticipated future shortfalls in supply.

Then there was the outbreak of war between Iran and Iraq on September 22, 1980. Iraq launched an attack on Iran's oil-producing region and Iran's air force in turn attacked Iraq's oil facilities. The result was a halt in oil exports from these two countries and a reduction in world supplies by an estimated 3.5million barrels per day; approximately 10% of world exports (Hart and Espero,1997).In December 1980, OPEC members set a new selling price of \$33 a barrel and spot prices reached \$41 per barrel. In 1989 and 1990, Iraq and Kuwait were on opposite sides of a significant conflict within OPEC. The UN resolution to close all world oil markets to Iraq exports affected 4.3million barrels per day of oil to world markets; approximately 7% of the world's stocks(Hart and Espero, 1997)

A central determinant of trade and FDI flows is world economic performance. Oil shocks have been closely linked to such performance – for example, all but one of the US recessions since World War II has followed an oil shock (Hamilton, 1983, 2003). Similarly, oil shocks have hurt economic performance in the other large oil – importing countries that are the primary home countries for FDI. Oil shocks have been found to have adverse effects on expected profitability of companies listed on the stock exchanges in the USA, UK, Japan and Canada as seen by their negative effect on stock prices (Jones and Kaul, 1996). The start of

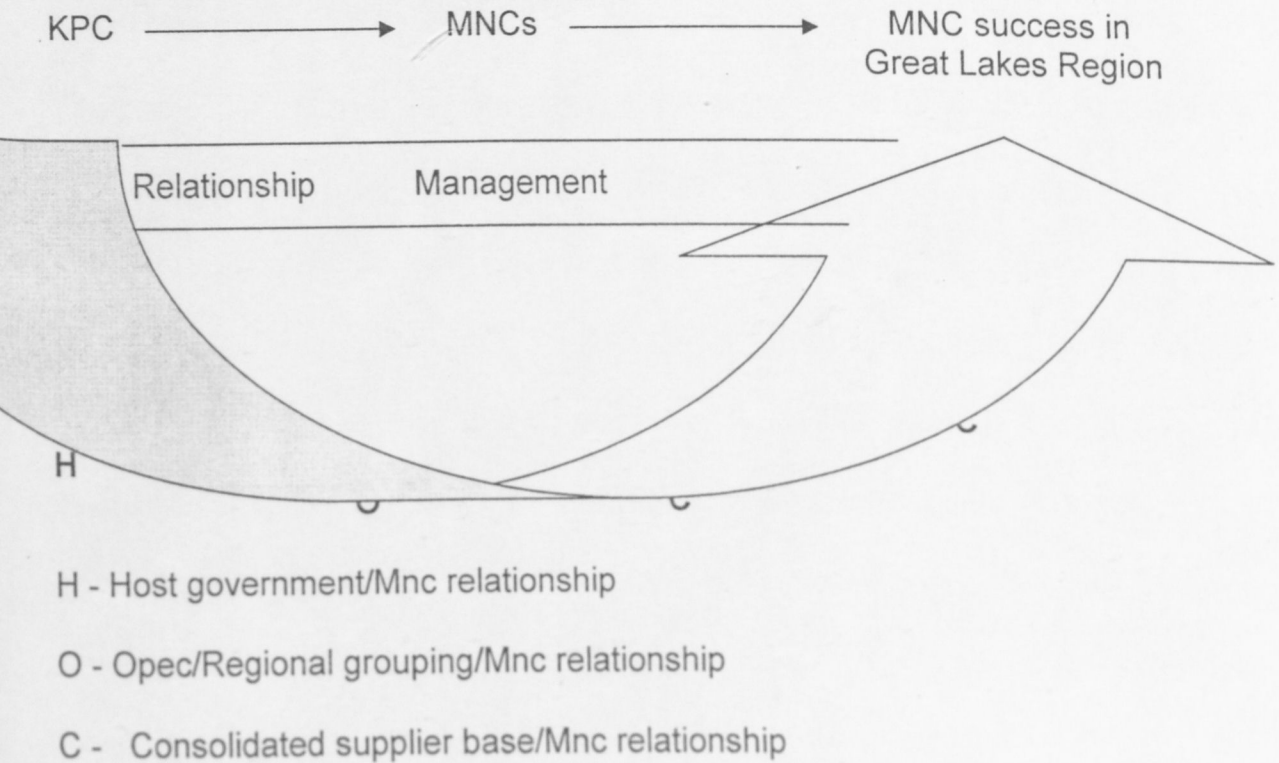
the Gulf crisis had negative effects on equity markets in sixteen nations in North America, Western Europe and East Asia (Malliaris and Urrutia, 1995).

Source: Project Author

Turning to political economy, oil shocks may affect the bargaining power of Multinational oil companies and governments and State – owned oil companies of oil – exporting countries, especially those considered to be remote from the sources of likely shocks (Weiner, 2005). Given the systemic effects of oil shocks, undertaking the factors that cause or exacerbate them is important both for predicting their occurrence and for mitigating their effects. Weiner, 2005 found that it is fundamentals rather than speculation that drive oil – price volatility.

2.3.5 Summary

Figure 2: The HOCC Model



C - Cultural distance – MNC adaptation to different cross border cultural orientations.

CHAPTER THREE: RESEARCH METHODOLOGY

Source: Project Author

This was a census study of the five oil multinational companies in Kenya. The relationship between KPC and the MNCs is typified by the components of the HOCC model. The post war activities in the great lakes region have resulted in attractive emerging markets for the MNCs. Their success in exporting petroleum products to this region is dependent on the MNC effective management of this relationship.

3.2 Population of Study

The population of the study consisted of the only five Multinational oil companies operating in Kenya as of June 2008. Since the liberalization of the industry in 1994, many new companies have entered into importation, distribution and retail marketing activities. According to Ministry of Energy statistics, by November 2005, 25 companies had import licenses, however, the top five MNCs had maintained leadership in Kenya and the region through investment in petrol stations and leadership in market share. They were also the top five in terms of total local and export sales and percentage market share. They included Shell/PP, Total, Kenya/Kobil, Chevron/Texaco and Exxon/Mobil.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

This was a census study of the five oil multinational companies in Kenya who also export to the African great lakes region. The study of these five companies gave the most representative scenario of the export activities since they have been the most visible in the industry in terms of market share, length of operation with KPC and market leadership activities. Further, this design was most relevant because, Multinational Companies have well defined structures and engage in in-depth analysis of foreign markets. They thus had comprehensive data useful for an in depth exploration of issues arising from the phenomenon this study sought to address.

3.2 Population of Study

The population of the study consisted of the only five Multinational oil companies operating in Kenya as of June 2006. Since the liberalization of the industry in 1994, many new companies have entered into importation, distribution and retail marketing activities. According to Ministry of Energy statistics, by November 2005, 25 companies had import licenses. However, the top five MNCs had maintained flagship in Kenya and the region through investment in petrol stations and leadership in market share. They were also the five biggest oil companies in terms of total local and export sales and percentage market share. They included Shell/BP, Total, Kenol/Kobil, Chevron Texaco and Exxon Mobil.

3.3 Data Collection Methods

The research drew its data from primary sources selected based on the relevance of their duties in dealing with KPC in supply logistics and management of exports. The respondents included: Five supply and logistics managers based in Kenya; one from each of the five companies. Five export managers based in Kenya; one from each company. In most cases the supply managers doubled up as the export managers. For most of the companies, the regional operations were centralized in Kenya and thus the supply/export managers became the reference point of information. The questionnaire (see Appendix II) was administered personally to the respondents in Nairobi.

3.4 Data Analysis

We used content analysis to analyze qualitative data and descriptive statistics for the quantitative data. Percentages were used to determine the MNC's annual business sales consisting of exports. They were also used to analyse the projected export business the MNC's failed to realize, due to KPC related problems. Mean scores were used to analyse the MNC's rating of KPC's performance and the frequency of stock run outs.

CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

4.1 Introduction

This chapter covers data analysis and findings. The findings are presented in three major parts:- Company profile, The Mnc's responses to transport and storage capacity challenges associated with KPC, and the Lost export business that can be attributed to KPC problems.

4.2 Company profile

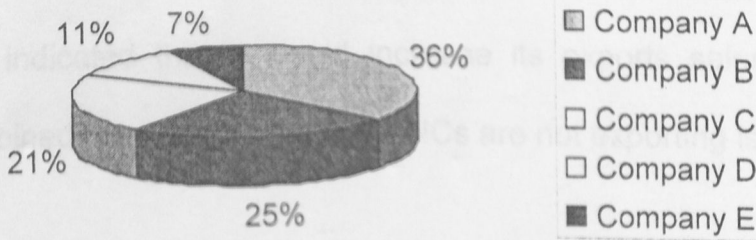
All the five companies were established in Kenya between 1900 and 1984. They all export petroleum products from Kenya; to at least five of the countries in the region. These countries include Uganda, Rwanda, Burundi, Northern Tanzania, Eastern Democratic Republic of Congo and South Sudan.

Two of the companies had subsidiaries in these countries. One had subsidiaries in all the countries except in South Sudan. One other company had subsidiaries in only three of the countries. The fifth company had no subsidiaries in all the countries and exports to its customers directly from Kenya.

4.3 Lost Export Business

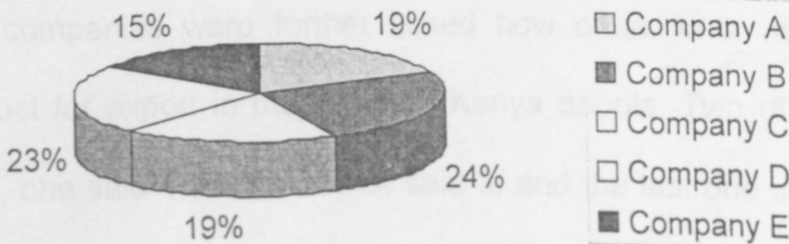
The respondents were asked to indicate what percentage of their annual business plans consists of exports to the region. The percentages indicated were 50%, 35%, 30%, 15% and 10%. This gave an average of 28% as the total planned annual export business for these Multinationals.

Figure 3: Percentage of MNCs Annual Business Sales Consisting of Exports



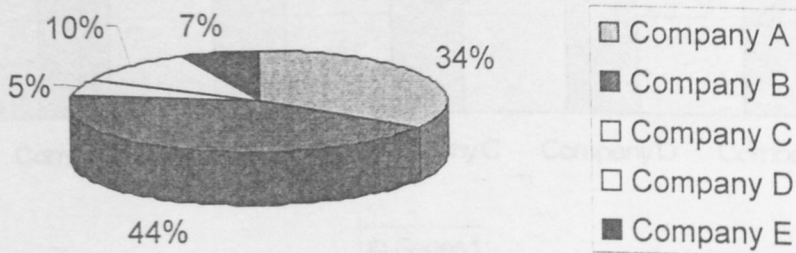
The companies were also asked to indicate what percentage of this projected export business they fail to realize due to KPC related problems. The percentages indicated were 65%, 60%, 40%, 50% and 50%. This gave an average of 53%.

Figure 4: Percentage of the Projected Export Business the MNC's Fail to Realise due to KPC Related Problems



The respondents were further asked how much more product they would sell if KPC availed all the volume that they needed. Two of the companies said their export sales would increase by 50%, one by 65%; another by 60% and the last one indicated that it would increase its exports sales by 8%. Therefore the combined percentage that the MNCs are not exporting is approximately 41.6%.

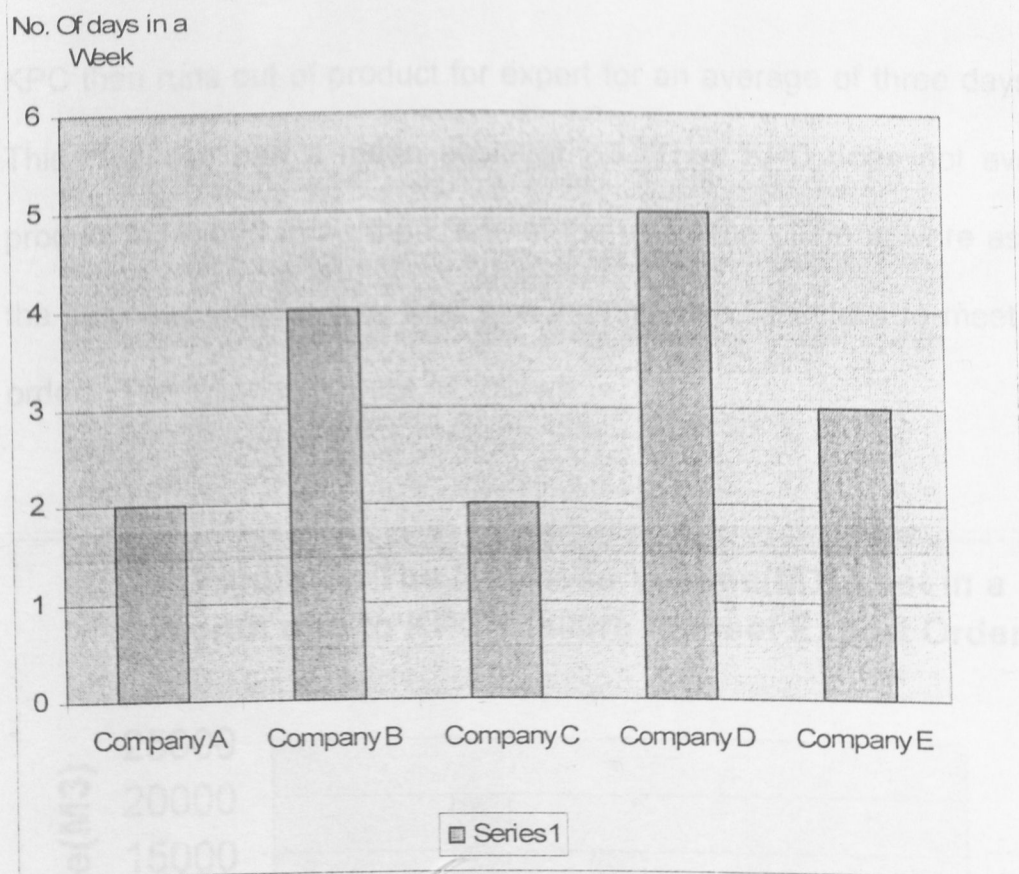
Figure 5: Additional Export Sales the MNCs would Realize if KPC Aailed all the Volume they Needed



The various companies were asked to state the number of days KPC runs out of

The companies were further asked how often, in a week, KPC runs out of product for export in the Western Kenya depots. Two of the companies said 2 days, one said 4 days, another said 3, and the last one said daily. The following graph illustrates these responses.

Figure 6: No. of days KPC runs out of products for export at the Western Kenya depots



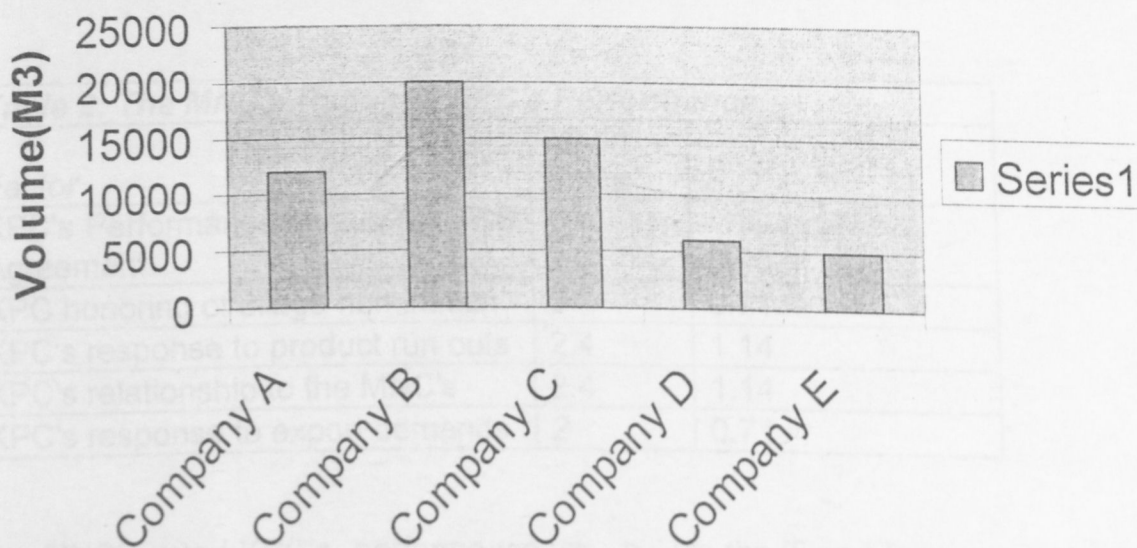
The various companies were asked to state the number of days KPC runs out of product for export in a week of five days. One company said all week, another said four days, two said that KPC runs out for 2 days, and only one said it runs out for one day.

Table 1: Frequency of Stock Run Outs

Factor	Mean Score	S.D
Frequency of stock outs	2.8	1.30

KPC then runs out of product for export for an average of three days in a week. This response had a mean score of 2.8. Thus KPC does not avail sufficient product for export more than 50% of the time. The oil firms were asked to state the business volume they lose in a month when KPC fails to meet their export orders. The responses were as follows

Figure 7 : The Business Volume(M3) Lost in a Month due to KPC's failure to meet Export Orders



When this volume is represented in a graph, it clearly shows that the MNC's lose a combined volume of 58000 M3 of export business per month.

4.4 The MNCs response to KPC's inadequate capacity to store and transport petroleum products for export

All the companies agreed that the demand for export products to the region had increased between 2003 and 2006. They attributed this growth in demand to the following factors: Improving political stability in the region, Climatic changes in the Nile that have led to the need for diesel power generating plants in Uganda, Increased economic activity in the Northern Tanzania mining region

The companies were asked when they signed the Transport and Storage agreement with KPC. Four of the companies signed in 1978 when KPC began its operations and the fifth signed in 1984 when it began operations in Kenya.

The companies were asked to rate KPC's performance vis-à-vis this agreement and gave the following results:

Table 2: The MNC's Rating of KPC's Performance

Factor	Mean Score	S.D
KPC's Performance versus the T&S Agreement	2.6	0.90
KPC honoring of ullage nomination	3	0.71
KPC's response to product run outs	2.4	1.14
KPC's relationship to the MNC's	2.4	1.14
KPC's response to export demands	2	0.71

The MNC's rated KPC's performance vis - a - vis the T and S agreement as fair with a mean score of 2.6. That KPC honors their nomination for ullage/product storage space at KOSF, sometimes, and this was also considered fair with a mean score of 3. That product run outs started in 2003 and heightened in 2005, but KPC's response was reactive as opposed to proactive. The oil companies

rated this response as poor with a mean score of 2.4. The companies felt that in as much as they anticipated the problem in 2003, and warned KPC, in various meetings, KPC did not respond at the time. Instead it underestimated the growth of demand in the region. Further, the companies felt that KPC's capacity enhancement programmes were slow and not at pace with the demand.

The companies however indicated that they faced reliability challenges with The relationship between KPC and the Oil Multinationals is suspicious. KPC is a government parastatal while the oil Multinationals are private corporations that may be viewed as more efficiently managed. Thus in KPC the element of bureaucracy that may slow down capacity enhancement projects may not be lacking. The Oil Multinationals suspect KPC of lack of transparency in ullage allocation while the parastatal suspects the Oil Companies of victimizing some employees. The relationship between the two was rated as poor with a mean score of 2.4. The relationship is however improving as the two parties are now having interactive meetings to address issues as stakeholders.

Overall, the companies rated KPC's response to the demand for exports to the great lakes region as poor with a mean score of 2. All the companies indicated that as a result of this poor response, they have had to rethink alternative transport modes. The following are the alternatives modes:

Table 3: Alternative Transport Modes

Company	Alternative Mode
A	Road from Nbi depots
B	Road from Nbi / Nakuru depots, Dar es Salaam Port, Rail from Mombasa
C	Rail from Mombasa depots, Dar es Salaam Port
D	Road from Mombasa depots
E	Road from Nbi depots, Rail from Mombasa depots

The companies however indicated that they faced reliability challenges with these alternative transport routes. They also indicated that the cost of transport had increased by \$ 13/m³ due to use of some of these transport modes.

Table 4: Summary of Challenges of the Alternative Transport Modes

Alternative Transport Mode	Associated Challenge
Road	<ol style="list-style-type: none"> 1. Increased cost of transport to \$13/m³ 2. Product loss through siphoning 3. Product loss through evaporation 4. Delays in loading from local demand
Rail	<ol style="list-style-type: none"> 1. Unavailability of wagons 2. Delay of up to two weeks. Ideally it should take three days from Mombasa to Eldoret 3. Product loss through theft while in transit

5.1 Summary, Discussions and Conclusions

This study had two objectives and the results are shown in the order of the objectives.

1. The first objective sought to determine the magnitude of lost export business for the selected oil companies that can be attributed to Kenya Pipeline Company. The results showed that the combined percentage of projected export business by the Multinationals is 28%. But they fail to realize 53% of this planned export business due to KPC related problems, as shown above. The oil companies also indicated that they would export an additional 41.6% of petroleum products if KPC availed the entire product they needed.

It is thus clear that KPC has not been able to store and supply the oil companies with the product they need to meet their customer needs. In essence they not only fail to do so, but this also costs the country much needed revenue. The problem gets compounded because this not only affects the economic growth of Kenya, but also that of the countries in the region.

Of all these countries, Kenya is the only one that has a pipeline system for transporting white petroleum products. It is also strategically located and serves countries that are landlocked. Kenya thus enjoys a location specific advantage that is not fully utilized.

Oil is a strategic commodity, and the governments of these other countries may begin to seek alternative sourcing if KPC continues to fail to satisfy their demand. For example, South Sudan may consider importing from Northern Sudan. Uganda and Northern Tanzania may consider using the port of Dar es Salaam. Sourcing from Cape town is also a possibility.

From the foregoing discussion, KPC needs to take advantage of its competitive advantage in the region and speed up their capacity enhancement programmes in order to match them with the demand in the region.

5.2 Limitations Of The Study

2. The second objective sought to determine the MNC's response to the growth in demand for exports and resulting capacity challenges at KPC. The results show that the MNCs have had to rethink alternative transport modes, as shown above, to reduce their reliance on KPC. They felt that KPC's response to the problem is so poor that they are willing to explore alternative routes that are more costly.

In one case the company has been incurring an additional cost of \$8 /m³ on an alternative road route. In another case the additional cost has been \$12-\$13/m³ on an even longer road route. And incurring this cost is in effort to try and satisfy their customers demand. From the findings KPC runs out of product for export for at least 3 days in a week in Kisumu and Eldoret depots. The companies have then had to result in incurring this additional cost.

From the foregoing discussion the following may be concluded regarding the MNC's response to KPC capacity challenges. The MNC's feel that KPC handles them with a 'take it or leave it' attitude. In as much as the situation has forced the oil companies to consider other alternatives, KPC would still be their preferred alternative. Their responses have motivated by the fact that they think KPC will still not be able to meet the export demand for at least another two years. This is despite the fact that KPC has stated that they will do so within a year.

5.2 Limitations Of The Study

Had their been more resources in terms of time and finances it would have been good to interview some key customers and government officials in the region, just to have a feel of their experience in this crisis. However, the business they lose was captured in the percentages given by the oil Multinationals. Companies were in some cases careful to divulge information because they are competitors in the industry. However sufficient data was gathered to satisfy the research objectives.

5.3 Recommendation For Further Research

I recommend that a study on KPC's infrastructural and administrative responses to the growth in demand for exports of petroleum products in the region be carried out. Such a study would complement this one.

5.4 Recommendation For Policy And Practice

Organizations operate based upon their cultural orientation when engaging in business practices. There may exist a marked difference in the speed with which government parastatals and multinationals may respond to problems. Adapting to local cultural values that are transmitted through a nation's political economy, education, religion and language may create an additional burden to MNCs and cost the host country considerable revenue loss like is the case here.

There is a bureaucratic approach to handling issues on one hand, and a corporate drive to realize profits and market share growth on the other.

KPC and the oil Multinationals thus need to work as a team in handling this problem and proactively anticipating future scenarios.

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APPENDICES

APPENDIX I: LETTER TO RESPONDENTS

July 24, 2006

Grace Mumo
C/O MBA office
Faculty of Commerce, UoN,
P.O. BOX 30197
NAIROBI

Dear Respondent,

I am a postgraduate student in the University of Nairobi, pursuing a Master's degree in Business Administration. I am undertaking an International Business research project in partial fulfillment of the academic requirement of the MBA degree. The topic am researching on is the Impact of Kenya Pipeline Company on the exports of the Multinational Oil Companies operating in Kenya.

This study seeks to establish the magnitude of lost export business that can be attributed to KPC, and the MNC's response to the problem. We request you to take a few minutes of your valuable time to respond to the questions that follow. Your responses will be kept confidential and your assistance will be highly appreciated.

Yours faithfully,

Grace Mumo

Dr. Ogutu

MBA Student

Project Supervisor

APPENDIX II : QUESTIONNAIRE

SECTION A - Company Profile

1. Name of Company (optional)
2. Year of establishment in Kenya
3. Which countries do you export to from Kenya?
4. Do you have subsidiaries in those countries?

SECTION B -MNC's response to growth in demand and capacity challenges

5. Would you say the demand for export products has increased?
6. If yes, when was this growth in demand felt by your company?
7. What factors would you say led to this growth?
8. When did your company sign a T & S agreement with KPC?

On a scale of 1 – 5, where this scale will apply for questions 9, 10, 12, 13 and 14, and 5 – Excellent, 4 – Good, 3 – Fair, 2 – Poor, 1 – Very Poor,

9. How has KPC performed vis – a – vis the T & S agreement?

Excellent
Good
Fair
Poor
Very Poor

10. How would you rate KPC's performance in honoring your import nomination for storage space allocation at KOSF?

Excellent
Good
Fair
Poor
Very Poor

11. When did product run outs for export in western Kenya depots begin?

12. How would you rate KPC's response to this?

Excellent

Good

Fair

Poor

Very Poor

13. How would you rate KPC's initial response to the problem in meeting your export demands?

Excellent

Good

Fair

Poor

Very poor

14. Since that time how would you describe KPC's managed of the problem?

Excellent

Good

Fair

Poor

Very poor

15. What has been KPC's attitude towards the oil companies?

As customers whose demands should be met

As private firms which don't understand KPC's problem

As stakeholders who must content with KPC's policies

16. Have you had to rethink alternative transport modes/route?

Yes

No

17. If yes, which ones?

Port of Dar es Salaam

Kenya Railways wagons from Shimanzi

Others (Please specify)

18. What has been the implication of this crisis to:

(i) Customer service levels

(ii) Working capital

(iii) Profit margins

(iv) Other trading aspects (please specify)

19. What has been your response to the impact indicated above on:

(i) Customer Service

(ii) Working Capital

(iii) Profit Margins

(iv) Other

20. What strategic responses have you adopted as a result of this crisis?

Divesting

Mergers

Acquisition

Expansion in to other countries not supplied by KPC

Others (Please specify)

21. What motivated the company to adopt the response adopted in 15 above?

Perception that:

KPC will not meet the export demand in the long run

The crisis is temporary

Others (please explain)

22. Have you had to revise your lead times? If so how?

23. Have you also had to revise the capacities of product ordered and stored?

24. What other supply related changes have you had to make as a response to the KPC problem?

SECTION C - Lost Export Business

25. Roughly, what percentage of your annual business plans consists of exports?

26. What percentage of this projected export business do you fail to realize due to KPC related problems?

27. If KPC had availed your product as needed, how much more would you have sold? Indicate in percentage

28. How often, in a week of five days, does KPC run out product for export in the Western Kenya depots?
- Five days
 - Four days
 - Three days
 - Two days
 - One day
29. When you ask KPC to avail product for export, on average what percentage of that may not be catered for/availed in a week?
30. What percentage of your export requests to KPC is met in a week?
31. If KPC fails to meet your orders at any one time, what percentage business volume, in M3, do you lose in a month?
32. Despite this, do you manage to regain the lost business volume if KPC finally avails the product?
33. Do you consider KPC's failure to meet designated orders to affect customer loyalty?
34. If yes, what has been your response to mitigate this? Please explain.
35. What would you say is the export market potential of the region in M3?
36. Of this potential, what percentage is not exploited that can be attributed to KPC?
37. If the MNC's were to fully exploit the market potential of the region, how much would it be in M3?
38. What percentage of this would be exploited by your company?
39. Of this percentage, how much are you actually exploiting?
40. What marketing strategies are you employing to ensure your company does not lose any export business volume?