FOREIGN DIRECT INVESTMENT DETERMINANTS: THE CASE OF CITIBANK'S CLIENTS INVESTING IN KENYA

BY

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A MANAGEMENT RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, FACULTY OF COMMERCE, UNIVERSITY OF NAIROBI

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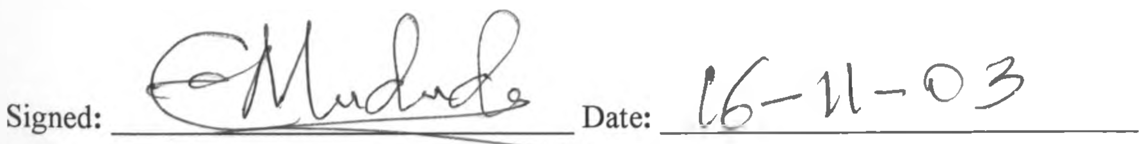
DECLARATION

This research project is my original work and has not been submitted for a degree in any other university.

Signed: ______________________ Date: 13th November 2003

Constance .M. Mcharo

This project has been submitted for examination with my approval as university supervisor.



Signed: ______________________ Date: 16-11-03

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DEDICATION

To my husband Mwafuga and our son Mwaumba for being a source of encouragement during my MBA.

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Special gratitude to my supervisor Eliud Mududa for the guidance and advise throughout the project.

I have benefited from the comments and valuable suggestions from all the respondents, without which there would be no findings.

A message of gratitude to all my friends and colleagues for their input throughout the MBA course period.

I am especially indebted to my parents, Mr. and Mrs. Mwakio Mcharo for their unrelenting support and determination to see me through my education and always challenging me to greater heights. Thank you Daddy and Mao. To all my family for their motivation and moral support, I am indeed blessed.

A loving "thank you" to my husband, Mwafuga and son, Mwaumba, for sacrificing family moments so I can complete the course, and for always being there when I needed a shoulder to lean on.

Last but not least, I would like to thank the Almighty God for His abundant blessings, which have molded me into the person I am today.

ABSTRACT

In recent times, the importance of Foreign Direct Investment has taken a new dimension. Debate among academics and policy makers has shifted from whether or not countries should attract FDI to how countries can attract and reap the full benefits that come with FDI. The benefits of FDI include serving as a source of capital, employment creation, technology transfer, to mention a few. As expected, the answer to the question "why is FDI important to a country" will depend on the needs of the country. The role of FDI as a source of capital has become increasingly important to Sub-Saharan Africa (SSA). The empirical literature on the determinants of FDI to developing countries has generally focused on identifying the location-specific factors that are relevant for FDI to developing countries with only a few African countries in their sample. With regards to research on the determinants of FDI to Africa, there appears to be a dearth of literature.

This study had two primary objectives:

1. To identify factors that influence Foreign Direct Investment growth in Kenya
2. To evaluate foreign investor perspective on adequacy of incentives offered.

To facilitate this study, a list of 54 companies with a global banking relationship with Citibank was obtained. These were multinational firms. Only 25 respondents agreed to participate in the study, with the rest saying their policies are too protracted to allow them participate. Of those who did not respond, the time frame was too short, whereas others needed to seek information from their head office.

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A semi-structured questionnaire was emailed/ delivered to relevant senior managers in the companies. Data collected was analysed using descriptive statistics such as summarised tabulations, percentages, frequencies, and rankings.
The results show there is high level of sophistication with the foreign investors with diverse needs. A large number of them are aware of the incentives given to attract foreign investments. However, they are also aware that the incentives provided are not sufficiently adequate to attract higher levels of capital and equity investments.
The findings also show that many investors view Kenya as a potential economic giant with market growth opportunities, especially given its strategic location and the new government's willingness to enhance investments.

Major conclusion arrived at is for the government to go back to the drawing board and restructure the incentives especially taxation. They should also work closely with the private sector in a bid to monitor changing patterns of Foreign Direct Investment in the emerging markets. The challenge is for the government to create an enabling environment.

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CHAPTER ONE

INTRODUCTION

1.1 Background

Today between 25% to 30% of the World's stock of Foreign Direct Investment (FDI) is in the developing countries. About 40% of this is in the manufacturing sector. (World Development Report, 1987).

Multinational corporations (MNCs) have been attracted to developing countries such as Latin America because of the trade policies that restrict imports of final products to these countries. On the other hand they have been attracted to other developing countries like Kenya, due to their large markets and abundance of semi-skilled cheap labour (Sharma, 1989).

Foreign Direct Investment plays an active role in the economies of the host countries. A considerable proportion of capital formation arises from the activities of foreign private firms. It seems from the above that MNCs are the best antidote to the weak economies of the third world and that the less developed countries cannot survive without their existence (Sharma, 1989).

Foreign Investment in the form of loans or equity is an important source of capital for growth in developing countries. Equity investment can be either indirect (Portfolio) or direct, known as foreign direct investment (FDI). FDI does much more than provide

developing countries with financing for their growth. It brings them new technologies, management techniques, and market access as well. FDI may be stimulated by exploitation of proprietary technology or natural resources or by access to markets (Weigel et al, 1997).

In the period after independence, Kenya was a favorite destination for most foreign investors. However, this role seems to have reversed in the 1990s as new foreign investments declined drastically, with neighboring countries like Uganda picking on this windfall of opportunity to boost their FDIs. A broad view of some of the factors responsible for this pattern is corruption, high taxation and expensive credit.

It is important to address the causes of poor investment levels as FDIs play a key role in the economy.

However, it is also important to evaluate strategies the government of Kenya is engaging to address economic reforms with a view of addressing investments.

Kenya has followed a mixed economic development strategy since independence. While the receptive roles of the public and private sectors have evolved over time, the country has experienced remarkable continuity in its underlying economic development strategy. However, there has been a shift in emphasis from public investment to private sector-led economic growth. Market-based reforms have been introduced and more incentives for both local and foreign private investment provided.

The key economic reforms the Government has carried out include:

- Abolishing export and import licensing, except for a few items listed in the Imports, Exports and Essential Supplies Act (Cap 502);

- Rationalising and reducing import tariffs;
- Freeing the shilling exchange rate to be determined by the market;
- Removing all current account restrictions;
- Allowing residents and non-residents to open foreign currency accounts with domestic banks;
- Removing restrictions on domestic borrowing by foreign-owned companies;
- Allowing residents to borrow without limitation from abroad;
- Revoking of blocked funds provision;
- Liberalising unconditionally the Capital Market - foreign companies can buy stocks to a maximum of 40 % of company's total quoted stocks and individuals up to 5%; and,
- Removing price controls, and
- Repealing the exchange Control Act.

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1.2 FDI in Developing Countries.

Foreign Direct Investment in developing countries has a long history. It has fluctuated over time, as investors have responded to changes in the environment for investment, including government policies toward foreign direct investment and the broader economic policy framework. Hence, trends in FDI have reflected changes in policy stances by developing countries, from import substitution in the 1950s and 1960s through natural resources– led development in the 1970s, structural adjustment and transition to market economies in the 1980s, and an increased role for the private sector in the 1990s.

FDI in developing countries has flowed into manufacturing and processing industries. It has traditionally been concentrated in a small group of countries, which partly reflects the size of their economies and partly their attractiveness as a location for FDI. Competitiveness, mainly in terms of good and stable banking environment has become a main determinant of attractiveness. Restrictions notwithstanding, the volume of FDI flows has swelled from an average of $77 billion in 1983 –1987 to $ 318 billion in 1995. Developing countries, with average inflows of only $18 billion in 1983 – 1987, received nearly $100 billion by 1995, a more than fivefold increase (Weigel et al, 1997). Developing countries that have more highly skilled labour available at relatively low wages can more favorably influence plant location decisions. More fundamentally, the impetus of Africa's growth and sustainable development will come only by investing in and accelerating the education, training and skill development and capacity of its human resource by improving the means of linking these skills and capacities to the world market through trade, capital flows, technology and investment (Husain, 1993)

1.3 Statement of the Problem

For almost a decade now, there has been a stagnation of new investment in Kenya. Some multinationals have opted to close down their manufacturing units in Kenya and import from other countries they have invested in as the cost of production has been unfavorable. For example Proctor and Gamble is now selling products manufactured in Egypt and Morocco, Unilever is outsourcing some of their products from West Africa, Coca-Cola has relocated its regional offices to South Africa.

These are a few examples of FDI's Kenya is losing to other competitive countries. There have been calls for a more proactive approach to forestalling relocation of foreign capital from Kenya.

Many factors influence the flow of foreign direct investment to developing countries, but the most obvious one is often overlooked; namely, the willingness of developing countries to allow it. Historically, many countries have placed onerous limitations on the scope for FDI, even when seeking to promote it. Inevitably, this has acted as a deterrent.

Restrictions on inflows of FDI have taken many forms, including limits on entry to certain sectors (such as state owned monopolies; telecommunications, railways, Ports Authority), Complex approval mechanisms (bureaucracies and corruption), high taxes and complex incentive regimes, restrictions on share of foreign ownership, and restrictions on use of land and expatriate labor.

Restrictions have been imposed for many reasons, including concerns over excessive foreign influence and loss of national wealth, desire to promote indigenous

entrepreneurship and workers, and desire to achieve transfer of technology and management techniques.

A similar research done by Sharma in 1989 raised suggestions for further research as:

- There is a need to conduct a study to find out from the MNCs the ways in which the current incentives can be changed to suit their needs. Possible suggestions can be given and a rating determined using a semantic differential scale.
- A further research could be done to determine the areas in which the MNCS have generally made important contribution. This information would enable the government to introduce new incentives, relating to the areas of major contribution to the economy of the country.
- A wider research could be conducted to compare the investment incentives offered by Kenya and those offered by neighboring countries.

Since then, many significant changes have taken place, necessitating another research to establish if the factors and incentives then are still relevant now, and if any new initiatives have been adopted to enhance FDI in Kenya.

There does exist a knowledge gap, as the researcher is not aware of any recent research having been undertaken to address this.

In view of the above, it is of interest to establish what considerations are important in attracting foreign direct investments in Kenya. The questions that this study seeks to satisfy would be:

1. What factors are important when considering investment in a developing country such as Kenya?
2. How adequate are the current incentives offered by the government of Kenya?

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1.4 Objectives of the Study

The objectives of this study are:

- To identify factors that influence FDI growth in Kenya
- To evaluate foreign investor perspective on adequacy of incentives offered.

1.5 Significance of the Study

- The study will provide an insight into what attracts foreign investors to a country.
- To policymakers, the study will highlight areas of concern that need to be addressed in order to stimulate foreign investment growth.
- To the society, the study will seek to portray the role of FDI's in the society.
- To foreign investor, a reason to consider investing in Kenya.
- Basis for further research to academics.

CHAPTER TWO

LITERATURE REVIEW

2.1 FDI as an Entry Option.

What is Foreign Direct Investment?

Foreign Direct Investment (FDI) involves the ownership and control of a company in a foreign country. In exchange for the ownership, the investing company usually transfers some of its financial, managerial, technical, trademark, and other resources to the foreign country. The foreign company may be created as a new venture by the investor, or it may be acquired from an existing owner (Grosse and Kujawa, 1995).

As defined by the International Monetary Fund (IMF), Foreign Direct Investment is "Investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise." (IMF, Balance of Payments Manual, 1977).

Foreign Direct Investment is a long-term investment that can include new equity investments, reinvested earnings, and related lending. Any given investment can involve establishing, acquiring or an affiliated subsidiary corporation or branch. An essential element of a direct investment (contrasted with a portfolio investment) is a continuing substantial interest in, and an effective voice in, managing the real assets of a foreign affiliated entity. An ownership share of at least 10 to 25 percent is commonly considered the minimum threshold for an investment to be considered a direct investment, but the

essential ingredient is control over assets (Brewer, 1991).

2.2 History of FDI's.

The story of the development almost everywhere includes foreign direct investments from the Persian Gulf's oil fields to India's tea plantations and Malaysia's rubber plantations. Early in the 20th century, a large part of the world's infrastructure was developed through foreign direct investment, including electric power in Brazil and telecommunications in Spain. British firms invested in consumer goods manufacturing abroad from an early date. German chemical companies were expanding outside Germany before World War I, as were US auto manufacturers. Swedish, Swiss, French, and Japanese firms had established foreign subsidiaries at an early date as well.

These investments were based on new technologies and management and organizational practices. By 1914, the world stock of FDI was estimated at $ 15 billion, about one third of all international investment at the time. The United Kingdom was then the largest source of investment, followed by the United States and Germany. The United States was the largest recipient of FDI. The stock of world FDI had risen to $66 billion by 1938, with U.K firms still the largest investors. After World War II, US firms became the main source of FDI and manufacturing investment became most prevalent. (Weigel et al, 1997).

During the 1950s and 1960s, most developing countries pursued " inward- oriented" development strategies which emphasized the growth of domestic industry behind trade

barriers. Production for the domestic market was encouraged over exports, and imports were discouraged or restricted.

Escalating commodity prices in the 1970s had 2 effects on FDI. First, high prices encouraged increased FDI in extractive sectors, particularly oil and gas. This benefited countries such as Congo, Ecuador, Indonesia and Nigeria. Second, the balance of payments surpluses of commodity – exporting countries provided an abundant source of investable capital. This money was recycled to developing countries through large scale sovereign lending by commercial banks. Thus, developing countries became more reliant on sovereign borrowing and less interested in attracting FDI.

Colombia, Kenya, and Pakistan were among countries where FDI fell sharply in the early 1970s. FDI stagnated in the 1970s and continued into early 1980s. Insulation from the global economy led to a collapse in exports and massive balance of payments deficits in many countries.

Many countries, Kenya included, embarked on structural adjustment programmes, designed to reorient their economics toward private sector production, international trade, and competitiveness. FDI flow began to increase in the second half of the 1980s in response to these changes. Liberalization of FDI policies by developing countries continues.

Multilateral agreements on investment have also been developed, mainly as part of wider multilateral agreements such as the North Atlantic Free Trade Agreement (NAFTA).

World Trade Organization (WTO) members are increasing the idea of a global investment agreement.

Table 1: FDI flows region of Host Developing countries, 1981 –87 (percent of all developing countries)

REGION	1981	1982	1983	1984	1985	1986	1987
LATIN AMERICA	35.5	24.5	21.2	20.4	31.6	24.6	46.4
AFRICA	7.0	6.9	7.2	6.7	6.4	5.6	5.6
ASIA	22.1	17.6	31.0	28.8	37.6	32.8	51.6
MIDDLE EAST	31.3	48.1	35.8	38.5	17.3	30.8	-13.8
EUROPE	4.4	3.0	5.5	5.7	6.8	6.2	10.3

Source: IMF

In Table 1, where yearly flows are given, the increased share going to Asian countries is apparent. By 1985-86, one third of all FDI flows to developing countries were going to Asian countries. (Brewer, June 1991).

2.2.1 Current FDI Trend

Foreign Direct Investment is a large and growing source of finance that may help developing countries close the technology gap with high-income countries, upgrade managerial skills, and develop their export markets (World Bank 1993,3).

Globally, FDI has increased dramatically over the past decade. However, most of the

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increase has occurred in the industrial countries. In the developing countries, FDI has been heavily concentrated among a small number of countries. Over 90 per cent of FDI inflows to developing countries in 1990 were received by only 18 countries. Half of this total flowed to eight Pacific Basin developing market economies (Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand). Given that neither Korea nor Taiwan has shown strong interest in attracting FDI, it may seem surprising that these economies feature in this group of developing countries. Their appearance in this list may support the view that *explicit incentive packages are not the key determinants of FDI flows* (Fry et al, 1995).

2.3 Industrialized Countries Policies Affecting Foreign Direct Investment in Developing Countries.

Numerous studies have examined the impact of developing countries' policies and structures on Foreign Direct Investment (FDI) inflows. United States was chosen to be the subject of this country study as it is the largest single home[1] country of FDI. In 1987, for instance, US companies held over US $ 320 billion in FDI stocks abroad or nearly one- third of all FDI stock in the world. The US share of FDI flows declined sharply during the 1980s but still averaged about 18 percent of total worldwide flows. (Dreyer et al, 1991)

2.3.1 Overview of Trends in US FDI

In the period 1975 –80, the US was responsible for 42.4 percent of world FDI inflows.

Although in 1987 the US still maintained its position as the largest source country of FDI, its share of FDI stock declined sharply in the 1980-87 period. In 1980, the combined FDI position of the European Community countries was smaller than that of the US. Today, the reverse is true.

In the early 1980s, US FDI among developing countries was concentrated in Asia, especially East Asia and the Middle East. By contract, Africa and the Western Hemisphere experienced the sharpest slow down in US FDI growth during 80s.

The financial services sector has become an increasingly prominent flow of FDI flows to developing countries at the expense of mining, utilities, petroleum and manufacturing.

2.3.2 US Official Institutions and programs to promote FDI in developing countries.

US government FDI promotional services are modest since the government philosophy is to let investment flows follow market forces. However, various mechanisms have been established to promote US investments abroad by enhancing the private resources of US investors to penetrate overseas markets, particularly for special sectors or countries where it is felt that long-term risks or costs need to be reduced to make them attractive to US investors.

Investment Guarantees.

Established in 1971, Overseas Private Investment Corporation (OPIC) operates an investment insurance program that is designed to encourage US FDI in developing countries. OPIC provides investors with protection against loss due to three types of political risks: currency inconvertibility, expropriation, and political violence.

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[1]In this context, the term "host country" refers to the developing country and "home country" to the industrialized country, the major source of FDI.

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Bilateral Investment Treaties (BITS)

Formed in 1981 its objective was to protect US investments abroad and to help increase capital flows to developing countries.

Financial Support Services

OPIC also provides direct loans and loan guarantees to US companies that pursue commercially and financially sound ventures in developing countries.

Investment Promotion

The responsibilities for foreign investment promotion lie primarily with two officers of the United States Agency for International Development (USAID). The Bureau for Private Enterprise (PRE) was established to link USAID's traditional programmes more closely with private sector activities.

The office of the Private Sector Coordinator is responsible for coordinating USAID efforts to promote greater US private sector business and investment in developing countries.

Other Official support

For example Export-Import Bank of the United States (EXIM Bank), an independent agency, facilitates US exports by providing loans, guarantees and insurance to foreign buyers and US manufacturers.

2.4 Factors Considered By Multinational Corporations When Deciding On The Host Country to Invest In

The following factors are considered when multinationals are contemplating investing in a third world country (Sharma, 1989).

Political stability of host country and neighbouring country; availability of technology, capital, and raw materials; labour laws; climate; incentives.

2.4.1 Political stability of Host Country and Neighbouring country

High risk is involved in investing in a politically unstable country. Apart from the high risk of expropriation (forceful ownership of property by government), there is fear of economic depression, resulting in low profits, if any.

Political stability of neighbouring country may have some adverse effects on the host country, for example, in the case of a landlocked country.

2.4.2 Availability Of Technology, Capital and Raw Materials

1] Availability Of Technology

Usually when multinational firms invest in a third world country they bring technology and managerial skills with them. Infact one of the reasons why developing countries promote foreign direct investment is to get modern technology. They want the technology to be adapted to local conditions and the requisite skills to be transferred to local citizens. (Langdon, S, 1975)

2] Availability of Capital

Capital can be generated internally or it can come from abroad. International loaning bodies like the International Monetary Fund (IMF) and the World Bank finance many projects, which are undertaken in the third world countries. However, foreign firms

prefer to borrow capital locally as it is cheaper this way. They can get loans quite easily as compared to the local borrower. (Davis, 1977)

3] Availability Of Raw Materials

Usually, foreign companies have been out to exploit raw materials in various host countries. Many MNCS have been known to establish subsidiaries in various parts of the world due to the availability of raw materials in those parts. One would expect the manufacturing firms to consider the availability of raw materials of more importance than the service firms. (Reuber, 1973)

2.4.3 Labour laws

Foreign firms are very cautious about the type of labour laws agreed to, for the formation of unions and their regulations can be harmful to the MNC. Since the various host countries labour differs in history, philosophy and structure, a very rigorous analysis has to be done before coming up with the labour laws and regulations. Manufacturing firms are usually more concerned about labour laws as they are the ones, under whom a large number of workers are employed. (Kaplinsky, 1979).

2.4.4 Climate

Though not very important, the climate of a host country is fairly important in an investment decision. The probable reason for this could be that the technology transferred may not function well in very hot or very cold conditions. Also a very hot or cold climate could result in the breakdown of transport and communication, which could prove harmful to the investing firm. On the other hand it may just be a matter of convenience, because the general manager cannot live in a very hot (cold) climate he may decide not invest in that particular country. (William, 1965)

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The host country offers investment incentives to the foreign investor. These are given to promote FDI.

2.5 Getting The Policy Environment Right

Many different factors affect the type and volume of Foreign Direct Investment (FDI) to developing countries. These include: conditions in the investors' home countries, market size in host countries, their macroeconomic policies, and structural changes leading to globalization of industry changes. (Weigel et al, 1997)

2.5.1 Improving The Investment Climate By Addressing Specific Constraints

It is widely assumed that future investment inflows will be directly related, minimally, to the package of direct incentives which influence the expected rate of return, the security of the investment, and the scope and speed with which companies are able to disinvest (Guisinger, 1986).

The tax regime, the investment code or guidelines, the overall macro-economic policies, including those related to access to foreign exchange, domestic borrowing by foreign companies, the setting of prices, wages and employment regulations, are clearly all central elements which affect this overall package. (Cockcraft et al, 1991). A more favourable and increasingly welcoming attitude to foreign investment must be adopted. In this context, particular note should be made of the following factors inhibiting investment where action is still needed.

Lack of Formal Legislative Provision For Foreign Investment:

Some countries have still not published investment codes or provided a clear-cut policy

for foreign investment. In these cases, foreign companies are reluctant to invest, in no small measure, because of the greater likelihood that the host government will change the rules for foreign investors. Concern about the absence of fixed and certain legislation is one of the most frequent complaints of foreign investors: if legislation is changed, notice could be given and retroactive legislation strictly avoided.

Lack of Legal Infrastructure;

Some countries still lack up-to-date company legislation, and in these cases suitable amendments are an urgent priority. More widespread is the maintenance of traditional land tenure legislation; this can impede exploiting mineral and agricultural potential.

Price Controls;

These are a major impediment both because they lower all returns on investment and because they create the need to secure government intervention for routine decisions. Some countries are also criticized for erratic and inconsistent policies on prices. This particular problem, together with restrictions on access to foreign exchange to purchase imported inputs into the production process, has been one of the most important obstacles to investment in Africa.

Labour Legislation;

In African countries this has been most often seen as an obstacle with regard to employment of expatriates, but where there are severe restrictions on hiring and firing of workers, these are likely to be seen as especially serious because they are an operational restriction.

Taxation policy;

In general, taxation policy appears most important at the time of initial interest in investing (the point at which comparisons with other countries are made) and before operating conditions become relevant. Thus what is often important at this initial time is taxation policy in other countries. Comparisons raise the threshold of what companies expect. (Page et al, 1988)

Foreign Exchange Controls, Particularly on Profit Remittances;

As a general statement, potential investors are unlikely to invest if companies present in the country are unable to repatriate their profits. Yet most countries in Africa still have significant foreign exchange controls. What is important is the nature of such controls (or unexpected changes in them) and how they compare with any other countries a potential investor is considering.

Particular problems still encountered include the following: the requirement that management and "know-how" fees should be denominated in local rather than foreign currency–thus exposing investors to exchange rate fluctuations; pressures for an investor to register a corporate presence in the host country so as to register himself liable for local corporation and/or turnover tax; lack of clarification in the interpretation of corporate tax codes – opening up the possibility of taxes on dividends and fees being withheld at both the company and country level; high rates of personal tax on expatriate employees – or penal limitations on their remittability.

Exchange Rate Level;

The majority of African countries have devalued their currencies by significant amounts in the late 1980s. As a result, the potential returns to investments, which generate exports

based on domestic resources, have improved.

The Media;

Africa, more than any other developing region, suffers from adverse media exposure. The importance of the media in forming judgements about investments is well brought out from a 1980s survey on US perceptions on African investment. (Baker, 1983)

"Respondents were asked how they obtained their information in making their risk assessments and investment decisions. By far the main source of information on Africa for the business community is the mass media, primarily the press. Since the American press selectively focuses on trouble spots impressions are more negative than positive."

Skill Shortages;

A more specific impediment to increased FDI in Africa is that of skill shortage in the host economy. In many countries this shortage covers management and accountancy skills, but even in countries like Nigeria there is evidence that the shallow base of a wide range of technical skills leads to inefficiencies and low levels of productivity, which deter foreign investors. (Cockcroft et al, 1991)

Inadequacies of The Domestic Infrastructure;

A major impediment to foreign investment in many African countries has been and continues to be the poor state of the infrastructure. This has led to low levels of efficiency in current productive sector investments, and have deterred new investors.

Bureaucratic Delays and Lack of Decisions;

This is a range of factors associated with the administration and decision-making arm of the host government. These frequently begin in long delays- sometimes stretching into years- in obtaining the initial permission to invest in the country, even when the foreign

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investment conforms in every way with the respective investment code of guidelines. Unless further steps are taken to cope with the myriad of complaints foreign investors make in this area, this impediment will remain a significant deterrent to future investment flows.

Country Size and Regional Markets;

The disadvantage of smallness for attracting foreign investors cannot be overstressed: restricted purchasing power associated with the small size of the market in many African countries has proved a serious impediment both to investors whose output has been exclusively for the domestic market and to those who have required a strong domestic market as a base for export -oriented production.

Creation of trading blocs e.g. COMESA, EAC, PTA provide some encouragement. These would appear to have stimulated some foreign investment, on a joint venture basis, to exploit the new opportunities presented by these developments.

Providing Matching Finance;

Lack of access to domestic capital markets is most frequently encountered through restrictions placed on borrowing locally. Foreign companies may also be prevented from buying into local companies.

Central Banks have endeavored to respond to the problem of shortage of local capital for investment projects by laying down guidelines on the volume of banks' loan portfolio, which should be long-term.

2.6 History of Foreign Direct Investments in Kenya

In the late 19th century and early 20th century, the incorporation of the Kenyan economy into the international capitalist system under the umbrella of British commercial interests, yoked the country to the interests of metropolis. Colonial Kenya was used to create a local market and so a source of raw materials for investors from foreign countries. Therefore, the main preoccupation of the early capitalist venture in Kenya was in the sectors of agricultural production, ancillary services and the processing of primary products. At that time, manufacturing was mainly carried our by metropolitan bourgeoisie and the local settler class. (Sharma, 1989)

The colonial patterns of foreign capital investments were geared towards labour intensive export oriented primary producing areas with the attendant abundance of cheap unskilled labour. After World War II, there was a pronounced shift from primary production to processing industries, from export orientation to import substitution from labour intensive to scientific capital intensive.

Kenya's independence, in 1963, did not mean disengagement from the political economic and social edifice established by the colonialists. The basic structure sill remains "externally oriented", in part through the continued influence and control of strategic sectors of the economy by multinational corporations. Some of the businesses, which existed in the colonial period, continue to exist e.g. Unilever Kenya, Brookebond, Delmonte.

2.7 Foreign Direct Investments and The Kenyan Economy

In common with other third world countries, the Kenyan economy suffers from a shortfall between the desired level of investment and the savings available to fund investments, and for which the government may seek to fill in by direct foreign investments. For the Sub-Saharan African countries, and particularly Kenya, an increase in foreign private investment inflows is always associated with and therefore expected to be able to lead to a greater economic growth and equal social benefits (Gould, 1987).

Despite the foreign investment in the manufacturing sector, Kenya still continues to experience severe economic frustrations that may be manifested in social and political upheavals. Like most other third world countries, Kenya, however continues to regard MNC foreign direct investments as capable of bringing about growth and development on the economy. (Gould, 1987)

Kenya appears to have a very open economy. Exports and imports make up a large proportion of the GDP, and though this is to some extent explained by the small size of the Kenyan economy, it also reflects a pattern of openness to the world economy.

The result of this open economy has been patterns of consumption being set in terms of global taste patterns and industrialization largely following the pattern of import substitution.

In most cases this has led to minimal value added by firms, which take advantage of very high levels of effective protection. Due to such an economy many foreign subsidiaries have been established and /or some local firms have been taken over by multinationals. (Jorgensen, 1975)

As in other third world countries, MNC investments in Kenya have played a very small part in the equitable redistribution of wealth and transfer of resources to Kenya (Gould, 1987). For example, MNC investments in Kenya have resulted in increasing unemployment and regional inequality; have made very little and possibly a negative contribution to the balance of payments; and have failed to make linkages with the local economy and especially its resources. (Langdon, 1975)

An extract from the Policy Framework Paper of 1996:

"With respect to structural reforms, the government has, since mid 1993, made significant strides. It has eliminated exchange controls including restrictions on inward portfolio investments and removed all trade restrictions, except for a short list of a few products controlled for health, security and environmental reasons.

Privatisation of 211 non-strategic public enterprises has started, with the government divesting its holdings in over 100 firms by the end of 1995."

Manufacturing sector is an area where investment opportunities exist. Initially developed under the import substitution policy, there has been a shift to export-oriented manufacturing as the thrust of Kenya's industrial policy. The sector plays an important role in adding value to agricultural output, providing forward and backward linkages, hence accelerating overall growth.

Value of Manufacturing Sector Output (at Current Prices)

YEAR	Value of output Kshs Million	Value Added
1996	576,400	51,000
1997	675,200	58,300
1998	703,000	71,600
1999	745,500	85,700
2000**	661,200	96,100

**Provisional

Source: Economic Survey 2001

The manufacturing sector now comprises of more than 700 established enterprises and directly employed over 218,000 people in 2000. A wide range of opportunities for direct and joint-venture investments exist in the manufacturing sector, including agro-processing, manufacture of textiles garments, assembly of automotive components and electronics, plastics, paper, chemicals, pharmaceuticals, metal and engineering products for both the domestic and export markets.

2.8 Nature Of Investment Incentives Offered By The Kenya Government [2]

The basic strategy of the Kenya Government has been one of indigenisation. This strategy involves more than just replacement of the foreign elite by the African elite; it includes the creation of an economy responsive to the human needs of the member of the society. The structural level indigenization entails production for domestic needs rather than for external needs, indigenous technology and indigenous patterns of consumption rather than imported ones. This basic strategy underlies the package of potential foreign investors. (Kaplinsky, 1978)

These incentives are:

2.8.1 General Legal Guarantees

Before undertaking to invest in another country, an investor needs to be assured that an unfavorable situation will not be created at a later date. These investors gain some assurance when a favourable legal situation has existed for a sufficiently long time, or when the country's economic and political structure is so stable that there is little possibility of any radical change in the immediate future.

Normally, since it is the capital importing states that are in need of foreign capital, it is incumbent upon them to offer legal guarantees to prospective investors. In Kenya, the instruments for foreign investment guarantees are: (Pannell, Bellhouse and Mwangi, 1988)

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[2] Mulei, C.M, The MNC and Government Control In Kenya, Unpublished LLB Thesis, UON, 1976

1. The foreign protection Act.

Under this Act, foreign investors may be issued with a Certificate of Approved Enterprise provided that the proposed investment is likely to benefit the Kenyan economy. Even through the term "benefit" is a hollow term it can be interpreted to mean:

a) That the investment will lead either to an earning or saving of foreign exchange.

b) That the investment will result in an increase in the economic wealth and social stability of the country by raising the national income or promoting the diversification of the economy.

Foreign investors holding the Certificate to Approved Enterprise are protected from expropriation or compulsory acquisition of their enterprises and are entitled to the repatriation of both capital and profits.

Capital repatriation, remittance of dividends and interest are guaranteed to foreign investors under the Foreign Investment Protection Act (FIPA) (Cap 518). Investors can repatriate:

- After tax profits, including retained profits which have not been capitalised;
- The proceeds of the investment after payment of the relevant taxes;
- Principal and interest associated with any loan.

2. International protection.

Kenya is a signatory to the World Bank Convention For The Settlement of Disputes (ICSID). This provides machinery for the reconciliation of disputes and voluntary

arbitration (Sharma, 1989).

3. Guarantee Against Expropriation

The Constitution of Kenya provides guarantees against expropriation of private property, which may occur for reasons of security or public interest. In such a case, a fair and prompt compensation is guaranteed.

4. Other Guarantees

Kenya is a member of the World Bank-affiliated Multilateral Investment Guarantee Agency (MIGA), which issues guarantees against non-commercial risk to enterprises that invest in member countries. Kenya is also a member of the Africa Trade Insurance Agency (ATIA).

2.8.2 Fiscal, Financial and Trade Incentives.

Since Kenya is a signatory to the International Union For The Protection of Industrial Property, it leans on a liberal patent policy. Thus given patent protection and the promotion of brand names plus lack of effective regulation over these privileges, foreign investors are no doubt attracted by such a favorable situation (Sharma, 1989).

2.8.3 Freedom of Operation

Minority Government ownership of shares in investments is a sign of government appraisal and support.

With the current ware of privatization of state owned firms, foreign investors may see this as an incentive promoting freedom of operation for the private enterprise.

2.8.4 Export Performance and Future Prospects

Kenya's export base has continued to depend on food and beverages, followed by non-industrial food supplies. In the year 2000, food and beverages accounted for 56.27%; industrial non-food supplies 19%, while fuel and lubricants 8.5% of the total exports. The Government strategy is to enlarge and diversify the production of exportable non-traditional items such as manufactured goods, horticultural products and services.

Kenya has continued to export her products to traditional markets within the COMESA region (42.1%), and the European Union (EU) (30%). However, the bulk of her imports totaling Kshs 247.8 billion in the year 2000, were from EU (31%) and the Middle East (30%). The objective is to expand existing market shares and to diversify into new markets

2.9 The Investment Promotion Center

The Investment Promotion Centre has also outlined major investment incentives, which can be found in their website *www.ipckenya.org*.

The Government policy is aimed at extending facilitation measures in favour of private sector investment. The following is a summary of current incentives that have been put in place:

Investment Allowance;

Investment allowance is provided as an incentive for investment in the manufacturing and hotel sectors at the rate of 100% for July 2000 to December 2001, 85% for the year 2002, 70% for 2003, and 60% for 2004 countrywide. For Manufacturers Under Bond, the

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applicable rate is 100% for all locations. In addition, eligible capital expenditures have been expanded to include certain infrastructure and environmental protection equipment related to the manufacturing activity.

Depreciation;

Liberal rates are allowed for the depreciation of assets based on book value as follows:

Buildings:

Industrial buildings 2.5% (straight line)

Hotels 4.0% (straight line)

Machinery: (All declining balance)

Tractors, combine harvesters, earth-moving equipment, and similar vehicles 37.5%

Other self-propelled vehicles, including aircraft 25%

All other machinery, including ships 12.5%

Computers and other office equipment 33.3%

Loss Carried Forward;

Business enterprises that suffer losses can carry forward such losses to be offset against future taxable profits.

Remission From Customs Duties;

Duties on capital goods, plant and machinery are at the rate of 5%. Large-scale private investment projects whose expenditure on productive physical assets are in excess of US$5 million within a two-year period, and that will generate net economic benefits for the country, can recover the value of import duties paid on imported capital goods for the project against income tax liability.

2.9.1 Export Promotion Programmes;

1) Duty Remission Facility

Materials imported for use in manufacturing for export, the production of raw materials for export, or the production of duty free items for sale domestically, are eligible for duty remission. Applications for this facility should be made to the Export Promotion Programme Office (EPPO) at the Ministry of Finance.

2) Manufacture Under Bond

To encourage manufacturing in Kenya for export to the world market, the Government has established the Manufacture Under Bond programme that is open to both local and foreign investors. Enterprises operating under the programme are offered the following incentives:

- Exemption from duty and VAT on imported plant, machinery, equipment, raw materials and other imported inputs; and,
- 100 per cent investment allowance on plant, machinery, equipment and buildings.

  Bonded manufacturing enterprises can be licensed to operate within a 30 km radius of a Customs Office. This programme is facilitated by the Investment Promotion Centre and administered by the Kenya Revenue Authority.

3) Export Processing Zones Programme

The Export Processing Zones Authority (EPZA) coordinates operations of Export Processing Zones (EPZs).

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The Government encourages the development of private EPZs, and a number of them have already been established. Enterprises operating in these zones in Kenya enjoy the following benefits:

10 year tax holiday and thereafter a flat 25 per cent tax for 10 years; Exemption from all withholding taxes on dividends and other payments to non-residents during the first 10 years; Exemption from import duties on machinery, raw materials and intermediate inputs; No restrictions on management or technical arrangements; Exemption from Stamp Duty; Exemption from VAT; and, Operate on one license only.

Market Access;

Exports from Kenya enjoy preferential access to world markets under a number of special access and duty reduction programmes.

1) Regional Markets

Kenya is a member of the East African Community (Kenya, Uganda and Tanzania) with a population of about 80 million. The country is also a member of the Common Market for Eastern and Southern Africa (COMESA) with a population of about 380 million. Exports and imports within member countries enjoy preferential tariff rates.

2) ACP/Cotonou Agreement

Exports from Kenya entering the European Union are entitled to duty reductions and freedom from all quota restrictions. Trade preferences include duty-free entry of all industrial products and a wide range of agricultural products including beef, fish, dairy products, cereals, fresh and processed fruits and vegetables.

3) African Growth and Opportunity Act (AGOA)

Kenya qualifies for duty free access to the United States of America (USA) market under the African Growth and Opportunity Act enacted by USA. Kenya's major products that qualify for export under AGOA include textiles, apparels, handicrafts, etc.

4) Generalised System of Preferences (GSP)

Under the Generalised System of Preferences, a wide range of Kenya's manufactured products are entitled to preferential duty treatment in the United States of America, Japan, Canada, New Zealand, Australia, Switzerland, Norway, Sweden, Finland, Austria, and other European countries. In addition, no quantitative restrictions are applicable to Kenyan exports on any of the 3,000-plus items currently eligible for GSP treatment.

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter deals with research design, which was used to conduct the research. It covers the population of the study, data collection method, and data analysis method.

3.1 The Population

The population of interest in this study consisted of all foreign firms operating in Kenya, who have a global banking relationship with Citibank, fifty-four in number. The basis for this is twofold:

1) A visit to the Registrar of Companies in a bid to obtain a listing of all foreign firms as at 2002 was futile. The reason given was that there are thousands of such companies and therefore providing this information will be a daunting task.
2) Citibank is a leading International bank providing services to many foreign firms, which are involved in medium to large-scale international trade. These same companies are also likely to be multi-banked. They have been classified as GRB's (Global Relationship Banking). A list of all the companies under this classification is attached in appendix 1.

This study was a census intended to cover the whole population.

3.2 Data Collection

The study used primary data obtained using the survey method.

Data was collected using a semi-structured questionnaire comprising of both open and close-ended questions (see appendix 11). This was addressed to either directors or senior managers involved in strategy issues in the companies, who delegated to the relevant personnel.

A sample of the questionnaire is attached in appendix, designed mostly using likert type scales. The questionnaire was administered using the "drop-and –pick-later" method. Others were also sent via email.

3.3 Data Analysis

Of the original targeted population of 54 companies, only 25 agreed to participate in the study as they said their policies do not allow them to participate in such studies. The others indicated their organization policies are too protracted when seeking approvals to provide information required. Out of the 25 questionnaires sent, only 14 were returned, representing 56%. The data collected captures statistics of various variables that were considered important in this study.

Data obtained from the study was analysed using statistics package for social sciences (SPSS):

1) Descriptive statistics such as summarised tabulations, percentages, frequencies, and rankings.
2) Factor analysis has also been used to identify the most prominent factors that explain investment decisions of foreign firms given the incentives available.

CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

4.1 Introduction

The data in the study was summarised and presented in the form of tables, percentages, frequency distribution, and pie charts.

4.1.1 General Information on the Foreign Investors

The questions were aimed at establishing year of establishment in Kenya, and the home countries of the parent companies.

Table 1: Year of establishment

Year of establishment in kenya

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1903	1	7.1	7.7	7.7
	1922	1	7.1	7.7	15.4
	1958	1	7.1	7.7	23.1
	1961	1	7.1	7.7	30.8
	1968	1	7.1	7.7	38.5
	1993	1	7.1	7.7	46.2
	1997	2	14.3	15.4	61.5
	1999	1	7.1	7.7	69.2
	2000	2	14.3	15.4	84.6
	2002	2	14.3	15.4	100.0
	Total	13	92.9	100.0	
Missing	System	1	7.1		
Total		14	100.0		

Table 1 above shows that 46.2% of the companies were established in Kenya before 1993 and 54.8% after 1993.

As Table 2 below shows, 21.4% of the companies are registered in the UK, 14.3% in USA, and the rest distributed mainly in Europe. One of the companies registered in Kenya has some foreign shareholders.

Table 2: Parent company

Country the parent company is registered

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid		1	7.1	7.1	7.1
	Belgium	1	7.1	7.1	14.3
	Denmark	1	7.1	7.1	21.4
	France	1	7.1	7.1	28.6
	Germany	1	7.1	7.1	35.7
	Greece	1	7.1	7.1	42.9
	Japan	1	7.1	7.1	50.0
	Kenya	1	7.1	7.1	57.1
	Netherlands	1	7.1	7.1	64.3
	UK	3	21.4	21.4	85.7
	USA	2	14.3	14.3	100.0
	Total	14	100.0	100.0	

Table 3: Classification of Investment

The question was aimed at finding out the different forms of ownership of the investments.

Classify your investment in Kenya

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Joint venture with the government	1	7.1	7.7	7.7
	Partnership (joint venture with other bodies not government	1	7.1	7.7	15.4
	Contract	1	7.1	7.7	23.1
	Branch of foreign company	8	57.1	61.5	84.6
	Public Quated Company	2	14.3	15.4	100.0
	Total	13	92.9	100.0	
Missing	System	1	7.1		
Total		14	100.0		

Majority of the respondents are branches of foreign companies (57.1%) while 14.3% are public quoted companies and the balance is either joint ventures with the government, partnerships (other than government) or contracts.

4.2 Factors considered when making investment decisions.

Respondents were asked to list and rank what factors they considered important when investing in a developing country. A high percentage of the companies considered the political stability of a country (71.4%) followed by economic growth and market size. Other important factors cited were:

1. Cost of production, including taxation.
2. Tariffs
3. Communication infrastructure.
4. Availability of raw materials.

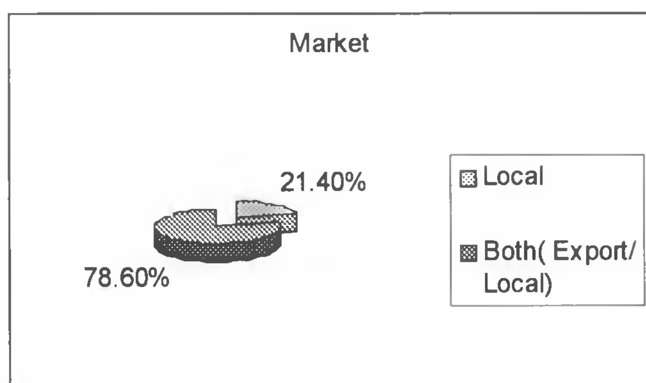
Table 4: Market for products/services

The question sought to establish the market for the various products and services.

The market was classified into three categories: Local/domestic, Export, and Both

Markets for your goods

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Local/domestic	3	21.4	21.4	21.4
	Both	11	78.6	78.6	100.0
	Total	14	100.0	100.0	



The information from table 4 reveals that 78.6% of foreign investors produce both for the local and export market and this is represented in the pie chart above. It is understandable therefore that most companies ranked highly market size and tariffs as factors to consider.

4.3 Factors considered important when making investment decisions in a developing country.

The research question was aimed at finding out the importance of given factors to an investor when considering investment in a developing country.

16 factors were listed, and respondents were asked to rate on a likert scale the degree of importance: ranging from very important, important, somewhat important, less important, and least important. The general factors consisted of political stability of host country and neighboring country, stability of host country's currency, labour laws, availability of raw materials, technology and capital, and climate. Incentives consisted of tax, export and import compensation, capital repatriation and protection against expropriation.

There was a need to compare the importance of such factors and the adequacy of the same, so as conclusions can be drawn on what incentives need to be addressed.

The results were analysed using frequency tables below:

Table 5

Political stability of host country

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very Important	12	85.7	85.7	85.7
	Important	2	14.3	14.3	100.0
	Total	14	100.0	100.0	

Table 6

Political stability of neighbouring country

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very Important	4	28.6	28.6	28.6
	Important	6	42.9	42.9	71.4
	Somewhat Important	3	21.4	21.4	92.9
	Less Important	1	7.1	7.1	100.0
	Total	14	100.0	100.0	

A high percentage of respondents (85.7%) were in agreement that political stability of the host country was most critical in making investment decisions. This is because ultimately it is the political environment that will dictate the flow of the other factors. Political stability of neighbouring country was not considered as important, as shown by the ratings in table 6 above.

The ratings of the other 14 factors were analysed in one table, and standard deviation used to measure the most commonly agreed factors

Table 7: Rate Importance of factors other than Political Stability

Tax incentives had 78.6% of respondents rating it as very important, also evidenced by the lowest standard deviation (measure of dispersion) of 0.426. This was followed by guarantee for capital repatriation with a standard deviation of 0.469. 71.4% of respondents considered it as very important. The least important factor across the board was price control (21.4%, and a standard deviation of 1.692), probably because the

government has no control over prices, as was the case ten years ago. Market forces dictate prices.

Statistics

	N		Mean	Std. Deviation
	Valid	Missing		
Export compensation	14	0	2.00	1.177
Import compensation	14	0	1.86	1.099
Tax incentives	14	0	1.21	.426
Protection against expropriation	14	0	1.64	.842
Guarantee for capital repatriation	14	0	1.29	.469
Stability of host country's currency	14	0	1.57	.938
Full ownership guarantee to investor	14	0	1.86	1.099
Price control by government	14	0	2.36	1.692
Labour laws eg. unions, compensations	14	0	2.14	1.167
Availability of raw materials in the host country	14	0	2.29	1.437
Availability of technology	14	0	1.79	1.251
Availability of capital (goog credit/banking system)	14	0	1.29	.611
Climate of host country	14	0	2.14	1.406
Availability of good infrastructure	14	0	1.36	.497

From above summarized table, it will be important to note those factors that are also incentives, that is, of tax incentives, export and import compensation, capital repatriation and protection against expropriation. Their importance will be measured against their adequacy so that relevant action items can be addressed. For example, if tax incentives are rated very importance, and not adequate, then the government will have to address the tax regime.

4.3.1 Reasons for continued investment in Kenya

The question sought to find out from the firms what prompted them to continue investments in Kenya. This was an open-ended question and the reasons occurring most frequently are under listed:

1. Political stability
2. Skilled labour
3. Location of strategic partners.
4. Geographic location- access to seaport and other markets.
5. Ability to repatriate profits.

4.4 Adequacy of Incentives Offered By Kenya Government

This section deals with the analysis of the adequacy of incentives from the investor's perspective. The incentives provided were export compensation scheme, customs reduction on imports, customs reduction on exports, infant industry protection scheme, and foreign investment protection act (incorporating capital repatriation scheme, expropriation scheme and freedom of operations).

Table 8: Export compensation scheme

Export compensation scheme

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very adequate	1	7.1	7.1	7.1
	Adequate	1	7.1	7.1	14.3
	Somehow adequate	6	42.9	42.9	57.1
	Less adequate	4	28.6	28.6	85.7
	Least adequate	2	14.3	14.3	100.0
	Total	14	100.0	100.0	

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Only 7.1% of the respondents found this scheme to be adequate, yet it had 100% of the same respondents rating it as important or very important.

Table 9: Custom reduction on imports

Custom reductions on imports

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Adequate	5	35.7	38.5	38.5
	Somehow adequate	4	28.6	30.8	69.2
	Less adequate	3	21.4	23.1	92.3
	Least adequate	1	7.1	7.7	100.0
	Total	13	92.9	100.0	
Missing	System	1	7.1		
Total		14	100.0		

Majority of the firms, 69.2% found this to be somewhat adequate or adequate.

The same applied to customs reduction on exports, where a cumulative 69.2% found it somewhat adequate to very adequate, as table 10 below reflects.

Table 10: Customs reduction on exports

Customs reductions on exports

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very adequate	2	14.3	15.4	15.4
	Adequate	2	14.3	15.4	30.8
	Somehow adequate	5	35.7	38.5	69.2
	Less adequate	3	21.4	23.1	92.3
	Least adequate	1	7.1	7.7	100.0
	Total	13	92.9	100.0	
Missing	System	1	7.1		
Total		14	100.0		

Table 11: Infant Industry protection scheme

Infant indutry protection scheme

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Adequate	2	14.3	16.7	16.7
	Somehow adequate	4	28.6	33.3	50.0
	Less adequate	3	21.4	25.0	75.0
	Least adequate	3	21.4	25.0	100.0
	Total	12	85.7	100.0	
Missing	System	2	14.3		
Total		14	100.0		

This was a 50:50 tie, with half the respondents finding it adequate and half not adequate. This may be explained by the period of operation of the respondents since 46.2% of the companies were established in Kenya before 1993 and 54.8% after 1993.

Table 12: Tax Incentives

Tax incentives

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very adequate	1	7.1	7.1	7.1
	Adequate	3	21.4	21.4	28.6
	Somehow adequate	2	14.3	14.3	42.9
	Less adequate	2	14.3	14.3	57.1
	Least adequate	6	42.9	42.9	100.0
	Total	14	100.0	100.0	

This was a factor considered very important by 78.6% of the respondents. However, we note that only 7.1 % have rated it as very adequate with 42.9% considering it least adequate. This is also emphasized in the research as some respondents have indicated that in other developing countries the corporate tax is lower and they also enjoy tax breaks and holidays especially for infant industries.

Table 13: Capital repatriation scheme

Capital repatriation scheme

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very adequate	2	14.3	14.3	14.3
	Adequate	5	35.7	35.7	50.0
	Somehow adequate	3	21.4	21.4	71.4
	Less adequate	3	21.4	21.4	92.9
	Least adequate	1	7.1	7.1	100.0
	Total	14	100.0	100.0	

14.3% found it very adequate whereas only 7.1% found it least adequate.

This is an important incentive, as foreign investors should be allowed to repatriate their profits to the parent companies. Since liberalization, this incentive has been adequately addressed and a cumulative 71.4% have rated it as somewhat adequate and above.

Table 14: Expropriation scheme

Expropriation scheme

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very adequate	2	14.3	15.4	15.4
	Adequate	2	14.3	15.4	30.8
	Somehow adequate	5	35.7	38.5	69.2
	Least adequate	4	28.6	30.8	100.0
	Total	13	92.9	100.0	
Missing	System	1	7.1		
Total		14	100.0		

Similarly a high percentage 69.2% has found this sufficiently adequate.

Table 15: Freedom of operation

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Freedom of operation

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very adequate	4	28.6	28.6	28.6
	Adequate	7	50.0	50.0	78.6
	Somehow adequate	3	21.4	21.4	100.0
	Total	14	100.0	100.0	

All respondents, 100%, were in agreement that this incentive is adequate. The government has given foreign firms a degree of freedom in their operations without undue influence.

4.4.1 Importance of Incentives offered.

Question 15 was addressing the issue of 4 major incentives to which the government is a member. These are membership to Lome convention, membership to the generalized system of preferences, membership to the International Centre for the Settlement of Disputes (ICSD), and membership to regional trade blocs e.g. COMESA, NEPAD.

Table 16: Membership to Lome Convention

Membership to lome convention

		Frequency	Percent	Valid	Cumulative Percent
Valid	Very adequate	2	14.3	16.7	16.7
	Adequat	6	42.9	50.0	66.7
	Somehow adequate	3	21.4	25.0	91.7
	Less adequate	1	7.1	8.3	100.0
	Total	12	85.7	100.0	
Missing	System	2	14.3		
Total		14	100.0		

This convention allows Kenya's exports privileged access to the European markets. This is necessary to exporting companies. 91.7% thought the incentive is somehow adequate to very adequate. This is an important incentive since 78.6% are exporters.

Table 17: Membership to the generalized system of preferences

Membership to the general system of preferences

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very adequate	1	7.1	8.3	8.3
	Adequate	3	21.4	25.0	33.3
	Somehow adequate	7	50.0	58.3	91.7
	Less adequate	1	7.1	8.3	100.0
	Total	12	85.7	100.0	
Missing	System	2	14.3		
Total		14	100.0		

According to this system, Kenya's exports to all major markets of the industrialized countries are subject to preferential tariff treatment.

The rating for this was as above, that is 91.7% considered it adequate.

Table 18: Membership to the ICSD

Membership to the International Center for the Settlement of Disputes

		Frequency	Percent	Valid	Cumulative Percent
Valid	Very adequate	1	7.1	8.3	8.3
	Adequate	3	21.4	25.0	33.3
	Somehow adequate	3	21.4	25.0	58.3
	Less adequate	2	14.3	16.7	75.0
	Least adequate	3	21.4	25.0	100.0
	Total	12	85.7	100.0	
Missing	System	2	14.3		
Total		14	100.0		

Only 8.3% found this to be very adequate with 25% saying it was least adequate. This may be explained by the fact that most respondents have not been involved in international disputes that require arbitration.

Table 19: Membership to regional trade blocs

Membership to regional trade blocks

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very adequate	12	85.7	92.3	92.3
	Somehow adequate	1	7.1	7.7	100.0
	Total	13	92.9	100.0	
Missing	System	1	7.1		
Total		14	100.0		

Kenya is a member of virtually the main trade blocs in the region such as COMESA, EAC and NEPAD. This offers firms privileged access to the region's markets and enjoy preferential tariffs. All respondents found this incentive adequate with 92.3 % rating it very adequate.

Overall this is the most highly rated incentive.

4.5 Respondents views on Incentives

The last section of the research required the firms to give a comparative analysis of incentives being offered by other developing countries vis a vis those on offer in Kenya. Interestingly there were varied responses but the most recurring were:

1. Privatisation encouragement through enhanced structures to manufacturers with minimum government red tape.
2. Government participation in promoting FDI's through media.
3. Attractive tax regimes, with tax breaks for some industries.

Table 20: Communication of Incentives

The researcher asked questions to help determine if the incentives are clearly communicated to investors/ potential investors.

Are the incentives clearly communicated to the investor/potential investor

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	6	42.9	42.9	42.9
	No	8	57.1	57.1	100.0
	Total	14	100.0	100.0	

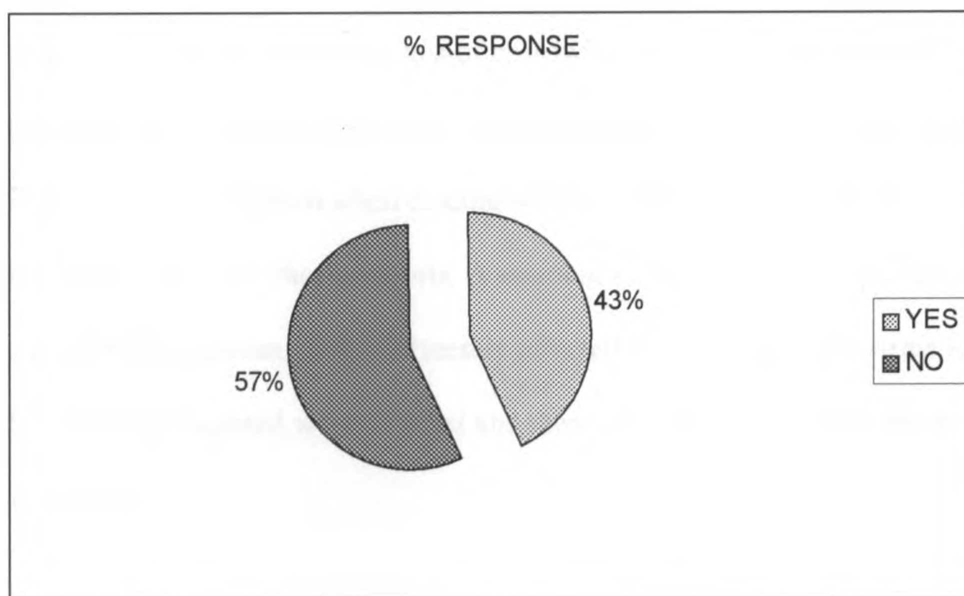

Table 20 indicates that 42.9% felt the communication process good whereas the majority, 57.1% felt there was lack of clear communication on the incentives.

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As a remedy, various suggestions were given on how this information can be disseminated:

1. The government should come up with aggressive promotion campaigns either via trade fairs, Internet and media in foreign countries.
2. Strong and proactive Investment Promotion Council targeting both local and foreign investors.
3. Periodic bulletins on opportunities available.

4.5.1 Challenges facing investors in Kenya

When asked on what challenges they were facing as investors in Kenya, some responses were specific to the industry for example falling tea prices for the tea sector. The general challenges encountered were high cost of borrowing and high taxation which overstretched the companies resources, poor infrastructure leading to high production and distribution costs, corruption when dealing with government processes. There was also unfair competition from cheap imports. A stagnant economy with low purchasing power made local sales plummet, which adversely affected the survival of the firms in Kenya. All the challenges sighted were external and these are some of the areas the government has to address.

CHAPTER FIVE

SUMMARY AND CONCLUSIONS

5.1 Summary

The objective of the study was to identify factors that influence Foreign Direct Investment growth in Kenya. The study also set out to evaluate foreign investor perspective on adequacy of incentives offered.

In my search for literature on the subject, I found out that most of the research on foreign direct investments has been done on developing countries such as Latin America and those in Asia. Research in Africa was concentrated on West and South African countries. Though the issues discussed in the literature are relevant to Kenya as a developing country, very little information is specific to Kenya. Sharma's research was done way back in 1988, and there has been a need to conduct another research to address the gap that exists.

My research was exploratory and an attempt to bring to the views of foreign investors on the investment environment and considerations in Kenya.

5.1.1 Factors considered Important for Foreign Direct Investment Growth

It is evident that political stability has featured highly in this research as the most crucial factor. It carries with it the determination of all the other factors and incentives.

Tax incentives also ranked highly as most firms reckoned the corporate tax was too high. Taxation on raw material and other imports also tends to discourage new productions. The overall effect of high taxation translates to increased production costs, which creates

an unfavorable condition for new investments.

Similarly, firms were concerned with the stability of host country's currency. An appreciating currency is unfavorable to importers, as they would have to pay more for the imports, whereas for exporters, they would gain. The converse is true for a depreciating currency.

On the issue of good credit system, most companies viewed this as an important factor, but were quick to add that due to thin capitalization, most multinationals in the developing world trade with little or the minimum capital investment. Consequently, they borrow locally and they feel the interest rates are too punitive. Interest paid is also added back for tax computation if the companies return a loss at the end of the financial period. Some resort to offshore borrowing backed by the parent companies, which is cheaper. When remitting repayments, proof of withholding tax submission is mandatory.

However, all were in agreement that Kenya has a highly skilled workforce, given the education levels and expertise.

5.1.2 Adequacy of Incentives

From the feedback received, most incentives were found to be fairly adequate, not very adequate. It is the government's challenge to ensure the incentives offered are sufficiently adequate. Tax incentives which have been rated very highly as an important consideration, are not adequate as evidenced from the response. The key focus point of investors is to maximize profits and market share, and if taxation becomes a bottleneck to achieving this end, something needs to be done about it.

The memberships to which Kenya is a signatory: membership to Lome convention, membership to generalized system of preferences, membership to ICSD, and membership to regional trade blocs, allows exporters privileged access to the respective markets with preferential tariff structures. Respondents have found the first three incentives fairly adequate, whereas membership to regional trade blocs is very adequate, given the 92.3% rating as very adequate. This membership was found to be a positive factor in the investment package.

5.2 Conclusions

The study sought to address two major issues:

1. To identify factors that influence FDI growth in Kenya and the importance attached to them
2. To evaluate foreign investor perspective on adequacy of incentives offered.

From the survey, it is evident that most foreign firms in the country are faced with various challenges in terms of high taxation, corruption, capital constraints, imbalanced macro-economic parameters such us wages versus inflation rates. Consequently, pumping in more investment capital has become a contracted battle, as the parent companies have to weigh benefits against costs. They reckon other countries in Africa have a more conducive investment climate by offering enhanced tax structures such as tax breaks and holiday.

To quote one respondent in the pharmaceutical industry, they considered investing in Uganda because of the government's commitment to fighting HIV/AIDS with enhanced participation through the media. This invites researchers and consequently investors.

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5.3 Recommendations

The government should not assume all is well as regards the incentives on offer. From the study, it is clear there is lack of communication on what incentives and opportunities exist for potential investors, both local and foreign. Partnerships can be easily forged between the two-investor groups for various industries such as health, telecommunication and agriculture.

The Investment Promotion Council is doing an excellent job through its website www.ipckenya.org. However, a more proactive approach to marketing is required, with participation of the private sector. Periodic reviews of investment patterns vis a vis those of neighboring countries should also be conducted. This is aimed at addressing the factors and incentives that draw investors to a particular country as opposed to another with similar endowments.

Marketing Kenya abroad will definitely go along way in sensitizing potential investors of opportunities available. As suggested by some respondents, this can be done through trade fairs, renowned marketing and public relations consultants, bulletins, and use of the Internet, where investor profiles can be posted and updated frequently.

5.4 Limitations of the study

Most companies targeted for the study were reluctant to participate in the research, as they have policies and procedures, which require top-level approvals for this. Due to this red tape, and given the time constraint, only 46% of the initial population of 54 agreed to participate. There is also a general research fatigue experienced with respondents, as out of the 25 questionnaires sent, only 14 were returned. Lack of response may also be

explained by the fact that the questionnaires were targeted at managers of the companies who said the key decision makers on investments are based in other countries, and would require more time to adequately respond.

The population selected was relatively small, and a larger population consisting of a cross-section of investors would have been more ideal. However, the choice of the population was explained in chapter 3.

5.5 Suggestions for further research

As this research was done from Kenya's perspective, another research in a neighboring country such as Uganda or Tanzania can be conducted to establish the different incentives offered and government participation in foreign investments.

Another study can also be conducted on the foreign investors in a bid to identify their investment patterns and preferences when making investment decisions. Their contribution to the economy can also be analysed and results used to give recommendations on how to structure incentives so as to suit investor needs.

APPENDIX 1

LIST OF CITIBANK GLOBAL RELATIONSHIP BANKING CLIENTS

1	3M KENYA LIMITED
2	A.T. AND T COMMUNICATION SERVICES
3	ACHELIS (K) LIMITED
4	ACNIELSEN KENYA LIMITED
5	AVENTIS CROPSCIENCE KENYA LIMITED
6	B.A.T.KENYA LIMITED
7	BASF EAST AFRICA LIMITED
8	BATA SHOE COMPANY (K) LTD
9	BAYER EAST AFRICA LIMITED
10	BECTON DICKINSON EAST AFRICA LTD.
11	BEIERSDORF EAST AFRICA LIMITED
12	BESTFOODS KENYA LIMITED
13	BROOKE BOND KENYA LIMITED
14	CALTEX KENYA LTD
15	CARGILL KENYA LTD
16	COATES BROTHERS EAST AFRICA LTD
17	COCA-COLA EAST AFRICA LTD
18	COLGATE PALMOLIVE (EA) LTD.
19	CORN PRODUCTS KENYA LTD
20	DELMAS LIMITED
21	EAST AFRICA SOFTWARE LIMITED
22	EAST AFRICAN COMMERCIAL & SHIPPING
23	ECOLAB EAST AFRICA (KENYA) LTD
24	FRAMIN LIMITED
25	FRIGOREX EAST AFRICA LIMITED
26	GENERAL ELECTRIC INTERNATIONAL
27	GENERAL MOTORS KENYA LTD
28	GEOPOWER PROJECT COMPANY LIMITED

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29	GLAXO WELLCOME (KENYA) LIMITED
30	HENKEL KENYA LIMITED
31	JOHNSONDIVERSEY EAST AFRICA LIMITED
32	KENYA SHELL LTD
33	KODAK K LTD
34	LIPTON LIMITED
35	MAERSK KENYA LTD
36	MITSUBISHI HEAVY INDUSTRIES LTD
37	MOBIL OIL KENYA LIMITED
38	MOMBASA DIESEL GENERATING POWER
39	NORSK HYDRO EAST AFRICA LIMITED
40	P AND O NEDLLOYD EAST AFRICA LTD
41	PIONEER OVERSEAS CORPORATION
42	PROCTER AND GAMBLE (E.AFRICA) LTD
43	PROCTOR AND ALLAN E.A LIMITED
44	RECKITT BENCKISER EAST AFRICA LTD
45	SAFARICOM LTD
46	SANDVIK KENYA LTD
47	SDV TRANSAMI (KENYA) LIMITED
48	SMITHKLINE BEECHAM CONSUMER HEALTHCARE LTD
49	SYNGENTA EAST AFRICA LTD
50	TETRA PAK LIMITED
51	TOTAL KENYA LIMITED
52	TOYOTA EAST AFRICA LIMITED
53	UNILEVER KENYA LIMITED
54	WARNER LAMBERT (KENYA) LIMITED

APPENDIX 11

QUESTIONNAIRE

PART A

1. Name of Company ....

2. Year of establishment in Kenya ....

3. Designation of respondent..

4. In which country is your parent company registered? ....

5. In how many countries does your parent company have subsidiaries? ....

6. How many of the above-mentioned subsidiaries are in Africa.........................

7. What factors do you consider important when investing in a developing country (Please list and rank them) 1.Very important 2. Important 3. Somewhat important 4. Not important.

	Factors considered when investing in a developing country	Ranking
i.		
ii.		
iii.		
iv.		
v		

Others (specify)

....

....

....

....

8. Into which of the following would you classify your investment in Kenya?

i. Joint venture with the government ( )

ii. Partnership (joint venture with a body except the government ( )

iii. Contract ( )

iv. Branch of foreign company ( )

v. Other (specify)..

9. List the types of products/ services you sell?

(1)

(2)

(3)

(4)

10. Which is the market for your goods

(1) Local/ Domestic (2) Export/ Cross border (3) Both.

11. Who do you consider as your major competitor in the industry?

(Please list in order of importance, from the most important to the least).

1. Very important 2. Important 3. Somewhat important 4. Not important.

	Major competitors in the industry	Ranking
i.		
ii.		
iii.		
iv.		
v		

PART B

12. How would you rate the importance of the following factors when considering investment in a developing country?

	Very Important	Important	Somewhat Important	Less Important	Least Important
a) Political stability					
i) Of host country	( )	( )	( )	( )	( )
ii) Of neighbouring country	( )	( )	( )	( )	( )
b) Tariffs grant					
i) Export compensation	( )	( )	( )	( )	( )
ii) Import compensation	( )	( )	( )	( )	( )
ii) Tax incentives	( )	( )	( )	( )	( )
c) Protection against Expropriation	( )	( )	( )	( )	( )
d) Guarantee for capital Repatriation	( )	( )	( )	( )	( )
e) Stability of host country's currency	( )	( )	( )	( )	( )
f) Full ownership guarantee to investor	( )	( )	( )	( )	( )
g) Price control by government	( )	( )	( )	( )	( )
h) Labour laws (e.g. unions, compensation)	( )	( )	( )	( )	( )

i) Availability of raw materials in the host country	( )	( )	( )	( )	( )
j) Availability of technology	( )	( )	( )	( )	( )
k) Availability of capital (Good credit/banking system)	( )	( )	( )	( )	( )
l) Climate of host country	( )	( )	( )	( )	( )
m) Availability of good Infrastructure	( )	( )	( )	( )	( )

Others (specify)

....

....

....

....

13. What factors prompt you to continue investment in Kenya? (Please list from most important to least important)

	Factors that prompt you to continue investing in Kenya	Ranking
i.		
ii.		
iii.		
iv.		
v		

PART C

14. How would you rate the adequacy in the incentives offered by Government of Kenya?

	Very Adequate	adequate	somehow Adequate	less Adequate	least Adequate
a. Export compensation Scheme	( )	( )	( )	( )	( )
b) Customs reduction On imports (raw materials)	( )	( )	( )	( )	( )
c) Customs reduction on Exports (products)	( )	( )	( )	( )	( )
d) Infant industry Protection scheme	()	()	( )	( )	( )
e) Tax incentives	()	( )	( )	( )	( )
f) Foreign investment Protection Act:					
i) Capital repatriation scheme	( )	( )	( )	( )	( )
ii) Expropriation scheme	( )	( )	( )	( )	( )
g) Freedom of operations	( )	( )	( )	( )	( )

15. How would you rate the importance of the following incentives offered by the government of kenya?

	Very Adequate	adequate	somehow Adequate	less Adequate	least Adequate
a) Membership to Lome Convention	( )	( )	( )	( )	( )
b) Membership to the Generalised System of Preferences	( )	( )	( )	( )	( )
c) Membership to the International Center for The settlement of Disputes (ICSD)	( )	( )	( )	( )	( )

d) Membership to regional
trade blocs e.g.
EAC, COMESA, NEPAD ( ) ( ) ( ) ( ) ( )

16. What incentives are being offered by other developing counties where you hold investments?

Outline briefly

a)..

b)..

c)..

d)..

e)..

17. In your opinion, are the incentives clearly communicated to the investor/potential investor

1. Yes 2. No

18. If the answer to 17 is NO, please give suggestions of how you would want this information disseminated

a)..

b)..

c)..

19. Please briefly list challenges that your organization is facing as an investor in Kenya

a)..

b)..

c)..

20. Please state anything that you may feel is relevant to the research

....

....

....

....

....

Thank you for your co-operation.

APPENDIX 111

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