FACTORS CONSIDERED IMPORTANT BY MULTINATIONAL FIRMS WHEN DECIDING ON THE HOST COUNTRY TO INVEST IN: A CASE STUDY OF KENYA

BY

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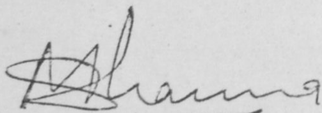
A Management Project Submitted in Partial fulfilment For the Degree of Master of Business and Administration, (M.B.A.), Faculty of Commerce, University of Nairobi.

JUNE 1989

DECLARATION

This Management Project is my own original work and has not been presented for a Degree in any other University.



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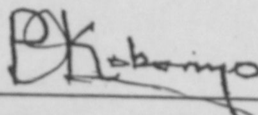
This Management Project has been submitted for examination with my approval as the University supervisor.



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DEDICATION

To Daddy, Mummy, Kamal, Vimal and Sanju, with all my love.

Madhu

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ACKNOWLEDGEMENTS

This study in its present form has been made possible by a number of people and institutions to whom I am greatly indebted and to whom I would like to express a lot of gratitude.

I must sincerely thank my supervisor Dr. Peter O. K'Obonyo, for the continuous guidance and advice he gave me during the study. I would also like to extend my thanks to the staff of the Faculty of Commerce, University of Nairobi and all my collegeaues in the Master of Business and Administration (MBA) programe for their encouragement and assistance; particularly Mrs. Masinde for providing assistance during my supervisors leave.

In addition, I wish to thank the office of the President - Government of Kenya, for granting me permit to conduct the study; and the various respondents without whose co-operation the study could never have been conducted.

I wish to extend my special thanks to all members of my family, and my friends for their moral support and encouragement during the period of study.

Finally, I must also extend my sincere gratitude to Mrs. Mwiria, who tirelessly coped up with the typing of this Management Project; and to all the other people who contributed to this project one way or the other, I thank you all!!

ABSTRACT

The study reported in this project, was aimed at determining the factors which multinational firms consider important when deciding on the most country to invest in. Secondly, the study was aimed at determining the adequacy of the investment incentives offered by the Government of Kenya to the foreign investors.

In order to meet these objectives, information was sought through the use of a questionnaire. The questionnaire was directed to the General Managers or Managing Directors of multinational firms operating in Kenya. The latter had been sampled using simple random sampling method.

The data collected was analyzed using mean scores, Yates Chi -square, median test and Spearman's rank correlation test. Using these, the responses from the service oriented multinational firms were compared with those from the manufacturing oriented multinational firms. The findings from the analyses led to two major conclusions:-

(1) The factors considered important for foreign investment decision differed significantly between service oriented and manufacturing multinational firms.

(2) Some of the ivestment incetives offered by the Government of Kenya, wer found inadequate by the foreign investors.

In view of these conclusions, the following recommendations were made to the Government of Kenya:

(1) Something should be done about the incentives found inadequate by the foreign subsidiaries. A research could be carried out to determine the possible ways of improving the investment incentives.

(2) The investment incentives found adeuate by the foreign investors should be maintained.

CHAPTER ONE

INTRODUCTION

Multinational firms started becoming major actors in shaping the world's economy in 1950s and 1960s. Today between 25% and 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.[1] Multinational corporations (MNCs) have been attracted to large developing countries, especially 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.

Multinationals play an active part in the economies of the East African countries.[2] Kenya is by far the most industrialized of the three economies of East Africa (i.e. Kenya, Uganda and Tanzania). For this reason, foreign investors have tended to favour Kenya over Uganda and Tanzania. Another reason for this preference has been the political and economic strategy adopted

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[1] World Development Report published by The World Bank, Oxford University Press, 1987.

[2] Penrose, E.G., "MNCs in East AFrica: Roles, Policies and Practices" Paper 25. E.A. Univ. Soc. Sci. Council Vol. 2, 1971.

by the government of Kenya which favours private ownership. A considerable proportion of capital formation in Kenya 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. However, this is actually not so. Multinational firms have been the subject of considerable controversy[3] partly because they are foreign and partly because they are large and often seem to dominate host nation economy, particularly industrial sector. Also, because of their links with private enterprises in other countries, they are often accused of reducing economic independence of the host countries and of inhibiting the development of their local technologies.

Kenyan economists believe that although the economy obtains a net benefit from the activities of MNCs operating in the country, this benefit is less than it ought to be because the same or better results could be obtained at lower costs if the government exerted greater control and was less compliant.[4] It is held that foreign investors are given inducements greater than are

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[3]Gershenberg, Irving, "Multinational Corporations in East Africa". Dept. of Economics, University of Nairobi, Ph.D Thesis Proposal, 1975.

[4]U.N. Report on Transnationals Corporations in the Third World. Executive Summary. Oxford University Press, 1988.

necessary to attract them, and that they are permitted to engage in a variant of practices that are detrimental to the economy.[5]

1.1 DEFINITIONS

Ronald Muller defined a multinational firm as: "A firm whose apparent headquarters are in one country and who have subsidiary operations in a number of countries. The objective of the subsidiary is to maximize the parent company's profit".[6]

Professor E.T. Penrose defined a MNC as: "a large autonomous, administrative organization owning or controlling extensive capital purposes, including financial and marketing assets and using these not only in the production and sale of goods and services but also in the development of new technology and new products".[7]

A host country can be defined as: "Any country which receives direct foreign investment, especially a country in which a particular subsidiary is operating".[8]

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[5] U.N. Report Op.Cit 1988.

[6] Muller, Ronald: Multinational Corporations and the Third World. McGraw Hill Publications 1980, p. 102.

[7] Penrose, E.T., "MNCs in East Africa: Roles, Policies and Practices" Paper 25, E.A. Univ. Soc. Sci Council Vol. 2, 1971, p. 11.

[8] BrookeM.Z. and Remmers H.L: The Strategy of Multinational Enterprises. Pitman Publications 2nd Edition 1978, p. 21.

A parent (or home) company can be defined as: "A company which owns and controls the foreign direct investment".[9]

The parent country refers to the country where the main headquarters of the parent company are located.[10]

Finally, a subsidiary can be defined as, "A company which is more than half owned by the parent company".[11]

1.2 HISTORY OF MULTINATIONAL FIRMS IN KENYA[12]

As far back as the 17th century, European companies (Dutch, English, French) were well entrenched both commercially and strategically in their trading centres in Asia, Africa and the Middle East. In these areas, in the late 19th century and early 20th century, there was an upsurge in industrial growth and significant concentration of production in large enterprises. Capitalism then assumed a missionary role. It begun to extend throughout the world by means of capital exports, thus making it possible for capitalist ventures to be established in countries where monopolies had not yet established themselves firmly.

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9 M.Z. Brooke and H.L. Remmers, 1978, Ibid. p. 21.

10 M.Z. Brooke and H.L. Remmers, 1978, Ibid. p. 21.

11 Penrose, E.T. 1971, Op. Cit. p. 12.

12 Mulei, C.M. "The Multinational Corporations and Government Control in Kenya". University of Nairobi, Faculty of Law. Unpublished LLB Thesis, 1976.

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 the 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 out by metropolitan bourgeoisie and the local settler class.

Thus the Kenyan economy was taken over by the Europeans. The latter tried to establish a white settler regime in Kenya and to stiffle any signs of independent economic activity among Africans which might endanger the supply of agricultural produce for the domestic and export markets.

As historians recall, the colonial pattern of foreign capital investments were geared towards labour intensive export oriented primary producing areas with the attendant abundance of cheap unskilled labour. The colonial system, however, underwent great changes after the second World War. There was a pronounced shift from primary production to processing industries, from export orientation to import substitution, from labour intensive primitive techniques to scientific capital intensive and more up-to-date ones.

Kenya's independence, in 1963, did not mean disengagement from the political, economic and social edifice established by the colonialists. The basic strucutre still 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. Lyons Maid and Del Monte.

1.3 THE INVOLVEMENT OF MNCs IN DEVEOPING COUNTRIES

Over the past decade, there has been a clear evidence of a significant change in the relationship between developing countries and multinational firms. These changes have been reflected in the reduced incidence of expropiation and in the settlement of disputes. Already, many developing countries have taken initiative and are liberalizing foreign investment policies.[13]

Among the African countries, liberal attitudes towards Foreign Direct Investment (FDI) have been confirmed in recent legislative changes involving Cote d'Ivoire, Ghana, Tanzania, and Zambia, leading to alleviation of limitations on foreign investment; the most popular incentive continue to be tax incentives. Another approach to attracting FDI has been the

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[13] United Nations Report on Transnational Corporations in the Third World, Development Executive Summary, 1988.

establishment of promotional zones where special facilities are offered to enterprises engaged in the assembly and export of goods.[14]

The above situation seems to point to the fact that developing countries seem to be concentrating on the provision of incentives to promote FDI. However, Williams (1965)[15] feels that it is not only a good investment package that attracts foreign investment, other factors also play a vital role in the investment decision. As he puts it,

> Apart from intense technical and financial calculation or even a carefully prepared legal and administrative basis for the third world organizations the art of politics and the concepts of social sciences can play an important role in deciding whether to invest or not (page 89).

Factors such as climate, infrastructure and technology also play a vital role in deciding on the host country to invest in. Usually, multinationals which are in the fore-front of technological innovation are often reluctant to enter into joint ventures or to engage in contractual technology transactions with third world countries. This is because such an investment would involve the risk of expropiation and the entanglement into local political matters.[16]

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[14] U.N. Report, Ibid.

[15] Williams, S. "Negotiating Investment in Emerging Companies". Harvard Business Review, Jan/Feb 1965 p. 89.

[16] Hall, Edward T., "The Silent Language in Overseas Business". Harvard Business Review, May/June, 1960.

The above seems to point to the conclusion that, even though developing countries seem to concentrate on the provision of incentives to promote investments, multinational firms consider other factors as well.

The Government of Kenya offers what it considers a very 'attractive' investment package to foreign investors. However it is difficult to say whether the package is attractive to foreign investors or not. The package includes, export compensation scheme, investment allowances for encouraging industrial entrepreneurs and a proposal to establish manufacturing under bond export processing zones.[17] However, it is not clear to what extent the potential foreign investors are aware of this package. For this reason, the Kenya investment promotion centre is planning to launch an investors' guide. It is expected that this guide will enable potential foreign investors to easily find out the basic things they need to know about Kenya's suitability for foreign investment.

Contrary to the current trend whereby the third world countries are involved in serious attempts to increase incentives to foreign investors, Kaplinsky feels that the incentives that have been offered by these countries are already more than

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[17] Pannell, Belhouse & Mwangi: Kenya; Tax and Investment Profile Report, Nairobi, Kenya: July 1987.

necessary.[18] As he (Kaplinsky) puts it: "The Kenyan Government has gone out of its way to promote private foreign investment and to avoid actions which might frighten foreign investors, not desiring in any way to reduce their contribution in sustaining the momentum of the economy" (p. 15).

Also, the above mentioned U.N. Report goes on to advise governments of developing countries "... to guard against unnecessary incentives which serve only to reduce the host country's benefits from Foreign Direct Investment without increasing its inflow" (p. 16).

Whatever the case, it is difficult to say whether the third world countries are providing incentives which are more than necessary. However, one thing is clear, apart from the incentives offered by the host countries, multinational firms consider other factors, even though the investment package may contain the most important factors.

1.4. STATEMENT OF THE PROBLEM

To invest or not to invest in an underdeveloped country is a decision facing more and more top managers of multinational firms. With its many development needs, the third world offers many opportunities for investment.

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[18] Kaplinsky, Raphael: Readings on the Multinational Corporations In Kenya. Oxford University Press, Nairobi, 1978.

Currently, foreign investment promotion has become the talk of the day in Kenya. Recent remarks by government officials would appear to indicate that the subject of foreign investment has been out on a reasonably high pedestal. The government seems to feel that incentives offered in its foreign investment package are very suitable and adequate for promoting FDI. But how far this is true is difficult to say, for Mauritious, a neighbouring country and a competitor for foreign investment, offers a comparatively more attractive foreign investment incentives, such as, a tax-free break for ten years once the multinational is established.[19]

The question which then arises is: which of the incentives offered by the Kenya government, do the multinationals find important? There seems to be no systematic evidence on what multinationals consider before they undertake to invest in Kenya. Thus there is a need to determine the factors which multinationals consider important for investment.

To the best of the researchers's knowledge no similar study has been done in Kenya, i.e. there is no systematic and documented information about factors which foreign investors find important, to invest in Kenya, among other countries. Also, the subject of FDI in the third world countries has

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[19] The Standard Newspaper, March 15th 1989 p. 6.

received less sustained and systematic attention in terms of data collection and analysis than many other aspects of economic development.

1.5 OBJECTIVES OF THE STUDY

The objectives of this study are:

(1) To find out the factors which multinational corporations consider important for investment in the third world countries.

(2) To find out the views of multinational firms on the incentives offered by the Kenyan Government.

1.6 IMPORTANCE OF THE STUDY

This study may be useful to the following categories of people:

(1) The planners of the investment promotion centre in Kenya in their efforts to launch an investors' guide.

(2) To foreign investors considering the possibility of investing in Kenya.

(3) To academics: as a basis for futher research.

OVERVIEW OF THE STUDY

This research report is made up of five chapters. Chapter One, the introduciton, consists of background information on the subject matter of the study, statement of the problem, objectives of the study, importance of the study and the overview of the research report. In Chapter Two the literature review pertinent to or related to the subject matter of the study is reviewed. The chapter contains literature pertaining to Foreign Direct Investment and Multinational Corporations in Kenya. Chapter Three deals with the research design which covers the population, sample and the data collection method. The results of the study are presented and analyzed in Chapter Four. Chapter Five, the final chapter, contains discussions of the findings, suggestions for further research and limitations to the study.

CHAPTER TWO

LITERATURE REVIEW

A diligent search by the researcher revealed that little research has been done in this field. However, the researcher has compiled whatever was available with addition of material from newspapers and magazines.

The literature review starts with explaining the procedure followed by the multinational firms when deciding on the host country to invest in. It further explains the various factors considered and the plausible reasons for their consideration. Finally, it reviews the investment incentives offered by the Government of Kenya, to the foreign investors.

2.1 OBJECTIVES OF MULTINATIONAL FIRMS

Since the researcher has already given a background on multinational firms in Chapter One, she will immediately start by giving the objectives of MNCs. The researcher feels that in order to expalin the various factors considered by MNCs when investing in a host country, it is necessary to have some idea of their major objectives. This is because the MNC's objectives may influence the factors they consider.

The major objective of most MNCs is the satisfactory return on their investment. Thus the investment decisions are justified on a purely commercial basis. In other words

their basic aim is the attainment of profit for their parent companies.

To help ensure the attainment of this objective, MNCs would like some legal guarantees on the security of their investment from the host government. Generally, to compensate for the high risk invovled in investing in a third world country, the multinational firms seek privilages with regard to taxation, repatriation of profits or capital and import tariffs. To help in achieving their major objectives, the multinationals try to promote healthy relations with the host nation. They also try to provide products and services more suited to the local needs.[20]

Some multinationals, on the other hand, are not out to gain profits. The parent company sets up a subsidiary in a foreign country due to the availability of, say, raw materials in that country. This subsidiary operates to produce just to supply to its counterparts, operating in the nearby countries.[21]

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[20]Bates, D.L. and W. Eldredge: "Strategy and Policy". Published by W.C. Brown, Iowa, U.S.A., 1980, p. 252.

[21]Bates, D.L. and W. Eldredge: "Strategy and Policy". Published by W. C. Brown, Iowa, U.S.A., 1980, p. 253.

2.2 WHY FIRMS GO ABROAD[22]

Multinational firms do not become MNCs overnight; ordinarily no single earth shattering decision creates an MNC. This is decided over a period of time. Usually the reasons to why firms go abroad, play a part in their consideration of the factors which they consider important for investment in a foreign country. According to Raymond Vernon, a firm's decision to invest abroad is determined by one or several fo the following four reasons:

2.2.1 A desire to exploit a technological lead

A firm which is a leader in new product innovations and development may want to exploit this technological need further. Thus it may decide to go international. Such a firm usually has numerous foreign contacts and are encouraged by the fact that many countries welcome foreign investors, provided they manufacture new products at lower costs. However, where labour is scarce, the firm may stress the use of labour saving devices. This will enable it to make greater use of its technology. There are also characteristic differences in consumer products. Countries with very high per capita income offer opportunities

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[22] Vernon, Raymond: Manager in the International Economy. 4th Edition, Prentice-hall Publications, 1981 pp. 3 - 18.

to firms that are able to produce varieties, while those with low per capita income offer unique opportunities to firms that can provide lower-priced versions of existing products or new products. These countries are, therefore, very attractive to a firm that enjoys a technological lead. Such a lead enables it to satisfy the needs of such countries while assuring fair returns.

In Kenya, for example, the government offers unique opportunities to foreign investors that are willing to venture into small business development and projects aimed at developing rural areas. Infact, the Kenya Government gives more concessions to those who invest in agriculture, semi-arid and arid areas and those who make greater use of local raw materials. International companies such as Sanyo and Toyota have made their presence felt all over the world because of their technological leadership.

2.2.2 <u>A desire to exploit a strong trade name</u>

Another reason that has led entreprises to create producing facilities in foreign countries is the desire to exploit a strong trade name. In the modern world of easy international movements and communications, firms sometimes accquire a strong trade name in foreign markets without much conscious effort; for example, Mcdonald's fast food restaurants, even though not operating in Kenya, are very well known among

the younger generation of Kenyans.

This trade name may be based on the fact or illusion of superior performance but with predictable performance.

For this reason a firm may decide to set up a plant in country where it is favourably perceived.

2.2.3 Need to exploit the advantages of scale

The firms which decide to go international are usually very large and well established. These firms can easily establish themselves in foreign environments, whereas small firms find it difficult to assemble funds, physical assets and organization skills that are required for such a venture.

Some companies become multinational because it makes them less vulnerable to the random variations of demand that affects any national market and less vulnerable to the intervention of national governments. Another reason for firms becoming multinationals is the desire to avoid being left behind. Thus if a firms major competitor decides to invest abroad, it may follow suit.

In both these cases, the company is able to expand beyond the national boundaries because of the large scale advantages.

2.2.4 Need to exploit a scanning ability

Some firms have a very efficient research and development department. They are able to scan out areas for new investment. Firms usually look for new areas when it loses its technological lead. Even though their product may sell, it does not command a premium price. Firms having a better scanning ability will be able to find and invest in foreign markets sooner and thus take advantage of pioneer benefits.

2.3 ENVIRONMENTAL ANALYSIS[23]

When a multinational feels that a valid reason exists for it to invest in a third world country, it engages in an environmental analysis. Since this is the first step in analyzing the host country it plays a critical role in the decision to invest. It probably gives a rough idea to the MNCs about the factors they should consider important for investment. This importance of factors may vary from one MNC to another.

The environmental analysis for a MNC is far more complex that that for an organization engaged in domestic operations. The MNC faces a different political, legal and eocnomic environment which collectively are referred to as a different culture.

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[23] Wells, Louis T. and Vernon, Raymond: Economic Environment of International Busienss. Prentice-Hall Publication, 2nd Edition, U.S.A. 1976.

The amount of information that can be obtained from usual sources vary considerably from one country to another with respect to availability, details and reliability. Moreover the host country may not be amenable to utilizing modern methods of data collection and analysis. Such a situation can prove to be psychological and intellectual obstacle to a foreign investor, who may give up the idea totally, thereby passing a good investment opportunity. This sort of situation can also result in the multinationals considering factors like availability of information, technology and attitude of the host government, as important factors in investing in a host country.[24]

According to Eldredge and Bates,[25] the first area of analysis is the transfer controls. Transfer controls refer to any type of restriction on the flow of people and items that are tangible or intangible. The strategist who has been accustomed to an obstructed interstate transfer of items domestically may not be aware of the full range of transfer controls. Occassionally capital equipment cannot be transferred to a country at any price because its political situation requires high employment in order to remain stable. Permitting the

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[24] Williams, S. "Negotiating Investment in Emerging Countries". Harvard Business Review, Jan/Feb 1965.

[25] W. Eldredge and D.L. Bates, 1980, Op. Cit.

importation of modern capital equipment would place on the unemployment lists a number of semi skilled and skilled workers. This course may result in social unrest and political upheaval, which would threaten or oust the political party in power. Thus such a restriction on transfer controls would make the MNC view for similar incentives, thereby enhancing the importance of a certain incentive over another.

To a smaller, though significant, extent, social-cultural characteristics can also play a part in determining which factors are considered important for investment. For example, a very well established fashionable clothes factory, is more unlikely to want to set up a subsidiary in the Middle East, where it is against the law for women to clad in anything apart from the 'bui-bui'.[26]

Thus, before a company actually embarks on setting up a plant in a host country, a very complex environmental analysis is conducted to determine whether necessary conditions for a viable investment exist.

2.4 METHODS USED BY MULTINATIONAL FIRMS TO ASSESS INVESTMENT OPPORTUNITIES ABROAD

According to a research done by Robert Stobaugh[27], there

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[26] Lee, James, "Cultural Analysis in Operations Overseas". Harvard Busienss Review, Mar/Apr 1966, pp. 106-614.

[27] Stobaugh, Robert B. "How to analyze foreign Investment Climate". Harvard Business Review, Sept-Oct 1969 p.101.

are basically four techniques adopted by MNCs to invest abroad, namely,

(a) Go/No-Go approach

(b) Premium for risk

(c) Range of estimates

(d) Risk analysis.

2.4.1 Go/No-Go Approach

In this approach the manager either accepts or rejects a particular country based on an examination of one or two characteristics. Often no further study or research is conducted. For instance, a firm may decide not to invest in the Middle East due to political instability.

Although this approach has an advantage in that it reduces the amount of investigation to be done in looking for foreign investment opportunities, it has a major disadvantage in that some very good investment opportunities are passed over because a country was rejected on initial screening.

2.4.2 Premium for Risk

This method is more advanced than the above mentioned one. The company using premium for risk demands a higher return on investment from proposed projects in countries with a poor "investment climate". Various levels of sophistication exist

in using this premium for risk method. Some companies use executives in deciding the size of the premium to place on various countries. A few other companies have some type of scale for rating countries based on investment climate. While a rating scale might be useful as one of several variables in screening many countries as part of a search process,[28] its use in the premium for risk approach presents at least two types of problems:

(i) The various elements of the investment climate often have different effects for different projects. For example, the profitability of a plant built to serve the domestic market would more likely depend on the granting and continuation of tariff protection than would the profitability of another plant erected to serve the export market.

(ii) As is usually the case with rating scales, it is difficult to assign proper weights for each category of investment climate. However, regardless of whether a rating scale is used or not, a serious flaw with this method is that it assumes the risk premium to be constant over the life of the firm.

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[28] Stobaugh, Robert B., "Where in the World Should we put that Plant?" Harvard Business Review, Jan/Feb 1969, P. 129.

2.4.3 Range of Estimates

In using this method, the company manager makes his best estimate of the values for the various factors that will affect the project's profitability. To do this, the manager first decides on the variables and then assigns values to them. It is easier to make accurate estimates of certain variables, referred to as 'stable' factors. These include income, tax rates, depreciation allowance rates, availability of loans, tariff rates and exchange controls. On the other hand other variables, unstable factors, are difficult to determine. These include currency value, and political and economic stability. There is no standard formula to determine these.

There are two major difficulties associated with the use of the range of estimates approach:

(1) The manager must be on the constant lookout for variables that change in the opposite direction and thereby tend to offset one another; and

(2) The manager must avoid the indiscriminate use of all the pessimistic estimates of variables i.e. purposely giving a low weightage to each factor thereby getting a much more pessimistic out-come than the actual outcome is likely to be.

2.4.4 Risk Analysis

This approach involves the use of probability theory. Here the probabilities for other important variables are determined and then a simulation model to establish the distribution of the probable profits is used.[29] This differs from the premium for risk in the sense that, in this method a probability is assigned and not a weightage. It is the most sophisticated of the four methods.

2.5 FACTORS CONSIDERED BY MULTINATIONAL CORPORATIONS WHEN DECIDING ON THE HOST COUNTRY TO INVEST IN

By going through various articles on multinational firms the researcher was able to come up with the following factors which MNCs consider when contemplating investment in a third world country:

(i) Political stability of

- (a) host country
- (b) neighbouring country.

(ii) Availability of

- (a) technology
- (b) captial
- (c) raw material.

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[29] Hertz, David B. "Risk Analysis in Capital Investment". Harvard Business Review, Jan/Feb 1964.

(iii) Labour laws

(iv) Climate

(v) Incentives

2.5.1 Political Stability

(a) Of Host Country

This factor seems to be mentioned again and again in the relevant literature. It seems that the political stability of the host country is of utmost importance to the foreign investor. This seems quite logical, for a very high risk is involved in investing in a politically unstable country. Apart from the high risk of expropiation i.e. forceful ownership of property by government, there is fear of economic depression, which will result in very low, if any, profits.

(b) Of Neighbouring Country

This seems very important probably because it may have some adverse effects on the host country. For example, if the subsidiary being set up is in a land locked country, and the only sea port available is in a politically unstable country, the foreign investor has to be cautious. Therefore, relationship between the host country and its neighbours is of utmost importance to a prospective foreign investor.

2.5.2 Availability of

(a) Technology[30]

Usually, when multinational firms invest in a third world country, they bring technology and managerial skills with them. Therefore, the availability of technology does not seem to be of prime concern to the multinational firm, be it a manufacturing oriented firm or a service oriented firm. Infact one of the reasons why third world developing countries promote foreign direct investment is to get modern technology. They prefer to import technology rather than develop it anew at home, due to the cost. However, they want the technology to be adapted to local conditions and the requisite skills to be transferred to local citizens.

(b) Capital[31]

Capital can be generated internally or it can come from abroad. The ambitious growth plans of developing countries have generally meant that some of the required capital must come from abroad. Many projects which are undertaken in the third world countries are financed by international loaning bodies like the International Monetary Fund (IMF), and the World Bank.

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[30] Langdon, S. "Technology Transfer by MNCs in Africa". St. Marvins Press, New York, 1975.

[31] Davis Steven, "How Risky is International Lending?. Harvard Business Review, Jan/Feb 1977.

However, multinationals prefer to borrow capital locally, as its cheaper this way. The foreign firm can get loans quite easily as compared to the local borrower.

(c) Raw Material[32]

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. The raw material may be semi-processed and then exported to the parent company, or it may be converted into the final product for the local market. A crude example of these sort of subsidiaries, are those in South Africa. South Africa is rich in nuclear material, diamonds and gold; for this reason many MNCs have established subsidiaries to exploit these raw materials. These subsidiaries are mainly manufacturing oriented firms. This seems quite obivous as a service oriented firm is out for clientele and not raw material. Therefore, one would expect the manufacturing firms to consider the availability of raw materials of more importance than the service firms.

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[32] Reuber, G.L.: Private Foreign Investment in Development. Oxford University Press, 1973.

2.5.3 Labour Laws[33]

Multinational firms are usually concerned about the national labour they will have to employ once they are established. They 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. Service firms on the other hand mainly have to employ qualified staff. Therefore one would expect the former to be more concerned about labour laws.

2.5.4 Climate

This factor though not very important, seemed to be mentioned time and again. It seems that 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 very cold climate could result in the breakage of Transport and communication which could prove harmful to the multional

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[33] Kaplinsky, R.: Employment Effects of MNC Enterprises: Case Study of Kenya. Oxford University Press, Nairobi, 1979.

firm. On the other hand it may just be a matter of convenience, that is, because the general manager cannot live in a very hot (cold) climate he may decide not to invest in that particular country.[42]

2.5.5 Investment Incentives

Investment incentives are offered by the host country to the foreign investor. These are given to promote FDI. These are discussed in more detail later on.

[42]Williams, S. "Negotiating Investment in Emerging Countries". Harvard Buness Review. Jan/Feb 1965.

2.6 MULTINATIONAL FIRMS AND THE KENYAN ECONOMY[34]

In comparison to many third world countries, Kenya appears to have a very open economy. The prohibition of certain imports is largely due to the local production of equivalents rather than because of any policy of autarchy or a desire to reorient patterns of consumption. Exports and imports make up a large proportion of the G.D.P. and though this is to some extent explained by the small size of the Kenyan economy, it also reflects a pattern of openess to the world economy.

The result of this open economy has been patterns of consumption being set in terms of global taste patterns and industralization largely following the pattern of import susbstitution. 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. Some of these are shown in the table below.

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[34] Jorgensen, J.J. "Multinational Firms and The Indigenization of the Kenyan Economy". Uppasala Printers, 1975.

TAKEOVER OF LOCAL FIRMS BY FOREIGN FIRMS

Original local producer	New Foreign Takeover	Year of takeover
Sherwood Paints	Robbialac Paints	1958
Penguin Ice Cream	Lyons Maid	1959
Kenya Canners	Del Monte	1968
Fitzgerald Baynes	Schweppes	1968
Jensen and Nicholsen	Hoechst E. Africa	1970
Kenya Fishing Flies	Brooke Bond	1972

Source: Reuber, G.L.: Private Foreign Investment in Development. Oxford Press, New York, 1973.

Other firms such as Mobil and Magadi Soda, which were originally MNCs have been taken over by the government.

2.7. THE NATURE OF INVESTMENT INCENTIVES OFFERED BY THE KENYA GOVERNMENT[35]

The basic strategy of the Kenya Government has been one of indeginization. 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

[35] Mulei, C.M. "The MNC and Government Control in Kenya". Unpublished LL.B Thesis, Unviersity of Nairobi, 1976.

member of the society. The structural level indiginization entails production for domestic needs rather than for external needs, indegenous technology and indegenous patterns of consumption rather than imported ones. This basic strategy underlies the package of potential foreign investors. This package includes:[36]

2.7.1 General Legal Guarantees

Before undertaking to invest in another country, an investor needs to be assured that an unfavourable 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. In addition, foreign investors wish to be assured that they will avail themselves, both at present and in the future, to a definite legal treatment, specified in the relevant legal instruments and that they need not fear any major changes in local legal or political conditions that would be unfavourable to their interests.

Since international arrangements are difficult and faced with many limitations, the need for legal guarantees to foreign

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36 Kaplinsky, R. "Readings on the MNC in Kenya". Oxford University Press, 1978.

investors is essentially through host country action. Normally, since it is the capital- importing states that are in need of foreign captial, it is incumbent upon them to offer legal guarantees to prospective investors. In Kenya, the instrument for foreign investment guarantees are:[37]

2.7.1.1 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 though the term 'benefit' is a hollow term, it can be interpreted to mean:

(1) that the investment will lead either to an earning or saving of foreign exchange,

(2) 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 of Approved Enterprise are protected from expropiation or compulsory acquisition of their enterprises and are entitled to the repartriation of both capital and profits.

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[37] Pannell, Belhouse and Mwangi: Tax and Investment Profile. Published in Nairobi, July 1988.

2.7.1.2 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 artibration.

2.7.1.3 Fiscal, Financial and Trade Incentives

Many developing countries like Kenya have elected to foster the growth of local industry behind the protection of high tariffs and other import restrictions. For example, Firestone (Ltd) is protected by the Kenya Government's restriction of the importation of tyres into the country. Also, Leyland (Kenya) Ltd, is well protected under the agreement with the government which allows only two other companies to assemble commercial vehicles in the country. The agreement also prohibits the importation of second hand units for resale and vehicles comparable by those being assembled will only be imported in completed form, if they cannot be assembled in Kenya.[38]

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

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[38] Cronje and Ling: LONRHO: Potrait of a Multinational. Julian Friedman Books, 1976, London.

privelages, foreign investors are no doubt attracted by such a favourable situation.

2.7.1.4 Freedom of Operation

Minority participation in the operations of multinational firms can also be regarded as a kind of 'insurance' by the Government for uninterupted activities. Foreign collaboration is increasingly becoming a common form of foreign investment in Kenya. Such collaboration usually involves financial participation and technology transfer. Although the government's main wish is to lessen the embarassment of depedency and to eventually acquire the greatly needed technological advance, from the point of view of MNCs, minority government ownership of shares is a sign of government appraisal and support.

2.7.2 Other Incentives

These include the flexible work permit system whereby foreign firms are allowed to engage in the services of expatriates. For more protection, foreign firms have also found it expedient to appoint 'political' notables to management positions and directorship in foreign subsidiaries.

CHAPTER THREE

RESEARCH METHODOLOGY

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

3.1 THE POPULATION

The population of interest in this study consisted of all multinational firms operating in Kenya. The list used for this purpose was obtained from the Registrar of Companies in Nairobi. Since the population was too large, it was necessary to use a sample.

3.2 THE SAMPLE

This consisted of 60 respondents (organizations) which were selected by simple random sampling, using a table of random numbers.[39] To get the sample, the elements of the parent population were firstly numbered, 1, 2, ..., N. Since N was a three-digit number, the random number table used was of three numbered digits. Thirdly a starting point was determined arbitrarily (by placing a pencil at any point on the table of

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[39] Churchill, Gilbert A: Marketing Research: Methodological Foundations. 3rd Edition, Dryden Press 1983, p. 360.

random numbers) and then according to the number on the list of random numbers a firm was picked. For example, if the random number which was arbitrarily chosen was 200, then from the list of multinational firms, the 10th firm was picked. After that every next tenth random number was picked and the same procedure was followed.

3.3 DATA COLLECTION METHOD

The study used both primary and secondary data. Primary data was collected using a structured questionnaire consisting mainly of close-ended questions and was constructed on the basis of a list of factors obtained from the investment guide.[40] However, a reference was also made to pertinent literature as well as discussions with acedemics in order to make the questionnaire more relevant to the Kenyan environment. The quesitonnaire was designed for the whole sample, mostly using likert type scales. It was directed to the Managing Directors or General Managers of the companies, who normally passed it onto the relevant members of their staff. The questionnaire was administered using the 'drop-pick-later' method.

The secondary data was obtained from various pamphlets and published reports given by the companies.

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[40] Pannel, Belhouse and Mwangi. Tax and Investment Profile. Published in Nairobi, July 1988.

3.4 DATA ANALYSIS METHOD

The data collected from this study was presented mainly by the use of summarized tabulations and percentages. Mean scores were evaluated and ranked to give the importance of adequacy of the incentives.

The differences between the manufacturing and service firms were tested with respect to the following issues:

(1) Mean scores of service and manufacturing firms for the importance of various factors.

(2) The adequacy of the incentives.

The significance of differences in scores was performed using the median test, Chi-square test and the Spearman's Rank Correlation test, depending on the nature of the data [41] (See Appendix C).

[41] Daniel W.W. and Terrell J.C.: Business Statistics. Published by Houghton Miffling Company U.S.A. 1975, p. 326.

CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

In this section, the data from the completed questionnaires was summarized and presented in the form of tables and mean scores. Further, the median test and the Spearman's rank correlation tests were used.

The analysis were presented in three parts. The first part dealt with the general characteristics. The second and third parts were aimed at answering the earlier stated objectives.

4.1 OVERVIEW

The first step in the analysis was to give an overview of the data. This involved tabulation of the questionnaires distributed and returned. These were presented in Table 1.

TABLE 1: Questionnaires Distributed and Returned

Type of Company	Number of questionnaires distributed	Percentage of questionnaires distributed	Number of questionnaire returned	Percentage of questionnaires returned
Manufacturing firms	40	67%	23	57.5%
Service firms	20	33%	13	65%
Total	60	100%	36	

As is discernable from Table 1, 67% of the questionnaires were given to manufacturing firms and the response rate was 57.5%; 33% of the questionnaires were given to service oriented firms and the response was 65%. The overall response rate was 60%.

Of the companies from which responses were received, four have been in Kenya since the colonial time while two were newly established subsidiaries. The remaining have been here for about 5 to 20 years. The respondents came from nine parent countries, distributed as shown in Table 2.

TABLE 2: Parent Country and Number of Subsidiaries from them

Parent Country	Number of Subsidiaries in Kenya
France	1
West Germany	4
India	5
Italy	1
Japan	3
Netherlands	2
Switzerland	2
United Kingdom	10
United States	8
Total	36

The data presented in Table 2 shows that most of the multinational firms interviewed came from the United Kingdom, followed by the United States of America. As far as the type of investment is concerned, two companies were joint ventures with the government; nine were partnerships, that is, joint ventures with non-government bodies; there were no contracts; and twenty-five were branches of foreign companies (See Table 3).

TABLE 3: Type of Companies by Type of Investment

Type of Company	Type of Investment			
	Joint Venture with Government	Partnership	Contract	Branch of Foreign Company
Service oriented		8		5
Manufacturing oriented	2	1		20
Total	2	9		25

Table 3 shows that service oriented firms are mainly partnerships (8 out of a total of 13), whereas manufacturing firms are mainly branches of foreign based companies (20 out of a totla of 23).

4.2 FACTORS CONSIDERED BY MULTINATIONAL CORPORATIONS WHEN DECIDING ON THE COUNTRIES TO INVEST IN

Factors refer to those aspects other than the incentives. Since the incentives are very specific to a country, they are dealt with separately. Thus, this section of the analysis deals with the various factors considered by mutlinational firms when deciding on the host cuntry to invest in. The respondents were asked to state the factors they found important, when considering investment in a less developed country (Appendix B, Q5). Their responses were presented in Table 4.

TABLE 4: Factors Found Important by MNCs when Considering Investment in a Third World Country

Factor	Number of Companies	Percentage
Political stability	32	89%
Investment opportunities	21	58%
Market for product	19	53%
Nearness to seaport	4	11%
Government attitude towards FDI	2	6%

It is clear from the table that a very high percentage (89%) of the companies considered the political stability of a country when deciding on the suitability of a country for investment. This was followed by the investment opportunities available (58%) and the market for the product (53%). To some extent some firms (11%) consider nearness to the seaport, Mombasa in our case, while others (6%) considered the attitude of the host government towards foreign direct investment. The fact that the MNCs stated these factors on their own shows that they considered them important.

4.3. This sub-section of the analysis deals with Q. 7 (Appendix B). In these questions the respondents were asked to rate the importance of various factors they generally consider when deciding on the host country to invest in. For ease of analysis the factors were divided into two: General factors and investment incentives. The general factors consisted of political stability, stability of host country's currency, price control by government, labour laws, availability of raw materials, technology and capital, and, finally the climate (weather) of the host country. The incentives consisted of tax, export, import, capital repatriation, expropiation, and membership to ICSD (Internaitonal Centre for the Settlement of Disputes). Another reason for this division is to enable the researcher easily compare the importance

of an incentive with its adequacy in Kenya. For example, suppose tax incentives are rated as very important and their adequacy is rated as somewhat adequate, the researcher can conclude that something needs to be done about this incentive. To enable comparisons the results for service oriented companies and manufacturing companies have been separated.

4.3.1. From Table 5 one can discern that among the general factors, for the service firms the stability of the host country's currency had the highest mean score (4.77), whereas the availability of raw materials had the lowest mean scores (2.00). It is worth noting that availability of capital, political stability of host country, price control, availability of technology received compratively high mean scores, whereas labour laws, political stability of neighbouring countries, and climate (weather) of host country, received comparatively low mean scores.

4.3.2 The manufacturing firms:- The highest mean score (4.87) was received by political stability of host country and the lowest mean score (1.48) by labour laws. Price control, availability of raw materials, capital and technology and the climate received above average mean scores. Political stability of neighbouring country, stability of host country's currency and labour laws received below average mean scores.

TABLE 5: Ratings of General Factors by Multinational Firms

Factor	Very Important		Important		Somewhat Important		Less Important		Least Important		Mean Score		Rank	
	S	M	S	M	S	M	S	M	S	M	S	M	S	M
Political stability of host country	5	20	7	3	1						4.31	4.87	3	1
Political stability of neighouring countries		1		2	6	1	3	1	4	18	2.15	1.57	7	8
Stability of host country's currency	10	1	3	2		8		7		5	4.77	2.43	1	7
Price control by government	9	7	1	5	2				1	11	4.23	2.87	4	5
Labour laws (e.g. unions working hours)			1		10	1	1	9	1	13	2.85	1.48	6	9
Availability of raw materials in host country		5	3	9	1	6	2	2	7	1	2.00	3.65	8	3

TABLE 5 (Cont'd)

Factor	Very Important		Important		Somewhat Important		Les Important		Least Important		Mean Score		Rank	
	S	M	S	M	S	M	S	M	S	M	S	M	S	M
Availability of technology	3	2	5	12	4	17	1	2			3.77	3.61	5	5
Availability of capital	7	4	6	15		3				1	4.54	3.91	3	3
Climate (wheather) of host country		2	2	7	1	3	3	6	7	5	2.15	2.78	7	6

KEY: S = Service firms

M = Manufacturing Firms

In Table 6, the overall ranking of the general factors is given. For service firms the highest ranking was for the "stability of the host country's currency" whereas the one for manufacturing firms was for "political stability of host country." Similarly, the lowest rank for service firms was for availability of raw materials and that for manufacturing firms was for "labour laws."

TABLE 6: Overall Ranks of General Factors

Factor	Rank by service firms	Rank by manufacturing firms
Political stability of host country	3	1
Political stability of neighouring countries	7	8
Stability of host country's currency	1	7
Price control by government	4	5
Labour laws	6	9
Availability of raw materials	9	3
Availability of technology	5	4
Availability of capital	2	2
Climate of host country	7	6

4.4 This sub-section of the analysis deals with the importance of the investment incentives. Table 7 gives the mean scores for the investment incentives. As shown in Table 7, for service firms firms guarantee for capital repartriation has the highest average score (4.92) indicating that the service firms regarded it as an important factor to consider in foreign investment decisions. At the other extreme end is export and imports compensation with the lowest average score of 1.77, showing that for most service firms they were not critical factors in foreign investment decisions. This is supported by the fact that all the 13 respondents rated "guarantee for capital repatrition" as being very important or important, while no respondent rated "export or import compensation" as being very important or important. On the other hand, no respondent rated "guarantee for capital repatrition" as being somewhat important as compared to all the 13 respondents rating "export and import compensation" as less or least important.

For manufacturing firms, tax incentives have the highest average score of 4.65 indicating that most firms regarded them as an important factor to consider in foreign investment decisions. At the other extreme end is full ownership to investor with the lowest mean score of 3.04, showing that it was not a critical factor in foreign investment decisions. [However, note that even though this mean score (3.04) is

TABLE 7: Ratings of Importance of Investment Incentives by Respondents

Investment incentive	Very Important		Important		Somewhat Important		Less Important		Least Important		Mean Score	
	S	M	S	M	S	M	S	M	S	M	S	M
Gurantee for capital repatriation	12	11	1	9		2				1	4.92	4.26
Tax incentives	11	18	2	2		3					4.85	4.65
Protection against expropriation	8	17	5	1		5					4.62	4.52
Membership to ICSD	5	2	2	5	3	11	2	1	1	4	3.62	3.04
Full ownership gurantee to investor		3	7	4	3	10	3	3		3	3.31	3.04
Export compensation		15		7	1	1	8		4		1.77	4.61
Import compensation		12		9		2	9		5		1.77	4.43

the lowest of all the factors, it is still an above average score showing that the factor is quite important, if not the most critical one. This is supported by the fact that 20 out of 23 respondents rated "tax incentives" as being very important or important while only 7 out of 23 respondents rated "full ownership guarantee to investor" as being very important or important. On the other hand, only 3 out of 23 respondents rated "tax incentives" as being somewhat important as compared to 16 out of 23 respondents that rated "full ownership guarantee to investor" as being either somewhat important, less important or least important.

4.4.3 Table 8 gives the overall rankings of investment incentives. As shown in the table capital repatriation received the first rank for service firms whereas tax incentives received the first rank for manufacturing firms. Full ownership to investor and export/import compensation received the lowest rank for service and manufacturing firms respectively.

TABLE 8: Overall Ranking of Investment Incentives

Factor	Ranking by Service firms	Ranking by manufacturing firms
Export compensation	6	2
Import compensation	6	4
Tax incentives	2	1
Guarantee for capital repatriation	1	5
Protection against expropriation	3	3
Membership to ICSD	4	6
Full ownership guarantee to investor	5	7

4.4.4 Table 9 shows the total ranking for all the factors irrespective of whether they are general factors or investment incentives. Thus it gives the overall ranking of importance of various factors. Guarantee for capital repatriation is ranked 1, by service firms whereas manufacturing firms rank it 4. Political stability of host country is ranked 1st by manufacturing firms and 6th by the service firms. Labour laws is ranked last (16) by manufacturing firms whereas service firms rank it 11th.

TABLE 9: Ratings of factors by firms

Factor	Ranking by service firms	Ranking by manufacturing firms
Guarantee for capital repatriation	1	4
Tax incentives	2	2
Stability of host country's currency	3	14
Protection against expropriation	4	6
Availability of capital	5	7
Political stability of host country	6	1
Price control by host government	7	12
Availability of technology	8	9
Membership to the international centre for the settlement of disputes	9	10
Full ownership guarantee to investor	10	10
Labour laws	11	16
Political stabililty of neighbouring countries	12	15
Climate of host country	13	8
Availability of raw material in host country	14	13
Tariffs grant on exports	15	3
Tariffs grant on imports	16	5

Tariffs grant on import/export compensation is ranked last by service firms whereas manufacturing firms rank it 5. These rankings show a definite distinction between the factors considered important for investment in a third world country, by service and manufacturing firms.

4.5. In this sub-section, a median test was performed tos how if the difference between service and manufacturing firms with respect to the importance they attached to both general factors and incentives was statistically significant.

Statement of the hypothesis:-

Ho: There is no difference between the factors considered important by service and manufacturing multinational firms.

H1: There is a difference between the factors considered important by the service and manufacturing multinational firms.

99.0% level of significance was used. For the median test, the total scores were used. These are presented in Table 10. A total score is arrived at by multiplying the mean score with the total number of respondents.

TABLE 10: Total scores for all firms

Factor	Total score for service firms	Total score for manufact-uring firms
Political stability of host country	56	112
Political stability of neighbouring countries	28	36
Tariffs grant on export compensation	23	106
Tariffs grant on import compensation	23	102
Tax incentives	63	107
Protection agianst expropriation	60	104
Guarantee for capital repatriation	64	99
Stability of host country's currency	62	56
Membership to ICSD	47	70
Full ownership guarantee to investor	43	70
Price control by host government	55	66
Labour laws	37	34
Availability of raw materials	26	84
Availability of technology	49	83
Availability of capital	59	90
Climate of host country	28	64

From Table 10, the median of the sample is 61. This was obtained by arranging the whole sample in ascending order and then picking

the centre value.

TABLE 11: Importance of investment factors

Number of observations	Service firms	Manufacturing firms	Total
Above median	3	13	16
Below median	13	3	16
Total	16	16	32

$$X^2 = \frac{n(ad - bc)^2}{(a+c)\ (b+d)\ (a+b)\ (c+d)}$$

Where X^2 = Calculated value

n = Total number of observations = 32

a = Number of observations above median for service firms = 3

b = # of observations above median for manufacturing firms = 13

c = # of observations below median for service firms = 13

d = # of observations below median for manufacturing firms = 3.

Substituting the values:

$$X^2 = \frac{32(9 - 169)^2}{(16)(16)(16)(16)} = 12.5$$

However this value cannot be considered as the frequency of the cells in the 2 x 2 contingency table (Table 11) are less than 5, Yates correction† formula has to be used.

$$X^2_c = \frac{N(/ad - bc/ - 0.5n)^2}{(a+c)(b+d)(c+d)(a+b)}$$

Where X^2_c = corrected Chi-square value.

$$X^2 = \frac{32[(9-169) - 0.5*32]^2}{(16)(16)(16)(16)}$$

$$= \frac{32*(-176)^2}{65536} = \frac{991232}{65536} = 15.125$$

Since the critical value of X^2 (7.88) is less than the calculated value of X^2 (15.125) at 99.0% level of significance, the null hypothesis is rejected. This implies that service and manufacturing firms differ significantly with regard to the factors they consider important when deciding on a host country to invest in.

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† Daniel, Wayne W.: Applied Non-parametric statistics. Houghton Mifflin Company, Boston, U.S.A., 1978, p. 168.

4.6 This sub-section of the analysis deals with the determination of the adequacy of the various incentives offered by the government of Kenya to the foreign investors. This differs from section 4.4, as it considers the adequacy of Kenyan incentives whereas the former referred to the importance of incentives in general.

Before rating the adequacy of the incentives, the respondents were asked the reasons for their continued investment in the country. The most frequently occurring answers are listed in Table 12, along with their frequencies. It appears from Table 12 that political stability was more important to most firms (78%) for their continued stay in Kenya, than any other single factor. This was followed by availability of a large market (47%) and good infrastructral facilities (36%). The other factors received comparatively low percentages with "well mixed economy" getting the lowest percentage (8%).

TABLE 12: Reasons for Continued Investment by Foreign Companies in Kenya.

Reason	Frequency	Percentage
Political stability	28	78%
Availability of a large market	17	47%
Government's attitude towards FID	12	33%
Good infrastructural facilities	13	36%
Investment incentives	8	22%
Nearness to seaport	5	14%
Well mixed economy	3	8%

4.7 this sub-section focused on the adequacy of investment incentives offered by the government of Kenya to the foreign investors. The ratings of the adequacy of the incentives have been shown in Table 13. As shown in this table, for:-

4.7.1 Service oriented firms:- Tax incentives have the highest mean score (4.92), indicating that the respondents find this incentive extremely adequate. At the other extreme end is custom reduction on exports with the lowest mean score (1.92), showing that this incentive is not adequate. This is supported

TABLE 13: Ratings by Respondents on the Adequacy of Incentives

Investment Incentive	Very adequate		adequate		Somewhat adequate		Less adequate		Least adequate		Mean Score	
	S	M	S	M	S	M	S	M	S	M	S	M
Export compensation scheme		7		7	9	6	3	2	1	1	2.61	3.74
Custom reduction on imports		3		8	7	12	4		2		2.38	3.61
Custom reduction on exports		7		5	1	10	10	1	2		1.92	3.78
Infant industry protection schemes	5	2	5	5	1	9	2	5		2	4.00	3.00
Tax incentives	12	2	1	17		1		3			4.92	3.78
Expropriation scheme	7	12	5	7	1	4					4.46	4.35
Capital repatriation scheme	11	1	2	5		11		2		4	4.85	2.70
Freedom of operations by government	10	15	1	3	2	2		1		2	4.62	4.22

KEY: S = Service

M = Manufacturing

by the fact that all 13 respondents rated "tax incentives" as being very adequate or adequate while no respondent rated "custom reduction on exports" as being either very adequate or adequate.

4.7.2 For manufacturing firms:- Expropriation scheme has the highest mean score (4.35) indicating that the respondents found this incentive extremely adequate. At the other extreme end is capital repatriation scheme, with the lowest score (2.70) showing that the respondents found this incentive not adequate. This is supported by the fact that 19 out of a total of 23 respondents rated "expropiation scheme" as very adequate or adequate whereas only 6 out of a total of 23 rated "capital repatriation scheme" as very adequate or adequate. On the other hand, 4 out of a total of 23 rated "expropiation scheme" as somewhat, less or least adequate whereas 17 out of a total 23 rated "capital repatriation scheme" as either somewhat, less or least adequate.

Table 14, gives the rankings of the various incentives. From the table it can be seen that for manufacturing firms, expropriation scheme is ranked 1st whereas for service firms it is ranked 4th. For service firms Tax incentives are ranked 1st whereas for manufacturing they are ranked 3rd. These ratings show a difference in the incentives considered adequate by service and manufacturing firms.

TABLE 14: Rankings for the Adequacy of Investment incentives

Investment Incentives	Ranking by Service Firms	Ranking by Manufacturing Firms
Export Compensation scheme	6	5
Custom reduction on imports	7	6
Custom reduction on exports	8	3
Infant industry protection scheme	5	7
Tax incentives	1	3
Expropriation scheme	4	1
Capital repatriation scheme	2	8
Freedom of operations (by host government)	3	2

4.8 The purpose of this sub-section is to determine whether the difference in the ratings for adequacy of investment incentives between service and manufacturing firms is real or due to chance. A median test was performed to determine if the observed difference was significant. They hypothesis was stated as below:

Ho: There is no difference in the ratings given by the service and manufacturing firms.

H1: There is a difference in the ratings given by the service and manufacturing firms.

The level of significance was 0.005. Table 15 gives the total socres for the ratings on the adequacy of investment incentives.

TABLE 15: Total Scores of Adequacy of Incentives

Investment Incentives	Manufacturing firms	Service firms
Export compensation	86	34
Import compensation	83	31
Custom reduction on exports	87	25
Infant industry protection scheme	69	52
Tax incentives	87	64
Expropriation scheme	100	58
Capital repatriation	62	63
Freedom of operations	97	60

As before the median (63.5) was determined.

TABLE 16: Investment Incentives' Contingency Table

Number of observations	Service firms	Manufacturing firms	Total
Above median	1	7	8
Below median	7	1	8
Total	8	8	16

Since the contingency table has frequencies of below 5, Yates correction forumula was used.

$$X^2 = \frac{n(|ad - bc| - 0.5n)^2}{(a+c)(b+d)(c+d)(a+b)}$$

$$X^2 = \frac{16[(1 - 49) - 0.5*16)^2}{(7)(7)(7)(7)}$$

$$= \frac{50176}{2401} = 20.89$$

Since the critical value of X^2 (7.78) at 99% level of significance is less than the calculated value of X^2 (20.89), the null hypothesis is rejected. This implies that service and manufacturing firms differ significantly with regard to the adequacy of investment

incentives.

4.9 This section, although also on the ivnestment incentives, has been analyzed separately, as the incentives cannot be rated on the basis of adequacy but on the basis of importance. Table 17 gives the mean scores of these incentives.

4.9.1 Service firms:- Membership to the International Centre of Disputes got the highest mean score (4.00) and this was supported by the fact that all 13 respondents rated it as being very important or important. The lowest mean score (2.31) was for membership to the generalized system of preferences, and this was supported by the fact that all 12 respondents rated it as being somewhat, less or least adequate.

4.9.2 Manufacturing firms:- Membership to the generalized system of preferences received the highest mean score (3.56) and this was supported by the fact that 10 out of a total 13 respondents rated it as being very important or important. The lowest mean score (3.04) was received by membership to the Lome Convention, and this was supported by the fact that 13 respondents rated it as being somewhat important or less important.

TABLE 17: Ratings of Investment Incentives by Respondents

Factor	Very important		Important		Somewhat Important		Less Important		Least Important		Mean Score	
	S	M	S	M	S	M	S	M	S	M	S	M
Membership to the Lome Convention		6		4	8	2	5	7		4	2.61	3.04
Membership to generalized system of preferences		7		3	6	9	5	4	2		2.31	3.56
Membership to the International Centre of Disputes	9	5	4	8		2		1		7	4.00	3.13

KEY

S = Service

M = Manufacturing

A statistical test was done to confirm whether the observed difference is real or due to sampling error. The hypothesis is stated as:

Ho: There is no difference between the responses of the service firms and the responses of the manufacturing firms.

H1: There is a difference between the responses of the service firms and the responses of the manufacturing firms.

The level of significance is 99%. The nature of the data did not permit the use of the median test. Instead the Spearman's rank order correlation test (See Appendix C) was used.

TABLE 18: Investment Incentives Contigency Table

X Mean scores of service firms	Y Mean scores of manufacturing firms	(d = (X − Y)	d^2
3.04	2.61	0.43	0.1849
3.56	2.31	1.23	1.5625
3.13	4.00	− 0.87	0.7569

$$\therefore \sum d^2 = 2.5043$$

$$rs = 1 - \left[\frac{6(d_1{}^2)}{n(n^2-1)} \right]$$

Where

rs = Spearman's rank correlation

$d_1{}^2$ = Squared difference between means

n = Number of respondents.

$$rs = 1 - \frac{6 * 2.5043}{3(9 - 1)}$$

$$= 1 - \frac{(15.0258)}{24}$$

$$= 1 - 0.626 = 0.374.$$

Since 0.374 is a positive figure showing that the mean scores are positively correlated even though the relation is not strong, in order to determine whether there is evidence of a significant positive relation the z - test has been used.

$$Z = rs \sqrt{n - 1}$$

$$= 0.324 \sqrt{3 - 1}$$

$$= 0.4582$$

The critical Z* value from the tables is +1.645. Since the calculated value is less, we fail to reject the null hpothesis. This shows that the relationship between service and manufacturing firms as far as adequacy of incentives is probably due to chance.

CHAPTER FIVE

DISCUSSION AND CONCLUSIONS

In this concluding chapter the findings of the study in relation to the major questions raised in the objectives of the study care discussed and summarized. This Chapter also includes conclusions drawn from the study, recommendaitons, limitations of the study and suggestions for further research.

5.1 DISCUSSIONS

The findings reported in chapter four are discussed here. Each factor is discussed separately for both the service and manufacturing firms. The discussion is broken down into two parts; the first part deals with the factors and the second with the incentives.

5.1.1 Factors Considered For Investment (given in Table 5)

(a) Political Stability of Host Country

This factor has been rated very high by both service and manufacturing firms. This seems in line with what the researcher expected. No company, be it a multinational firm or a local firm, would like to invest in a politically unstable country, due to the high risk involved.

(b) Political Stability of Neighbouring Countries

This factor received very low mean scores and ranking of 7th and 8th by service and manufacturing firms, respectively. This, again, is in line with what the researcher expected. Even though an investor would like political stability of neighbouring countries, its absence is not one of high priority in an investment decision.

(c) Stability of Host Country's Currency

This factor received contradictory mean scores, in the sense that service firms rated it very high as compared to manufacturing firms. This may be due to the fact that most of the service firms were joint ventures in which the partnership involved financial help from abroad. For example, a company which is a joint venture, may be financed by a foreign body such as the International Monetary Fund, which loans the money in dollars. If the Kenyan currency depreciates, the multinational firm will have to pay more than what it would have had to pay the currency remained stable. For this reason, the financial institutions are extremely concerned about the stability of the currency.

(d) Price Control by Government

The results for this factor were also diverse as far as service and manufacturing firms are concerned. However, these

results seem a little difficult to interpret. One would have expected manufacturing firms to be more concerned with price control, yet they rated it lower than did service firms. Since the manufacturing firms rated price control lower (mean score 2.87) than did the service firms (mean score 4.23), it may imply that even though they consider price control, the factor is not one of priority. Since the service firms interviewed consisted mainly of financial institutions, they may have taken price control to mean pricing of securities, interests or deposits. This may explain their high rating (mean score 4.23) of the price control factor.

(e) Labour Laws

As the researcher expected, this factor received overall low mean scores. These laws are not one of prime considerations in an investment decision probably because these laws are usually not as stringent as those in the MNCs home countries.

(f) Availability of Raw Materials

This factor received mean scores as expected by the researcher. Manufacturing firms rated this factor high, because they need raw materials. As stated in the literature, many multinational firms have set up subsidiaries in various parts of the world, mainly because of the availability of raw materials in those areas. Service firms are more concerned about the availability

of clientele and so did not rate this factor as high as did manufacturing firms.

(g) Availability of Technology

This factor was rated above average by both the service and manufacturing firms. Even though the multinational firms usually bring their own technology, they still value the availability of other technology.

(h) Availability of Capital

This factor was rated highly by both the service and manufacturing firms. This seems quite logical, because, capital is requried for any investment to expand and grow.

(i) Climate (weather) of the Host Country

This factor received average scores and low rankings by both the service and manufacturing firms. The probable reason for this could be that investors would prefer to work in a comfortable environment, if possible. However, this factor is not one of prime importance, which seems quite logical as one would not expect a good investment opportunity to be passed over, just because of the weather.

5.1.2 Adequacy of Investment Incentives (presented in Tables 7, 13 and 17)

(a) Export Compensations Scheme

This factor received high rating from the manufacturing firms as compared to service firms, for it is the manufacturing firms that are involved in export trade and, as such, should be more concerned with export compensation scheme. The fact that multinational manufacturing firms found the export compensation scheme adequate is a welcome message to the Government of Kenya. It shows that the scheme should be maintained.

(b) Custom Reduction on Exports and Imports

The results for this factor were similar to the ones for the above scheme. They were more important to manufacturing firms which considered them adequate. The above reasoning applies to this factor.

(c) Tax Incentives

These incentives were considered very important by all the multinational corporations. This seems logical as no investor would want its profits to be 'eaten away' by high tax rates. The respondents rated the Kenyan tax incentives as very adequate, showing their satisfaction with it.

(d) Capital Repatriation Scheme

This factors was ranked high by all the multinational firms. This again is quite logical, as the major objective of any multinational firm is to earn profits for its parent company. If the restrictions on repatriation of capital are high, no multinational firm would want to invest. As far as the adequacy of the capital repatriation scheme offered by the Government of Kenya is concerned, service firms found it quite adequate whereas manufacturing firms did not. This result is rather confusing as the repatriation scheme is the same for all firms. A further study is called for to find out the possible reasons for these differences.

(e) Protection Against Expropriation

This factors was considered very important by all the

respondents and the protection offered by the Government of Kenya was considered very adequate. All respondents were satisfied with the fact that they faced no risk of their land and property being expropiated by the government of Kenya.

(f) Freedom of Operations

This incentive offered by the Government of Kenya was found by the foreign investors to be very adequate. This is because it allowed them to expand and prosper in a manner they found appropriate, without outside intervention.

(g) Infant Industry Protection

This incentive offered by the Kenyan Government was found to be appropriate by the respondents as they gave it very high scores. This incentive assures an upcoming subsidiary extra incentive for a given period of time. Thus the Government of Kenya should maintain this incentive.

(h) Membership to the International Centre for the Settlement of Disputes

This membership seems to be of prime concern to foreign investors. This is supported by the fact that the respondents rated it very highly. This membership enables a dispute between the host country and a multinational firm to be settled by a neutral counsel.

(i) Membership to the Lome Convention

This convention allows Kenya's exports priveleged access to European markets. This is necessary for manufacturing firms who usually need to export their products. They found this incentive quite adequate. The service firms were not concerned with this and so gave it an average rating.

(j) Membership to the Generalized System of Preferences

According to this system Kenyan exports to all major markets of the industrialized countries are subject to preferential tariff treatment. Again that is more essential to manufacturing firms who need to export products. This membership was found to be a positive factor in the Investment package.

5.1.3 Inferences from Statistical Tests (presented in Tables 11, 16, and 18)

Various statistical tests were performed to see whether the differences in rankings of the factors and incentives by the service and manufacturing firms were statistically significant or not. The results showed that a difference did exist between their ratings and that the difference was not just inherent in the sample. Given the various reasons in Chapter Two, one would have expected a difference. Thus the statistical tests confirm the difference anticipated by the

researcher. However, (as shown in Table 18) for the ratings on the importance of various incentives, the statistical tests show that there is no difference between the mean scores, and the apparent difference is one of chance. The probable reason for this could be that, since the service oriented firms were not familiar with the membership they rated them fairly, whereas the manufacturing firms actually found them to be fairly important and adequate.

5.2 CONCLUSIONS

Two major issues were addressed to in this study. First, the study sought to determine which factors are considered important by multinational firms. Second, the study sought to determine the adequacy of the investment incentives offered by the Government of Kenya.

Regarding the factors which are considered important, the findings lead to the following conclusions: First, factors such as political stability of host country, tax incentives, availability of technology, guarantee for capital repatriation, and availability of capital are very important in the investment decision. Secondly, incentives such as tax incentives, infant industry protection scheme, membership to ICSD and freedom of operations were considered adequate. Thirdly, their is a distinction between the responses of the manufacturing firms

and service firms. As explained, this is due to their nature of operations.

On the whole, one can conclude that foreign investors find the investment incentives offered by the Government of Kenya fairly adequate.

5.3. RECOMMENDATIONS

Emanating from the foregoing, the following recommendations are presented: There is scope for improvement on investment incentives. Most of them seem a long way from being adequate. A major effort should be made to improve the incentives found inadequate. For example, the capital repatriation scheme was found to be inadequate by the manufacturing multinationals. The probable reason for this should be determined. Also, the Investment Promotion Centre could conduct a research which could bring about possible suggestions for the improvement of incentives. They can employ part-time personnel from major multinational firms to help them out. The Government of Kenya should maintain the incentives found adequate by the foreign investors.

5.4. LIMITATIONS

This study was constrained by a number of factors. The major limiting factor was time. This led to the reduction in

the scope and depth of the study. Owing to the short time during which the study had to be completed, it was not possible to follow-up and receive all the questionnaires. The result of this was that out of the 60 questionnaires distributed only 36 were received. Further, due to shortage of time, only the importance of investment factors and the adequacy of investment incentives were investigated.

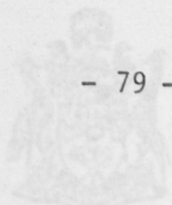
5.5 SUGGESTIONS FOR FURTHER RESEARCH

From the findings of the present study and the limitations thereof, the following are suggested as areas for further research:

(a) There is a need to conduct a study to find out from the MNCs the possible 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.

(b) 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.

(c) A wider research could be conducted to compare the investment incentives offered by Kenya and those offered by neighbouring



countries. This information would enable the researcher to determine why some MNCs prefer Kenya as a host country while others do not.

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APPENDIX A

Dear Sir/Madam,

I am a postgraduate student in the Faculty of Commerce at the University of Nairobi. For my final year research project, I am conducting a research on "Factors considered by Multinational Firms when continuing investment in a Third World Country: The Case of Kenya".

Your firm has been selected to form part of the study. I kindly request you to fill the attached questionnaire. Any information that you provide will be treated in the strictest of confidence. Neither your name nor the name of your organization is required.

A copy of the research project will be made available to you upon request.

Your co-operation will be greatly appreciated.

Thanking you in advance,

Yours sincerely,

MADHU SHARMA (MISS)
MBA II STUDENT

DR. P.O. K'OBONYO
SUPERVISOR

APPENDIX B

QUESTIONNAIRE

SECTION A

1. In which country is your parent company registered?

   ____

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

3. How many of the above mentioned subsidiaries are in Africa? ____

   (Please ( ) the appropriate bracket).

4. Is your company,

   (a) Manufacturing oriented ( )

   (b) Service oriented ( )

   (c) Others (specify)________________________________

5. What factors do you consider important when investing in a developing country?

   ____

   ____

   ____

   ____

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

   (a) Joint venture with the government ( )

   (b) Partnership* ( )

   (c) Contract ( )

   (d) Branch of foreign company ( )

   (e) Others (specify)-----------------------------------

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

	Very Impor- tant	Impor- tant	Somewhat Impor- tant	Less Impor- tant	Least Impor- tant
(a) Potitical stability					
(i) of host country	( )	( )	( )	( )	( )
(ii) of neighouring country	( )	( )	( )	( )	( )
(b) Tariffs grant					
(i) Export compensation	( )	( )	( )	( )	( )
(ii) Import compensation	( )	( )	( )	( )	( )
(iii) Tax incentives	( )	( )	( )	( )	( )

---

* This refers to a joint venture with a body except the Government.

Que. 7 (cont'd)

	Very Important	Important	Somewhat Important	Less Important	Least Important
(c) Protection against expropiation	( )	( )	( )	( )	( )
(d) Guarantee for capital repatriation	( )	( )	( )	( )	( )
(e) Stability of host country's currency	( )	( )	( )	( )	( )
(f) Host country's membership to the International Centre for the Settlement of Disputes	( )	( )	( )	( )	( )
(g) Full ownership guarantee to investor	( )	( )	( )	( )	( )
(h) Price control by Government	( )	( )	( )	( )	( )
(i) Labour laws (e.g. Unions, working hours e.t.c.)	( )	( )	( )	( )	( )
(j) Availability of raw materials in the host country	( )	( )	( )	( )	( )

Q.7 (cont'd)

	Very Impor- tant	Somewhat Impor- tant	Less Impor- tant	Least Impor- tant
(k) Availability of technology	( )	( )	( )	( )
(l) Availability of capital	( )	( )	( )	( )
(m) Climate of host country	( )	( )	( )	( )
(n) Others (specify)				

____

____

____

____

(If more, please list at the end of questionnaire).

8. What factors prompt you to continue investment in Kenya?

____

____

____

____

____

____

____

SECTION B

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

	Very adequate	adequate	Somewhat 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) Expropiation scheme	( )	( )	( )	( )	( )
(g) Freedom of operations (.e. intereference by					

10. How would you rate the importance of the following incentives offered by the government of Kenya?

	Very Impor- tant	Impor- tant	Somewhat Impor- tant	Less Impor- tant	Least impor- tant
(a) Membership to the Lome Convention**	( )	( )	( )	( )	( )
(b) Membership to the generalised system of preferences***	( )	( )	( )	( )	( )
(c) Membership to the International Centre for the Settlement of Disputes	( )	( )	( )	( )	( )

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

----

** This convention allows Kenya's exports privileged acces to European markets.

*** According to this system Kenyan exports to all major markets of the Industrialized countries are subject to preferentical tariff treatment.

THANK YOU FOR YOUR CO-OPERATION

APPENDIX C

MEDIAN TEST

The median test is used to find out whether or not the two populations differ with respect to central tendency. This test focuses on the median as a measure of central tendency and enables the testing of the null hypothesis that the two independent samples were drawn from populations having the same median.

The display for the median test is as below:

Number of observations	Factor I	Factor II	Total
Above median	a	b	a+b
Below median	c	d	b+d
Total	n_1=a+c	n_2=b+d	N =n_1+n_2

$$X^2 = \frac{n(ad - bc)^2}{(a+c)(b+d)(a+b)(c+d)}$$

Where

X^2 = Calculated value of Chi-square.

If the frequency in the 2 x 2 contingency table above, is less than 5, then a Yate's correction formula is used. The corrected formula is

$$X^2 = \frac{n(/ad - bc/ - 0.5n)^2}{(a+c)(b+d)(c+d)(a+b)}$$

SPEARMAN'S RANK CORRELATION

This test focuses on the difference of the mean scores as a measure of the extent to which the paired rankings depart from perfect direct or inverse correlation. The formula for Spearman's rank correlation is given below.

$$rs = 1 - \frac{6(d_1{}^2)}{n(n^2-1)}$$

Where

rs = Spearman's rank correlation

$d_1{}^2$ = Squared difference between means.

n = number of respondents

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