# DETERMINANTS OF MULTINATIONAL FIRMS' INVESTMENT DECISIONS IN THE DOWNSTREAM OIL INDUSTRY IN KENYA

**BY**

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# DECLARATION

I, Pauline Wambui Nginga, declare that this thesis is my own original work and that it has not been presented and will not be presented to any other university for similar or any other degree award.

Signature ___________________ Date ________________

D61/62044/2010

The project has been forwarded with my approval as the University Supervisor

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# DEDICATION

I dedicate this study to the almighty God for granting me the strength and inspiration which was vital in my endeavours. I also dedicate the study to my family for their continual encouragement and support.

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# ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| **FDI** | Foreign Direct Investment |
| **IOC** | International Oil Companies |
| **LPG** | Liquefied Petroleum Gas |
| **UNCTAD** | United Nations Conference on Trade and Development |
| **GDP** | Gross Domestic Product |
| **OLI** | Ownership-Location-Internalization |
| **TIC** | Tanzania Investment Centre |
| **MNC** | Multinational Corporation |
| **SPSS** | Statistical Package for Social Sciences |
| **ODI** | Overseas Development Institute |

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# ABSTRACT

The objective of this study was to examine the determinants of multinational firms' investment decisions in downstream oil industry in Kenya. The study employed cross-sectional descriptive research design. The study focused on multinational firms involved in the downstream oil industry in Kenya. The targeted population included 5 multinational oil companies, out of which 4 responded. Questionnaires were used as the main data collection instruments. Data collected from the field was presented in form of descriptive statistics such as charts, tables and graphs. The study found out that the most important determinants of multinational oil firms' investment decisions is the investor security and good infrastructure mainly in the transportation and telecommunication sectors. Government regulations and investor security were indicated as the main difficulties and concerns facing the foreign investors in Kenya. The study recommends the following: one focal point that deals with all Government related issues to reduce the multi-agency approach to handling various issues by Government agencies which increases the cost of operations in Kenya, maintain consistency in application of the legal and regulatory provisions when addressing oil industry concerns and the revision of the price regulatory and control process to ensure incorporation of all operational cost incurred by the foreign investors thereby making the investment environment favourable. The study also recommends further studies to be done on the same in the areas such as upstream and midstream oil sectors in the country.

# CHAPTER ONE

# INTRODUCTION

## 1.1 Background of the Study

There are many reasons underlying the decision of multinational corporations entering specific markets. The main objective is a profitable return on investment. International businesses try to achieve efficiency by minimizing their cost and maximizing economies of scale while reducing duplication (Hill, 2011). They invest in different locations to get different advantages from host countries in order to operate better in their home base, however, different factors are noticed, which lead firms to expand and invest abroad and become multinationals (Hill, 2011). Market size and growth prospects of the host country, openness of the host country to international trade, the availability of infrastructure, reasonable levels of taxation and the overall stability of the tax regime, stable political environment, as well as conditions that support physical and personal security, legal framework and the rule of law and corruption and governance concerns constitute the main concerns of International Corporations in taking their decisions in developing countries (Hill, 2011). Feenstra, (2004) notes that with liberalization of the developing markets and opening of their economies with the removal of foreign investment barriers, privatization of the state economic enterprises and development of foreign direct investment attractive policies, has increased the investment of International firms, especially in the developing countries.

There are several theories of foreign direct investment (FDI) entry strategy that provide insight into how firms can gain and sustain competitive advantage (Cavusgil, Knight and Riesenberger, 2008). These theories approach the various phenomena of

FDI from three complementary perspectives: Monopolistic Advantage, Internalization Theory and Dunning's Eclectic Paradigm (Cavusgil, Knight and Riesenberger, 2008). The theories seeks to explain why a firm will favor direct investment as a means of entering a foreign market when two other alternatives that is, exporting and licensing are open to it (Hill, 2011). The theoretical perspective known as the eclectic paradigm, attempts to combine the various theoretical perspectives into a single holistic explanation and hence its eclectic nature (Hill, 2011).

Petroleum remains East Africa's major source of energy which drives the Kenya's commercial activity accounting for 22% of the primary energy consumed in the country (National Oil Corporation, 2013). At the retail level, there are a number of subsidiaries to foreign based and local companies of varied sizes who have outlets through which petroleum products are sold directly to consumers. The subsidiaries of foreign oil marketing companies are by far the largest players in the sub-sector despite the liberalization of the industry which allowed for the entry of more players in the market (Owino, 2000).It is considered the backbone of the region's economy with price fluctuations in petro-fuels having a direct effect on the prices of other consumer goods and services thereby making it a lucrative business stream for Government and oil marketing companies (Owino, 2000).

### 1.1.1 Determinants of Multinational Firms' Investment Decisions

Cross-border investment by multinational firms is one of the most salient features of today's global economy (Hooper & Newlands, 2009).International firms expand their activities to a foreign country for a number of reasons including, among others, the exploitation of economies of scale or scope, the use of specific advantages, often owing to a life-cycle pattern of their products or just because their competitors are

engaged in similar activities (Agiomirgianakis, Asteriou, & Papathoma, 2003). On the other hand, Governments are also engaged in a policy competition by changing key factors of their economic policies, such as domestic labour market conditions, corporate tax and tariff barriers, subsidies, privatization and regulatory regime polices so as to improve foreign direct investment activity in their countries. Bouoiyour (2003) notes that many countries have been actively trying to attract foreign investment offering income tax holidays, import duty exemptions and subsidies to foreign firms, as well as measures like market preferences, infrastructures and sometimes even monopoly rights.

There are many determinants of multinational firms' investment decisions in developing countries. Among them is the market size and growth rate that supports an idea that a large market is required for efficient utilization of resources and exploitation of economies of scale. Jordaan (2004) mentions that foreign direct investors (FDI) will therefore move to countries with larger and expanding markets and greater purchasing power, where firms can potentially receive a higher return on their capital and by implication receive higher profit from their investments.

Overseas Development Institute- ODI (1997) found labor costs to be significant, particularly for foreign investment in labour-intensive industries and export-oriented subsidiaries. However, when the cost of labour is relatively insignificant, the skills of the labour force are expected to have an impact on decisions about FDI location.

Infrastructure covers many dimensions ranging from roads, ports, railways and telecommunication systems. According to ODI (1997), poor infrastructure can be seen, however, as both an obstacle and an opportunity for foreign investment. For the majority of low-income countries, it is often cited as one of the major constraints. But

foreign investors also point to the potential for attracting significant FDI if host governments permit more substantial foreign participation in the infrastructure sector. Jordaan (2004) claims that good quality and well-developed infrastructure increases the productivity potential of investments in a country and therefore stimulates FDI flows towards the country.

Indeed, the world market for foreign direct investment (FDI) is highly competitive, and Kenya in particular, seeks such investment to accelerate her development efforts. What is likely to be more critical in the future is the distinctive combination of location advantages, especially, created assets that Kenya can offer potential investors. The level of FDI has been low and stagnant over the past couple of years and well below Kenya's potential. There has also been a worrying trend of foreign investors moving out of Kenya and gravitating to other countries (Kinaro, 2006). It is on this basis that the study will seek to establish what determines the investment decisions of foreign oil companies in upstream oil industry in Kenya and how to increase investor interest in the country.

### 1.1.2 Industry Attractiveness Framework

Attractiveness of an industry is a critical piece of the market research puzzle when planning. Market attractiveness is a term that describes the profit possibilities available in a given market or industry (Olsen, 2012). An industry is attractive if it offers above-average potential for healthy long-term profitability and sustainable comparative advantage. Determining industry attractiveness requires analyzing trends in the business environment and the likely behaviour of competitors. According to Porter, a Harvard Business School professor, five forces shape industry structure: barriers to entry, buyer power, supplier power, the threat of substitutes, and industry

rivalry. These forces set limits on prices, costs, and investment requirements — the basic factors determining the profitability and hence the viability of your social enterprise. The overall industry attractiveness does not imply that every firm in the industry will return the same profitability. Firms are able to apply their core competencies, business model or network to achieve a profit above the industry average (Porter, 1980).

The main objective of international oil corporations in oil partnerships is a profitable return on investment. However, it is not easy for international oil companies (IOCs) to decide what country is good for oil investments. The amount of reserves, geology certainty, political stability, infrastructure, sector governance and oil prices are crucial elements of oil investment assessments. Combining these factors with the capital-intensive and long-term nature of oil investment leads to a high level of unpredictability characterized by regulatory or environmental issues, stagnating buyer demand, industry overcapacity, mounting competition. The degree of risk and uncertainty plays a fundamental role in determining the attractiveness of a market or industry.

### 1.1.3 Downstream Oil Industry in Kenya

There are three divisions of the Kenyan petroleum industry: Upstream sector, midstream sector and downstream sector. The downstream sector includes oil refineries, petroleum products distributors and retail outlets, the midstream deals with the pipeline network, storage and refinery while the upstream sector deals with exploration and production activities (National Oil Corporation, 2013). The downstream sector includes the refining of petroleum crude oil, processing and purifying of raw natural gas as well as the marketing and distribution of products

derived from the crude oil and natural gas. The downstream sector also touches consumers through products such as gasoline or petrol, kerosene, jet fuel, diesel oil, heating oil, fuel oils, lubricants, natural gas and liquefied petroleum gas (LPG) (Jedrzej, 2004).

The key institutions involved in the regulating the downstream oil sectors are currently the Ministry of Energy and the Energy Regulatory Commission. These institutions are responsible for the setting petroleum policies and regulation including price controls in the downstream oil sector in Kenya (Ministry of Energy and Petroleum, 2013). Section 102 of the Energy Act empowers the Minister to make regulations upon recommendation by the Commission on petroleum related activities including importation, exportation, and landing, open tender systems for importation, minimum operational stocks, and determination of retail prices for petroleum products among others (Energy Regulatory Commission, 2013).

The liberalization of the Kenyan downstream oil sector in 1994 has seen a lot of growth and improvements in quality and level of service. However, without an appropriate regulatory environment being in place at the time of liberalization, several challenges faced the sector which included proliferation of substandard petroleum dispensing and storage sites which posed environmental, health and safety risks; diversion of petroleum products destined for export into the local market by unscrupulous business people to evade tax (Energy Regulatory Commission, 2013). The Government noting these challenges recommended the review of the Petroleum Act Cap 116 and other energy sector statutes leading to the introduction of new energy sector legislation to cover petroleum, electricity and renewable energy (Energy Regulatory Commission, 2013).

In 2006, the Energy Act No. 12 of 2006 was enacted. This led to the transformation of the then Electricity Regulatory Board to the Energy Regulatory Commission (ERC) (Energy Regulatory Commission, 2013). The Energy Act states in Section 5(a) (ii) that the objects and functions of ERC include regulating the importation, exportation, transportation, refining, storage and sale of petroleum and petroleum products. Construction Permits are also to be issued by ERC for all petroleum related facilities in order to check proliferation of substandard sites (Energy Regulatory Commission, 2013).

With the liberalization and subsequent regulation of the downstream oil sector, opportunities for investment in the oil market were now opened to local oil companies that did not command a huge market share in terms of the downstream business but had managed to smoothen their way into the lucrative trade of oil importation (Owino, 2000). The opening of the oil market has led to the sector becoming highly competitive thereby affecting the multinational oil corporations that have dominated the oil industry for decades. The multinationals have therefore had to rethink their strategy so as to maintain and if possible increase their market shares. Currently, there are 5major subsidiaries to foreign based companies of varied sizes who have outlets through which petroleum products are sold directly to consumers (Owino, 2000). The subsidiaries of foreign oil marketing companies are by far the largest players in the sub-sector despite the liberalization of the industry which allowed for the entry of a more players in the market. Among the major multinational players in the downstream oil sector include Total Kenya, Essar Energy, Oil Libya, VTTI and Vivo/Shell (Jedrzej, 2004).

These examples show the interest in the oil industry in Kenya and the amounts of investments being made in the industry. Being a liberalised oil market, it is imperative for the multinational corporations (MNCs) to be motivated to invest in the downstream oil market. The factors that are driving such investments by like Total Oil and Oil Libya have not been explored and therefore this study will be important in addressing this gap in literature.

## 1.2 Research Problem

According to UNCTAD (1998), economic factors such as business facilitation, investment promotion and incentives, hassle costs related to corruption and administrative efficiency, social amenities and after investment services are some of the determinants of international firms' investments. Dunning (1993), notes that location-specific advantages such as natural resources for instance, oil and minerals which are by their character specific to certain locations, skilled labour, and inexpensive capital a country possesses from which companies can derive specific benefits highly affect foreign investor decisions. He argues that combining location-specific assets or resource endowments with the firm's own unique capabilities often requires the firm to establish production facilities where those foreign assets or resource endowments are located (Hill, 2011). Clearly this explains the foreign investments undertaken by many of the world's oil companies which have to invest where oil is located in order to combine their technological and managerial capabilities with this valuable location-specific resource (Hill, 2011).

The MNC's are by far the largest players in the downstream oil sub-sector currently. This is despite the liberalization of the Kenyan oil industry in 1994 which allowed for the entry of more local players in the now open market (Owino, 2000).

This consequently led to multinationals facing stiff competition from these upcoming independent or indigenous oil dealers such as Engen, Gapco, and Galana. Multinational players with interests in the downstream oil sector in Kenya include Total Kenya, Essar Energy, Oil Libya, VTTI and Vivo/Shell (Jedrzej, 2004).

Mottaleb and Kalirajan (2010) demonstrated that countries with larger Gross Domestic Product (GDP) with higher growth rates, higher proportion of international trade and a more business-friendly environment are more successful in attracting foreign investors. Asiedu (2002) found that infrastructure, openness to trade and high returns on investments are key factors that promote international oil companies (IOC's) investment decisions. Babatunde (2012), in a study on the impact of tax incentives on foreign direct investment in the oil and gas industry in Nigeria, found that there is a significant impact of tax incentives, availability of natural resources and openness to trade on foreign direct investment. Mahiti (2012) focused on the entire East African region to investigate the factors that determine international corporation investments mainly focusing on the political systems of the countries and was therefore not exhaustive enough. Mwega and Rose (2007) used panel data of 43 countries with a Kenyan dummy and therefore did not focus on the international corporations in Kenya as well as the upstream oil industry.

The literature review carried out above has presented the various determinants of multinational firms' investment decisions in various countries, however, these studies have shown varying results and have not been exhaustive in the downstream oil sector in Kenya. The current study will therefore seek to establish the factors that determine the multinational firms' investment in the downstream oil industry with a focus on Kenya.

The purpose of this study is to address the knowledge gap by assessing the attractiveness of the Kenyan oil industry to multinational oil companies and will therefore seek to answer the question: What factors influence the multinational firms' investment decisions in the downstream oil industry in Kenya?

## 1.3 Research Objective

The objective of the study was to identify the determinants of multinational firms' investment decisions in the downstream oil industry in Kenya.

## 1.4 Value of the Study

The findings of the study have provided a source of information for any further studies and research undertaken thereafter. This study is most useful to the Government of Kenya, and all other stakeholders involved in the marketing of the oil industry.

The study findings have provided the policy makers in the Government of Kenya with insights on the critical factors considered when formulating policies. The study has further enhanced implementation of strategies aimed at attracting international investors.

This study has added onto the theory of foreign direct investments in emerging economies like Kenya by focusing on the downstream oil industry investment by the International Oil Companies (IOCs). The determinants of Foreign Direct Investment in the industry have gone a long way in complimenting the theoretical foundation of foreign direct investments.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 Introduction

This chapter presents the literature review. First, a theoretical review is provided focusing on theories that explain the determinants of multinational firms' investments decisions. Secondly, the empirical review of the studies that have been done on the determinants of international firms' investments is made.

## 2.2 Theoretical Foundation

This study is based on two theories. These are The Eclectic Theory of Foreign Direct Investment and Internalization Theory. An overview of the theories is provided in the following sections.

### 2.2.1 Eclectic Theory of Foreign Direct Investment

British economist John Dunning champions the eclectic paradigm. He argues that in location-specific advantages are also of considerable importance in explaining both the rationale for and the direction of Foreign Direct Investment (Hill, 2011). John Dunning draws from various theoretical perspectives including the comparative advantage, factor proportions, monopolistic advantage, and internalization advantage theories (Cavusgil, Knight and Riesenberger, 2008). The eclectic paradigm specifies 3 conditions that determine whether or not a company will internationalize via FDI: ownership-specific, location-specific and internalization advantages (Cavusgil, Knight and Riesenberger, 2008). Ownership-specific advantages condition stipulates that International Corporations possess advantages unique to the firm relative to other

firms already doing business in the market such as knowledge, skills, capabilities, processes, relationships, physical assets held by the firm that allow it to compete effectively in the global marketplace. They amount to the firm's competitive advantages and must be substantial enough to offset the costs that the firm incurs in establishing and operating foreign operations (Cavusgil, Knight and Riesenberger, 2008). The ownership-specific advantages must also be specific to the International firm that possesses them and readily transferable to other firms. Examples of ownership-specific advantages include proprietary technology, managerial skills, trademarks or brand names, economies of scale, and access to a substantial financial resource (Cavusgil, Knight and Riesenberger, 2008).

Location advantages refer to the comparative advantages that exist in individual foreign countries (Cavusgil, Knight and Riesenberger, 2008). By Location-specific advantages, Dunning means the advantages that arise from utilizing resource endowments or assets that are tied to a particular foreign location and that a firm finds valuable to combine with its own unique assets such as technological, marketing or management capabilities (Hill, 2011). Examples of foreign assets or resource endowments include natural resources such as oil and minerals, which are by their character specific to certain locations. This clearly explains the foreign investments undertaken by many of the world's oil companies which have to invest where oil is located in order to combine their technological and managerial capabilities with this valuable location-specific resource (Hill, 2011).

Internalization aspect of the eclectic paradigm explains the advantages that the firms derive from internalizing foreign-based manufacturing, distribution or other stages in its value-chain (Cavusgil, Knight and Riesenberger, 2008).

Internalization advantages, according to Dunning, give a firm the ability to control how the firm's products are produced or marketed and the ability to reduce buyer uncertainty about the value of products the firm offers. For international firms to be profitable abroad they must have some advantages not shared by its competitors (Eden, 2001). It is therefore the internalization advantages part of the OLI paradigm that explains why International Corporations are integrated businesses, producing in several countries, and using intra-firm trade to ship goods, services and intangibles among their affiliates (Sachwald, 2001).

### 2.2.2 Internalization Theory

Internalization theory also known as market imperfection, explains the process by which firms acquire and retain one or more value-chain activities inside the firm, minimizing the disadvantages if dealing with external partners and allowing for greater control over foreign operations. By internalizing foreign-based value-chain activities it is the firm rather than its products that crosses international borders (Cavusgil, Knight and Riesenberger, 2008). It contracts the costs and benefits of retaining key business activities within the firm against arms-length foreign entry strategies such as exporting and licensing in which the firm contracts with external business partners to perform certain value-chain activities (Buckley and Casson, 1985). The costs of transactions conducted at arm's length in an external market may be higher than transactions within an intra-organizational market (Buckley and Casson, 1985). Internalization, in turn, requires centralized decision-making responsibility and authority. Nevertheless, control should be segmented by product line and distributed among different subsidiaries, depending on particular capabilities and environmental conditions (Buckley, 1988).

### 2.2.3 Motivations for Foreign Direct Investment

The various theories discussed above explain and describe the determinants of foreign direct investment. Using this theoretical basis a number of key motivations for foreign investment can be derived. They basically fall into four groups (Dunning, 1993).

Companies engaging in market seeking foreign direct investment may be seeking entry to a new market or trying to protect an existing stake in a particular market. Motives in this type of FDI include incentive schemes offered by host governments such as tariff incentives, familiarisation with local conditions allowing the multinational corporations to compete on a level playing field with local producers, among others(Dunning, 1993).

Natural resource seeking foreign direct investment is the focused on extracting or refining natural resources such as petroleum, natural gas, or timber. The motives for this type of foreign investment are largely based on relative factor endowments such as securing supply of and minimising the cost of raw resources(Dunning, 1993).

Efficiency seeking foreign direct investment is essentially a rationalization of market seeking and resource seeking FDI to allow the multinational corporations to exploit gains, mainly from risk diversification and economies of scale and scope, from the common governance of activities spread across national borders (Dunning, 1993).

Strategic asset or capability seeking foreign direct investment is a firm that acquire and restructure their assets to meet strategic goals. The motives for this type of FDI include entering into alliances with or acquiring host country operations to prevent rivals from doing so, or complementary products allowing for a more diversified product range (Dunning, 1993).

Dunning (1993), concludes that over time the motivations for multinational corporations are liable to change as a result of the dynamic learning effects of international production.

## 2.3 Empirical Literature

In a survey of foreign owned firms in Africa, Sachs and Sievers (1998) find that the greatest concern of firm owners is stability, both politically and macroeconomic. In an empirical analysis of the social and political development of foreign investment in Africa, Kolstad and Tondel (2002) find that countries that are less risky attract more foreign investment per capita. Asiedu (2006) also shows that both macroeconomic and political instability deter investment flows in Africa. In addition, Rogoff and Reinhart (2003) obtain a statistically significant negative correlation between foreign direct investment and the indicators of political and economic instability in Africa such as conflicts and inflation.

Altzinger (1999) found that among 150 Austrian firms investing in Central and East Europe in the finance and insurance, food and beverages and construction sectors considered market potential to be the most significant factor. The market size in terms of population size and growth rate was found to be the primary motives for market-oriented International Corporations.

Pongsiri (2005) evaluated Foreign Direct Investment and Regulation in Thailand’s Oil and Gas Industry. He notes that it is necessary for developing countries to provide an investor-friendly environment through provisions of numerous incentives to International Oil Companies (IOCs).

The establishment of a stable and secure environment is a fundamental way that host Governments can play a vital role in reducing risk and promoting opportunity through the implementation of suitable regulatory terms and conditions as well as sufficient economic incentives to attract foreign investment capital.

Pongsiri (2005) further notes that in general, IOCs will diversify risks and prioritise their portfolios to invest in the potential markets that can provide them the highest commercial return. Evidence from Thailand indicates that IOCs require a favourable investment climate to maintain active development in the oil and gas sector. Due to the high risk nature of Thailand's geological setting, IOCs need to have managerial and operational flexibilities when investing in and executing work programmes without mandatory government intervention. Apart from legal certainty, Thailand's oil sector investment climate can also be strengthened by enhancing the working relationship between the Government and the IOCs.

Kinaro (2006) investigated the determinants of Foreign Direct Investment in Kenya. The main objective of the study was to identify the key factors that influence FDI decisions in Kenya. The results indicate that both economic openness and human capital affects FDI positively in the short run. Likewise, inflation and real exchange rate have a negative influence on FDI inflows in the short and long run respectively.

Mwega and Rose (2007) using panel data of 43 countries with a Kenyan dummy find that Kenya is not different from other countries and that FDI is determined by growth rates, terms of trade, external debt ratio and quality of institutions. UNCTAD (2005) argue that Kenya's inability to attract FDI is due to growing problems of corruption and governance, inconsistencies in economic policies and structural reforms, deteriorating public service and poor infrastructure.

Kinuthia (2010) investigated the main drivers of Foreign Direct Investment (FDI) in Kenya. It is now widely acknowledged that Foreign Direct Investment has potential economic benefits that can accrue to developing countries as they provide the much needed capital for investment, increase competition in host countries' economies, and aids local firms to become more productive by adopting more efficient technology or by investing in human or physical capital. Foreign investment is also said to contribute to growth in a substantive manner because it's more stable than other forms of capital flows. Kinuthia (2010) provides fresh evidence on the determinants of Foreign Direct Investment based on a survey of foreign firms in Kenya in 2007. The study findings reveal that most of the foreign firms in Kenya are marketing firms and that the most important determinants are market size, political and economic stability, bilateral trade agreements and a favourable climate. In addition the three main impediments to foreign investment inflow to Kenya are political instability, crime and insecurity, and institutional factors most notably corruption.

Okafor (2012) evaluated whether domestic macroeconomic variables matter for foreign direct investment inflow in Nigeria. He notes that economic theory predicts that foreign capital flows could stimulate economic growth of nations. The empirical analysis addresses the role of key domestic macroeconomic variables on Foreign Direct Investment (FDI) in Nigeria using the Ordinary Least Square (OLS) estimation technique. The result shows that real gross domestic product, interest rate, and real exchange rate are key determinants of foreign direct investment in Nigeria. The result suggests that these domestic macroeconomic variables are critical to FDI inflow. Thus, policy makers should strive to improve the macroeconomic environment to encourage the flow and benefits of foreign direct investment in Nigeria.

Mahiti (2012) examined the determinants of Foreign Direct Investments in Tanzania and Kenya. The research was carried out at Tanzania Investment Centre (TIC) and the Embassy of Kenya. The study concludes that infrastructure mainly in the transport sector plays a major role in attracting more Foreign Direct Investments into the East African Region. Indeed it is important to review incentives granted to investors as well as ensuring that new technologies are transferred to Tanzania and Kenya so that the two countries can become competitive globally.

Moffet (2005) adds that multinational companies try to achieve efficiency by minimizing their cost and maximizing economies of scale while reducing duplication. They invest in different locations to get different advantages from host countries in order to operate better in their home base. Looking for domestic markets to sell more goods, seeking raw materials and managerial knowledge or technology and trying to find countries where factors of production are cheaper are the main motivations behind global expansion of companies. Multinational companies are looking for the perfect mix of these factors in answering the "where to invest" question. While labour costs and attributes of the workforce such as skill and educational levels are critical variables of investment decision, the purchasing power of the market and proximity to other markets are taken into consideration in taking the investment decision. Additionally, the type of investment such as joint venture or wholly owned subsidiaries highly affects the investment decisions.

Dumludag, Sara and Kur (2007) stated that the main concerns of MNCs in taking their decisions in developing countries include market size and growth prospects of the host country, the availability of infrastructure, reasonable levels of taxation and the overall stability of the tax regime and stable political environment.

Other conditions that support physical and personal security, legal framework and the rule of law and corruption and governance concerns also constitute concerns of MNCs in taking their decisions in developing countries. The openness of the host country to international trade is another dimension that affects investment decisions of MNCs which allows the companies to export their final product to alternative markets easily and without limiting their sales operations with the host country market. As a result of this, foreign investors prefer countries that trade more with the rest of the world.

# CHAPTER THREE

# RESEARCH METHODOLOGY

## 3.1 Introduction

This chapter presents the methods and techniques that the researcher used for data collection. The chapter was divided into research design, population, data collection and data analysis sections.

## 3.2 Research Design

The study employed a cross-sectional descriptive research design. It forms a class of research methods that involve observation of an entire population or a representative subset at one specific point in time with the aim of providing data on the entire population under study Saunders, Lewis and Thornhill (2009).

This design was considered most appropriate as it gave provision to study an entire population. This provided more accurate information that met the objectives of the study.

## 3.3 Population of the Study

The population of this study included all multinational firms involved in the downstream oil industry in Kenya. Currently, there are 5 major multinational corporations with interests in the downstream oil sector in Kenya (Appendix I).

A census survey was employed in this study. Bryman, (2007) defines a census survey research design as an enumeration of an entire population and since the population is relatively small and thus manageable, the census survey will be most suitable for this study. Within these companies, the researcher targeted one management employee.

## 3.4 Data collection

This study employed the use of both primary data and secondary data. Primary data was obtained through semi-structured open and closed-ended questionnaire served on respondents through drop and pick method.

Secondary data was obtained from various websites such as the Energy Regulatory Commission website and the Ministry of Energy website. The respondents were the commercial relations managers and the terminal/operations managers in these companies.

## 3.5 Data Analysis

Quantitative data collected was analyzed, presented and interpreted using descriptive statistics such as frequencies, percentages, means while content analysis techniques were used to analyze qualitative data collected. Primary data from the field was cleaned to eliminate errors made by respondents.

Statistical Package for Social Sciences (SPSS) package was used to analyze the quantitative data. Data presentation was in form of descriptive statistics such as frequency distribution, percentages and tables. Editing was undertaken before data analysis.

# CHAPTER FOUR

# DATA ANALYSIS, PRESENTATION AND INTERPRETATION OF RESULTS

## 4.1 Introduction

This chapter presents, analyzes, and interprets data according to the objectives of the study. The findings obtained are presented in tables, and in descriptive statistics such as pie charts, tables and bar graphs. In addition, the chapter is subdivided into sections that reflect the various aspects of the subject under study.

## 4.2 Research Findings

This section will present a summary of the findings according to the objectives. The section describes the basic information derived from the analysis through descriptive statistics.

### 4.2.1 Response Rate

The targeted population was the management of 5multinational oil companies with presence and interests in Kenya. Data was collected from only 4 of these companies. This gave a response rate of 80%. This is presented in Table 4.1

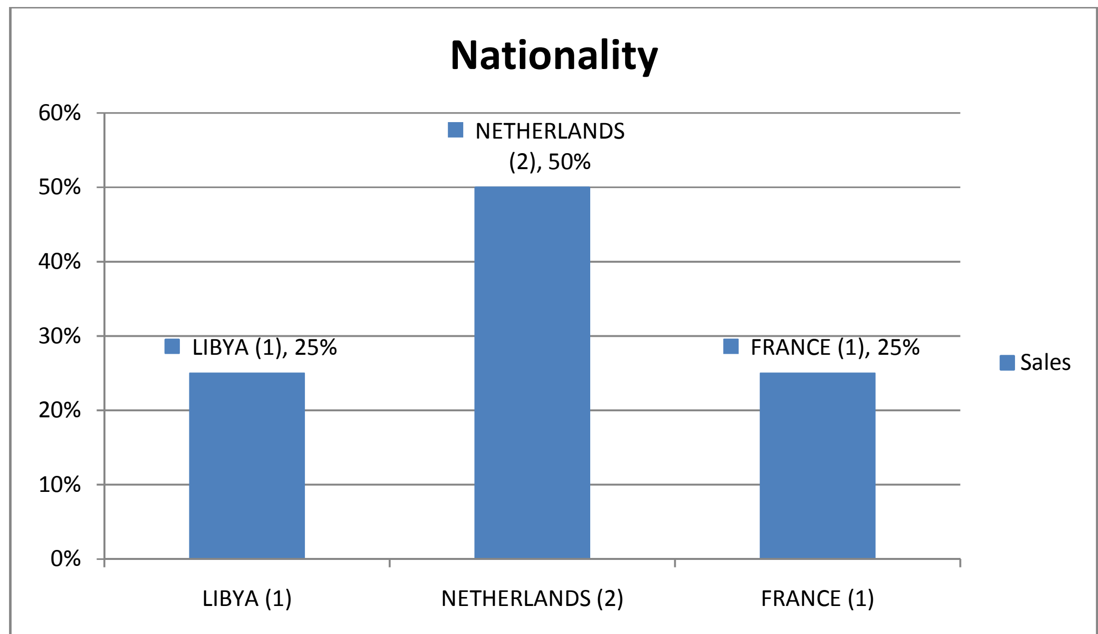
**Table 4.1: Response Rate**

| | **Targeted population** | **Response rate (%)** |
|---|---|---|
| Respondents | 5 | 80% |

### 4.2.2 Distribution by Nationality

The respondents were requested to indicate their nationality. According to the findings, the nationalities varied with the one company originating from Libya (25%), two of them originated from Netherlands (50%) and while one originated from France (25%). The findings are presented in Figure 4.1

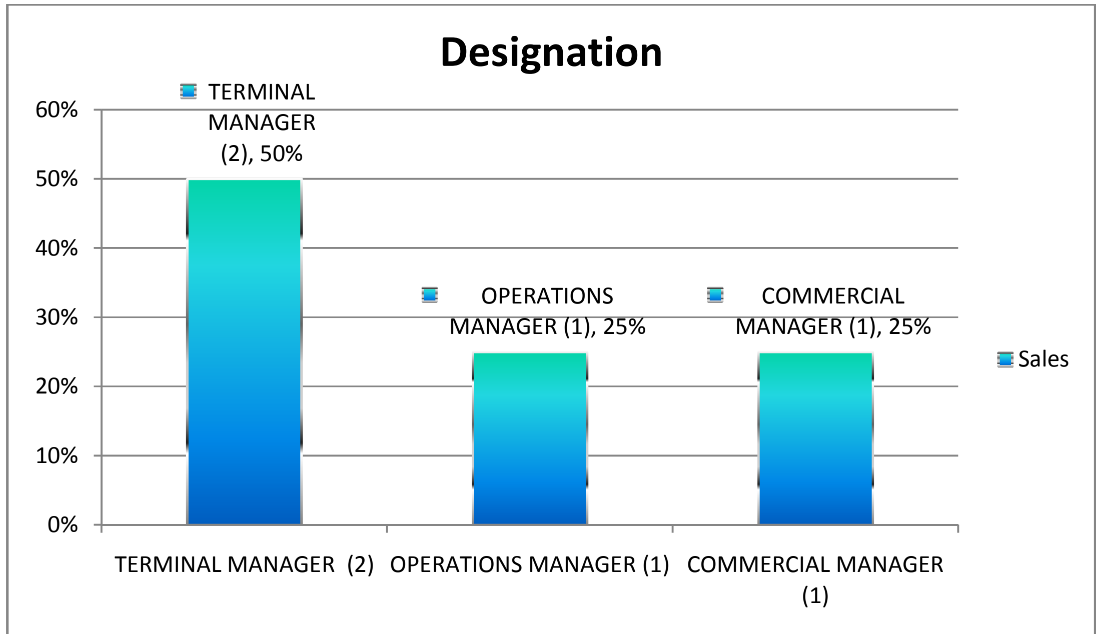
**Figure 4.1: Distribution by Nationality**




### 4.2.3 Distribution by Designation

The respondents were asked to indicate their designation in the company. Fifty percent (50%) of the respondents were terminal managers, the rest of the respondents each at 25% were: commercial managers and operations manager. The findings are presented in Figure 4.2

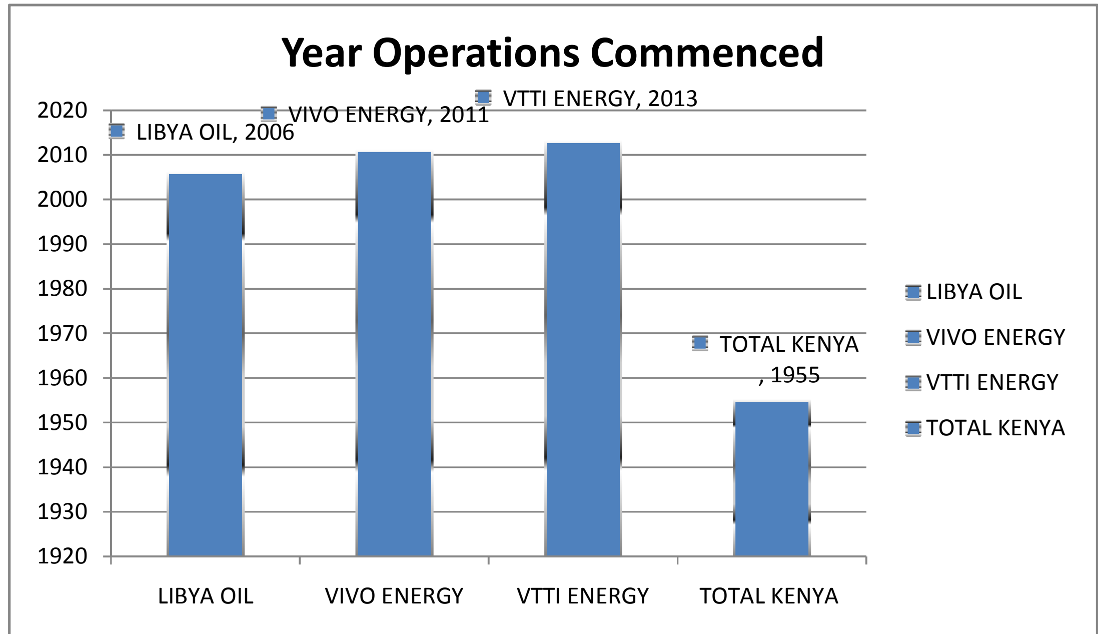
**Figure 4.2 Distribution by Designation**




### 4.2.4 Distribution by Year the Operation Started

The researcher requested the respondents to indicate the year that the company started in Kenya. According to the findings, the companies started in 2006, 1900.The rest (each at 14.3%) started in 2013, 2011 and 1965 respectively. The findings are presented in Figure 4.3.

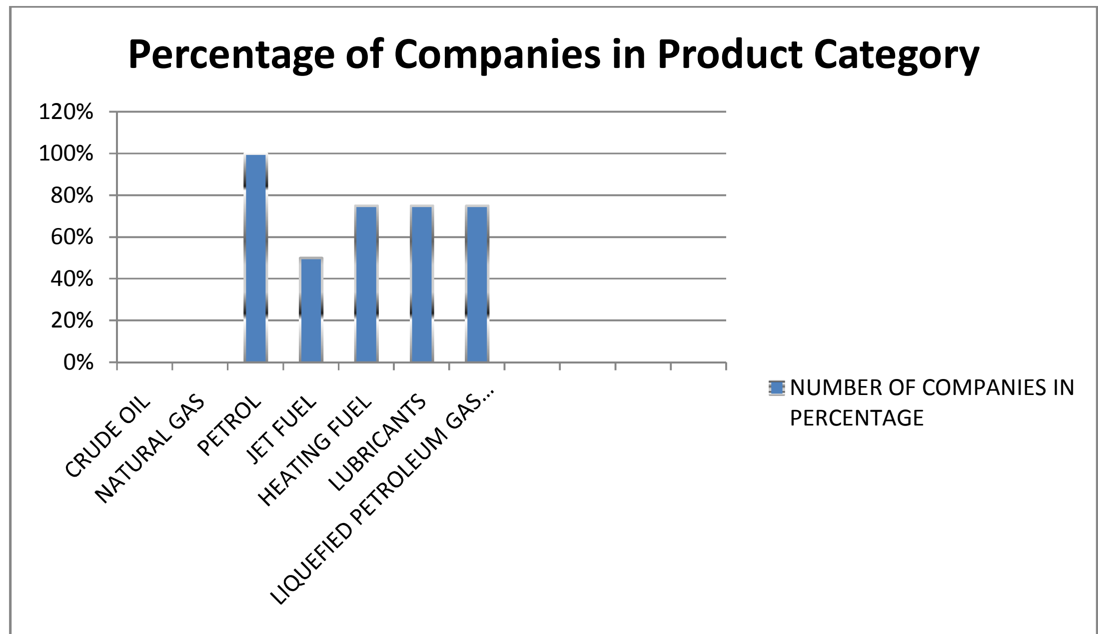
**Figure 4.3: Distribution by Year the Operation Started**




### 4.2.5 Product Category

The researcher sought to find out the product categories the companies dealt with. According to the findings, 100% of the respondents dealt with petrol or gasoline, 50% of the respondents dealt with jet fuel while 75% of the respondents dealt with heating fuel, lubricants and liquefied petroleum gas (LPG) respectively. None of the companies dealt with crude oil or natural gas. The findings are presented in Figure 4.4.

**Figure 4.4: Product Category**




### 4.2.6 Distribution by Main Activity of the Investment

The respondents were asked to indicate the main activity of the investment. Fifty (50%) of the respondents stated that their main activity is distribution, (25%) were involved in production while (75%) of the respondents were involved in marketing and retailing. The findings are presented in Table 4.2.

**Table 4.2: Distribution by main Activity of the Investment**

| Main activity | Frequency | Percent |
|---|---|---|
| Production | 1 | 25% |
| Marketing & Retailing | 3 | 75% |
| Distribution | 2 | 50% |

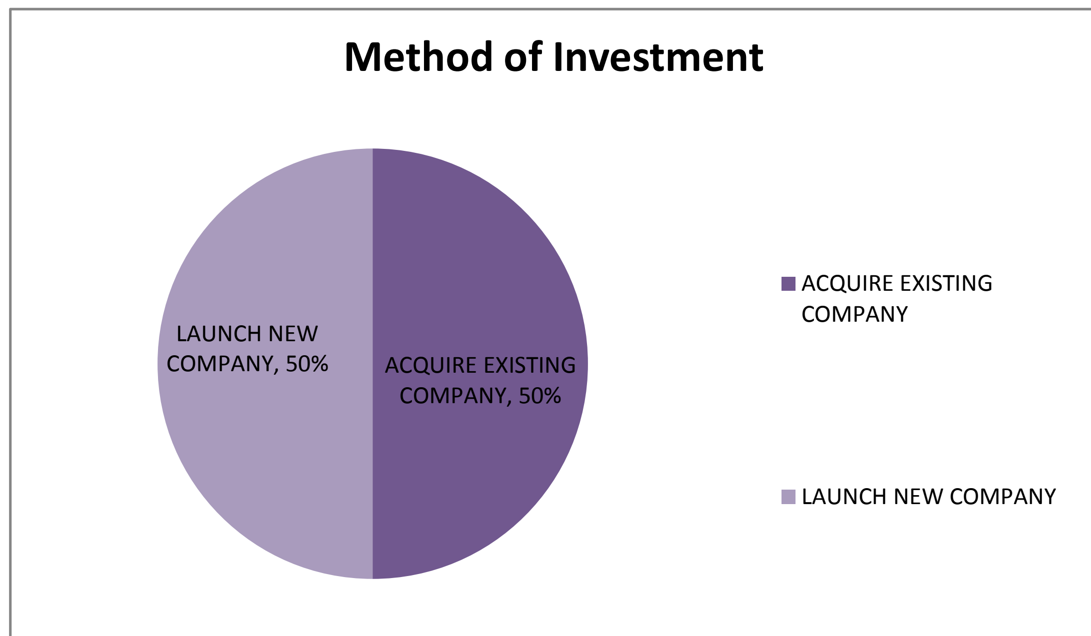
### 4.2.7 Methods of Investment

The respondents were requested to indicate their methods of investment. 50% of the respondents mentioned that they acquired already existing companies while 50% of the respondents launched a new company. The findings are presented in Table 4.3 and Figure 4.5.

**Table 4.3: Methods of Investment**

| Method of investment | Frequency | Percent |
|---|---|---|
| Acquiring Existing Company | 2 | 50% |
| Launch new company | 2 | 50% |
| **Total** | **4** | 100% |

**Figure 4.5: Methods of Investment**



### 4.2.8 Mode of Investment

The researcher sought to find out the mode of investment of the companies. According to the findings, 100% of the respondents were companies that were wholly owned. The findings are presented in Table 4.4.

**Table 4.4: Mode of Investment**

| **Mode of investment** | **Frequency** | **Percent** |
|---|---|---|
| Wholly owned | 4 | 100% |
| **Total** | **4** | 100% |

### 4.2.9 Importance of having Local Partner

The respondents were asked to indicate if it was important to have local partner. Of all the companies sampled 50% indicated that it was important to have local partners while 50% indicated it was not important to have a local partner. The findings are presented in Table 4.5.

**Table 4.5: Importance of Having a Local Partner**

| **Having local partner** | **Frequency** | **Percent** |
|---|---|---|
| Important | 2 | 50% |
| Not Important | 2 | 50% |
| **Total** | **4** | **100%** |

### 4.2.10 Determinants of Multinational Investments Decisions

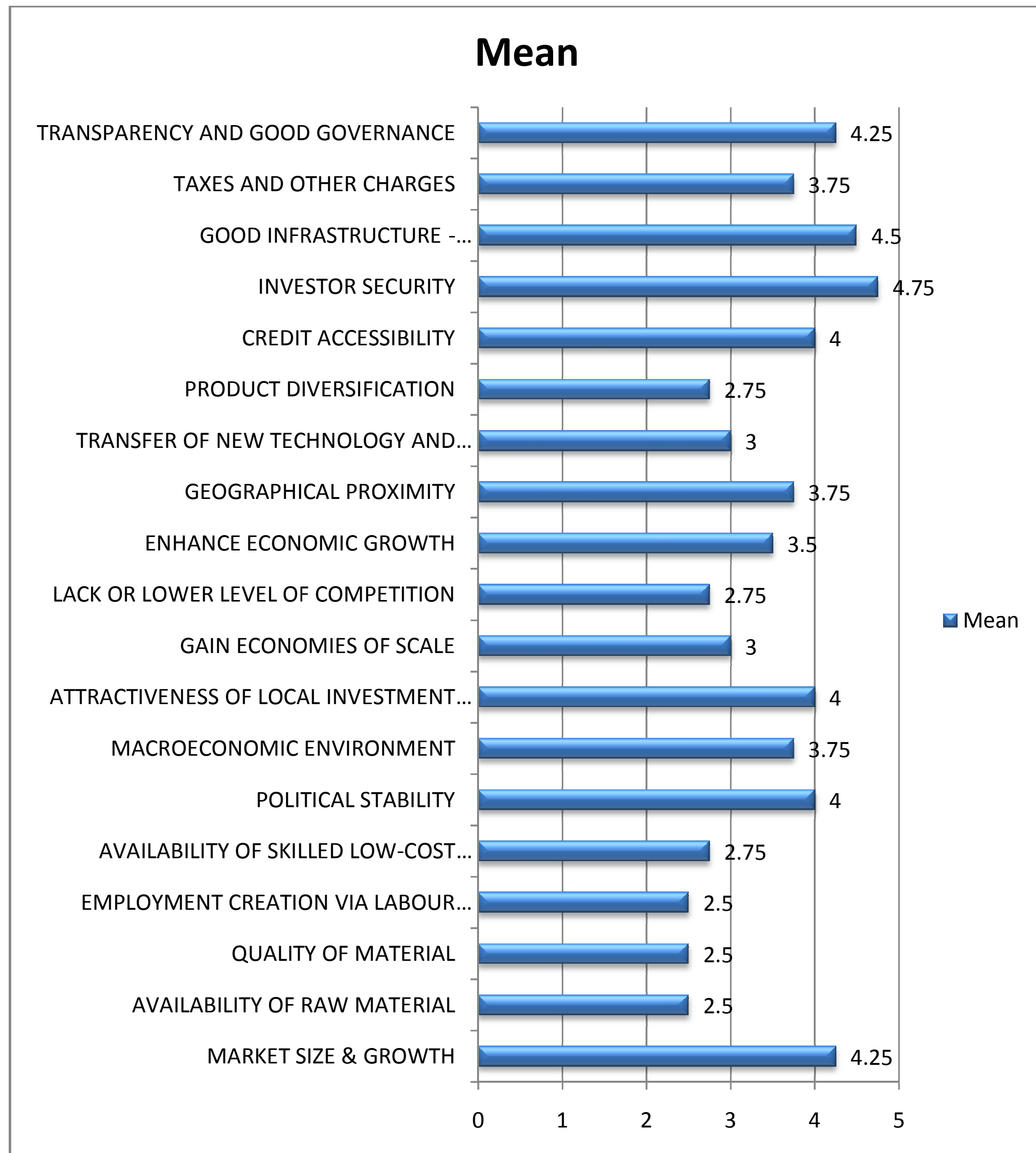
The respondents were requested to rate the given determinants of multinational investment decisions according to their importance. The respondents were given a scale of 1-5 as follows: 1- Not important; 2- Fairly important; 3- Important; 4- Very important and 5- Most important. The means of the responses given were calculated using the following formula: Mean= ∑ scores/N. Where ∑ scores is the summation of all responses given and N is the total number of respondents (4 in the case of this study). The findings were interpreted using the following criterion: mean of 1.00-1.49=not important; mean of 1.50 – 2.49=fairly important; mean of 2.50-3.49=important; mean of 3.5 to 4.49= very important; and mean of 4.50-5.00-most important.

The findings indicate that investor security and good infrastructure in terms of transportation and telecommunication services with a mean of 4.75 and 4.5 respectively was the most important determinant of multinational investment decisions. These were followed by transparency, good governance, market size and growth (each with a mean of 4.25), credit accessibility, political stability and attractiveness of local investment policy (each with a mean of 4), taxes and other charges, enhancing economic growth, geographical proximity, macroeconomic environment that were viewed as very important factors influencing multinational firms' investment decisions. Factors that were seen as being important included transfer of new technologies, product diversification, lack of competition, gaining economies of scale, availability of skilled labour, employment creation, quality and availability of raw materials. The findings are presented in Table 4.6 and Figure 4.6.

**Table 4.6: Determinants of Multinational Investments Decisions**

| **Determinants** | **1** | **2** | **3** | **4** | **5** | **Mean** |
|---|---|---|---|---|---|---|
| Market Size & Growth | 0 | 0 | 1 | 1 | 2 | **4.25** |
| Availability of raw material | 1 | 2 | 0 | 0 | 1 | **2.5** |
| Quality of material | 1 | 2 | 0 | 0 | 1 | **2.5** |
| Employment creation via labour surplus | 1 | 1 | 1 | 1 | 0 | **2.5** |
| Availability of skilled low-cost labour force | 0 | 1 | 3 | 0 | 0 | **2.75** |
| Political Stability | 0 | 0 | 1 | 2 | 1 | **4** |
| Macroeconomic Environment | 0 | 0 | 2 | 1 | 1 | **3.75** |
| Attractiveness of local investment policy | 0 | 0 | 1 | 2 | 1 | **4** |
| Gain economies of scale | 1 | 0 | 2 | 0 | 1 | **3** |
| Lack or lower level of competition | 1 | 0 | 2 | 1 | 0 | **2.75** |
| Enhance economic growth | 0 | 1 | 1 | 1 | 1 | **3.5** |
| Geographical proximity | 0 | 1 | 0 | 2 | 1 | **3.75** |
| Transfer of new technology and skills | 0 | 2 | 1 | 0 | 1 | **3** |
| Product diversification | 0 | 2 | 1 | 1 | 0 | **2.75** |
| Credit Accessibility | 0 | 1 | 3 | 0 | 1 | **4** |
| Investor security | 0 | 0 | 0 | 1 | 3 | **4.75** |
| Good infrastructure – Transportation and Telecommunication services | 0 | 0 | 0 | 2 | 2 | **4.5** |
| Taxes and other charges | 0 | 0 | 2 | 1 | 1 | **3.75** |
| Transparency and good governance | 0 | 0 | 1 | 1 | 2 | **4.25** |

**Figure 4.6: Determinants of Multinational Investments Decisions**




The findings indicate that the most important determinants of multinational investment decisions are investor security and good infrastructure in terms of transportation and telecommunication services. The same was echoed by Mahiti (2012) whose study found that infrastructure mainly in the transport sector plays a major role in attracting more Foreign Direct Investments into the East African

Region. The current study also correlates with Kinuthia (2010) who while noting that most of the foreign firms in Kenya are marketing firms and that the most important determinants are market size, political and economic stability, bilateral trade agreements and a favourable climate, the study also revealed that the three main impediments to foreign investment inflow to Kenya are political instability, crime and insecurity, and institutional factors most notably corruption.

### 4.2.11 Difficulties or Concerns Facing Foreign Investors in the Oil Sector

The researcher sought to find out the difficulties and concerns facing the investors in Kenya oil sector. The findings indicate that all respondents (100%) mentioned that they face Government regulation difficulties. The findings also indicate that 75% of the respondents find investor security to be a concerning issue. The findings are shown in Table 4.7.

**Table 4.7: Difficulties or Concerns Facing Foreign Investors in the Oil Sector**

| Difficulties | Frequency | Percentage |
|---|---|---|
| Government Regulation | 4 | 100% |
| Investor Security | 3 | 75% |

The study correlates with the findings of Dumludag, Sara and Kur (2007) who found that reasonable levels of taxation and the overall stability of the tax regime, stable political environment, as well as conditions that support physical and personal security, regulations and legal framework and the rule of law, corruption and

governance concerns constitute the main concerns of MNCs in taking their decisions in developing countries. UNCTAD (2005) affirms the same as it argued that Kenya's inability to attract FDI is due to growing problems of corruption and governance, inconsistencies in economic policies and structural reforms, deteriorating public service and poor infrastructure.

### 4.2.12 Foreign Investment Environment of Kenya in the Foreseeable Future

The respondents were asked to indicate if they see foreign investment environment in Kenya as promising in the foreseeable future. Of all the respondents (75%) answered in the affirmative while 25% indicated they see no promising investment environment in Kenya in the foreseeable future. The findings are presented in Table 4.8.

**Table 4.8: Do you see foreign investment environment of Kenya as promising in the foreseeable future?**

| **Response** | **Frequency** | **Percentage** |
|---|---|---|
| Yes | 3 | 75% |
| No | 1 | 25% |
| **Total** | **4** | **100%** |

# CHAPTER FIVE

# SUMMARY, DISCUSSION AND CONCLUSION

## 5.1 Introduction

The purpose of this study was to examine the determinants of multinational firm's investment decisions in the downstream oil industry in Kenya.

## 5.2 Summary

The respondents of the study were terminal managers, commercial managers and the operations managers. These were staff members involved in the formulation and implementation of the policies of the Multinationals they manage. Out of the 5 questionnaires given only 4 were returned and analyzed.

All the respondents dealt with petrol as their main product category while 75% of the respondents also dealt with heating fuel, lubricants and liquefied petroleum gas (LPG) in their product categories. 75% of the respondents' main activity of investment was in marketing and retailing with all respondents indicating their mode of investment as wholly-owned. When asked on the importance of having a local partner, only 50% responded in favour of a local partner.

The findings of the study indicate that investor security and good infrastructure mainly in transportation and telecommunication services were the most important determinant of multinational investment decisions. These were followed by transparency, good governance, market size and growth, credit accessibility, political stability and attractiveness of local investment policy, among others that were viewed as very important factors influencing multinational firms' investment decisions.

Factors that were seen as moderately important included transfer of new technologies, product diversification, lack of competition, gaining economies of scale, availability of skilled labour, employment creation, quality and availability of raw materials.

The respondents indicated Government regulations and investor security as the main difficulties and concerns facing foreign investors in Kenya. When asked to indicate if they see foreign investment environment in Kenya as promising in the foreseeable future, only 75% of the respondents answered in the affirmative.

## 5.3 Discussion

The findings indicate that the most important determinants of multinational investment decisions are investor security and good infrastructure in terms of transportation and telecommunication services. The same was echoed by Mahiti (2012) whose study found that infrastructure mainly in the transport sector plays a major role in attracting more Foreign Direct Investments into the East African Region. The current study also correlates with Kinuthia (2010) who while noting that most of the foreign firms in Kenya are marketing firms and that the most important determinants are market size, political and economic stability, bilateral trade agreements and a favourable climate, the study also revealed that the three main impediments to foreign investment inflow to Kenya are political instability, crime and insecurity, and institutional factors most notably corruption.

The study correlates with the findings of Dumludag, Sara and Kur (2007) who found that reasonable levels of taxation and the overall stability of the tax regime, stable political environment, physical and personal security, regulations and legal framework and the rule of law, corruption and governance concerns constitute the main concerns of MNCs in taking their decisions in developing countries.

UNCTAD (2005) affirms the same as it argued that Kenya's inability to attract FDI is due to growing problems of corruption and governance, inconsistencies in economic policies and structural reforms, deteriorating public service and poor infrastructure.

## 5.4 Limitations of the Study

The study set out to investigate the perception of managers of foreign oil companies operating in Kenya. In this regard, other stakeholders in the oil sector such as investors, clients, and company owners were left out. The results were generalized to the extent of the sample size.

One of the major limitations of this study was the population of the study. The target population of the study was Multinational Oil Corporations(MNC) in the Kenyan downstream oil sector. Currently there are only five major MNCs' in the sector, which may prove to be a small number to obtain sufficient findings for a research study.

## 5.5 Recommendations

The respondents pointed out that there were various ways in which investment in Kenya's oil sector could be enhanced. There was need for the reduction of multi-agency approach in handling various issues by Government Agencies which ultimately leads to increased cost of doing business for the foreign investors. To solve this problem, the respondents propose having one focal point that deals with all Government related issues. The Government also needs to strengthen the legal and regulatory system ensuring consistency in its application when addressing industry concerns. The respondents also noted the need for improved good governance and transparency.

Price regulations and controls were also of concern to the respondents noting the adverse effects this has on the multinational corporations with huge investments in the country. To reduce this effect in their favour, the respondents suggest that the regulatory body, Energy Regulatory Commission mandated to control prices in the oil industry, should put into consideration all operational costs incurred by the companies when regulating the prices for the oil market. If this was done then the success rate of investment into the local market would be enhanced.

## 5.6Area for Further Research

The study focused on 4 multinational oil corporations in the Kenyan downstream oil sector. The researcher recommends more research on the determinants of international firms' investment decisions in Kenya oil sector to be carried out in other areas such as the upstream and midstream oil sectors.

Furthermore, it is expedient to undertake other studies on the subject focusing on the perceptions of other stakeholders other than the management of the multinational oil companies. This could be the National Oil Company, Ministry of Energy and individual shareholders (investors) in the sector. This would be expedient for correlation purposes.

## 5.7 Implication of the Study on Policy, Theory and Practice

The study findings indicated that the most important factors driving foreign investments in Kenya are based on investor security and good infrastructure mainly in the transportation and telecommunication sectors. Other factors that influence multinational investment decisions include the attractiveness of local investment policies, transparency, good governance as well as political stability in the country.

Price control and regulations in the oil industry was also noted as a concern facing foreign investors in Kenya. It is these findings that form the foundation for policy makers in the Government of Kenya when formulating and implementing policies aimed at attracting International Investors.

This study will add onto the theory of foreign direct investments in emerging economies like Kenya by focusing on the downstream oil industry investment by the International Oil Companies (IOCs). The determinants of Foreign Direct Investment in the industry will go a long way in resolving the theoretical inconsistencies in the area.

## 5.8 Conclusion

From the findings, it can be concluded that there are various determinants of multinational firm's investment decisions in the downstream oil industry. The major determinants established from this study are investor security and good infrastructure mainly in transportation and telecommunication services. Government regulations and investor security are indicated as the main difficulties and concerns facing foreign investors in Kenya.

From the study it can be noted that there are various ways in which investment in Kenya's oil sector could be enhanced. To this end, the respondents pointed out that there was need for the reduction of multi-agency approach in handling various issues by Government Agencies which ultimately leads to increased cost of doing business for the foreign investors. To solve this problem, the respondents propose having one focal point that deals with all Government related issues.

The Government also needs to strengthen the legal and regulatory system ensuring consistency in its application when addressing industry concerns. The respondents also noted the need for improved good governance and transparency.

Price regulations and controls were also of concern to the respondents noting the adverse effects this has on the multinational corporations with huge investments in the country. To reduce this effect in their favour, the respondents suggest that the regulatory body, Energy Regulatory Commission mandated to control prices in the oil industry, should put into consideration all operational costs incurred by the companies when regulating the prices for the oil market. If this was done then the success rate of investment into the local market would be enhanced.

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# APPENDICES

## Appendix 1: List of Respondents from the Downstream Oil Sector in Kenya

1. Total Oil
2. VTTI
3. Oil Libya
4. Vivo Energy
5. Essar Energy

**Source:** Kenya Pipeline Company Ltd (2013).

## Appendix II: Research Questionnaire

This questionnaire is to collect data for purely academic purposes. All information will be treated with strict confidence. Do not put any name or identification on this questionnaire.

*Answer all questions as indicated by either filling in the blank or ticking the option that applies.*

## Section 1: General Information

1. Name of the Company.........................................................................................
2. Location.......................................................................................................
3. Nationality....................................................................................................
4. What is your position in your Company?

   ………………………………………………………………………………………

5. When did your firm start operations in Kenya?

   ………………………………………………………………………………………

6. What is your Product Category (s)?
   - Crude Oil
   - Natural Gas
   - Gasoline or Petrol
   - Jet Fuel
   - Heating Fuel
   - Lubricants
   - Liquefied Petroleum Gas (LPG)
   - Others, (Please Specify).........................................................................
7. What is the main activity (s) of your investment?
   - Production
   - Processing/Refining
   - Marketing and Retailing
   - Consulting
   - Transportation
   - Distribution
   - Others, (Please Specify).........................................................................

8. What was your method of investment?

- o Acquire existing company
- o Launch new company
- o Others, (Please Specify)...........................................................................

9. A. Which of the following is the mode of your company investment in Kenya?

- o Wholly-owned
- o Joint-Venture
- o Licensing
- o Contract
- o Others, (Please Specify)...........................................................................

9. B. If joint venture, 1. [.....................%] Your Company. 2. [.......................%] National Oil Corporation

9. C. If Contract, Nature ...................................................... Period ...........................

9. D. If licensing, Nature ..................................................... Period ............................

10. Do you think that it is important to have local partner to operate successfully in Kenya?

- o Not Important
- o Important
- o Very Important

## Section 2: Motivational Factors affecting Multinational Investments Decisions

The following statements represent the factors that motivated your company to invest in Kenya. Please circle a number from 1 to 5 which best describes your views.

| | STATEMENT | Not Important | Fairly Important | Important | Very Important | Most Important |
|---|---|---|---|---|---|---|
| a) | To what extend does Market size and market growth motivate your company to invest in Kenya? | 1 | 2 | 3 | 4 | 5 |
| b) | Availability of raw materials | 1 | 2 | 3 | 4 | 5 |
| c) | Quality of Material | 1 | 2 | 3 | 4 | 5 |
| d) | Employment creation via labour surplus | 1 | 2 | 3 | 4 | 5 |
| e) | Availability of Skilled Low-Cost Labour force | 1 | 2 | 3 | 4 | 5 |
| f) | Political Stability | 1 | 2 | 3 | 4 | 5 |
| g) | Macroeconomic Environment (GDP, Price levels, Exchange & Interest rates, Inflation rates, Unemployment rates, etc) | 1 | 2 | 3 | 4 | 5 |
| h) | Attractiveness of Local Investment Policy (Legal, Regulatory and Institutional Environment) | 1 | 2 | 3 | 4 | 5 |
| i) | Gain economies of scale | 1 | 2 | 3 | 4 | 5 |
| j) | Lack or Lower Level of Competition | 1 | 2 | 3 | 4 | 5 |

| | | | | | | |
|---|---|---|---|---|---|---|
| k) | Enhance economic growth | 1 | 2 | 3 | 4 | 5 |
| l) | Geographical proximity | 1 | 2 | 3 | 4 | 5 |
| m) | Transfer of new technology and skills | 1 | 2 | 3 | 4 | 5 |
| n) | Product diversification | 1 | 2 | 3 | 4 | 5 |

## Section 3: Operational Factors affecting Multinational Investments Decisions

The following statements represent the factors which will encourage your company's continued stay or operations in Kenya. Please circle a number from 1 to 5 which best describes your views.

| | STATEMENT | Not Important | Fairly Important | Important | Very Important | Most Important |
|---|---|---|---|---|---|---|
| a) | Credit Accessibility | 1 | 2 | 3 | 4 | 5 |
| b) | Investor Security | 1 | 2 | 3 | 4 | 5 |
| c) | Good Infrastructure – Transportation and Telecommunication Services | 1 | 2 | 3 | 4 | 5 |
| d) | Taxes and other Charges | 1 | 2 | 3 | 4 | 5 |
| e) | Transparency and good governance (Level of corruption) | 1 | 2 | 3 | 4 | 5 |

## Section 4: Concerns and Suggestions

1. From your own past, experiences, what are the main difficulties or concerns facing foreign investors in the Kenya oil sector?
    - Technical
    - Employment
    - Managerial
    - Financial
    - Marketing
    - Government Regulation
    - Environmental
    - Investor Security
    - Others, (Please Specify)..............................................................
2. Do you have any suggestions for promoting foreign investment in the Kenyan oil sector?

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3. Do you have any further comments you would like to make, please do so?

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4. Do you see foreign investment environment of Kenya as promising in the foreseeable future?

   Yes ( ) No ( )

**END OF QUESTIONNAIRE**

*Thank you very much for you taking your time to fill this questionnaire.*