

**DETERMINANTS OF FOREIGN DIRECT INVESTMENT INFLOW IN
HOSPITALITY INDUSTRY IN KENYA (1990 – 2014)**

BY

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DECLARATION

I declare that this Research Project is my original work and has not been presented in any other University or Institution of Higher Learning for Examination.

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This Research Project has been submitted for examination with my approval as University Supervisor.

Sign.....Date.....

GERRISHON K. IKIARA

DEDICATION

This Research Project is dedicated to my *mom*, Mrs. Damaris Agola Ouma.

The best mother I can ever wish for.

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First and foremost, I am forever grateful to the Almighty. I could not have accomplished this Research Project without his renewing strength. Step by step, he has seen me through to the completion of this work.

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ABSTRACT

The aim of the study was to establish the determinants of Foreign Direct Investment inflow in hospitality industry in Kenya, 1990 - 2014. FDI has attracted renewed interest both in the developing and developed worlds. The increase in importance of FDI in the global economy is due to the additional resources they pool for development in the host country. Many factors determining the inflow of FDI in a host country have been discussed by many authors. However, the literature also indicates that there is no conclusive argument on factors determining FDI. Different factors work differently in different countries based on investment type and investor motive. FDI inflow in the industry has continued to decline despite the country's comparative advantage. Why is the industry not attracting FDI inflow? The study was guided by the objectives and hypotheses. The study sought to establish the influence of political factors, bureaucratic business procedures and insecurity. A survey was carried out in North Coast, South Coast, Kilifi and Malindi Zones (Coastal Region) which provided primary data. Secondary data was obtained from economic surveys, UNCTAD and KenInvest among other sources. The study findings indicated that Kenya's hospitality industry is largely dominated by the local private investors who lack adequate and management skills to ensure international standards required by the increasing tourist and visitors' demands. This has subsequently undermined the industry's competitiveness. The findings also indicated that there are few FDI in the industry and the number continues to decrease. Factors identified to be contributing to this trend are restrictive investment climate that deters potential investors at entry point; increased level of corruption due to bureaucratic business procedures and misuse of discretionary powers accorded to some public office holders has led to uncertainty on what to expect discouraging many investors; insecurity as a result of continued terrorist attacks and potential threats leading to decrease in international visitor arrivals from key market source, consequently leading to divestment. Worth noting was that the restrictive investment measures laid down were however not being implemented. Partly because of lack of harmony among the various government agencies, coupled with lack of clarity on which agency should enforce or carry out the implementation; secondly, there are no monitoring mechanisms to ensure that the already existing FDI operate within the set rules. Corrupt public officers also contribute to lack of proper monitoring of the existing enterprises, most of them receive monetary gains in form of bribes not to inspect the operation of enterprises not complying with the laid down rules. Existing investors find it easy to operate and expand since they are already familiar with the bureaucratic procedures and they know how to go about the restrictive investment climate, unlike the incoming investors who are discouraged by the business climate. In conclusion, a country's endowed resources such as attractions; political and regulatory factors; and level of security play an important role in determining investment decisions by foreign investors in hospitality industry.

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CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Foreign Direct Investment (FDI) was initially common in developed countries as a form of international trade in goods and services. It involved physical presence of a firm from a developed country setting up its production in another developed country. The United States of America was one of the preferred countries for FDI inflows. This was largely attributed to the country's market size, favourable political environment, openness of the country to FDI and a stable economy.¹

FDI has gained prominence in both the developed and the developing nations. The increase in importance of FDI in the world economies is due to the injection of capital to the host economy that they provide. The benefits associated with FDI for the host country include additional revenue in form of tax, employment creation, transfer of knowledge and skills, improvement of the local firms as a result of competition and general economic growth for the country.² These positive externalities explain why many countries provide a range of incentives to entice FDI.

China's growing importance as a recipient of FDI has been one of the driving forces of increase among the emerging economies. In 2004, China attracted approximately US\$ 60 billion of FDI, a figure that saw a steady growth reaching a high of US\$ 92 billion in

¹ Hill, C.W.L., *International Business, competing in the global marketplace*, (New York: McGraw-Hill, 2011), pp. 232-264.

² Pradhan J., Foreign Direct Investment and Economic Growth in Developing Countries, *Asian Economic Review* Vol 45, No. 2 pp 197-217

2008.³ Another region of developing nations that has seen an increase in FDI inflow is Latin America, with Mexico and Brazil being the top two recipient countries in the region.

African countries continue to lag behind among the developing nations despite recording an inflow of US\$ 62 billion in 2008.⁴ Some of the factors that have been attributed to Africa's inability to attract greater FDI are political instability, armed conflict and frequent changes in economic policies.

FDI has rapidly grown as a mode of entry into the foreign market as a result of some of the following reasons: fear of protectionist pressures associated with import and export trade; a shift towards democratic political institutions and open market economies; globalization of world economy; and removal of many restrictions on FDI have attracted many investors and multinational companies.

The liberalization of trade in services through World Trade Organization (WTO) and the on-going General Agreement on Trade in Services (GATS) has attracted FDI in services. FDI in services is being propelled by development especially technology which has made services internationally mobile and the developed economies shift from manufacturing to service industries; progress made by GATS in terms of modes of supply and nature of some services which have to be consumed where they are produced.

³ Ibid, Hill

⁴ Op cit, Hill

Tourism is one of the productive sectors in the Kenyan economy. It encompasses tours and travels; hotels and restaurants; and recreation and entertainment. Hospitality industry is a segment of the tourism sector that entails provision of food, drinks and lodging to tourists or guests who are away from the home environment.⁵

The accommodation enterprises stand out among other hospitality enterprises since they provide the base from which tourists can engage in the process of staying at a destination. Secondly, they offer multiple services such as food, drinks, sports and entertainment facilities, and overnight lodging to guests. In addition, an accommodation enterprise involves erecting of infrastructure which makes it capital intensive. The multiple services offered to guests in accommodation enterprises also make them labour intensive. Consequently, hotels are the key aspect of accommodation enterprises. They play an important role in most countries such as provision of facilities for the transaction of business, meeting and conference venues and act as attraction sites for tourists.

Their capital intensive nature has hindered the government and the local private investors from investing in them due to inadequate funds. This has created investment opportunities in potential locations within the country for foreign investors.

⁵ Page S.J., & J. Connell, 'Tourism: A modern synthesis, Third Edition', (United Kingdom: Cengage Learning EMEA, 2009) p226

1.2 Statement of the Problem

Numerous studies on FDI carried out by Svetlicic⁶, Diana and Adil⁷ as well as Kumar⁸ have highlighted on several factors that determine inflow of investment. The literature also indicates that there is no conclusive argument on factors determining FDI. Different factors work differently in different countries based on investment type and investor motive. FDI studies carried out on Kenya such as Mwega and Ngugi have highlighted on general determinants of FDI inflow in the economy.⁹ Some of the sectors that have been extensively studied include extractive and manufacturing industries, with little emphasis on services. Studies, so far, carried out in hospitality industry and the wider tourism sector have emphasized on the private sector consisting of both the local and foreign investors. Few studies, if any, have been done focusing on foreign investment alone in the industry.

In the recent past, the industry has continued to record a declining performance partly attributed to increased competition from other tourist destinations. FDI is a more stable form of foreign investment with capacity to establish infrastructure that meets international standards unlike public or domestic private investment that lack such capacity. Since Kenya has liberalized trade in hotels and restaurants' services, FDI can provide the means by which the country can improve its' competitiveness. In addition,

⁶ Svetlicic M., 'Transition economies' multinationals – are they different from third world multinationals?' in C., Chandana (ed.), *Proceedings of the 8th International Conference on Global Business and Economic Development*, (January 7-10, 2004, Guadalajara, Mexico).

⁷ Diana, F. and S.Z. Adil, 'A richer future of India', *McKinsey Quarterly*, 0475394, (2004) Special Edition

⁸ Kumar, N., 'WTO Regime, Host Country Policies and Global Patterns of MNE activity: Implication of Recent Quantitative Studies for India', *Economic and Political Weekly*, Vol36, No. 1, (2001): 39-50.

⁹ Mwega, F.M., & R.W. Ngugi, 'Foreign Direct Investment in Kenya' in S.I. Ajayi, (ed), *Foreign Direct Investment in Sub-Saharan Africa: Origins, Targets, Impact and Potential*, (Nairobi: African Economic Research Consortium, 2006).

FDI through injection of capital, tax revenues and job creation can facilitate rapid economic growth of the country. It is against this backdrop, that the study seeks to establish determinants that are specific and important for FDI inflow in hospitality industry.

1.3 Objectives of the Study

The general objective of the study is to explore the determinants of FDI inflow in hospitality industry in Kenya between 1990 and 2014.

The specific objectives are as follows:

- i. To examine the trends in hospitality industry in Kenya.
- ii. To establish the influence of political stability on FDI inflows in hospitality industry in Kenya between 1990 and 2014.
- iii. To investigate the impact of bureaucratic business regulatory procedures on FDI inflows in hospitality industry in Kenya between 1990 and 2014.
- iv. To evaluate the influence of insecurity on FDI inflows in hospitality industry in Kenya between 1990 and 2014.

1.4 Literature Review

Many studies, for instance Svetlicic have highlighted on several factors that determine inflow of investment.¹⁰ These determinants include: economic factors such as market size, macro-economic indicators like a country's real GDP growth, real exchange rate and inflation rates; political stability; host country's endowed resources and business environment. Such factors have been considered as influential in determining where

¹⁰ Op cit, Svetlicic 2004

investment goes. According to Svetlicic, market size has a positive impact on FDI inflow.¹¹ However, researchers like Kokko argue that the case is no longer the same since smaller countries can also compete by providing incentives as seen in some smaller South-East Asian countries like Singapore.¹² Market openness or an open economy has more chances of receiving FDI inflow than closed ones as argued by Diana and Adil.¹³

According to Kumar, there is a strong correlation between investment incentives and inflow of FDI.¹⁴ Incentives include tax incentives and government strategies aimed at attracting FDI. However, a study by Swenson proposes that increasing taxes encourage FDI inflow.¹⁵

According to Svetlicic, a highly political unstable country negatively impacts on FDI inflow.¹⁶ Contrary to Svetlicic, Buckley et al found that some Chinese investors were attracted to countries with political instability.¹⁷ They cited Chinese investors in Sub-Saharan Africa countries with political instability. They argued that higher returns on investments surpassed destination risks involved.

¹¹ Ibid, Svetlicic 2004

¹² Kokko, A., *Globalization & FDI incentives*, (World Bank ABCDE-Europe Conference, June 2002, Oslo, Norway).

¹³ Diana, F. and S.Z. Adil, 'A richer future of India', *McKinsey Quarterly*, 0475394, (2004) Special Edition.

¹⁴ Kumar, N., 'WTO Regime, Host Country Policies and Global Patterns of MNE activity: Implication of Recent Quantitative Studies for India', *Economic and Political Weekly*, Vol 36, No. 1, (2001): 39-50.

¹⁵ Swenson L.D., 'The impact of U.S tax reform on foreign direct investment in the United States', *Journal of Public Economics*, 54 (1994) pp. 243-266.

¹⁶ Svetlicic M., 'Transition economies' multinationals – are they different from third world multinationals?' in C., Chandana (ed.), *Proceedings of the 8th International Conference on Global Business and Economic Development*, (January 7-10, 2004, Guadalajara, Mexico).

¹⁷ Buckley,P.J., L.J. Clegg, A.R. Cross, X. Liu, H.Voss and P. Zheng, 'The determinants of Chinese outward foreign direct investment', *Journal of International Business Studies*, 38, (2007) pp. 499-518.

Various authors such as Han and Brewer¹⁸ and UNCTAD¹⁹ agree that countries rich in natural resources attract more FDI inflow. A country's endowed resources determine the decisions of most investors when deciding where to invest.

According to Newell and Seabrook location decisions for investment depend on several factors like market demand and availability; market size and economic growth; comparative and competitive advantages held by the host country and home country firm respectively; and motive of foreign investors.²⁰

Dwyer and Kim look at two components that determine tourism investment destination; comparative and competitive advantages.²¹ They define comparative advantages as those endowed resources that are provided by nature to a given destination and competitive advantages as hotels and physical infrastructure such as road and telecommunication networks. These competitive advantages can be invested by a firm or facilitated by a government through its policies.

Crouch focuses on competitiveness of a destination based on aspects of comparative and competitive advantages.²² He identifies factors that make a destination attractive in

¹⁸ Han C. Min and T.L. Brewer, 'Foreign Direct Investments by Korean Firms: An Analysis with FDI Theories', *Asia-Pacific Journal of Management* Vol 4, No. 2, (1987) pp. 90-102

¹⁹ UNCTAD, 'Case Study on outward foreign direct investment by Indian small and medium -sized enterprises', TD/B/COM.3/EM.26/2/Add.2, 31 October 2005.

²⁰ Newell, G. and Seabrook, R., Factors influencing hotel investment decision making. *Journal of Property Investment and Finance*, Vol24 no.4(2006) pp 279 -294

²¹ Dwyer, L. and C.Kim, 'Destination Competitiveness: Determinants and Indicators', *Current Issues in Tourism*, Vol 6, No. 5, (2003) pp. 369-414.

²² Crouch, G., *Modelling destination competitiveness: A survey and analysis of the impact of competitiveness attributes*, (2007, CRC for Sustainable Tourism Pty Ltd., Australia).

comparison to others; develops general and conceptual models of destination competitiveness; and theories of comparative and competitive advantages.

One of the theories explaining why foreign direct investment goes where it does is the eclectic theory. In this theory, Dunning categorizes the location advantages of host countries into macro-economic indicators, Ricardian-type factors and environmental factors.²³ Macroeconomic factors consist of market size, a country's economic growth rate and exchange rate. On the other hand, Ricardian-type factors entail natural resources and manpower while environmental factors comprise of a country's regulatory policies and infrastructure. Dunning also considers a firm's specific advantages.

Calgary model of tourism competitiveness proposed by Ritchie and Crouch explains the determinants of investment destination in tourism.²⁴ The model identifies five key factors of destination competitiveness: destination appeal- does it attract or deter; destination management- in terms of managerial and marketing efforts; destination organization- in reference to management and strategic alliances; destination information- in terms of decision making and research to better manage product's destination performance; and destination efficiency- experience in delivering as promised, staff training and productivity. The authors considered a destination's ability to attract to be important in tourism. They further identified elements considered attractors and those considered

²³ Dunning, J.H., 'Explaining the international direct investment position of countries: towards a dynamic or developmental approach' In J., Black & J.H.Dunning (Eds.), *International Capital movements: papers of the fifth annual conference of the International Economics Study Group*, (Surrey: Macmillan Publishers Ltd, 1982) pp. 84-116.

²⁴ Ritchie, J.R.B. and G.I Crouch, *Competitiveness in International Tourism: A framework for understanding and Analysis*, (Proceedings of the 43rd Congress of the Association Internationale d'Experts Scientifique du Tourisme, 17-23 October 1993, San Carlos de Bariloche, Argentina).

deterrents. Natural features, climate, general infrastructure, basic services infrastructure, accommodation establishments, transport network availability, pricing, attitudes towards tourists were some of the elements considered attractors. While political instability, lack of supporting services such as healthcare facilities, visa requirements were some of the elements considered deterrents. Such deterrents have a negative impact to visiting a particular destination which in return hinders investment in tourism.

Ritchie and Crouch developed conceptual model.²⁵ This was an improvement of Calgary's model. In the conceptual model they emphasized on distinctive characteristics of destination competitiveness namely comparative advantage and competitive advantage. The model entails global macro-environmental factors such as global economy and terrorism and host environmental factors like a country's policies. The conceptual model like Calgary's model identifies five main groups of destination competitiveness factors though different.

Integrated model of destination competitiveness by Dwyer et al combines the key elements of a host country and firm competitiveness as proposed by Calgary's model and Dunning's eclectic theory.²⁶ The model's primary elements include endowed resources²⁷, created resources²⁸ and supporting resources²⁹. According to the proponents of the model, these three groups of resources form the key destination resources which act as an

²⁵ Ibid, Ritchie and Crouch

²⁶ Dwyer, L., R. Mellor, Z. Livaic, D. Edwards and C.Kim, 'Attributes of Destination competitiveness: A Factor Analysis', *Tourism Analysis*, Vol 9, No. 1-2(2004) pp. 91-101.

²⁷ Endowed resources as defined by the authors refer to both natural resources like general scenic features, mountains and heritage such as language and customs.

²⁸ Created resources as defined by the authors refer to tourism infrastructure.

²⁹ Supporting resources as defined by the authors refer to aspects like accessibility and general infrastructure.

attractor or deterrent to visiting a destination which prompts further investment in a destination.

The next key component of integrated model is the destination management.³⁰ The other core component of the model is the demand conditions which consist of awareness, perception and preferences. These determine visitation of a destination which in return determines an investor motive especially when targeting a particular market.

Integrated model involves the interaction of the three components to influence a destination's competitiveness therefore attracting investments. The ability of a country to attract foreign investment not only ensures returns on investment to an investor but also leads to a country's economic growth. Hence, destination competitiveness is not only a determinant of a country's attractiveness to investment but also an indicator of national economic growth.

Dwyer et al further assert that indicators of destination competitiveness consist of both subjective attributes as well as objectively determined attributes.³¹ Subjective in that, destination appeal for instance scenic beauty are based on an individual's perception, as opposed to objectively determined attributes which have standard of measure such as a country's tourism market share.

³⁰ The authors define as those factors that enhance the attractiveness of the key resources, maintenance and good utilization of the supporting resources and adjust to the situational conditions Situational conditions as defined by the authors refer to forces in the wider environment that define the limit of destination competitiveness. These forces can influence destination competitiveness by weakening the impact of other groups of factors namely resources, destination management and demand conditions. For example, high levels of security and political stability have a positive influence on a country's competitiveness while insecurity and political instability have a negative influence on a country's competitiveness.

³¹ *Ibid*, Dwyer et al, (2004) .pp. 91-101

The main aim of Travel and Tourism Competitiveness Index (TTCI) is to develop a country's travel and tourism sector by highlighting indicators that require changes.³² The TTCI model uses survey data from the World Economic Forum and quantitative data available from public sources, travel and tourism experts and institutions like World Travel and Tourism Council (WTTC), United Nations World Tourism Organization (UNWTO) and International Air Transport Association (IATA).

The TTCI model uses three broad categories referred to as sub-indexes which provide indicators used to determine a country's attractiveness. One of the sub-indexes is the T&T regulatory framework which is mainly concerned with policy related issues adopted by a government. The next sub-index is the T&T business environment and infrastructure. Last but not least, the T&T human, cultural and natural resources. The sub-indexes are further divided into pillars which consist of individual variables. There are two parameters used in assessing a country's competitiveness. One, a score based on a 1 to 7 scale where 7 represent the greatest score. The second parameter involves comparison of the ranked countries.

Newell and Seabrook listed factors that they considered to be the main influence of hotel investment decision.³³ Some of the factors they listed were location, economic and diversification.

³² World Economic Forum (WEF), *The Global competitiveness Report 2010-2011*, <http://gcr.weforum.org/>.

³³ Newell, G. and R., Seabrook, 'Factors influencing hotel investment decision making', *Journal of Property Investment and Finance*, Vol 24, No.4 (2006)pp. 279-294

A study by Ussi and Jianguo, “the location determinants for hotel foreign direct investment (FDI) in Zanzibar,”³⁴ listed the following factors as important determinants of choice for hotel investment: economic growth, the available tourism market, availability of diverse endowed resources, good infrastructure, openness to trade and political stability. The study indicated a significant difference with reference to political instability in relation to the investors’ country of origin. Those from developed countries placed greater importance on the country’s political stability while those from developing countries placed a lesser importance on political stability in Zanzibar. The study also found out that factors such as location, cost of labour and investment did not feature as very important neither did they determine inflow of hotel investors in the region. However, quantity and quality human capital were noted to be necessary in promoting labour intensive and export oriented FDI.

Brown et al argue that there is a positive correlation between availability physical infrastructure and hotel investments.³⁵ However, they cited a situation showing that depending on the investor motive the case may not always be true. For example, a number of multinational hotel companies and Italian investors like to carry out their investments in developing countries with market potential and very little infrastructure. Factors that influence investment decisions by domestic investors are often shared by foreign investors in the same environment. However, local investors tend to have a better

³⁴ Ussi, M.U and W., Jianguo, ‘The Location determinants for hotel foreign direct Investment (FDI) in Zanzibar’, *International Conference on Management and Service Science*, IPEDR Vol.8 (2011). Available at: <http://www.ipedr.com/vol18/21-S10025.pdf>.

³⁵ Brown, J.R., Dev, C.S., Zhou, Z., ‘Broadening the foreign market entry mode decision’ in R.C., Lewis (ed), ‘ Forum on feasibility studies told it like it is’, *Hotel & Motel Management*, Vol 21, No. 14 (2003) pp. 20-23

understanding of the business environment than their foreign counterparts. To be competitive, foreign firms must have firm specific advantages that give them an edge over the local firms. This can be in the form of management skills and product distribution capabilities.

According to a survey done by UNCTAD, mode of investment is an important factor in the hotel industry.³⁶ In addition to location of investment factors that determine where to invest. This can take the form of equity or non-equity depending on various factors that the investor finds favourable. Management skills and financial requirement involved in hotel construction and operation were some of the reasons encouraging FDI in the industry. The survey by UNCTAD indicates the increasing role played by mode of investment in the hotel industry. Out of all the hotels in the developing and emerging economies, 80 per cent were found to be under non- equity mode of operation while the remaining 20 per cent composed of joint venture and full ownership.³⁷ The same study also found out that equity investment was preferred in Least Developed Countries (LDCs).

Another study by UNCTAD carried out in India showed an increasing prevalence of Transnational Corporations (TNC) opting for franchising, leasing and management as modes of operation with a decreasing number in equity purchasing and ownership.³⁸

³⁶ UNCTAD, *FDI and Tourism: The development dimension East and Southern Africa*, (United Nations, 2008, New York and Geneva) pp. 75-118.

³⁷ Op cit, UNCTAD (2008) pp. 75-118.

³⁸ UNCTAD, *India's outward FDI: a giant awakening?* UNCTAD/DITE/IIAB/2004/1, (20 October 2004).

Erramilli and Rao also noted that non-equity modes without equity investment by foreign investors are becoming more common in the hotel and restaurant firms.³⁹

Contractor and Kundu noted that worldwide non-equity modes make up 65.4% of transnational hotel brands.⁴⁰

A study by Christie and Crompton carried out in Kenya in 2001, found out that of the many hotels located along the coastline, national parks and reserves, and in Nairobi, 70-80 per cent had foreign share.⁴¹ Subsequently, complete foreign ownership was less than 20%. This was further asserted by UNCTAD which noted the declining trend of foreign share.⁴²

Authors like Koch and Root have identified various factors that determine what mode of investment entry a firm would choose.⁴³ Some of the factors they identified are country risk, market openness and “follow the client abroad.”⁴⁴

³⁹ Erramilli, M. and C.P. Rao, ‘Services firms’ international entry mode choice: A modified transactions costs approach’, *Journal of Marketing*, Vol 57, No.3 (1993) pp. 19-38.

⁴⁰ Contractor, F.J and Kundu, S.K., ‘Modal Choice in a world of Alliances: Analyzing Organizational forms in the International Hotel Sector’, *Journal of International Business Studies*, Vol. 29, No.2 (2nd Quarter, 1998) pp. 325-357. <http://www.jstor.org/stable/155606>.

⁴¹ Christie, I.T. and Crompton, D.E., *Tourism in Africa*, (Africa Region Working Paper Series No.12, The World Bank, 2001, Washington D.C.).

⁴² UNCTAD, *Investment Policy Review: Kenya*, (United Nations, 2005, New York and Geneva).

⁴³ Koch, A.J & Root, Factors Influencing market and entry mode selection: developing the MEMs model. *Market Intelligence and Planning* Vol 19 No.5 (2001)pp 351-361

⁴⁴ A hypothesis based on the assumption that global hotel chains draw a number of their clientele from international business travelers who are particularly concerned about quality standards.

1.5 Justification of the Study

It is generally believed that FDI provides net benefits to the host country. The current long term national policy, the Kenya vision 2030 for example, aims at achieving an industrialized middle-income society by 2030. In order to achieve this target, successive governments have put more effort geared towards attracting the private sector. FDI is seen as a stable form of the private sector with ability to develop a country's competitiveness. Attraction of FDI is likely to benefit the host country through creation of employment opportunities for the citizens, increase in tax revenue and general economic growth of the country. The study findings will be quite useful to various stakeholders in the sector and the country's policy makers in developing policies and enacting regulations that will attract FDI and consequently related benefits. The study findings will also serve as a guide to policy makers in addressing policy gaps and a benchmark for enacting future policies.

Secondly, the study findings will add knowledge to the general academia.

1.6 Theoretical Framework

Dunning's eclectic theory considered influential in explaining determinants of FDI has been applied in this study.

1.6.1 Eclectic Theory of FDI

The Eclectic theory of FDI also referred to as OLI paradigm was developed by John Dunning. He combines the best aspects of other theories that attempt to explain the

observed pattern of FDI inflows into a single holistic explanation of FDI, hence the term eclectic.⁴⁵

The theory explains basic aspects about FDI in relation to ownership, location and internalization advantages. This theory has been applied to this study as it not only considers the nature and characteristics of the hospitality industry but also gives a holistic approach that assists the researcher to explore determinants that lead to FDI inflow in hospitality industry.

Dunning argues that in addition to protecting a firm's technological know-how and reducing trade barriers that favour FDI, location specific advantages play an important role in explaining why firms opt for FDI as well as why FDI goes where it goes.⁴⁶ He defines location specific advantages as those advantages specific to a host country destination such as natural resources; infrastructure and human capital that a foreign firm finds valuable.⁴⁷ He further elaborates that a firm would find such location specific advantages valuable when combined with its capabilities such as management and marketing skills as well as technological know-how. This explains most investment done in the hospitality industry where endowed resources specific to a location such as climate, flora and fauna and scenery determine tourism destinations hence tourism structures such as accommodation investments.

⁴⁵ Op cit, Dunning, J.H., (1982)

⁴⁶ Op cit, Hill, (2007) pp 232 - 264

⁴⁷ Hill, C.W.L., "International Business, Competing in the global marketplace", (New York: McGraw-Hill Irwin,2011)

Dunning agrees with the argument brought forth by internalization advantages that favours FDI to licensing as a way of a firm protecting its own unique capabilities. Adding that combining resource endowments with a firm's comparative advantages ensures the company maintains its cutting edge. Hospitality establishments have to be utilized where they are built. In such instance, a firm can combine its managerial skills or capabilities with the destination resources to increase its production.⁴⁸

He acknowledges the difference in cost and skill of labour among countries and suggests that it is more economical for a firm to locate its production where it is most suited. Hospitality industry is considered labour intensive due to its service oriented nature. It requires a huge supply of labour in its many departments that require personalized services.

Dunning's theory goes further by elaborating on benefits accrued from a firm investing where similar firms already exist. Besides confidence building, such firms can benefit through spillovers. This to some extent may explain why many accommodation enterprises are concentrated in particular locations even within the same region of the country.

Hospitality industry is considered capital intensive. Lack of adequate funds and management skills may deter the government and local investors from participating in large scale investments. As proposed by the theory, FDI provides a means for foreign

⁴⁸ Ibid, Hill , (2007) pp 232-264

investors to enter into a foreign market especially where financial and managerial resources are not restrictive to the investors.

1.7 Hypotheses

The study will be guided by the following hypotheses:

- i. Political factors have been the key influence in FDI inflow in hospitality industry in Kenya between 1990 -2014.
- ii. Corruption is the most problematic factor in doing business for foreign investors in the hospitality industry.
- iii. Insecurity has negatively affected investor confidence in hospitality industry.

1.8 Research Methodology

This section highlights on the various stages of the survey used to collect data. It addresses the key elements of research such as design, target population, sampling procedure, data collection and data analysis procedures.

1.8.1 Research Design

The research design used in this study is a combination of survey and existing sources.

A cross-sectional survey was used in the study. The variables used in the study are insecurity, corruption, political factors and FDI inflow.

Existing sources refer to data obtained from what others have done such as economic surveys.

1.8.2 Target Population

Foreign investors in hospitality enterprises in Kenya are the study population.

Government officials from relevant organizations and corporations are the key informant on government agencies responsible for investment and regulation.

1.8.3 Sample Site

A total of 26 foreign owned hospitality establishments from North Coast, South Coast Kilifi and Malindi zones were used in this study.

1.8.4 Research Instrument

Questionnaires and interviews were used to collect primary data. The questionnaires were delivered to the establishments. The content of questionnaire items comprised of factual and subjective experiences. The factual questions such as background question were used to provide information that could be used to classify the respondents. Background questions included items like gender, age, education and nationality. Questions about subjective experiences were also used. Closed-ended and open-ended questions were employed in the questionnaire to complement each other. The structure, format and sequence were considered in formulating the questionnaire questions.

A focused interview or non-schedule-structured interview was used. The data instrument was used to probe for further information from government officials based on questionnaire responses. The researcher also aimed at collecting information from the interviewees' experiences regarding the situations under study.

Since primary research is a costly undertaking, existing data was used to supplement new data. Secondary data used in this study was obtained from United Nations Conference on Trade and Development (UNCTAD). Additional information was obtained from The Ministry of Tourism and Kenya Investment Authority (KenInvest). Statistics used have been obtained from Kenya National Bureau of Statistics (KNBS).

1.8.5 Data Collection and Preparation Procedure

The researcher went through the questionnaire with the respondents as they recorded their answers, in cases where the respondents were available. This enabled the researcher to clarify any upcoming issue from the respondents. It also enabled the researcher to observe nonverbal communication of the respondents. In cases where the respondents were left with the questionnaire, agreed dates were given for collecting the completed questionnaire.

Raw data collected was compiled and a code constructed. Coding facilitates entry of data into a statistical computer program for storage and analysis. To ensure errors are corrected and omission inserted, the coded data was edited and then cleaned. Data cleaning also enables wild codes to be identified and this can be tested through generating frequency distribution.

1.8.6 Data Analysis

The data was summarized by constructing frequency distributions of single variables. Frequencies were converted into measures such as proportions or percentages that can be

interpreted meaningfully. Percentages and proportions have been presented in form of tables and bar charts to communicate information more effectively. Different variables have been cross tabulated to show relationships between them.

Cross tabulated variables have been analyzed using Chi-square test.

1.9 Limitation of the Study

The study focused on the accommodation sector of the hospitality industry. Many accommodation enterprises have restaurants and entertainment facilities within their premises. However, there are hospitality enterprises such as independent restaurants and entertainment facilities that do not offer sleeping accommodation. It would have been ideal to examine all segments of hospitality industry. However, the amount of time and financial resources required proved to be beyond this researcher.

In addition, the study sites used in this study were limited to North Coast, South Coast, Kilifi and Malindi zones as opposed to all zones due to financial constraint.

It would have been ideal to have foreign owners of the premises responding to the survey. However, this proved difficult in situations where the operation of the enterprises were run through a management company or lease and the owners were out of reach. In some cases, foreign operated enterprises turned out that the premises were locally owned. To this end, the opinion of the available foreign owners and executive staffs of the enterprises have been included in this study.

The study targeted factors influencing foreign investors' choice of Kenya for hospitality investments. Factors that emerged during the analysis of data from local investors have been incorporated in the study.

1.10 Chapter Outline

Chapter 1: Introduction.

Background to the study, problem statement, objectives of the study and research methodology is also provided in the chapter.

Chapter 2: An overview of the hospitality industry.

This chapter looks at the nature and characteristics of the industry. It also presents the trend and evolution of the industry.

Chapter 3: Government Policies and their Implication on FDI.

The chapter will provide a discussion on the various policies adopted by the government and their effects on FDI.

Chapter 4: Investment and Regulatory frameworks and their Impact on FDI

This chapter examines the investment climate and their effects on FDI. The chapter also gives a discussion on the industry's regulations and their impacts on FDI.

Chapter 5: Impacts of insecurity.

The chapter highlights on the causes and impacts of insecurity. It also entails measures taken by the enterprises and the government to curb insecurity in the premises and the country respectively.

Chapter 6: Summary of findings, Conclusion and Recommendations.

CHAPTER TWO

AN OVERVIEW OF THE HOSPITALITY INDUSTRY

2.1 Introduction

Kenya's hospitality industry is part of the wider tourism sector. Its foundation is based on touristic attraction sites and the country's location as a regional hub for commercial, transport and communication network. Hospitality products such as accommodation enterprises⁴⁹ provide the base in which a tourist or a visitor begins to enjoy a destination. These enterprises provide services to international and domestic visitors who visit the country for holiday, business, transit or other purposes.

2.2 Attractions

Endowed resources play an important role in the decisions of most investors when deciding where to invest. Countries rich in natural resources attract more FDI inflow as argued by UNCTAD.⁵⁰ In 2013, Kenya was ranked 14th out of 140 countries for its natural resources by the Travel and Tourism Competitiveness Index.⁵¹ Kenya's tourism largely relies on its natural attractions of wildlife, beautiful white sandy beaches, warm weather throughout the year, unique historical and archaeological sites, and cultural diversity consisting of more than 42 tribes complemented with a tradition of hospitality. These attractions form the foundation upon which a successful tourism industry is established prompting construction of hospitality products such as hotels and lodges.

⁴⁹ Tourism Act No 28 of 2011, ninth schedule, Class A Enterprises pp. 56

⁵⁰ Ibid, UNCTAD 2005

⁵¹ GOK, National Tourism Strategy, 2013-2018

2.2.1 Climate

Kenya is one of the east African countries and lies on the Equator. The country's total size is 582,646 square kilometres.⁵² It is bordered by five countries and the Indian Ocean. South Sudan and Ethiopia are located north of the country. The Indian Ocean lies to the south east while Tanzania to the south of Kenya. Uganda to the west while Somalia to the east of Kenya. It has a single time zone of GMT +3 (Greenwich Mean Time + 3 hours).

The country is warm and dry. The long rains are experienced between the months of March and May. The short rains on the other hand, from October and December. The coastal region is usually hot and humid, the central highlands is usually cool and receive the most rainfall due to the high altitude. Lake Victoria basin tends to be wetter. The northern part of the country is very dry and hot. High daytime temperatures of 34 degrees and above are common with Suguta Valley being the hottest region. Most areas in Kenya above 2,500 metres experience frost.

The country's warm weather throughout the year has attracted many visitors from Europe and other continents during winter seasons.

2.2.2 Physical Features and Wildlife

Mount Kenya is the second highest mountain in the African continent, with an altitude of 5,199metres.⁵³ The mountain is constantly covered with snow at the top. Kenya also

⁵² Kenya National Bureau of Statistics (KNBS), Economic Survey 2015, Kenya Facts and Figures

⁵³ KNBS, Economic Survey 2013, Statistical abstract

shares Mount Elgon and Mount Kilimanjaro located along its borders with Uganda and Tanzania respectively. Other mountains and hills include Mount Longonot, Aberdare Range, Cheranganyi Hills, Mau escarpment, Taita and Chyulu Hills.

The Great Rift Valley divides the country into two. It contains fresh water lakes, namely Lake Baringo and Lake Naivasha. The alkaline lakes in the region are Bogoria, Elementaita, Turkana, Nakuru, Logipi and Magadi. Some of these lakes are shallow and are home to a number of birds such as lesser flamingo, great white pelicans, black-necked grebe, African spoonbill and yellow billed stork.

Other lakes within the country include Jipe, Bolossat, Chala, Kabongo, Kanyaboli and Loongojit.⁵⁴ Lake Victoria, the largest fresh-water lake in Africa⁵⁵ is shared among three countries namely Uganda to the southeast, Tanzania to the northwest and Kenya to the southeast. Kenya is also home to a number of rivers such as the Mara, Sagana, Athi, Sabaki and Tana.

Kenya's savannah is inhabited by most wild animals found in the country. Tsavo National Park is Kenya's largest National Park. The Maasai Mara Game Reserve, which is an extension of Tanzania's Serengeti, is renowned for its annual wildebeest migration. The spectacular event attracting many visitors from all over the world involves hundreds of thousands of animals including several calves which fall prey to the dramatic predator action, moving not only forward but also backwards and sideways, milling around,

⁵⁴ *Op cit*, KNBS 2013

⁵⁵ WWF 2012

splitting up, joining forces in a bid to reach Maasai Mara. The crossing of the Mara River filled with crocodiles is characterized by chaos and stampede as the herd struggle to get to the other side.

Other parks and reserves include Amboseli, Lake Nakuru, Meru, Hell's Gate, Ol Donyo Sabuk, Ruma, Samburu, Buffalo Springs, Shaba and Nairobi National Park which is the only park in the world that exist within a capital city. Kenya hosts some of the most ancient, fragile and diverse wildlife species consisting of the 'Big Five'⁵⁶ and the 'Big Five African snakes.'⁵⁷

The country's flora includes thousands of endemic and exotic tree species. These are found in indigenous forests and woodland such as Aberdare forest, Mount Kenya forest, Arabuko Sokoke forest and Kakamega forest. These forests are also home to a number of birds, colobus monkeys, buffalo, elephants and many smaller mammals like hyrax and squirrels. Some of the plant species found in Kenya are wild fig commonly referred to as *mugumo*,⁵⁸ mangrove, baobab, cypress, aloe, cactus, thorn tree, pine, papyrus, oak, both sensitive and creeping wood sorrel, mango and avocado trees, neem, mahogany, bougainvillea, lantana, sycamore fig and jacaranda.

⁵⁶ A name invented by big-game hunters. It refers to the lion, elephant, buffalo, leopard and rhinoceros.

⁵⁷ 'Big Five' African snakes refer to Python, Cobra, Puff Adder, Boomslang and Mamba.

⁵⁸ Kikuyu name for wild fig

The Kenyan coastline is approximately 536 kilometres of the Indian Ocean.⁵⁹ It is made up of south Coast, north Coast, Malindi, Watamu and Lamu beaches. Famed for its white, sandy beaches and marine life, the coastline also consists of spectacular coral reefs.

The physical features and wildlife attract international and domestic visitors who engage in activities and sports like mountain climbing, fishing, sun bathing, water sports, bird watching, game hunting, safari adventures, and scientists interested in studying plant and insect species.

2.2.3 Historic and Other Touristic Sites

These are popular sites loved and visited because of the interesting story behind their existence or the noble course that go on in these places. These include Koobi Fora, Kariandusi and Olorgesailie pre-historic sites popularly referred to as the Cradle of Mankind; Fort Jesus, Vasco da Gama Pillar, Karen Blixen House, and German Post are all associated with the early visitors to Kenya; Gede Ruins, Jumba la Mtwana, Mnarani ruins, and Swahili house tell of stories of the early inhabitants and how they lived; the Daphne Sheldrick Elephant sanctuary, Ol Pejeta sanctuary for Chimpanzee conservation and the Giraffe Centre are some conservation projects for wildlife and last but not least, a number of museums found in most towns.

Conservation models like conservancies have been adopted by Kenya to ensure wildlife protection and peaceful co-existence between wildlife and livestock communities living near tourism attraction sites especially the National Parks and Game Reserves. A

⁵⁹ KTB, 'Kenya: Tourism Guide', 2010-2011, Edition 6.

conservancy safari in Kenya involves horseback riding, walking or biking which gives a close and personal experience with the wildlife. One can also experience some of the most endangered⁶⁰ and vulnerable⁶¹ wildlife species with the help of professionally trained guides. In addition, tourists also get the opportunity to visit local community projects that the conservancy is involved in and interact with the local community cultures. Some of these conservancies include Lewa Wildlife Conservancy, Mara Naboisho Conservancy, Selenkay Conservancy and Mount Kenya Wildlife Conservancy. Marine Parks established at the coastal region also help to protect the rich aquatic life found in the waters. These protected waters thrive with marine life. Mombasa, Watamu and Malindi are some of the Marine Parks in Kenya.

Apart from attracting general tourists, these sites also attract archaeologists, anthropologists, historians, conservationists, animal activists, students and research groups from all over the world.

2.2.4 Diversity of Culture

Kenya is made up of more than 42 ethnic communities with various traditional cultures differing in music/songs, food/cuisine, taboos, rituals, and art. However, there exists a distinct Kenyan culture that draws the diverse communities together. Kenya's culture originates from the diverse ethnic communities and modern influences. The traditional societies and culture have been blended with modern norms and values. Nairobi, the country's capital city, is a thriving business district. It is more or less similar to most

⁶⁰ IUCN (International Union for Conservation of Nature) 2014 Red List, terminology used to refer to animals which are considered to be in extremely high risk of extinction

⁶¹ *Ibid*, IUCN 2014, terminology used to refer to animals considered to be at a high risk of extinction

cities in developed countries. In contrast, Kenyan rural areas exhibit traditional and customary way of life. The modern and the traditional lifestyles co-exist and at times they are too close to distinguish the difference. Kenyan culture is transitional and changes with generations.

The people of Kenya are also friendly and welcoming.

Traditional societies attract cultural tourism which has led to emergence of homestays as a form of visitor accommodation. Homestays provide visitors with an in-depth experience of Kenyan life.

2.2.5 Kenya's Level of Economic Development

The country's population in 2014 was 43 million compared to 23.4 million in 1990.⁶² The annual population growth rate is at 2.7%.⁶³ The country's GDP in 2015 and 2014 were 5.6% and 5.3% respectively. The government has maintained a relatively stable macroeconomic environment.

Kenya has a large domestic market and a growing middle-class population with an appetite for high value goods and services. The country has a relatively high level of general education that produces quality workforce relative to the economy's absorptive capacity. The market size and access to skilled human resource are some of the factors that create market demand and availability of skilled labour respectively hence attracting investment in the industry.

⁶² KNBS, Economic Survey 2015

⁶³ KNBS, Economic Survey 2015

The country's strategic location as the economic, commercial and logistical hub in the region has contributed to growth in hospitality products. Its regional and international connectivity makes it a gateway to other East and Central Africa as well as between Africa, Europe and Asia. Europe forms the largest proportion of transit visitors to Kenya.⁶⁴

Kenya is a member of the East African Community. It is also a member of the Common Market for Eastern and Southern Africa (COMESA). Market integration encourages trade promotion schemes and free movement of persons within member countries. Such agreements facilitate movement of persons which contribute to the international visitor arrivals prompting accommodation investments.

As a UN member, Kenya has ratified a number of international agreements. For instance, liberalization of trade in services through World Trade Organization is an agreement that Kenya has signed. The country also takes part in the international conferences related to UN bodies, besides hosting some of the offices. The United Nations Environmental Programme (UNEP) and the United Nations Centre for Human Settlements (UNCHS-Habitat) have offices in Nairobi. Kenya has hosted a number of international conferences such as the 10th World Trade Organization Ministerial Conference (MC 10), UNCTAD conference and Global Entrepreneurship Summit. This has led to an increase in accommodation facilities and diversification of tourism products to include conference tourism hence creating investment opportunities.

⁶⁴ Ibid, KNBS

As a commercial, communication and transport hub in the region, Kenya hosts Multinational Corporations' regional headquarters and branches such as Nokia research hub and Barclays Bank. The flow of business community in the country especially in Nairobi has boosted investments in hotels.

2.3 Trends in the Industry

Tourism is one of the leading sectors in foreign exchange earnings for the country. Accommodation and food service segment contributes substantially to the sector as illustrated in Table 2.1.

Table 2.1: General trend in the industry, 1990 -2015

Year	International Visitor Arrivals (Thousand)	Bed-night Available (Thousand)	Bed-night Occupied (Thousand)	Tourism earnings (KES Billion)	Accommodation & Food Service (KES Million)
1990	814.4	10,494.7	6,045.9	10.6	1,894
1991	804.6	11,036.7	6,518.5	11.7	2,266
1992	781.5	11,464.5	5,525.8	14.3	3,034
1993	826.2	11,908.9	6,188.8	24.4	3,840
1994	863.4	11,908.9	5,164.7	28.1	4,800
1995	973.6	11,562.2	5,054.6	25.0	6,476
1996	1,003.0	11,354.5	5,661.2	25.6	8,288
1997	1,000.6	9,516.6	4,910.3	22.6	10,980
1998	894.3	7,975.7	2,813.0	17.5	13,143
1999	969.3	8,711.4	2,951.0	21.4	12,947
2000	1,036.5	9,382.3	3,687.8	16.7	13,077
2001	993.6	8,327.8	3,354.9	24.2	13,247
2002	1,001.3	8,182.7	3,436.8	21.7	12,503
2003	1,146.2	7,765.7	2,605.9	26.4	10,708
2004	1,360.7	10,030.7	3,791.5	38.5	13,483
2005	1,479.0	10,845.6	4,476.5	48.9	19,357
2006	1,600.6	13,003.5	5,922.1	56.2	24,208
2007	1,816.8	14,711.6	6,939.4	65.4	29,612
2008	1,203.2	14,233.6	3,699.0	53.0	23,745
2009	1,490.4	17,125.3	6,242.8	62.5	39,421
2010	1,609.1	17,161.8	6,662.3	73.7	49,909
2011	1,822.9	17,419.6	7,015.2	97.9	50,296
2012	1,710.8	18,849.6	6,860.8	96.0	57,161
2013	1,519.6	18,292.2	6,596.7	94.0	58,068
2014	1,350.4	19,877.2	6,281.6	87.1	49,934
2015	1,180.5	20,187.2	5,878.6	84.6	49,689

Source: KNBS, Various Economic Surveys; and National Tourism Strategy

Table 2.1 presents the general trend in the industry over the years. The number of hotel bed-nights available in 2015 increased by 1.6% from 19,877.2 thousand in 2014 to 20,187.2 thousand in 2015, indicating increased investments in accommodation facilities in the hospitality industry.

Further decrease in international visitor arrivals and bed-nights occupancy in 1992 from 1990 were attributed to recession in major tourist market source, Europe and uncertainty due to upcoming general elections in the country at the end of the year. There was also increased competition for tourists in the region following the removal of trade and travel restrictions against South Africa.

In 1993 there was a marked improvement in international visitor arrivals following successive declines in 1991 and 1992. This was attributed to peaceful conduction of the 1992 general elections. Liberalization of exchange controls also attracted more investment leading to an increase of bed-nights available.

The late 1990s and the beginning of the 21st century experienced mixed performance in terms of international visitor arrivals, bed-nights available and bed-nights occupied. The mixed performance was also reflected in the tourism earnings. The acceleration and deceleration were due to frequent changes and reversals of economic policies associated with the beginning of reform process in the country. The period was also characterized by lack of and poor implementation of economic reforms; and macroeconomic problems. This created a feeling of uncertainty among the investors on whether to or not to invest. The poor performance in 2001 was largely as a result of global recession worsened by the aftermath of the September 11th terrorist attack in the USA. This led to closure of some hotels during the low season.

The significant decrease in bed-nights available in 2003 was attributed to closure of a number of hotels and lodges by most investors who adopted the wait-and-see approach following the 2002 general elections. The Economic Recovery Strategy adopted by the government led to a steady growth from 2003 culminating in 2007. Tourism earnings recorded the highest figure in 2007 since 1990 which became a bench mark for the sector. Some of reasons accounting for good performance of the industry during the period are political stability, sound and stable macroeconomic environment and improved governance.

The bed occupancy rate decreased from 47.2% in 2007 to 26% in 2008, lowest performance in the industry in a long time. The total earnings in accommodation and food service were dismal affecting the overall tourism earnings. The poor performance was attributed to insecurity arising from post-election violence. The negative travel advisories from western countries affected international visitor arrivals. This was reflected in decreased bed-nights occupancy. As a result there was also a reduction on bed-nights available indicating closure of enterprises or divestment

The country's resilience following the poor performance in 2008 is reflected in the steady growth observed in all the indicators from 2009 till 2011. Increase in international visitor arrivals, bed-nights available and bed-nights occupied was largely attributed to marketing strategies adopted by the government.

Despite the steady growth experienced between 2009 and 2011, the beginning of 2012 marked a declining trend. International visitor arrivals, bed-nights occupied and tourism earnings have continued decreasing since 2012. Factors associated with the declining performance include insecurity concerns related to terror attacks prompting negative travel advisories from the traditional tourist market source. In addition, global economic slowdown experienced in the Euro area accounted for the decline. In contrast to the downward trend, bed-nights available have continued to have a slight increase an indication of continued investment in the industry.

Table 2.2: Type of Accommodation Facility by Zone

Zone	Villas	Cottages	Campsites	Apartments	Total
Kwale	33	24	3	5	65
Mombasa	14	4	2	13	33
Kilifi	89	3	-	6	98
Malindi	662	20	4	47	733
Tana River	-	-	2	-	2
Lamu	46	2	-	1	49
Embu, Meru & Laikipia	4	22	29	2	57
Western region	-	4	18	-	22
Nakuru and other Upper Rift:	-	14	8	3	25
Kericho and Nyanza	1	6	5	5	17
Isiolo, Marsabit & Samburu	-	2	12	-	14
Kajiado	-	5	20	-	25
Narok and Transmara	-	1	39	-	40
Nairobi	-	1	1	9	11
	849	116	178	91	1,234

Source: KNBS, Economic Survey 2011

Hotels and lodges have been the traditionally preferred accommodation enterprises by tourists. Other forms of establishments have gained prominence.⁶⁵ A survey carried out in 2010, showed existence of an increasing number of these establishments as illustrated in table 2.2. The establishments have attracted foreign visitors staying for longer period and short holiday local tourists, due to their competitive prices and flexible accommodation. These accommodation enterprises have not been accounted for in most statistics. Most of them are also not registered. The survey revealed country-wide distribution of these accommodation facilities.

Table 2.3: Number of visitor days stayed by purpose of visit, 2010 -2014

Purpose	2010	2011	2012	2013	2014
Holiday	15,237.4	15,719.8	15,229.7	14,881.8	13,276.2
Business	2,303.6	2,637.6	2,681.1	2,691.6	2,568.1
Transit	256.3	154.5	213.4	205.9	270.0
TOTAL	17,797.3	18,511.9	18,124.2	17,779.3	16,114.3
Average length of stay in days	13.1	13.4	13.2	13.2	12.3

*Days in thousand

Source: KNBS, Economic Surveys

Table 2.3 shows number of visitor days stayed by purpose of visit over the given period. Holiday makers continue to dominate the industry in terms of days stayed. There was a

⁶⁵ KNBS, Economic Survey 2011.

downward trend in the number of days spent in the accommodation facilities from 2012 to 2014. This was partly as a result of less number of days spent by holiday makers.

The number of international conferences held in 2012 was 328, while 2013 and 2014 recorded continued decrease at 299 and 241 respectively.⁶⁶ The number of local conferences increased from 2,849 in 2013 to 3,077 in 2014.⁶⁷ This could be attributed to government strategies that involved reallocation of budget such that domestic travels replaced foreign travels.

⁶⁶ Ibid, Economic Survey 2011

⁶⁷ KNBS, Economic Survey 2015

Table 2.4: Hotel bed-nights occupancy by country of residence, 2010 -2014

Country of residence	2010	2011	2012	2013	2014
Permanent occupants	52.9	58.5	46.3	57.6	98.7
Germany	563.2	677.0	748.9	751.1	751.7
Switzerland	83.1	95.8	98.2	96.9	82.1
United Kingdom	964.7	765.9	521.6	498.3	275.0
Italy	651.0	495.3	415.5	234.8	156.2
France	222.7	239.5	160.0	113.9	75.6
Scandinavia	84.1	113.2	154.5	143.5	120.0
Other Europe	364.6	484.0	448.5	482.2	341.5
EUROPE	2,933.4	2,870.6	2,547.2	2,320.6	1,802.2
Kenya residents	2,348.9	2,603.4	2,787.7	2,699.1	2,948.7
Uganda	67.9	76.2	81.8	110.2	67.7
Tanzania	61.5	68.5	69.2	64.5	62.0
East and Central Africa	84.6	101.5	115.9	104.3	101.3
West Africa	55.1	63.1	55.9	63.3	68.0
North Africa	28.3	30.9	23.9	29.0	37.3
South Africa	88.1	88.4	88.2	91.1	75.2
Other Africa	66.2	50.8	40.7	37.5	37.0
AFRICA	2,800.6	3,082.7	3,263.3	3,199.0	3,397.2
USA	254.2	283.8	291.5	294.6	293.9
Canada	59.8	64.7	55.9	61.8	59.9
Other America	33.1	38.4	40.1	36.8	35.2
AMERICA	347.2	386.9	387.4	393.3	389.0
Japan	40.8	43.0	41.9	48.1	38.9
India	91.1	110.1	110.3	101.1	110.3
Middle East	36.6	43.6	50.2	50.6	57.4
China	50.7	89.6	114.0	105.9	92.1
Other Asia	42.9	53.0	68.2	54.4	49.4
ASIA	262.3	339.3	384.5	360.1	348.1
Australia and New Zealand	60.2	63.0	56.9	62.3	58.4
All other countries	205.6	214.1	175.2	203.9	188.0
TOTAL OCCUPIED	6,662.3	7,015.2	6,860.8	6,596.7	6,281.6
TOTAL AVAILABLE	17,161.8	17,419.6	18,849.6	18,292.2	19,877.2
Occupancy rate %	38.8	40.3	36.4	36.1	31.6

* Bed-nights occupancy in thousand

*Permanent occupants: corporate booking for non-resident staff staying for more than one month in the same hotel.

Source: KNBS, Economic Survey 2015

Table 2.4 shows that there was 15.8% increase in hotel bed-nights available in 2014 from 2010. However, from 2012 there was a downward trend in total number of hotel bed-nights occupied. This is reflected in occupancy rate, indicating an increased number of underutilized hotel beds. This downward trend in hotel bed-nights occupied can partly be attributed to the decrease since 2011 from the main market source, Europe. The general decrease in Europe was largely contributed by the United Kingdom, followed by Italy and France. In contrast to the trend in key market source in Europe, Germany residents visiting the country increased each year over the same period (2010 to 2014).

The only region that recorded an increased number of bed-nights occupied from 2013 to 2014 was Africa, at 6.2%. Kenya residents accounted for this increase, whereby the number of bed-nights occupied expanded by 9.2% in 2014 from 2013. Other regions in Africa that also recorded slight increase are North Africa and West Africa at 28.6% and 7.4% respectively. Africa accounted for 54.1% of total bed-nights occupancy in 2014. Since 2012, Kenya has been the dominant market source for the industry in terms of bed-nights occupancy.

Permanent occupants increased in bed-nights occupancy in 2014 from 2013 by 71.3%. This was 1.6% of the total bed-occupancy in 2014.

Table 2.5: Hotel bed-nights occupied by zone, 2009-2014

Zone	2009	2010	2011	2012	2013	2014
Coastal Beach	3,011.4	3,243.0	3,144.6	3,132.6	2,750.3	2,527.7
Coastal Other	152.5	151.1	283.8	260.0	124.0	95.9
Coastal Hinterland	210.9	119.6	82.3	88.7	125.5	133.2
Nairobi High class	1,164.1	1,123.6	1,155.7	1,145.0	1,175.3	1,119.1
Nairobi Other	498.1	410.7	526.2	490.5	455.7	388.0
Central	347.5	463.5	683.3	526.0	622.2	686.3
Maasailand	312.8	472.6	418.6	443.7	473.0	479.5
Nyanza Basin	213.2	301.2	301.9	252.1	345.3	357.7
Western	319.0	364.1	374.9	464.3	454.1	433.3
Northern	13.3	12.9	43.9	57.8	71.2	60.9
Total Occupied	6,242.8	6,662.3	7,015.2	6,860.8	6,596.7	6,281.6
Total Available	17,125.3	17,161.8	17,419.6	18,849.6	18,292.2	19,877.2

* Hotel bed-nights in thousand

Source: KNBS, Economic Survey 2010 and 2015

Table 2.5 indicates that there was a decrease in hotel bed-nights occupied in Coastal beach zone over the period. The zone was still the preferred location by visitors throughout the period. Coastal beach accounted for 40.2% of the total occupancy in the country in 2014. Nairobi high class accounted for 17.8% of the total share in the same year.

The Coastal beach recorded decreased performance in 2014 compared to 2013. In 2013 the zone accounted for 41.7% of the total occupancy in the country as compared to the 40.2% in 2014. While Nairobi high class maintained its total share of 17.8% in the two years. Coastal hinterland, Central, Maasailand, and Nyanza basin recorded slight improvements in the same period. The general decline observed in the Coastal beach from 2011 to 2014 was attributed to insecurity associated with potential external terror attacks, Mombasa Republican Council (MRC) violent activities and increased internal attacks from radicalized youths. The subsequent negative travel warning and advisories resulted to holiday makers opting for alternative zones.

2.4 Evolution of the Industry

Some of the factors that have contributed to the emerging diversity of the accommodation establishments include increased lifespan as a result of better health facilities, good nutrition and change in lifestyle, has led to many elderly retirees with disposable income and time leading to demographic changes in hospitality demand in terms of volume and structure. Many young people with disposable income have also contributed to the growing demand of luxurious accommodation. In addition, technological developments such as air transport have facilitated human mobility while innovations such as M-Pesa⁶⁸ and electronic payments have facilitated convenient mode of payments for services

Originally, guests had to choose between luxury hotels and budget hotels. However, with the increasing diversity of guests namely; business and leisure travellers, independent and group travellers, local and overseas travellers, and young and elderly visitors, investors

⁶⁸ Mobile phone-based money transfer

began offering specialized accommodation to cater for the various demands. The increasing need to provide more luxurious accommodation establishments to cater for the up market has also led to more establishments catering for the middle class. These specialized accommodations include boutique hotels, timeshares or vacation ownership, villas, serviced apartments, cottages, bed and breakfast inns and campsites. The growing diversity of the accommodation establishments mirror trends in the wider hospitality industry.

The emergence of Nairobi as a diplomatic hub has led to a boom of International hotel chains. Some of the newly developed International hotel chains in operation and under construction include Radisson Blu, Garden Inn by Hilton, Villa Rosa Kempinski and Accor. The increase in International hotel chains and local hotel chains are being driven by forces such as additional resilience provided by chain hotels during business difficulties. Properties within the same hotel chain benefit from risk sharing.⁶⁹ The hotel chains also target clients who are familiar with the brand and hope that their other properties would attract the same clientele wherever they visit.

From the traditional type of private ownership and management where an independent hotel was owned by a person or partners and managed by the owners, an increase of local and international group ownership with management contracts are on the increase. Cost of operation, high capital requirements for start-ups and upgrading schemes, and lack of

⁶⁹ UNCTAD, “*FDI in Tourism: The Development Dimension*,” (New York and Geneva, United Nations, 2007)

management skills are some of the factors encouraging new types of ownership and management.

Despite the positive aspects brought about by globalization like technological development and innovations, it has also created challenges in the industry such as an increasing concern for guests' safety and security.

CHAPTER THREE

GOVERNMENT POLICIES AND THEIR IMPLICATION ON FDI

3.1 Introduction

FDI inflow in hospitality industry is less than 20% and the share is still declining as noted by UNCTAD.⁷⁰ The downward trend is happening at a time when the neighbouring countries that did not attract FDI before are experiencing a global surge in flows. Kenya's poor performance in attracting FDI must certainly be related to internal factors.

3.2 Economic Reforms

The government in collaboration with donor funding agencies introduced economic reforms such as liberalization of interest rates (1991) and exchange rate (1993), removal of price controls (1994) and import controls and relaxation of capital controls (1995)⁷¹. The reforms aimed at shifting the economy towards a market system. A free exchange regime would facilitate repatriation of dividends by foreign investors while removal of barriers to foreign commercial private borrowing would provide a more enabling environment for foreign investors. Incentives such as exemption from import duties were aimed at attracting investments. The process of drafting a new investment code was geared towards streamlining the investment laws and procedures.

The measures introduced were perceived to be strengthening the private sector while ignoring the public sector. The reform process was therefore characterized by lack of

⁷⁰ *Op cit*, UNCTAD 2005

⁷¹ Mwega F.M & R.W.Ngugi, "Foreign Direct Investment in Kenya," in S.I, Ajayi (ed), *Foreign Direct Investment in Sub-Saharan Africa: Origins, Targets, Impact and Potential*, (Nairobi: African Economic Research Consortium, 2006) p 123

political will and commitment from the government, slow implementation, policy changes and reversals that created a lot of uncertainty. The lack and poor implementation led to cancellation of donor funding. Such on goings adversely affected investor confidence. The government's reluctance was viewed by foreign investors as prohibitive to investment resulting to decreased FDI inflows.

3.3 Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC/ERS), 2003-2007

Economic Recovery Action plan commonly referred to as ERS was the government's blueprint for economic recovery and development over the 5 year period, 2003 to 2007. ERS aimed at reviving the overall economic development of the country. Strategies adopted were therefore targeted at productive sectors of the economy. Hospitality industry and the wider tourism sector rely on other sectors for its growth and development. For instance, improved infrastructure like roads and air transport are likely to attract more international visitor arrivals, prompting more investments in accommodation facilities. An overall economic development of the country would strategically position Kenya as a competitive destination for investment hence attracting FDI.

One of the objectives of ERS was "creation of an enabling environment for the private sector to do business".⁷² Reforms in the macroeconomic environment consisted of rationalizing of the tax rates as well as broadening of the tax base, modernize revenue

⁷²Government of Kenya (GOK), Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC), 2003-2007. (Ministry of Planning and National Development, 2003)

administration, undertake Public Expenditure Management (PEM) reforms as well as increasing accountability and transparency in handling public funds. A stable macroeconomic environment was hoped to assist in the recovery of investment as well as attracting new investments. A transparent conduct of monetary policy apart from reducing information asymmetry would improve investor confidence in the monetary authority.

Other reform areas entailed strengthening of institutions of governance. These involved adopting measures in public administration, national security, and law and order among others. Proposed actions in public administration included right sizing and pay reforms as part of civil service reforms, privatization of state owned enterprises and implementations of the provisions of the Anti-Corruption and Economic Crimes Act as well as Public Officer's Ethics Act. Reform measures in national security comprised of strengthening the security agencies through recruitment, training and adequate provision of equipment while at the same time collaborating with the neighbouring countries. Strengthening the rule of law involved increasing availability of equipment and facilities; strengthening Judicial Service Commission; and harmonizing of laws among others.

The government acknowledged the importance of peace, security and the rule of law in attracting investors.⁷³ Protection of persons and property is important in attracting foreign investment. Insecurity has a negative effect on investment. Good governance, liberal regulatory policies, efficient public service and improved level of security attracts investment.

⁷³ *Ibid*, ERS

ERS acknowledged that the inadequate and inefficient telecommunications services had increased cost of production. They had also prevented innovation in other services like use of credit cards in banking and data transfer.⁷⁴ The reforms in the power sector were aimed at ensuring a reliable supply of electricity at affordable prices. Physical infrastructures are essential preconditions for most businesses. By providing low cost quality infrastructure services, the government hoped to make the country more competitive hence attracting foreign investors.

The challenges facing the industry and the wider tourism sector included increased global terrorism, inadequate infrastructure, dilapidated tourism products and increased regional competition.

Strategies to be undertaken to improve the sector involved increasing funding for destination promotion; upgrading the tourist police unit based in Coast and expanding its activities to other tourist potential regions; diversifying and improving tourist products to include conference tourism, sports tourism, retirement tourism and eco-tourism; offering incentives such as duty and Value Added Tax (VAT) exemptions for hotel refurbishing equipment; pursuing other sources of funding such as short and long term soft loan from International Development Finance Institutions; continuous review of taxation measures aimed at identifying measures that adversely affect the sector and providing necessary incentives to curb such measures; and development of a tourism policy, tourism development plan, legislation and regulatory framework.⁷⁵

⁷⁴ *Ibid*, GOK - ERSWEC

⁷⁵ *Ibid*, ERSWEC 2003

Such moves were likely to attract investment if implemented through widening the base of investment opportunities in conference and eco-tourism segments; tax incentives were likely to reduce cost of doing business hence greater returns on investments; improved security was bound to attract more international visitor arrivals and more days spent in the accommodation facilities as well as reducing cost of doing business associated with investment in security equipment and personnel; and regulation of the industry would ensure less competition from informal businesses.

Despite the slow process in implementing some of the measures, the government's commitment to implementing the strategies led to some progress. During the period of ERS, international visitor arrivals increased steadily leading to a steady growth of bed-nights occupancy from 2003. Occupancy bed-nights rate from 2003 to 2007 in yearly order were 33.6%, 37.8%, 41.3%, 45.5% and 47.2% at the end of the period.⁷⁶ Continuous growth was reflected in total tourism earnings which achieved a high of KES 65.4 billion in 2007, the highest recorded since the country's independence till 2007.⁷⁷ A figure, that was to become the sector's benchmark in successive years. Accelerating bed-nights available over the period was an indication of continued investments. In 2007, the investments in accommodation facilities almost doubled the number in 2003.⁷⁸

3.4 Kenya Vision 2030

Kenya vision 2030 is the country's current long-term development strategy for the period 2008 to 2030. The Kenya Vision 2030 is to be implemented in successive 5-year

⁷⁶ Source of statistical data obtained from analysis of secondary data in the study.

⁷⁷ KNBS, Economic Survey 2010

⁷⁸ Secondary Data analysis

Medium-Term Plans. It follows the expiry of ERS in December 2007. ERS saw the country rise from a GDP of 0.6% in 2002 to 7.0% in 2007.⁷⁹

3.4.1 First Medium-Term Plan, 2008 - 2012

The Kenya Vision 2030's foundation is to continue with creation of a stable macroeconomic environment, strengthen the on-going institutional reforms, governance reforms, public service reforms, provision and expansion of physical infrastructure, human resource development, and improvement in security. Such measures were bound to attract new and maintain the existing FDI due to enabling business environment that promote good returns on investments.

In addition, intensified application of Science, Technology and Innovation (STI) was to be introduced to raise productivity and efficiency levels. Consequently, an STI policy framework was to be created and implemented to support the Vision. This was geared towards aligning the country with global industrial changes. The measures if implemented were likely to attract FDI through reduction of red tape and bureaucracy prone to encouraging bribery and corruption that increases cost of doing business.

Land is an important asset as it forms the foundation upon which business projects are built. National land use policy was to be created and implemented to facilitate the process of land administration and registration. The national land use policy was also to foresee an introduction of an enhanced legal framework for quick resolution of land disputes.

⁷⁹ GOK, Kenya Vision 2030, (Nairobi: Ministry of Planning and National Development, 2007)

Such measures were likely to create transparency in land acquisition hence promoting investor confidence.

The specific policy measures to be adopted in hospitality industry in the First Medium-Plan aimed at increasing fourfold the industry's and the wider tourism sector's contribution to GDP (from total tourism earning of KES 65.4 billion in 2007 to KES 200 billion in 2012); increase its international visitors to 3 million in 2012 from 1.6 million in 2006 while at the same time increasing the average expenditure per visitor from KES 40,000 to KES 70,000 in 2012; and increase hotel beds to approximately 65,000 in 2012 from 40,000 with emphasis on high quality service.⁸⁰

The specific strategies to achieve the above goals involved: developing 3 resort cities in Isiolo, North and South Coast; increasing the country's premium safari parks; improving facilities in all under-utilized parks; creating new high value niche products such as water-based and eco-sports; attracting high-end international hotel chains; and investing in new conference facilities. The flagship or projects expected to take the lead in rapid generation of growth in tourism on the other hand, comprised of better marketing of little visited parks, certification of 1,000 home-stays sites to promote cultural tourism in Kenyan homes among others. Availability of investment opportunities such as identified resort cities and widening the investment segments to include sports tourism was likely to attract FDI. Marketing and promotion of touristic attractions were likely to widen the market source hence encouraging FDI.

⁸⁰ Op cit, Kenya Vision 2030

Most of the targets set were not achieved within the allocated time-frame. At the end of 2012, the number of international visitor arrivals was approximately 1.7 million as opposed to the targeted number of 3 million.⁸¹ Contrary to the targeted average expenditure per visitor of KES 70,000 in 2012, what was achieved was an average of approximately KES 56 000.⁸² Targeted tourist earnings at the end of the 1st MTP were approximately KES 200 billion, contrary to the achieved value of KES 96 billion.⁸³ However, there was an increase in tourism volumes from emerging markets such as India and China as a result of marketing.⁸⁴ The beginning of 2008 was offset by declining performance such as decreased international visitor arrivals which led to reduced bed-nights occupancy and consequent closure of some hospitality facilities or divestment. This was attributed to political instability that led to post election violence, resulting to insecurity in the country. Such occurrence could have contributed to under achievement of the expected targets. The country had to begin reviving its growth once again.

Out of the 3 resort cities proposed for development, only English Point Marina in North Coast has been completed (officially began operating in 2016). The progress made in the resort city in Isiolo entails land allocation for the project in Kipsing Gap. Other strategies proposed have been relatively achieved despite the slow implementation process. The development of a national strategy on Meetings Incentives Conventions and Exhibitions (MICE) aimed at marketing Kenya as a conference tourism destination has not started till

⁸¹ Statistical data from Kenya Vision 2030 and Economic Survey 2015

⁸² Statistical data obtained from analysis of secondary data used in the study

⁸³ Ibid

⁸⁴ KNBS, Economic Survey 2015

date/ behind schedule. Tourism Act of 2011 came into force in 2012 leading to formulation of National Tourism Strategy as stipulated in the Act.

3.4.2 Second Medium-Term Plan, 2013-2017

The Second Medium Term Plan for Kenya Vision 2030 takes into account the two-tier level of government, the national and county governments.

The sector's inability to achieve the targets set in 1st MTP were attributed to continued reliance on the traditional narrow products; declining product quality due to lack of investment incentives to initiate new developments; negative travel advisories as a result of security concerns; inadequate bed capacity and poor distribution of facilities within the country; inadequate physical infrastructure as well as tourism infrastructure.⁸⁵

The assessment was inconsistent and lacked innovation as the issues noted had already been considered under ERS. For instance, ERS proposed diversifying and improving of touristic products to include conference tourism, sports tourism and eco-tourism among others; and incentives such as duty and VAT exemptions for hotel refurbishing equipment. A follow up of earlier proposed strategies to find out why they were not implemented and whether they should still be implemented would have been the ideal situation. A review of the past policies successes and failures are important in understanding areas of challenges in order to deal with the challenges than formulating new policies without implementation. Bed-nights available since 1990 have always surpassed bed-nights occupied. An assessment indicating inadequate bed capacity does

⁸⁵ GOK, the Kenya Vision 2030 : Second Medium Term Plan (2013-2017)

not reflect the actual situation. However, there was poor distribution of facilities within the country.

2nd MTP proposed measures needed to achieve tourism earnings of KES 200 billion and tourist arrivals of 3 million, increase bed-nights by local tourists to 4 million from 2.8 million in 2012, and develop an additional of 30,000 beds in high quality accommodation facilities within the country.⁸⁶ To achieve the set targets, the 2nd MTP involved adoption of the following strategies: re-development of Kilifi, Kwale and Lamu into modern resort destinations by upgrading transport infrastructure and beach management programmes; global branding and advertising campaigns to create global awareness of Kenya while at the same time consolidating and penetrating in new emerging markets such as India, Russia and China; continuation of premium parks and under-utilized parks initiatives already begun in 1st MTP by providing incentives such as concessionary land leases and tax incentives; diversifying tourism products to include conference tourism, cultural tourism, health and medical tourism, eco-tourism and agro-tourism; and promoting Nairobi as a multilateral diplomatic hub among others.⁸⁷ The above measures were likely to increase visitor visits to the parks, widen market source and investment opportunities in the industry, hence attracting FDI.

So far, there has been a downward trend in terms of tourism earnings and international visitor arrivals since 2012. At the end of 2015, tourism earnings amounted to KES 84.6

⁸⁶ *Op cit*, Kenya Vision 2030

⁸⁷ *Ibid*, Kenya Vision 2030

billion while international visitor arrivals were 1.2 million.⁸⁸ Progress achieved so far include: ongoing upgrading of transport infrastructure between Kwale and Kilifi which is almost complete; ongoing global branding and advertising campaigns such as ITB (Internationale *Tourismus-Borse Berlin*) Fair in Berlin where Kenya participated; Increased international visitor arrivals from new emerging markets such as the BRICS (Brazil, Russia, India, China and South Africa) countries, especially India and China as a result of extensive and global marketing; rapid increase in conference tourism and international hotel chains; and Nairobi's increasing emergence as a multilateral diplomatic hub hosting UNCTAD conference and WTO Ministerial Meeting among others.

3.5 The Kenya 2010 Constitution

The new constitution of 2010 is as a result of enactment of the constitution of Kenya Review Act of 2008. The new constitution seeks to address the root causes of recurrent conflicts, establishes rules, values and principles that if implemented will facilitate national cohesion. It also aims to ensure a democratic society and provide for a devolved government. Devolution is the most significant initiative in governance aimed at enhancing service delivery. Business enterprises operate in localities for which local authorities are responsible for essential services; enhancing local governance through devolution is seen as a way of improving local government service delivery.

Land reforms, public finance reforms, institutional reforms and bill of rights are also some of the areas addressed by the constitution. Implementation of the new constitution

⁸⁸ KNBS, Economic Survey 2016

has potential to improve internal security through equitable distribution of resources hence reduction of crime and violence as well as ethnic conflicts arising from perceptions of marginalization and exclusion. Protection of persons and private property provision in the bill of rights, regulation of land ownership and administration are some of the measures in the constitution that are likely to create investor confidence, impacting positively on FDI.

The achievements of the new constitution so far include; the devolved government resulting to two-tier government, the national and county governments. This has potential to improve service delivery to the business community in the counties. The shortcoming of the constitution is discretionary powers given to senior public office holders. Such powers with no guidelines are a major contributor to corruption. They create uncertainty in the daily operation of businesses hence impacting negatively on FDI.

3.6 National Tourism Strategy, 2013-2018

The Department of Tourism under the Ministry of Commerce, Tourism and East Africa Region is responsible for planning and formulating policies in the sector. It is also responsible for guidance and policy coordination of state corporations and organizations. Tourism Act 2011 provides for a national tourism strategy.⁸⁹ The Tourism Strategic plan 2008 -2012 was developed in line with the Kenya Vision 2030 1st MTP. The strategy therefore aimed at achieving the goals set in the Vision's 1st MTP. National Tourism Strategy 2013-2018 succeeded Strategic Plan 2008-2012.

⁸⁹ Tourism Act No. 28 of 2011, Part II

Some of the constraints identified to be limiting the growth potential of the sector included numerous policies, legal and institutional frameworks; insufficient financial resources for developing and marketing the sector; inappropriate standardization and regulations for tourist facilities; high cost of doing business; unfavourable taxation regime; poor harmonization of roles among the implementing bodies; red tape and bureaucracy among others.⁹⁰

The National Tourism key policies involved developing and diversifying tourism products to include eco-tourism, conference tourism, sports and cultural tourism country-wide as opposed to the usual visited areas of the coastal regions; marketing and promoting Kenya's tourism products following the negative publicity in the source markets; developing the domestic market as the foundation of the industry; improving security through close monitoring and addressing of security concerns etcetera.⁹¹ Through improving the investment climate and offering incentives the government was likely to attract investment.

The strategic plan for addressing these issues involve working closely with other sectors in the development of infrastructure, integration of the institutional framework to avoid duplication of efforts and unnecessary conflicts, promoting the domestic market as the core market, proper management and utilization of the available funds, attracting private investors into the sector, ensure use of scientifically researched information in decision making as well as availing data and information to other stakeholders among others. Such

⁹⁰ GOK, National Tourism Strategy, 2013-2018

⁹¹ Ibid, National Tourism Strategy

measures if implemented were bound to create an enabling business environment and widen the domestic market therefore attracting FDI.

3.7 Other Government Strategies

These refer to government tax and fiscal incentives, disincentives or fees proposed by the ministry to induce or promote the development of the sector as stipulated in the Tourism Act of 2011.⁹²

For instance, in 2014, the government permitted all corporate and business entities to pay vacation expenses for their employees willing to go for a holiday within the country and then deducting such expenditures from their institutional taxes.⁹³ This was a move aimed at boosting domestic market so as to sustain the industry. Such measures were likely to boost the Kenyan market hence encouraging investment.

The government increased budgetary allocation for the Department of Tourism from KES 5.6 billion in 2014/15 budget to KES 10.7 billion in 2015/16.⁹⁴ The increased funds was to facilitate marketing of Kenya as a tourist destination of choice and counter the negative publicity created by adverse travel advisories in the traditional source markets of western countries. In addition, the reallocation of national government funds for foreign travel to domestic travel and similar move by county governments were meant to spur the growth of domestic market, increase international visitor arrivals and regain the traditional source markets hence attracting investment.

⁹² Tourism Act No. 28 of 2011, Part VII section 106

⁹³ KNBS, Economic Survey 2015

⁹⁴ Ibid, KNBS

Such strategies also involved creation of Ministry of Tourism as a separate Ministry by the government so as to focus on issues specific to the sector; revoking of the national treasury circular restricting public service from holding meetings and conferences in private establishments to include such facilities; and direction by the government to Kenya Revenue Authority to pay all outstanding income tax associated to refunds owed to the industry's investors as a way of ensuring liquidity and cash flow.

Other measures adopted by the government included a waiver of landing fees by 40% for charter flights landing in Mombasa and Malindi International airport for a period of time; waiver of visa fees for children below 16 years aimed at encouraging family holidays; the reduction of park entry fees from US\$ 90 to US\$ 60 aimed at attracting more visitors to the parks; and amendment of the VAT Act to include exemptions such as commissions earned by tour operators.

The government also increased passenger flight service charges for domestic travel to KES 600 from KES 500 while international travel increased to US\$ 50 from US\$ 40 in mid-2016. The collected fees were to be used for the development of the sector.

Such measures by the government are meant to attract more visitors leading to more investment while at the same time helping in developing the sector by providing relief measures depending on the prevailing conditions.

3.8 Conclusion

For a policy to effect the required change it must involve all stakeholders in its formulation and its objectives must be clear and attainable given the current state of affairs. National policies require political will and commitment to ensure implementation. The importance of a policy is not how good it is but its implementation makes the difference.

Policies geared towards creation of an enabling business environment have been crucial in attracting FDI in hospitality industry as portrayed by the achievement of ERS, 2003 - 2007. Policies that lead to an overall economic development of the country, increases a country's competitiveness. Enabling business environment entails improved infrastructure like roads and air transport which are likely to attract more international visitor arrivals. Secondly, it comprises of creation of a stable macroeconomic environment. In addition, it involves good governance, efficient public service and improved level of security.

The achievements of national objectives and targets in the industry have failed not because of lack of policies but as a result of poor implementation of policies. Lack of political will and inadequate allocation of funds to carry out laid down plans have contributed to the poor implementation.

CHAPTER FOUR

INVESTMENT AND REGULATORY FRAMEWORKS AND THEIR IMPACT

ON FDI

4.1 Introduction

The legal framework provides for an investment and regulatory environment. The Investment Promotion Act, 2004 and the Tourism Act, 2011 stipulate the rules and regulations governing investment and hospitality operation respectively.

4.2 Public Corporations and Private Organizations Promoting Investment

Attraction of the private sector has been an integral part of government policies. FDI is seen as a stable form of the private sector with long term commitment to the country. The government has established institutions to facilitate private sector investment. There are also private organizations advocating for creation of an enabling business environment in a bid to developing the private sector.

4.2.1 Kenya Investment Authority (KenInvest)

The Kenya Investment Authority (KenInvest) is a statutory body that was established in 2004 by the Investment Promotion Act. The main objective of the organization is to promote and facilitate investment by assisting investors in Kenya. It provides both pre-investment and post-investment services to investors. The pre-investment services include providing information on investment opportunities; sources of capital; business climate and operating rules. KenInvest also assist investors in obtaining necessary licenses and permits; incentives or exemptions under various Act of Law and other

regulations; other additional licenses and approvals required by other government agencies; and issuance of investment certificates that enables an investor to immediately start operating while awaiting the required licenses. The post-investment services entail investor tracking; facilitation of joint-venture between local and foreign investors; and policy advocacy. Investment certificates issued by KenInvest in tourism and hospitality sector have increased steadily since 2004 as illustrated in table 4.1.

Table 4.1: Number of Investment Certificates issued between 1990 and 2013 in the Tourism and Hospitality sector

Year	No. of Investment Certificates issued
1990 -1991	33
1992 -1993	32
1994 -1995	26
1996 -1997	14
1998 -1999	12
2000 -2001	08
2002 -2003	20
2004 -2005	21
2006 -2007	24
2008 -2009	29
2010 -2011	39
2012 -2013	27

Source: Kenya Investment Authority, 2015

4.2.2 Tourism Regulatory Authority (TRA)

Tourism Regulatory Authority is a corporate body established under section 4 of the Tourism Act No. 28 of 2011. It is charged with the responsibility of regulating tourism activities in line with the National Tourism Strategy. The role of TRA involves among others registering, licensing and grading all types of accommodation establishments, develop and implement criteria for standardization and classification of tourism facilities in consultation with relevant stakeholders, vet and recommend expatriates seeking employment in the tourism and hospitality sector and assessment and auditing of tourism activities and services annually.⁹⁵

Regulation of the sector ensures that enterprises meet the required standards expected and that qualified personnel are engaged in the industry. In addition, it ensures that the establishments become members of the recognized trade associations that adhere to given standards. A licensed enterprise enjoys benefits such as its promotion and marketing, the investor can access government incentives like custom duty waivers, access to government financing through loans from Tourism Finance Corporation and access to training and capacity building programmes organized by government agencies.

TRA liaises with Business Regulatory Reform unit to aid simplifying of the licensing process. The unit also ensures that the licenses introduced by TRA are in line with internationally accepted regulatory practices and standards.

⁹⁵ Tourism Act of 2011

4.2.3 The Kenya Private Sector Alliance (KEPSA)

KEPSA is the umbrella organization for the private sector that brings together business community in advocating for an enabling business environment through participation in public policy and engaging with the government and other stakeholders. It is a limited liability membership organization registered in 2003. The organization's business strategy main objective is to ensure a yearly improvement in three global business rankings, namely, World Bank's Ease of Doing Business Index, World Economic Forum's Global Competitiveness Index and Transparency International's Bribery Index.

On the Ease of Doing Business Index, the organization targets to achieve a ranking of 50 and below in the next five years from position 136 in 2014. It aims to achieve the same ranking of 50 and below by 2017 from position 96 in 2013 on the Global Competitiveness Index while in the Bribery Index it aims to move from position 146 in 2013 to 100 and below.⁹⁶

KEPSA serves as a bridge between the business community and the government in creating and improving the business environment. It has played key roles in business reforms through presidential roundtable, ministerial stakeholder forum, and inter-ministerial forum and council of governors' forum among others.

The organization is made up of sector committees representing key sectors of the economy, in resemblance to government ministries. KEPSA members raise issues of concern regarding their businesses to the sector committees, who then harmonize the

⁹⁶ Kenya Private Sector Alliance (KEPSA) <http://kepsa.or.ke/our-history/>

issues and prepare a position which becomes KEPISA's position. Other benefits of being a member include professional growth and prosperity through peer to peer and general networking events, access to wealth of information through its various communications channels and assistance to access top government officials to advocate for company specific issues.

4.3 Investment Framework

Kenya has liberalized most of its services' sectors. Tourism sector had been largely liberalized even before General Agreement on Trade in Services (GATS) due to the country's comparative advantage in the sector. Opening the market to foreign investors allows for the development of the industry through provision of quality international standards bound to attract more visitors.⁹⁷

Kenya has adopted a market approach with regard to competition and price setting in the hospitality industry. The market forces determine the existence of enterprises. However, the Competition Act enacted in 2010 give provisions for competition law and consumer welfare.

4.3.1 Investment Entry

Foreigners are required to obtain an investment certificate in order to invest in Kenya. An investment certificate entitles an investor to initial issuance of certain licenses such as hotel licenses, hotel manager's licenses, restaurant license, restaurant manager's license

⁹⁷ Honeck, D.B., 'The General Agreement on Trade in Services', *the courier*, No.175, May-June 1999.

and general retail liquor license in hotel investment.⁹⁸ This enables an investor to commence operation immediately while awaiting the actual issuance of the licenses. The certificate entitles the investor to entry or work permits for 3 management or technical staffs and 3 partners or co-owners valid for a two year period.⁹⁹

An investor must submit a completed application which must satisfy the applicable requirements under the Investment Promotion Act to obtain an investment certificate. The investor must also have a minimum investment amount of US\$ 100,000 or an equivalent of the same. The investment or the related activity to the investment must be lawful or beneficial to Kenya in terms of creation of employment for Kenyans, lead to acquisition of skills for Kenyans, contribute to revenue collection for the government and any or the other conditions as stipulated in the Act.¹⁰⁰

A foreign investor is not obligated to obtain an investment certificate as stated in the Investment Promotion Act; however, a foreign investor must show a minimum capital of the equivalent amount when applying for work permit. On the other hand, a local investor does not require an investment certificate but must register with KenInvest. Unlike the minimum investment amount required for foreign investors, a local investor must invest KES 1 million.

On receiving the completed application, KenInvest is expected to make and communicate its decision regarding an investment certificate within 10 working days. The process may

⁹⁸ Investment Promotion Act, 2004

⁹⁹ Investment Promotion Act, 2004, Part III

¹⁰⁰ Ibid, Part 11, section 4 (2)

take long if a third party referral is required especially in relation to environment, health and security approvals. Kenya has a restrictive regime to investment entry. The requirements to be met before a foreign investor can invest are prohibitive and deter FDI inflow.

4.3.2 Treatment of Foreign Investors

The principle of national treatment seeks to liberalize investment flows hence attracting FDI. Foreign investors receive the same treatment as local investors once established in terms of protection of private property, dealings and operation of business, expansion, management, enjoyment and disposal of investments.

The constitution guarantees the freedom to own and deal with property. It also provides for provisions under which public land can be acquired and used. The freehold land-tenure system where registered land is held in perpetuity subject to statutory laws applies to Kenyan citizens only. For foreigners, land can be acquired through leasehold tenure for a maximum period of 99 years.¹⁰¹ Both freehold and leasehold tenure system apply to private land. Land can also be controlled in more than one way. For instance, a freehold beachfront plot not within an urban area but located along the coast may be subject to provisions of the Land Control Act. The land can be considered as “agricultural” even though it is being used for a hotel. In such cases, it is preferable for such lands to be held

¹⁰¹ Constitution of Kenya, Chapter 5, Article 65

on leasehold titles restricted to non-agricultural purposes so as to avoid provisions applicable under the Lands Control Act.¹⁰²

The Land Acquisition Act and the Constitution of Kenya protects against expropriation of private property except in cases of public interest and at such times due process must be followed. Other forms of protection are provided for in bilateral investment treaties that Kenya has signed with other countries like China, Finland, Italy and Germany.

Most business disputes are resolved through litigation in courts. However, arbitration and alternative resolution can also be used. The Arbitration Act gives provisions for arbitration process. As a member of ICSID, Kenya recognizes ICSID arbitral awards. The Foreign Judgment Act permits enforcement in Kenya of judgments made in other countries under the reciprocal treatment. Without such agreements, a foreign judgment is not enforceable in the Kenyan courts unless a suit is filed on the judgment.

Kenya is a member of World Intellectual Property Organization (WIPO). It therefore has laws to enforce intellectual property rights. Foreign investors are entitled to such rights as are local investors. Kenya's Trade Mark Act amended in 2002, specifies penalties applicable to trademark infringement.

The management of foreign exchange is governed by the Central Bank of Kenya (CBK). There are no foreign exchange controls in Kenya and both Kenyans and non-Kenyans can

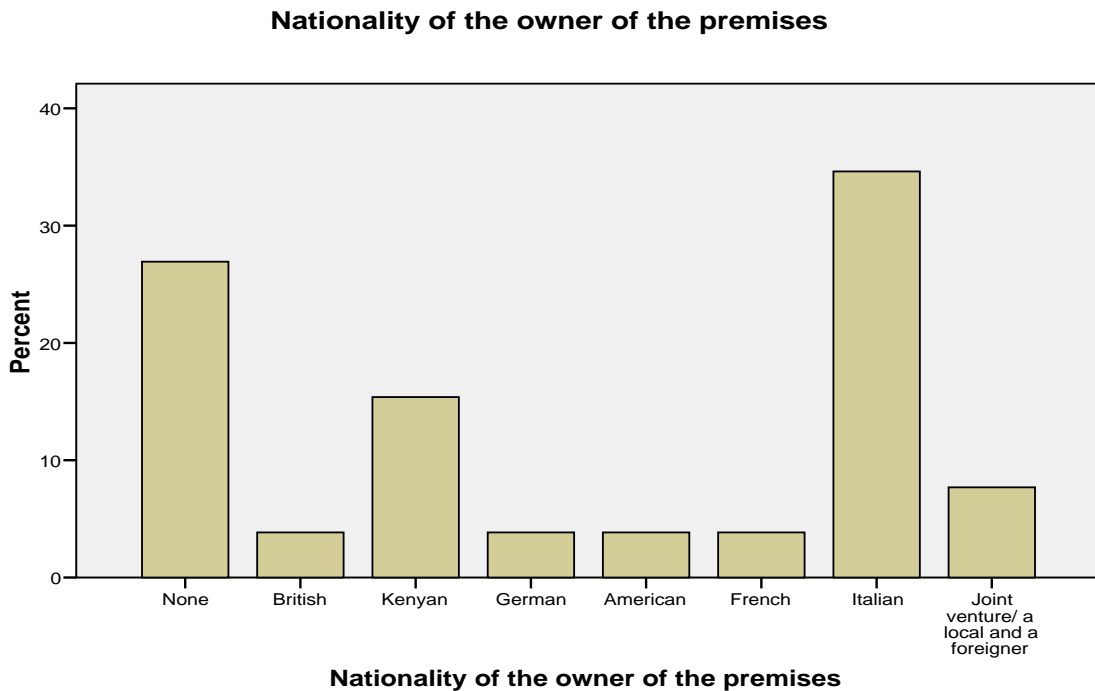
¹⁰² UNCTA, 'An Investment guide to Kenya: Opportunities and Conditions', (New York and Geneva, United Nations, 2012)

open a foreign currency accounts with domestic banks. Only authorized dealers are allowed to engage in foreign exchange business with an exemption of specific person or class of persons permitted by CBK under certain conditions as approved by CBK.

4.3.3 Investment Ownership

In terms of ownership, there are no regulations preventing joint-venture arrangements between citizens and non-citizens as illustrated by the survey study in Figure 4.1. There are also no regulations restricting acquisition of Kenyan companies by foreign-owned companies. All these are subject to mutual agreement between the parties.

Figure 4.1: Nationality of owners of the premises in Enterprises managed by Management Companies/lease



Source: Researcher, 2015

Figure 4.1 shows the nationality of the owners of the premises in cases where the enterprises were not owner- managed. None represent respondents who did not respond to the question since their establishments were owner-managed. The figure shows the existence of foreign management company/foreigners managing local premises. This is reflected by the percentage of Kenyans listed as owners of the premises. The figure also shows that there are a number of foreign premises being managed by foreign companies/individual foreigners. The figure also indicates the existence of joint-venture/ local and foreigner ownership. The local partners admitted to welcoming foreign business partners because of their skills, experiences and capital. The foreigners on the other hand, attributed partnering with the locals because of their better understanding and adjusting measures with the country's business environment.

4.4 Regulatory Framework

The government through its agency, the Tourism Regulatory Authority regulates business operation in the industry in line with the laid down rules and regulation stipulated in the Tourism Act, 2011 and other relevant legislation.

4.4.1 Starting a Business

The process of starting a business begins with reserving a unique company name at the companies' registry. This is followed by a number of processes such as stamping of the memorandum of association and articles of association, signing a declaration of compliance before a commissioner of oaths or a notary public, registering with the registrar of companies at the Attorney General Chambers in Nairobi, registering for taxes

at the Kenya Revenue Authority, applying for a business permit at the county government, registering with National Social Security Fund (NSSF) and National Hospital Insurance Fund (NHIF) before making a company seal. The process involves a number of public offices and takes a minimum of 34 days.¹⁰³

The process is long and characterized by overlapping roles which can be harmonized to facilitate the process, the many days required to register a company couple with discretionary powers of public office holders is prone to corruption. The long process discourages investment while discretionary powers create uncertainties that are likely to impact negatively on investment.

The introduction of electronic payment and huduma centres (One Stop Shop comprising of responsible institutions, namely, Registrar of Companies, KRA, County government, NSSF, NHIF and a bank) are likely to reduce the lengthy process and minimize level of corruption. These measures by the government are likely to facilitate the business start-up process.

The bureaucratic procedure can be improved by making name search available online; introducing electronic payment; increasing personnel authorized to stamp memorandum and articles of association as well as statement of the nominal capital; delegation of some duties such as signing of certificates of incorporation to relevant section heads by the

¹⁰³ The number of days according to Kenya Investment Authority

Registrar of companies; and instant issuance of business permits on payment whether physically or online.¹⁰⁴

4.4.2 Registering a Property

Foreign investors can own land under leasehold tenure. To register such land, an investor needs to apply for the title search at the lands office. The process also requires the investor to apply and obtain the land rent clearance certificate from the commissioner of lands; apply, pay and obtain the rates clearance certificate from the county government; apply and obtain the consent to transfer from the commissioner of lands; file the transfer and obtain an appointment for valuation. A site inspection will then be done by the state land-valuer and a valuation report obtained. The value is then endorsed for stamp duty purposes and an assessment of the stamp duty. The investor then proceeds to pay the stamp duty at the commercial bank and awaits confirmation of payment from KRA. The stamped transfer document is then presented for registration and duly registered documents received. The whole process of registering land takes a minimum of 73 days.¹⁰⁵

Some of the problems encountered in land registry include missing documents as a result of poor registration, storage and administration of documents coupled with high levels of corruption in the sector. The process is also characterized by red tape which is likely to deter FDI.

¹⁰⁴ Ouma M.A., Interview with Cheboi D., Investor Services Officer- Project Analyst, Kenya Investment Authority, Nairobi, September 2015.

¹⁰⁵ Number of days as suggested by KenInvest.

Introduction of online applications will reduce the long processes of manual applications. Establishment of country-wide land mapping as proposed in land policy will facilitate demarcation of agricultural and commercial land, this will not only do away with some processes like obtaining consent to transfer land but also reduce the whole process of registering land.

4.4.3 Acquiring Permit

A foreign enterprise can also employ expatriates for any category of skilled labour granted there are no suitable or qualified Kenyans for the position. Such expatriates need to obtain work permits as provided for in the Kenya citizenship and immigration Act. An applicant for work permit needs to describe the kind of work he/she intends to engage in and will be granted the permit for the indicated work only. An investor can also apply for a special pass which takes 14 days to be issued. To obtain a special pass, an investor is required to pay KES 25,000. Work permits on the other hand take 30 days to be issued and at a related cost of KES 10,000 processing fee with an additional fee of KES 200,000 for directors and KES 400,000 for expatriates.

The process of waiting for the work permit and special passes is restrictive to FDI, doing away with the special passes and amending the business visa policy so as to allow investors to start implementing their projects immediately as they await the work permit will facilitate prompt commencement of investment projects.¹⁰⁶

¹⁰⁶ *Ibid*, Kenya Investment Authority

4.4.4 Environment Assessment and Building Approval

The National Environment Management Authority (NEMA) is the government agency responsible for regulating environmental standards. Any construction to be undertaken in the country that touches on water bodies or conservation areas must undergo an Environmental Impact Assessment (EIA) and an EIA license obtained before construction begins. Upon submission of EIA study, NEMA is supposed to respond within six months. If there is no response after 9 months, an investor has the right to assume acceptance and proceed with construction.

The process of obtaining an EIA license involves the investor filling in an EIA form and submitting to NEMA. The Director General is then expected to respond to the applications for EIA within six months, a process that takes between 45 – 90 days. The associated cost for EIA license is charged at 0.05% of the total construction project with a minimum of KES 10,000 and a maximum of 1,000,000.¹⁰⁷ An environmental auditing is done and a review of the reports.

The investor should then approach the county government for building approval.

4.4.5 Kenya Power

In order to obtain installation of electricity in the enterprise, an investor should submit an application to Kenya Power and Lighting Company Ltd (KPLC). The KPLC will then do a site visit before giving an estimate cost. The investor pays the estimated cost and signs a supply contract. The investor then calls utility and collects meter and meter number. After which an excavation permit is obtained from the County government and submitted

¹⁰⁷ Applicable amount payable obtained from KenInvest

to utility by the investor. Finally, KPLC conducts external connection works, meter installation and electricity begins to flow.

Kenya electricity supply services is prone to frequent black outs which requires most investors to install back-up services. Poor and costly electricity supply increases the cost of doing business which impacts negatively on FDI.

4.4.6 Labour Regulations

The labour laws of Kenya are provided for in the Employment Act of 2007, the Occupational Safety and Health Act and the Labour Relations Act among others. The Employment Act for instance, covers issues to do with wages, non-discrimination, local and foreign contracts of service and termination of contract etcetera. The Cabinet Secretary for Labour sets the wages as proposed by the General Wages Advisory Board (GWAB). The labour laws expect less from employees when employing, yet dismissing an employee attracts high compensation among others.

4.4.7 Taxation

Income Tax Act requires investors to pay tax on income from business. Foreign employees working for non-Kenyan companies and are resident in Kenya are also subject to pay tax on all emoluments. The Income Tax Act also gives specification for corporate tax.¹⁰⁸ Investment in hotel buildings in cities such as Nairobi, Mombasa and Kisumu enjoy a 100% deduction, while such investments outside the cities enjoy 150% deduction.

¹⁰⁸ Corporate tax refers to direct tax on profits made by corporate bodies like limited companies.

The tax incentive is meant to encourage FDI in rural areas as a way of developing the rural areas.

The customs and Excise Act impose taxes on alcoholic beverages, tobacco products, mineral water, carbonated and fruit drinks, motor vehicles, petroleum products and cosmetics. The tax applicable to tobacco and alcohol are based on specific criteria.

VAT Act administers consumption tax charged on all taxable goods and services. The VAT applies to both locally produced and imported goods and services considered taxable. The VAT rate is normally 16% but there are some goods that are charged less such as some fuel oils and electricity at 12%. Food products and a wide range of services are VAT exempted.

A foreign investor may exit from an incorporated company as specified in the Companies Act. There are no obstacles in dissolving or divesting business assets to an investor's home country as long as the legal requirements and clearances have been met.

4.5 Investor Incentives in Hospitality Industry

The government exempts an investor from import duty and VAT on certain items and equipment used for hotel construction and refurbishment upon application. These items and equipment are kitchen ware, cutlery, linen, curtains, carpets, televisions, refrigerators, freezers, cookers, washing machines, air-conditioning systems and furniture. All the other items and equipment required for construction and refurbishment by hoteliers is only VAT exempt upon application.

4.6 Conclusion

The industry has liberal investment climate that guarantees equal treatment and non-discriminatory policies, a relatively fair issuance of work permits and free repatriation of profits. The restrictive entry of foreign investment associated with investment certificates tends to deter most new investors. In practice, the relevant agencies do not make follow-ups to check whether an investor engages in the business he/she is licensed to carry out. The regulation of the industry is characterized by red tape procedures prone to encouraging corruption, high taxation, labour laws that expect less from employees when employing yet dismissing an employee attracts high compensation among others.

Introduction of online searches and electronic payments currently underway will assist in eliminating corruption as attributed by many respondents who feel they have to bribe public officers for the process to be facilitated. So far, online services have been introduced in various institutions such as lands and KRA though most of the time they are not functional due to lack of maintenance and poor utilization. As a way of attracting investment, The Kenya Investment Authority aims to create an enabling environment as opposed to giving incentives.

CHAPTER FIVE

IMPACTS OF INSECURITY

5.0 Introduction

Insecurity has been categorized into two in this study based on origin. Internal insecurity which entails insecurity causes arising from within the country. The second category, external insecurity which refers to insecurity causes originating from outside the country.

5.1 Internal Insecurity

Inter-tribal or communal conflicts are one of the causes of internal insecurity. These conflicts emanate from competition for resources such as land, pasture and water. The conflicts are normally solved through peaceful negotiations between the communities. Where negotiations fail, the conflicts are likely to result into ethnic clashes. Ethnic clashes if not curtailed lead to loss of property and lives. It also disrupts social and economic life. Ethnic clashes are at times fuelled by politicians to achieve political mileage as observed during electioneering period. Local and international media coverage of ethnic clashes may be exaggerated at times, causing fear and inhibiting potential visitors.

The new constitution under the devolved government hoped to resolve such conflicts through initiating projects that would ensure economic achievement of Arid and Semi-Arid Lands (ASALS) and equitable distribution of national resources.

Secondly, political factors such as political demonstrations and riots lead to political instability in the country. Such events create commotion in central business districts disrupting businesses. Apart from adversely affecting the country's competitiveness as an investment and tourist destination, it causes damage to and loss of property.

Thirdly, increased poverty among sections of the population due to high unemployment rate among the youth has led to high cases of crime such as robbery without violence and with violence, burglary and house breakings as illustrated in table 5.1. More sophisticated criminals operate in organized groups to carry out crimes. The porous borders have worsened the situation through facilitating acquisition of small arms and light weapons from the neighbouring conflict countries. Many investors are deterred by high crime rate, which increases cost of doing business. Tourists are concerned with their security. Countries prone to high level of crimes do not attract tourists.

Other forms of internal insecurity include emergence of insurgent groups like Mombasa Republican Council (MRC) that was involved in a number of violent activities between 2008 and 2013; and a growing number of radicalized youths as a result of extremism. The Coastal region was mainly affected by these groups that led to low international visitor arrivals.

Table 5.1: Crimes reported to the police, 2007 -2015

Year	Homicide	Robbery	Breakings	Corruption	Offences involving tourists
2007	1,912	3,492	6,337	177	10
2008	2,037	3,401	6,626	133	6
2009	2,214	2,938	7,053	158	5
2010	2,239	2,843	6,453	62	1
2011	2,641	3,262	7,325	52	0
2012	2,761	3,262	7,578	49	0
2013	2,878	3,551	6,397	57	14
2014	2,649	3,011	5,656	138	21
2015	2,648	2,865	5,591	79	19

Source: KNBS, Economic Survey 2015; Kenya Police Service

Table 5.1 shows the number of crimes reported to the police over the given period. Homicide consists of murder, manslaughter, causing death by dangerous driving and suicide.¹⁰⁹ Offences to do with robbery entails robbery, robbery with violence, robbed of motor vehicle and carjacking. House breaking, burglary and general other breakings make up the category of Breakings. Offences involving tourist include bag snatching and other offences against tourist. The common type of crime identified based on the number of cases reported was breakings.

¹⁰⁹ KNBS, Economic survey 2008, Offences as classified with regards to new legislations

5.2 External Insecurity

Persistent conflicts in neighbouring Somalia due to lack of a stable government has led to lawlessness in the country. This has provided fertile ground for jihadist terror groups like Al-Shabaab to organize their activities and consequent attacks. In addition, Somali pirates have been involved in kidnapping of Kenyan visitors of foreign origin from the bordering towns. They have also attacked ships and boats operating in Kenyan waters. Countries like United Kingdom, United States of America and France have had to issue travel warnings against visiting the border towns. This has a negative impact to the industry.

The porous borders and high level of corruption in immigration and custom departments has led to an influx of refugees from conflict prone countries in the region such as Somalia, South Sudan, Democratic Republic of Congo, Burundi and Ethiopia. Lack of vetting and inspection of the incoming refugees has contributed to criminals coming to the country and posing a threat to the country's security. The refugee camps have also been used as hiding places for terror groups to plan and carry out attacks.

Terrorism as a form of insecurity has posed a great challenge to the industry. This is because the industry's enterprises have been one of the major targets of terrorist groups. The terrorists' preference of targeting hospitality enterprises can be attributed to; lack of the enterprises' preparedness to deal with such a magnitude of security threat; and diversity of the enterprises' guests which entails different nationalities, social class and vulnerable groups comprising of children and the elderly. Attacks of the enterprises are bound to generate a global effect, which in most cases are the goals of the terrorists.

Kenya has continued to experience terror attacks since the 1998 bomb attack. An Israeli-owned hotel in Kikambala near Mombasa in 2002 and a suspected Somali militants' raid on a Kenyan coastal resort targeting foreigners in 2011 are some of the incidences involving hospitality establishments. According to the Kenya National Police Service data, a total of 129 terrorist incidences occurred in the year 2012 and 2014 leading to 312 deaths and 779 injuries.

5.3 Survey Response on Insecurity Causes

Table 5.2: Percentage of Respondents showing what they considered most serious causes of insecurity

	Ethnic clashes	Crime & violence	Terrorism	Organized crime	Armed insurgents	Regional conflicts
None	20(76.9%)	13(50.0%)	6(23.1%)	17(65.4%)	13(50.0%)	22(84.6%)
Most serious	1(3.8%)	5(19.2%)	18(69.2%)	5(19.2%)	5(19.2%)	2(7.7%)
Serious	4(15.4%)	5(19.2%)	1(3.8%)	1(3.8%)	4(15.4%)	1(3.8%)
Least serious	1(3.8%)	3(11.5%)	1(3.8%)	3(11.5%)	4(15.4%)	1(3.8%)
Total frequency	26(100%)	26(100%)	26(100%)	26(100%)	26(100%)	26(100%)

Source: Researcher, 2015

Table 5.2 indicates that 18 of the respondents out of the total 26 (69.2%) indicated that terrorism was the most serious potential threat of insecurity for their establishments.

None in the table represent the respondents who did not answer the question and the respondents who did not rank the insecurity cause among the top three. All the mentioned insecurity causes were considered to be either most serious, serious or least serious by the respondents.

5.4 Impacts of Insecurity

According to the economic survey data by KNBS, The number of international visitor arrivals has been decreasing since 2011. Some of the reasons for the decrease include negative travel advisories by the main market source countries as a result of insecurity. Subsequently, reflecting on decreased bed-nights occupancy. The increasing availability of bed-nights, contrast to tourism earnings and hospitality earnings depicts the low spending power of the local market which has continued to dominate the industry.

Table 5.3: Percentage of Respondents who indicated poor performance

Period	Occupancy rate	Average room rate	Revenue per available room	Gross Receipts
1991/1992	1(3.8%)	1(3.8%)	1(3.8%)	1(3.8%)
1997/1998	2(7.7%)	1(3.8%)	1(3.8%)	1(3.8%)
2001/2002	N/A	N/A	N/A	N/A
2003/2004	1(3.8%)	1(3.8%)	1(3.8%)	1(3.8%)
2007/2008	10(38.5%)	8(30.8%)	6(23.1%)	6(23.1%)
2010/2011	4(15.4%)	2(7.7%)	3(11.5%)	2(7.7%)
2012/2014	11(42.3%)	9(34.6%)	10(38.5%)	9(34.6%)

Source: Researcher, 2015

Table 5.3 shows that the year 2012/2014 was considered by most respondents as having the worst performance in the four indicators. This was followed by the period 2007/2008. None of the respondents related the 2001/2002 to poor performance, partly because majority of the enterprises were not in existence then.

In line with the secondary data, the two periods were greatly affected by insecurity. The poor performance of hospitality enterprises in the period of 2012/2014 was as a result of terror attacks and fear of potential terror attacks which prevented many tourists from visiting the country. The on-going recession in Europe were also attributed to the dismal performance. The poor performance in the year 2007/2008 was attributed to insecurity associated with post-election violence. The enterprises which were operational in 2007/2008 indicated that they were affected by the post-election violence. Some of the enterprise had few or no guests, some of the employees were laid off from work and some indicated that the enterprises were forced to close.

Measures taken by enterprises to ensure guests safety and security like purchase of security equipment and hiring trained security personnel come with additional costs. Delays and lengthy procedures experienced by guests through screening of the guests, document and luggage inspection. Besides ensuring safety in the premises, such delays could also pose as a threat. At times too much security processes and equipment are perceived by some guests as a sign of expected or looming danger.

5.5 Measures Taken by the Enterprises and the Government to Ensure Safety and Security

Most enterprises used in the survey have taken certain measures to ensure the safety and security of guests, premises and staff. Such measures include: employing trained security personnel from reliable and registered security agencies; investing in equipment such as CCTV installation in most areas within the premises, alarms, communication gadgets such as walkie-talkies and portable radios to facilitate communication and enhance surveillance; continuous staff training on how to handle insecurity issues and procedures to follow in case of security threat; Inspection of all incoming and outgoing vehicles, visitors and staff; erecting electric fences around the parameter walls of the establishments; and community policing through organizations such as Watamu Against Crime.¹¹⁰

The measures undertaken by the enterprises have built confidence in guests making them feel secure thereby increasing chances of repeat guests. They have also hindered potential security threats as well as reducing incidences of insecurity.

Table 5.4: Is the government of Kenya handling insecurity issues well?

		Frequency	Percent
Valid	Not sure	1	3.8
	Yes	9	34.6
	No	13	50.0
	N/A	3	11.5
	Total	26	100.0

Source: Researcher, 2015

¹¹⁰ A programme initiated in Watamu to help the community and the government security department in reporting and handling crime issues.

Table 5.4 presents the respondents perspective on the government's handling of insecurity threats. 50% of the respondents felt that the government was not handling the issues of insecurity well, while 35% felt it was handling the issues well. N/A refers to the percentage respondents who did not respond to the question.

The respondents with the perspective that the government was handling the insecurity issues well gave reasons such as adequate measures had been put in place namely: deployment of the Kenya Defense Force in insecurity prone areas within the country, and in Somalia in pursuit of Al-Shabaab to deter any potential threats; increased supply of equipment and personnel training; community policing; and proactive measures such as alerting the public on potential threats.

The respondents with the perspective that the government was not handling the issues well attributed their reasons to continued existence of internal insecurity such as prevalence of organized crimes, poor response to terrorist attacks, lack of pro-active mechanisms, inadequate security officers, lack of professionalism and corrupt security officers.

To improve the country's security the respondents felt that the government should create job opportunities for the young to prevent them from joining criminal groups. Secondly, increased or better salary packages and remuneration for police force to ensure law enforcement and prevent vulnerability that encourages corruption. In addition to the measures undertaken by the government like proper training of the security forces on

counter-terrorism and investment in advanced surveillance equipment to be provided to anti-terrorist unit. Besides, the government has partnered with other countries in intelligence sharing. Furthermore, improving the state of infrastructure like roads; lighting of public places such as streets; and installation of CCTV camera in most public places will go a long way in preventing potential crimes. The Naval patrols by Kenya Navy act as deterrents to piracy attacks off the Coast of Somalia and Kenya. Last but not least, educating the public on basic security awareness such as reporting any suspected acts, persons and luggage left unattended has been emphasized.

5.6 Conclusion

The government has failed to tackle the root causes of insecurity as indicated in the policies. This has led to the continued existence of insecurity. Secondly, increased level of corruption within the security agencies, immigration and custom departments have contributed to porous borders which has facilitated entry of firearms and criminals.

CHAPTER SIX

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

6.1 Introduction

The purpose of this study was to investigate the determinants of foreign direct investment in hospitality industry in Kenya. The study sought to establish the influence of political stability, insecurity and bureaucratic business procedures.

6.2 Study Findings

This section presents summary of findings according to objectives and study hypotheses.

Table 6.1: Respondents ranking on Factors influencing choice of Kenya as the host country for Hospitality Investment

	Infrastructure as an influence of host country investment choice	Destination resource endowment as an influence of host country investment choice	Political and regulatory factors as an influence of host country investment choice	Marketing related factors as an influence of host country investment choice	Economic factors as an influence of host country investment choice	Other factors not listed as an influence of host country investment choice
N	26	26	26	26	26	26
Valid	26	26	26	26	26	26
None	16	10	20	14	11	26
Most important	4	11	3	8	10	
Important	3	1	1	3	4	
Least important	3	4	2	1	1	
Total	26	26	26	26	26	

Source: Researcher, 2015

Table 6.1 presents number of respondents on ranking of different factors considered to influence the choice of Kenya as a host country for hospitality investment. The most important factor indicated by the respondents was destination resource endowment, followed by Economic factors then marketing related factors. None in the table represent the number of respondents who did not consider the factor to be among the top 3 and the number of respondents who did not answer the question. According to the survey, the factors considered to influence the choice of Kenya as a host country for hospitality investment can be listed as follows in order of importance (i) destination resource endowment (ii) economic factors and (iii) marketing related factors. All the factors listed were at least indicated to be important by the respondents.

Table 6.2: Respondents ranking on problematic factors in starting and doing hospitality business

	Insecurity as the problematic factor in starting and doing hospitality business	Corruption as the problematic factor in starting and doing hospitality business	Political uncertainty as the problematic factor in starting and doing hospitality business	Infrastructure as the problematic factor in starting and doing hospitality business	Unfavourable regulatory environment as the problematic factor in starting and doing hospitality business	High cost of doing hospitality business as the problematic factor in starting and doing hospitality business
N	26	26	26	26	26	26
Valid	5	7	15	20	21	15
None						
Most problematic	17	11	6	3	2	6
Problematic	2	7	2	1	2	2
Least problematic	2	1	3	2	1	3
Total	26	26	26	26	26	26

Source: Researcher, 2015

Table 6.2 presents ranking of factors that the respondents indicated to be problematic in starting and doing hospitality business. Insecurity was considered to be the most problematic factor in starting and doing hospitality business. This was followed by corruption and then both the political uncertainty and high cost of doing business.

Theoretically, insecurity and corruption have been closely linked. The two variables when tested using a Chi-square test, Pearson Chi-square value is 16.978 with degrees of freedom of 9 giving asymptotic significance of 0.049. This is ideally the same as 0.05 meaning the relationship between the two variables is very strong.

Table 6.3: Cross Tabulation of Insecurity and Corruption Variables

Insecurity as the problematic factor in starting and doing hospitality business *Corruption as the problematic factor in starting and doing hospitality business Cross tabulation

		Corruption as the problematic factor in starting and doing hospitality business				Total
		None	Most problematic	Problematic	Least problematic	None
Insecurity as the problematic factor in starting and doing hospitality business	None	3	1	1	0	5
	Most problematic	4	8	5	0	17
	Problematic	0	1	0	1	2
	Least problematic	0	1	1	0	2
Total		7	11	7	1	26

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	16.978(a)	9	.049

6.3 Summary of Findings

The hospitality industry in Kenya is dominated by the local private investors. Domestic private investors lack capacities to ensure international standards that are expected by the increasing tourist demands. As a result, stiff competition from the region and globally has reduced the country’s competitiveness. The FDI inflow in the industry is estimated to be less than 20% and the figure is still declining. However, most foreign investors have opted to invest in the industry using non-equity mode of investment. More individual foreign investors are also opting for smaller investments. These include investments in accommodation enterprises such as villas, apartments and cottages.

Holiday makers form the largest share of international visitor arrivals. Kenya's attraction has largely contributed to holiday makers' decision in visiting the country. The Coastal beach is also the dominant zone visited by the holiday makers.

Worst performances in the industry have been characterized by period of insecurity threats such as 2007/2008 post-election violence. Tourists consider security levels as important when deciding which destination to visit, consequently high visitor arrivals are bound to attract investments.

The main purpose of investing is to reap returns on the investment. A stable macroeconomic environment ensures good returns on investment and also repatriation of profits.

Availability of market is an important aspect considered when investing. Kenya has a large market size that has sustained the industry during the hard economic times. It has also been the dominant market since 2012 in terms of bed-nights occupancy. An increase of international hotel chains in Nairobi is being driven by the City's emergence as a diplomatic hub expanding the market through conference tourism.

6.4 Conclusion

The key determinants of FDI Inflow in hospitality industry has been destination resource endowment in this case attractions, level of security in the country, economic factors such as a stable macroeconomic environment, marketing related factors such as availability of

market for a destination. Other factors also play a role but they have not been the key determinants of FDI inflow.

A country's political and regulatory framework has the potential to provide an enabling business environment needed to attract FDI inflows. In 2003 till 2007, the industry's performance was good leading to increase in investment. The then government adopted policies that ensured stable macroeconomic environment, improved governance and level of insecurity following their implementation. This clearly shows that creation of an enabling business environment attracts investment.

6.5 Recommendations

The study findings indicate that FDI in the industry has a small share. The benefits associated with FDI cannot be ignored given that Kenya has committed its hotels and restaurants' services. Hospitality industry is labour intensive and it has the potential to create indirect employment. The domestic private investors may not have the capacity and managerial skills to attract high demanding tourists with spending power. FDI have the capacity to ensure international standards and general improvement of the country's competitiveness.

The government should continuously review its policies and regulations to ensure that restrictive regulations are done away with and new ones adopted. The policies should also be consistent and harmonized within the government agencies. For instance, the Investment Promotion Act does not stipulate that an investor must have an investment

certificate. However, an investor must show the minimum amount of capital required to be issued with a work permit by the immigration department.

The industry lacks proper monitoring mechanisms that have led to an emerging number of unregistered accommodation facilities. These enterprises engage in commercial accommodation of tourists which create unfair competition to hotels and lodges that are registered. These accommodation facilities should be registered to ensure that their activities are included in the industry's statistics to provide the actual trend.

From the research findings, further research can be done on the emerging accommodation facilities to find out why more foreigners are attracted to these types of small investments.

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APPENDIX

APPENDIX 1: QUESTIONNAIRE FOR FOREIGN INVESTORS IN THE HOSPITALITY INDUSTRY

Introduction

Dear Sir/Madam,

My name is Monicah Akulo Ouma, a postgraduate student in International Studies (Masters of Arts in International Studies) in the University of Nairobi.

As part of my Masters studies, I am doing a research on **Determinants of Foreign Direct Investment (FDI) in Hospitality Industry in Kenya between the period of 1990 and 2014.**

The purpose of this study is to evaluate the factors that drive foreign investors into hospitality industry in Kenya as well as factors that deter foreign investment in the industry. The findings of this study will be important in informing policy makers and provide pointers to key stakeholders in promoting the industry.

The survey is anonymous and therefore does not require you to disclose your name or that of your establishment or company. You are at liberty to skip any question(s) or withdraw from the survey at any time. I, however, assure you that your opinion is very important to this study and therefore utmost confidentiality pertaining to any information that you may provide in this survey will be observed.

For any queries and further clarification, you may kindly contact:

The Director

Institute of Diplomacy and International Studies

University of Nairobi

Email: director-idis@uonbi.ac.ke

Tel: +254 -20-2319099

Thank you in advance for your time and cooperation.

Monicah Akulo Ouma.

A) About yourself

Instructions: Tick where appropriate

1. What is your position in your establishment/enterprise?

General Manager

Assistant General Manager

Duty Manager

Financial Manager

Sales and Marketing Manager

Guest Relations Manager

Any other, state-----

2. How long have you served in your current position?

Less than 5 years

Between 5 to 10 years

Between 11 to 15 years

Above 15 years

3. Age

Below 35 years

Between 35 and 45 years

Between 46 and 55 years

Above 55 years

4. Gender

Male

Female

5. Highest level of education

Diploma []

Higher Diploma []

Degree []

Masters/ Post Graduate []

Doctorate []

Any other, specify -----

6. What's your nationality? -----

7. Ability to communicate in the following languages

English []

Kiswahili []

Any other foreign internationally recognized language(s) -----

B) About your establishment/enterprise?

1. Which region within Kenya is your establishment/enterprise located? If you have other enterprises in other regions, tick the regions as well.

Region	Tick where appropriate
Nairobi	
Rift valley	
Western	
Mount Kenya	
Coast –North, South & Mombasa Island	
Amboseli/Tsavo	
Malindi - Watamu	

2. What is the mode of management?

Owner management []

Management Company []

Any other, specify-----

3. What nationality is the owner of the premise if a management company above?

4. How long has this establishment/enterprise operated in Kenya?

Less than 5 years []

Between 5 to 15 years []

Between 16 to 25 years []

Over 25 years []

5. The table below shows some regulated tourism activities and services as classified in Kenya. Which Class and grading represent your establishment or enterprise?

Show by ticking the relevant box.

Class "A" enterprises	1 star	2 star	3 star	4 star	5 star	Non-star rated
Accommodation establishments.						/give applicable rating
Tented camps						
Motels						
Lodges						
Vacation hotels						
Town hotels						
Villas						

Cottages						
Serviced Apartments						
Home stays						
Guest houses						
Hostels						
Camping/caravan site						
Class “B” Enterprises Restaurants						
Class “C” enterprises Tour/safari operators						
Class “F” enterprises Entertainment facility						
Any other, specify						

6. Which association is your enterprise a member?

Kenya Association of Tour Operators (KATO) []

Kenya Association of Hotel Keepers and Caterers (KAHC) []

Kenya Association of Travel Agents (KATA) []

Mombasa & Coast Tourism Association (MCTA) []

Eco Tourism Kenya (EK) []

Pubs, Entertainment and Restaurants Association of Kenya (PERAK) []

None

Any other, specify-----

7. How has the enterprise grown since its inception in Kenya?

Expansion of the already existing establishment/enterprise []

Greenfields/ construction of new premises []

Mergers and Acquisitions []

It has not grown []

Any other, specify -----

C) Factors influencing Foreign Direct Investment inflow in the hospitality industry

1. What are the three (3) most important factors that influenced your choice of Kenya as the host country for your hospitality investment?

Rank values must be between 1 and 3 with 1 representing the most important factor.

Infrastructure []

Destination resource endowment []

Political and regulatory factors []

Marketing related factors []

Economic factors []

Any other important factor not listed above, specify

2. What influenced the location decision within Kenya?

i. -----

ii. -----

iii. -----

3. How would you categorize country of origin of the guests/visitors/tourists/clients in your establishment/enterprise?

	Kenya	Rest of Africa	Europe	North America	South America	Asia	Australia
Above 80%							
60- 80%							
39- 59%							
09- 38%							
Below 09%							

4. What percentage of your guests/visitors/tourists/clients forms repeat guests?

Above 80% []

Between 60% to 80% []

Between 39% to 59% []

Between 09% to 38% []

Below 09% []

5. Using the four or any of the variables (occupancy rates, average room rate (ARR), revenue per available room (Rev Par) or Gross receipts), identify - by ticking a period which your enterprise was not doing well economically.

	1991/ 1992	1997/ 1998	2001/ 2002	2003/ 2004	2007/ 2008	2010/ 2011	2012- 2014
Occupancy rate							
Average room rate							
Rev par							
Gross receipts							

6. What do you attribute to the low performance in question 5 above? Explain

7. Was your establishment/enterprise affected by the 2007/2008 post-election violence?

Not affected []

Positively affected []

Negatively affected []

Very much affected negatively []

Very much affected positively []

Explain your answer above-----

D) Business start-up and operation

1. How satisfied are you with the following :

	Very Satisfied	Satisfied	Unsatisfied	Very Unsatisfied	No comment
Ease of starting a hospitality business					
Getting credit					
Paying taxes					
Enforcing					

contracts					
Labour regulations					
Cost of doing hospitality business					

2. What do you consider to be the top 3 problematic factors in starting and doing hospitality business in Kenya, with 1 representing the most problematic factor?

Insecurity []

Corruption []

Political uncertainty []

Infrastructure []

Unfavourable regulatory environment []

High cost of doing hospitality business []

Other, specify-----

3. Do you believe the government of Kenya is doing its level best to tackle the above identified problematic factors?

Yes []

No []

How best do you think the issues can be handled?

4. How would you describe the services provided by the following government bodies and institutions?

	Excellent	Good	Fair	Poor	No comment
The Tourism Regulatory Authority (TRA)					
The Kenya Tourist Board (KTB)					
The Kenya Utalii College (KUC)					
The Tourism Protection Service					
Kenya investment Authority (KenInvest)					

5. What three government regulations in the hospitality industry would you like abolished or changed?

- i. -----

- ii. -----

- iii. -----

6. What three regulations would you recommend formulated and adopted in the hospitality industry?

- i. -----

- ii. -----

- iii. -----

7. What three government policies can you commend Kenya for in encouraging inward Foreign Direct Investment (FDI) in hospitality industry and what three policies restrict inward FDI?

Encouraging inward FDI	Restricting inward FDI
i.	
ii.	
iii.	

E) Security issues

1. Rank the top three serious aspect of insecurity for your establishment/enterprise, with 1 representing the most serious aspect.

Ethnic or Tribal clashes []

- Crime and violence such as mugging []
- The potential of terrorism []
- Prevalence of organized crime []
- The threat of armed insurgents []
- Regional conflicts that threaten to spill over into
neighbouring countries []

2. Has your establishment/enterprise ever experienced any incident of insecurity?

Yes []

No []

If yes, elaborate

3. Are you confident that the government of Kenya is handling insecurity issues well?

Yes []

No []

Explain your answer,-----

4. In your opinion, what more needs to be done to improve the country's security?---

5. What measures have you taken as an establishment/enterprise to ensure the safety of your premises, guests/clients/visitors and staff?

6. How do the above measures affect your enterprise?

