INFLUENCE OF GOVERNMENT REGULATORY AND FISCAL POLICY REQUIREMENTS ON FOREIGN DIRECT INVESTMENT IN THE OIL AND GAS SECTOR IN KENYA

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DECLARATION

This research project is my original work and has never been presented for any degree in this or any university.

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This research project has been presented for presentation with my approval as the university supervisor

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DEDICATION

This project is dedicated to God, for His wisdom, grace and favour. It is dedicated to my wife, children, parents, siblings and significant friends with whose help, support and encouragement this project has been completed. It is also dedicated to the oil and gas firms presently exploring in Kenya, whose resolve to risk investing in Kenya, has birthed an oil and gas industry in this great and beautiful country and has given the industrious people of Kenya, the hope of being an oil producing nation with the expectation that the resource will not taint this country with sorrow but rather colour it with the blessing of prosperity.

ABSTRACT

Reliable energy supply in a country is recognised as a significant contributor to an improved economy and society. Oil and gas is seen as a major source of energy. Since 2014, foreign capital in the oil and gas sector has relatively become scarce as international oil and gas companies focus on exploitation of known commercial reserves rather than focus on exploration of potential reserves; consequently, Kenya is one of the countries that has been adversely impacted. This is presumably due to weak global prices of crude oil and increased competition among suppliers. The purpose of the study was to establish the influence that the government's regulatory and fiscal policy requirements have on foreign direct investment in the oil and gas sector in Kenya. The study adopted a survey design. The population of the study was the 11 foreign oil and gas firms currently participating in oil and gas exploration business in Kenya. The study relied on primary data collected using semi-structured questionnaires. The collected data was analysed using descriptive and inferential statistics as well as content analysis. From the analysis, it was found that there is a positive relationship between key government regulatory and fiscal policy requirements in the oil and gas sector and foreign direct investment, inferring that these requirements significantly affected foreign direct investment in the said sector. The study recommends to the relevant policy makers in Government, to review the current policy framework in consultation with industry players, so as to ensure formulation of sound fiscal policies that spur foreign direct investment in the sector whilst ensuring adequate control and fair revenue collection for the Government. The study concludes with a recommendation for further research on the extent to which regulatory and fiscal policy requirements affect foreign direct investment in the sector in relation to other factors that are generally attributed to attracting investment in a country.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Kenya has had no known petroleum reserves until 2012 when oil was discovered in Turkana County. This has seen many International Oil Companies (IOCs) take interest in Kenya leading to the emergence of the upstream oil and gas sector in Kenya. If well managed, the industry has great potential for the economic empowerment of the country. The industry in Kenya however faces several challenges including attraction of adequate foreign investment.

In discussing the determinants of competitiveness of countries, Porter (1990) identified demand conditions, industry structure conditions, supporting industries conditions and factor conditions as the key determinants. He also considered two variables that play a significant role in influencing these determinants, namely chance and the role of government. Chance refers to events that tend to be beyond the control of a firm or a country, whereas the role of government involves development of polices that could influence these major determinants and enhance a country's competitive advantage. Studies have revealed that multinationals consider the cost impact of regulatory and fiscal policies and they consider how a country's policies compare with that of another country, with the intention of investing where the regulatory and fiscal policy environment is likely to facilitate a fair return to their investments (Ahlering, 2004).

Foreign direct investment refers to movement of capital by a foreign firm, into an economy, with the aim of acquiring a long term managing interest in an enterprise in that economy. It may be driven by among others; natural resources, labour and access to markets (Nayyar, 2014). It may also be influenced by regulatory and fiscal policies

as these provide a measure of predictability on a country's requirements and their potential impact on a business (World Bank, 2011). Regulatory policy refers to the regulations and laws that are prescribed by a government to enable it achieve a certain objective in the country's socio-political and economic context (Organisation for Economic Cooperation & Development, 2017) whereas fiscal policy, refers to the taxes or the directives issued by the government, intended to influence its economy.

1.1.1 Regulatory and Fiscal Policy Requirements

The Organisation for Economic Cooperation and Development (2017), describe regulatory policy as "achieving a governments objective through use of regulations, laws and other instruments to deliver better economic and social outcomes that would enhance the life of citizens and businesses". Regulatory policy requirements entail government approvals for starting a business, government expectations on how activities in an industry should be done and government's approach to monetisation of private investments including assurance of repatriation of profits, importation of specialised equipment or specialised labour. Sappington (1994), suggests that regulatory polices differ in nature and affect different individuals and firms' behaviours in varying degrees. These type of policies employ different methods of oversight and control and are enacted in different forms, function and scope. It entails regulatory compliance considerations, the associated cost of compliance and demands by other regulatory stakeholders such as parliaments, governments and organisations.

El-Ganainy and Horton (2012), economists writing for the International Monetary Fund, describe fiscal policy "as the use of government spending and taxation to influence the economy" (p.52). Fiscal policy, similar to regulatory policy, is used to influence investments and consumption of both public and private sector, through tax.

Fiscal policy makers ordinarily have two major instruments through which they influence the economy: monetary policy and fiscal (tax) policy. Monetary policy is used by a state's central bank to influence flow of money through interest rates, sale of government securities and banking requirements. Fiscal (tax) policy on the other hand is primarily used by the state (often defined by the country's Ministry responsible for finance) to stir up growth in a certain sector or derive more revenue from a certain sector of the country's economy. The latter will be the focus of this study. Fiscal policy could therefore be described as loose, where the government's efforts entail reduction of taxes or stringent where the government's efforts entail increasing tax revenue (Kariithi, 2007). United Nations Conference on Trade and Development (UNCTAD, 1999), observes that economic determinants, business facilitation determinants and policy framework determinants affect the attraction of foreign direct investment.

1.1.2 Foreign Direct Investment

Piana (2005), accurately captured the traditional view of foreign direct investment (FDI) as "the establishment of a manufacturing plant using foreign technology and management techniques to exploit low cost local resources with sales made to the local clients of the investor through exportation". More recently with the advancement in carrying out transactions and the growth in information technology, the Organisation for Economic Cooperation and Development (OECD, 2008) has sought to define it as "cross border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise that is resident in a different economy (the host country)". Firms are major players in influencing the flow of FDI. These firms are multinational corporations (MNCs) and they may choose to invest in existing businesses or industries or choose to invest in new industries.

FDI is an important source of funds for developing countries as it enables them to grow their economies by injecting external capital into certain sectors of these economies that would otherwise be very expensive or too risky for the local government or the local private sector. A distinguishing factor of FDI, is the duration that these investors are willing to invest in order to recoup their investment. Contrasted with capital markets, it tends to be long term in nature and not short term. FDI also acts as a means of transferring technology and skills to the receiving country and in certain instances it also enables the receiving country to access new markets (Piana, 2005).

FDI also entails investment that gives rise to the investor having a substantive influence on how the recipient firm is controlled. Additionally, foreign investors undertake FDI solely or in conjunction with host governments or local firms (OECD, 2008). FDI may comprise equity capital, reinvested earnings or intracompany loans and may be categorised into three broad types. Firstly, horizontal integration, which describes how the MNCs execute the same activities in foreign countries as they do in their home country. Secondly, vertical integration, which describes how the MNCs carry out activities in foreign countries in an effort to be nearer the market or nearer the raw materials or for efficiency. Lastly, it may be categorised as, conglomerate, which describes how MNCs acquire or invest in an unrelated business in foreign countries. These investments may take forms such as mergers and acquisitions or Greenfield entries; referring to new industries in the host country (Herger & McCorriston, 2013).

1.1.3 Oil and Gas Industry in Kenya

Energy has been identified as a key driver and contributor to the country's economy according to Kenya's current long-term vision (Government of Kenya, 2007). One of the major sources of the country's energy is from petroleum; a by-product of crude oil.

The O&G sector, commonly also referred to as the upstream petroleum industry or upstream oil and gas industry will be the focus of this study. In Kenya, oil and gas exploration is being undertaken in blocks, these being reflective of the underlying geology and as at 2016, there were sixty-three gazetted exploration blocks. The license that grants an entity the right to explore in a block is referred to as the Production Sharing Contract(PSC). The entry of major foreign companies has boosted Kenya's oil and gas industry. Besides National Oil Corporation of Kenya most of the other companies are foreign and include; Tullow, Shell, Africa Oil, Total, Erin Energy, Zarara and Octant Energy Kenya (Appendix 1).

The industry has several challenges, key of which is the massive amount of resources needed to carry out exploration or to develop the discoveries so as to start producing. In addition, lack of adequate geological data on where exactly to drill and the volatility of the international price of crude, makes exploration highly risky. Other significant challenges are: the high cost of acquisition of new technology; inadequate technical capacity within Kenya; increased taxes; access to exploration sites; poor infrastructure and unpredictable inter-government and host community relations (Tims, 2015). How Kenya may influence the impact of these factors will determine how competitively it could attract FDI and hence the need for Kenya to review its respective policies.

1.2 Research Problem

Reliable energy supply in a country is recognised as a significant contributor to an improved economy and society (Government of Kenya, 2007). According to International Energy Agency (2014), reliance on oil by African countries in Sub-Sahara will double by the year 2040; reflecting an increase of almost four million barrels per day, majorly due to increased demand in infrastructure and transport in the respective

Sub-Saharan African countries. As these countries seek to explore and exploit their oil and gas resources in an effort to address their energy inadequacies, they often have to rely on foreign investment due to the capital intensive nature of the business, the risks of the business and the specialised skills required during exploration and production phases of oil and gas life cycle (African Development Bank & African Union, 2003). However, since 2014, presumably due to weak global prices of crude oil and increased competition among suppliers, foreign capital has become scarce as international oil and gas companies focus on exploitation of known commercial reserves rather than on exploration of potential reserves and as such, Kenya is one of the countries that has been adversely impacted (The Economist, 2015; Tims, 2015; & Sunday, 2016, p. 31).

Despite efforts by the Government of Kenya to promote oil and gas exploration in the country through: formulating a new energy policy, providing incentives to the sector, collection of data and strengthening of institutions such as National Oil Corporation of Kenya, attraction of FDI in the sector has slowed down, evidenced by low uptake of new oil blocks or low-key work programmes (Githinji, 2016; Senelwa, 2016). This problem has negatively impacted Kenya's acceleration to be an oil producer and therefore impacted its efforts to towards attaining Vision 2030 goals. It has also led to continued reliance on imported oil; which constitutes almost 20% of Kenya's import bill as well as loss of jobs and loss of business opportunities for Kenyans (Sy, 2014, Government of Kenya, 2015). Therefore, Kenya has to compete with other African and developing nations, in its effort to attract FDI in its O&G sector.

Various international and local studies have been carried out on either foreign direct investment in Africa or in the oil and gas sector. International studies observe that one of the possible causes of continued low flow of FDI in this oil and gas(O&G) sector are

a country's regulatory and fiscal requirements (Basu and Srinivasan, 2002; Alves & Oliveira, 2012). Tannenwald (1997), conducted a study on regulatory policy and economic development where he found that, "there is a significant relationship between regulatory stringency and economic activity on the part of firms". Within the local context, some studies have also been carried out on either foreign direct investment in Kenya that have suggested legal and fiscal requirements or lack thereof, as possibly being one of the factors that impact on the flow FDI into Kenya, with the O&G sector as an illustration (Karembu, 2009; Mutuma, 2012; Some, 2013; & Sunday, 2016).

Whilst these studies have been undertaken suggesting legal and fiscal requirements as possible factors impacting FDI in the oil and gas sector, the studies are limited in scope or research design. The studies have also lacked relevant empirical evidence in support of the finding and where such evidence has been adduced, it is either not updated or it has been limited to the case study of a single company. Accordingly, the studies have not given due regard to cross-sectional empirical consideration of how fiscal and regulatory requirements currently impact FDI in the sector in Kenya. What then is the effect of the government's regulatory and fiscal policy requirements on foreign direct investment in the oil and gas sector in the country?

1.3 Objective of the Study

The objective of the study was to establish the effect of the government's regulatory and fiscal policy requirements on FDI in the O&G sector in Kenya. This was done by exploring the possible relationship between the regulatory and fiscal requirements in the said sector and the investment behaviours of foreign firms in the said sector.

1.4 Value of the Study

The study contributes to managerial policy as it highlights challenges posed by current regulatory and fiscal requirements to the attraction of FDI in the O&G sector in Kenya. It will therefore assist the policy makers and stakeholders in their design and development of policies for this nascent sector of Kenya's economy. The study will also contribute to managerial practice as it will equip both government and policy implementation stakeholders on perspectives with how to implement and administer the country's regulatory and fiscal requirements in a manner that may not impact the country's attractiveness in a negatively. It will also equip oil and gas firms seeking to invest or present in Kenya on entry decisions and influence policy respectively

The study has also contributed to theory, as it validates the use of the resources based theory and the industrial organisation economic theory as useful theoretical tools to explain the various phenomenon associated with foreign investment, multinational corporations and the oil and gas industry. It also contributes to knowledge, as it addresses a significant gap in literature on this issue and provides updated empirical information on how current regulatory and fiscal requirements affect investment decisions in the O&G sector in Kenya. The study concludes with suggestions for future research and to this extent, it assists academicians with a reasonable basis to start from.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter discusses the theoretical foundations underpinning this study, their strengths and their limitations. It further explores the respective theories on regulatory and fiscal policy requirements as well as theories on FDI. Lastly, it reviews literature on the impact of these requirements on FDI and the O&G sector.

2.2 Theoretical Foundation

This study relies on two strategic management theories. The main one being the resource based theory and the second and complementary theory being the industrial organisation economic theory. These are discussed in the following subsections, with emphasis on the strengths and limitations of the resource based theory and how the industrial organisation economic theory renders further support for purposes of this study. It has been argued that the unit of focus in the international markets is a firm and not necessarily a state and therefore one has to appreciate how companies and businesses develop and maintain their competitive edge, so as to describe and appreciate the role of states in the global markets (UKEssays, 2013).

2.2.1 Resource Based Theory

This theory has emerged to be a significant theory in strategic management. Its focuses on the firm and it seeks to explain how the internal resources or competencies of a firm may be deployed to enable it create and sustain a competitive advantage. It suggests that a firms' source of competitiveness lies in its ability to utilize its resources and competences in a manner that allows it to maintain a competitive advantage over others (Wernefelt, 1984). It is relied upon in this study to attempt to give a relevant perspective as to the behaviours and decisions by firms to invest in and stay in foreign countries.

Also, whereas it is conceded that the theory is predominantly relied upon to explain firm behaviour, it has also been used to attempt to describe behaviour of countries towards FDI, especially where it can be shown that the country's resources such as oil and gas are valuable, heterogeneous, immobile, inimitable and non-substitutable (Barney, 1991; Span, 2010).

Jurevicius (2013), in tracing the history of the resource-based view, argues that it gained pre-eminence around the 1980s and 1990s following the works of authors like: Wenerfelt who in 1984, wrote on; "The resource based view of the firm", Hamel and Prahalad who in 1990, wrote on; "The core competence of the corporation", and Barney, who in 1991, wrote on; "The firm's resources and a firm's sustained competitive advantage", among others authors. The proponents of this view argue that, organisations should look inside the company to find the sources of competitive advantage instead of looking outward at the competitive environment. A firm's core competencies and resources are classified into physical, monetary, human, technological competences, organisational competences, firm attributes as well as information and knowledge controlled by a firm (Wang, 2014).

Emerging from the resource based theory are two complimentary views; one based on knowledge and the other based on the firm's dynamic capability. The knowledge based view is premised on the argument that knowledge is superior to other assets the firm may have in this current information age where intellectual competencies are regarded as major enablers of a firm's superior performance (Hamel and Prahalad, 1994; Zack, 1999). The dynamic capability based view is premised on a firm's capacity to use its unique competencies, resources and organisational process whilst constantly cognisant of its changing environment (Amit & Schoemaker, 1993).

Some of the strengths of the resource based theory are that, it is simple and is easily used to explain a variety of firm behaviours and performance. It allows an explanation of firm performance that is not related to economic or industry conditions. In Colbart's analysis (as cited in Datt, 2014) the resource based view is also useful in capturing the link between profitability, capabilities and resources associated within a firm; the more a firm is able to recognize and utilize its resources in an inimitable manner as compared to its competitors, the more profitable and competitive it will be. However, the theory has received criticism; Kraaijenbrink, Spender and Groen (2009) argue that it fails to take into account dynamic environments that are prone to rapid changes in technology, markets, processes and even value of resources. There is therefore need to complement this theory for purpose of this study.

2.2.2 Industrial Organisation Economic Theory

This theory places focus on the industry and how an industry is structured. It seeks to describe the behaviour of firms in their role in the production or sale or purchase of goods and services whilst interacting with the environment of the industry and market they operate in. It postulates the view that competition in the markets are imperfect and as such it seeks to describe market power and competitive firm behaviour (Cabral, 2017). It further prescribes the view that the structure of a market has an influence on firms and their conduct, which contributes to different performances based on the ability of such firms to adjust to the external market structures (Berger, 2008).

This theory is relied upon to attempt to give a relevant strategic perspective as to the behaviour of foreign firms with regard to the oil and gas industry. Whereas it is conceded that the theory is often relied upon to explain industry structure and related firm conduct or performance, it has nonetheless also been used, albeit in a limited

manner, to attempt to give a view on behaviour of countries towards the oil and gas industry, where it can be shown that the country can influence firm behaviour in the industry (Porter, 1990; Sukhoruchenko, 2007).

The theory has its roots in the evolving works of micro-economics, tracing back to traditional neo-classical theories of economics. Due to the inadequacies of this theory to explain the emerging issues of imperfect competition, Edward Chamberlain in his works in the 1930s, addressed monopolistic competition and the structure of firms and industries based on how industries differentiated themselves. Joe Bain built on this research and in the 1960s, authored several works on the relationship between the market structure, the conduct of firms and the performance of firms in that market leading to the structure-conduct-performance paradigm (Policonomics, 2017). Researchers later contributed to these works, Michael Porter being one of them. He developed the five force model as a tool to assess a firm’s external environment arguing that a firm’s strategy should meet the opportunities in its environment whilst also addressing the threats presented therein. Berger (2014), summarised Michael Porter’s components of the five force model as follows; “Barrier to entry, threat of substitutes, bargaining power of suppliers, bargaining power of buyers and rivalry among competitors”.

This theory has been cited in support of the view that MNCs engage in FDI in order to benefit from unique capabilities that they own so as to give them monopoly in the industries of their host countries (Njoroge, Namusonge & Sakwa, 2015). With this theory one appreciates the opportunities and threats that may exist in the environment of the firm and the need to develop appropriate responses. It also allows one to appreciate the role of international trade in industry competition (Porter, 1981).

However, major criticisms of this theory is that it fails to take into account a firm's resources and competencies (Berger, 2008). It assumes resource homogeneity and mobility of resources within an industry and fails to take into account that some industries are complex (Einav & Levin, 2010). The theory can therefore not fully explain on its own, the behaviour of firms, states or industries.

2.2.3 Regulatory and Fiscal Policy Theories

Literature identifies two major theories on regulatory policy. One is the use of regulation as a means of social engineering achieved by constraining individuals and firms with obligations. A major feature of this theory is the cost associated with complying with these obligations. Second is the use of regulation as a means of advancing public interest including environment conservation, public health, safety, competition and prevention of market failures. (Sappington, 199; Eisner, Ringquist & Worsham 1999; see also Piraino, 2007; Feaver & Sheehy, 2015). In this study, reliance was placed on both theories, so as to explain government's motives behind its regulatory policy requirements and to explore the impact of compliance costs on firms.

Regulatory and fiscal policy requirements can therefore be described as products of public policy. Regulatory policy has been described as: "Achieving government objectives through the use of regulations, laws and other instruments to deliver better economic and social outcomes and thus enhance the life of citizens and business". It has also been described as; rules issued by a government and targeted at an individual, business, organisation or government agency, aimed at promoting or discouraging certain behaviour so as to achieve certain intended outcomes (OECD, 2017).

A country's regulatory requirements therefore are critical in supporting policy towards business and foreign direct investment. These requirements may be clustered into two:

Entry requirements such as industry restrictions, company set-up, permits for work, tax registration and others; locational requirements such as leases, construction permits and environmental impact assessments; and operational requirements such as health and safety, technical standards, labour laws, anti-trust and competition laws, local content, taxation and industry specific operational laws (Sun, 2002).

With respect to fiscal policy, the major theories revolve around the neo-classical theories; which refer primarily to the non-interventionist approach by government so as to enable the economy to correct itself, and Keynesian theories; referring to the government's intervening by increasing or decreasing government spending or people's taxes so as to make an economy stable (Battaglini & Coate, 2014; Spencer & Yohe 1970). The latter was relied on in this study. Accordingly, fiscal policy may be described to refer to the manner in which government uses its ability to spend or tax to influence the economy of the country. With specific reference to business and in particular, FDI, fiscal policy requirements act as tools to influence business.

There are two major descriptive types of fiscal policy; expansionary and stringent. Expansionary refers to when economic growth is stimulated by the government spending more or reducing taxes or both, resulting in putting more money into the hands of businesses and consumers, which potentially leads to more expenditure. A stringent fiscal policy refers to increases in taxes that slow down economic growth (Amadeo, 2017). Fiscal tax requirements for business include corporate income tax, withholding tax, customs excise and stamp duty, permit and license fees.

2.2.4 Foreign Direct Investment Theories

Literature written over the years, presents various theories used to describe FDI and which can be reduced broadly to two theories. The first is; "the market imperfections

theory” also referred to as industrial organisation theory, whereby, because of the imperfections in the international markets, a firm decides to invest in a foreign country so as to capitalize on its unique resources and competences and in so doing create a competitive edge over other firms in the industry. The second is; “international production theory” also referred to as imperialist theory, which suggests that the likelihood of a firm deciding to invest in countries foreign to it, will depend on the comparison between the nature of incentives offered by the home country on one hand and the incentives and the cost impact of performing the same activities in a foreign country (Morgan & Katsikeas, 1997; Shin, 1998). The latter theory will be pertinent to this study, to describe FDI performance and factors in the oil and gas sector in Kenya.

Foreign direct investment has been described as an investment made in business or enterprise located or situated in another country, that is foreign to the investor’s home country so as to maximise the value of advantages they are likely to enjoy in the host country. These advantages may be natural resources, location efficiencies, cheaper labour or simply increased profit margins. Such investment would often also involve the acquisition of significant influence or control by the investor and the operations of the business may be undertaken by the foreigners or where applicable in conjunction with host governments or local firms. (Nayak & Choudhry, 2014; OECD, 2008). Accordingly, FDI may be natural resource seeking, market seeking, efficiency seeking or strategic asset seeking. This study will focus on natural resource seeking FDI; these being investments made in host countries targeting the exploration, exploitation and eventually exportation of such a host countries’ natural resources to foreign markets (African Development Bank & African Union, 2003).

MNCs play a key role in FDI and it has been reported that until the 1980s, many governments viewed multinational corporations with suspicion and often restricted their participation in the local economy. This has however changed as countries and in particular developing countries have noted that development could be catalysed by FDI (UNCTAD, 1999). However, it has also been criticised for having negative impact on a host country if its cost to the local economy has not been considered (Re-define, 2014). The factors that drive the nature and amount of foreign direct investment in a country include; the potential size of the market, the country's political and economic risk, tax incentives, political certainty, labour, markets, infrastructure and legal and regulatory frameworks and adequate infrastructure (Basu and Srinivasan, 2002; & African Development Bank & African Union, 2009). To this end, a number of nations have developed regulatory and fiscal policies and the impact of these policies has been a subject of particular interest.

2.3 Impact of Fiscal or Regulatory Policy Requirements on FDI

A number of studies have attempted to explain how regulatory and fiscal policy requirements have impacted FDI and five main arguments emerge: One being that, a regulatory environment with regulations that are efficient and predictable, are a factor in attracting FDI and that deregulation and fiscal incentives do positively impact the attraction of FDI (Hanson, 2001; Busee & Groizard, 2006; Azemar & Desbordes, 2010; World Bank, 2010 & Munemo, 2015). The second one being that, regulatory and tax requirements have an effect on the existence of FDI in a country but past a certain threshold, they do not necessarily affect the increase or decrease of FDI flow into a country. That each country's profile is unique and tax incentives or deregulation may not automatically have the same impact in one country as compared to another. (Blongen, 2011; Haozhen Zhang, 2015).

The third one being that, only ease of trading requirements through lessening of export and import regulations and taxes, affect FDI flow and not the general regulatory or fiscal stringent policies (Corcoran & Anor, 2012). Fourthly and emerging from a protectionist view, is that, the more stringent the requirements; especially in areas affecting the environment, health, safety, intellectual property rights and anti-competitive practices, the higher the flow of FDI. Lastly, that regulatory stringency and the associated cost of compliance may not necessarily result in reduced economic activity because there are several other factors such as politics, economy and the environment that would have a heavier influence on a firm's investment decision (Gray, 1997). Corcoran & Gillanders (2012) complemented this argument by suggesting that in Africa, attraction of FDI is not influenced by regulatory or fiscal stringency, but existence of natural resources, infrastructure and political stability.

2.4 Impact of Regulatory and Fiscal Policy Requirements on the Oil and Gas Sector

Turning to the analysis of regulatory and fiscal requirements on FDI specifically in the O&G sector, several studies have attempted to examine this relationship. This section reviews some of the key recent and most relevant works, starting with Kemp and Kassim (2006), who did a study on the oil taxation in the North Sea and its impact on O&G sector in the United Kingdom, with the objective of determining the potential effects of tax changes on exploration and development decisions. The methodology used entailed quantitative analysis of data for the United Kingdom Continental Shelf over the period of 1964- 2002. The study found that the sector was negatively affected and that there is need to accommodate differential tax systems across offshore fields in the different geographical regions of the shelf given their varying cost characteristics. However, as may be appreciated, the study focussed only on the United Kingdom Continental Shelf with limited discussion on impact of regulatory requirements.

The World Bank developed the Ease of Doing Business Index, which it publishes annually in the form of a study. Its objective being to provide an objective measure of business regulations and their enforcements across 190 economies. Methodology adopted involved the use of primary data collected through questionnaires targeted at consultants and domestic small and medium sized firms. With specific reference to the use of the study to inform FDI, the World Bank (2010) found through statistical correlation, that higher ranked economies tend to attract more FDI reflecting more efficient and effective regulatory and fiscal framework, greater market access and trade openness in a country. However, the study's data is obtained primarily from domestic firms and not large multinationals and it has been criticised for not being robust enough to capture country or industry specific variances associated with certain variables. Indeed, World Bank in its own evaluation of the report, recommended industry focus.

Tordo and Warner (2013) did a study on local content policies in the oil and gas sector. The objective of the study being to determine whether local content requirements in the petroleum sector in 48 petroleum producing countries foster development or economic links. The methodology adopted involved a sampling design of the countries as well as qualitative analysis of secondary data. The findings of the study were that: for most of the countries the financial streams of resource rent and return on capital are far more productive than local content policies which impose additional fiscal and regulatory requirements or restrictions. It was further shown that for most countries, these local content policies tend to be unclear and unrealistic with no proper analysis done. However, the study was limited to 48 countries, mostly from within the OECD countries and focus was predominantly on local content and silent on the fiscal aspects.

Turning to local studies, Karembu (2009), examined Kenya's fiscal regime so as to determine whether it supports the Government objectives to create an enabling environment for petroleum exploration and production through attraction of investment. Karembu did a quantitative analysis of the Kenyan fiscal system, using a cash flow model based on different production and economic assumptions and testing the Government take from the project against its net present value; in both high and low oil price and costs scenarios. The study found that that the attractiveness of Kenya's fiscal regime for the O&G sector was doubtful given its failure to adjust to the fluctuations of oil and gas prices and costs. However, the study was based on a model case study of an offshore project and as such focussed only on project value with limited inquiry made into onshore projects as well as the impact of tax and legal requirements.

Cognisant that the O&G sector is a beneficiary of FDI, Nyamwange (2009), set out to study FDI in the country with specific focus on identifying the key factors that influence FDI decisions in Kenya and determining the empirical relationship between FDI and economic growth in Kenya. The study employed both theoretical and quantitative analysis using standard growth accounting frameworks to correlate FDI and independent variables such as openness of the economy, annual inflation, human capital and the country's domestic product. The study found that the main determinants of FDI are market size, steady macro –economic policies and to a certain extent- human capital. It was also found that there is a positive relationship between economic growth in the country and FDI attracted into the country. Additionally, it was established that there was need for greater policy sensitivity towards attraction of FDI. The study was cross cutting and not industry specific, as such, it was silent on FDI in the O&G sector, which has its unique attributes being an extractive industry.

Most recently, Some (2013) undertook a study on factors that attract Tullow to invest in prospecting for oil and gas in Kenya. It was the objective of the study to establish the extent to which Kenya attracted Tullow to prospect in Kenya and the challenges it faces when engaging in exploration in the country. The research design used was that of a case study on the company; Tullow Kenya, collecting primary data through interviews with at least three persons from the company. The study found that global demand for oil and the possibility of hydrocarbons in Kenya following successful finds in East Africa, is primarily what attracted Tullow and that the company continues to experience challenges with regard to infrastructure, community involvement, security as well as un-clear policies for such petroleum operations. However, the study was silent on actual impact of regulatory and tax fiscal requirements on FDI decisions by the company. Being a case study on one company- it did not reflect views of other members of the industry and one of the recommendations was for comparable companies to be studied.

A summary of relevant studies is captured in Table 1 below. It will be noted that there are emerging gaps with regard to the geographical context, scope of study and methodology adopted. Relying on the foregoing, this study will endeavour to answer the query; “What is the effect of regulatory and fiscal policy requirements on foreign direct investment in the oil and gas sector in Kenya?”

Table 2.1: Summary of the Literature Review and Research Gaps

Author, Year	Title	Purpose	Methodology	Findings	Limitations
Global studies					
World Bank, 2002- 2016	Ease of Doing Business Index Study	To provide an objective measure of business regulations and their enforcements across 190 economies (includes Kenya).	Adopted the use of primary data collected through research anchored questionnaires targeted at domestic small and medium, sized companies and consultants.	There was a significant correlation between the 11 indicators it employs and the flow of FDI. Higher ranked economies have been found, through statistical correlation, to attract more FDI.	Data was obtained primarily from domestic firms and not large multinationals. Study also criticised for being inconsistent and not robust enough to capture country or industry specific variances.
Kemp & Kassim, 2006	North Sea oil and gas taxation and activity levels in the United Kingdom Continental Shelf.	To study the economics of the North Sea oil and gas activity levels and potential effects of tax changes on exploration and development decisions and total investment.	Employed use of econometric models of the United Kingdom Continental Shelf as part of the quantitative analysis of collected data covering the period of 1964-2002.	There is need to accommodate differential tax systems across offshore fields in different geographical regions of the shelf given their varying cost characteristics so as to encourage investment.	Study focussed on the United Kingdom Continental Shelf and was limited to off shore exploration as compared to onshore exploration as is the case in Kenya.

Author, Year	Title	Purpose	Methodology	Findings	Limitations
Tordo & Warner, 2013	Local content policies in the oil and gas sector	Determine whether local content polices in the petroleum sector in 48 producing countries foster development.	The methodology adopted involved a sampling design of the countries under study and well as qualitative analysis of secondary data.	Local content policies that impose additional fiscal and regulatory requirements are not productive.	The study was limited to 48 petroleum producing countries, and was silent on impact of fiscal requirements.
Local studies					
Karembu, 2009	Kenya oil and gas fiscal regime	To analyse Kenya's oil and gas fiscal regime and to determine if it supported the attraction of international oil companies.	Quantitative analysis of the fiscal system, using a cash flow model based on production and economic assumptions, testing the Government take against project value and returns.	Kenya's fiscal regime was found to be regressive and inflexible when tested against high and low oil prices and costs.	Study focussed only on project value with limited inquiry made into the impact of taxes and legal requirements on FDI.
Nyamwange, 2009	Foreign Direct Investment in Kenya	To identify key factors that impact FDI choices in Kenya.	Content and quantitative analysis, correlating FDI and independent variables; openness of the economy, inflation and labour.	Main determinants are market size, steady macro – economic policies and human capital.	The study was cross cutting and not industry specific, as such, silent on FDI in oil and gas sector.
Some, 2013	Factors that attract Tullow to invest in prospecting for oil and gas in Kenya.	To establish the extent to which Kenya attracted Tullow to invest in oil and gas prospection in Kenya.	Research design used was that of a case study on the company; Tullow Kenya.	Global demand for oil and the possibility of hydrocarbons in Kenya is what attracted Tullow.	Case study focussed on one company- Tullow. Study is silent on actual impact of regulatory and tax fiscal requirements on FDI decisions.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the research design adopted and the techniques that were used to collect and analyse data with the objective of describing and explaining what effect government's regulatory and fiscal policy requirements have had on FDI into Kenya's O&G sector.

3.2 Research Design

Cooper and Schindler (2006) define research design as "the blue print for the collection, measurement and analysis of data". For this study, it was intended to use a survey design given the descriptive and diagnostic nature of the study so as to determine existence of a relationship and the strength thereof. Sekran (2003), explains that, "a descriptive study is undertaken in order to ascertain and be able to describe the characteristics of the variables of interest in a situation" and it is diagnostic when it seeks to determine the association between two things of interest (Kothari, 2004). Surveys have been shown to be useful in the collection and analysis of data whilst ensuring minimal bias and maximum reliability of evidence gathered (Saunders, Lewis & Thornhill, 2009).

3.3 Population

Sekran (2003) describe population as; "the entire group of people, things or events of interest that a researcher wishes to investigate". For this study, the population of interest consisted of 11 foreign oil and gas firms currently doing oil and gas exploration business in Kenya (Appendix 1). Given the size of the population was manageable, the information was collected by way of a census. Given the variables of the study feature fiscal and regulatory issues, the census targeted the respective Country/General Managers, Finance Managers, Commercial, Legal and Public or Policy Affairs Managers of the respective firms, these being persons having significant perspectives on these issues.

3.4 Data Collection

Data collection refers to the techniques used to gather reliable evidentiary data. This study relied on data collected from primary sources using standardised questionnaires informed by background research. This technique was appropriate given that it was a census and given further that the questionnaires could be structured in such a way as to capture well thought out answers from the respondents (Saunders et al, 2009). The questionnaire was semi-structured; Section A featured demographic characteristics of the respondents; Section B featured government regulatory and fiscal policy requirements; and Section C featured foreign direct investment. Format of the questionnaire is appended to this study under Appendix 2.

3.5 Data Analysis

For Section A of the questionnaire, given that the facts from such data were categorical, they were analysed primarily using frequencies. The data collected pertaining government regulatory and fiscal policy requirements was coded using the numerical scale that was used by the respondents in responding to the questions that were posed in the questionnaire. This transformed the data into a quantitative form that permitted analysis using quantitative methods. Analysis for Section B and C relied on descriptive statistics, using Microsoft Excel and Statistical Package for Social Sciences (SPSS) as tools. Accordingly, dispersion and central tendency measures, namely mean and standard deviation were employed for purposes of exploring the responses given in a quantitative manner. The mean and standard deviation assisted in providing the average values for purposes of reliance on the same as a typical value.

Finally, to assess the relationship between foreign direct investment in Kenya and government regulatory and fiscal policy requirements, correlation techniques and regression analysis were used to test the dependent against the independent variables.

CHAPTER FOUR: RESEARCH FINDINGS AND DISCUSSIONS

4.1 Introduction

The analysis and interpretation of the findings of the study are presented in this chapter. The study aimed at assessing the impact of the regulatory and fiscal policy requirements on FDI in the O&G sector in Kenya. This chapter reports the findings on the general information, the variables of the study and the reliability of the same. It ends with an analysis and a discussion.

4.1.1 Response Rate

The researcher targeted 11 foreign oil and gas firms currently operating in Kenya. Out of these, 8 firms responded, with an average of two questionnaires duly filled by the managers of the respective firms. This transpired into a response rate of 73%. According to Babbie (2010), a response rate of 70% and above is considered adequate for analysis and interpretation.

4.1.2 Reliability Results

Cronbach Alpha coefficient was used to determine reliability of the research instrument by exploring the consistency of the responses given to each of the items in the three respective structured sub-group of questions under Section B and Section C. Results are in Table 4.1.

Table 4.1: Reliability Results

Variable	Number of Items	Cronbach Alpha
– Regulatory and Fiscal Policy Requirements on Entry	8	0.875
– Regulatory and Fiscal Policy Requirements on Operations/Transactions	8	0.763
– Foreign Direct Investment (FDI)	8	0.781

Cronbach (1951) held that Cronbach coefficients of 0.7 and above show that the overall research instruments were reliable. As can be seen in Table 4.1, the response to the structured questions exploring each variable was 0.7 and above, hence the instruments were reliable.

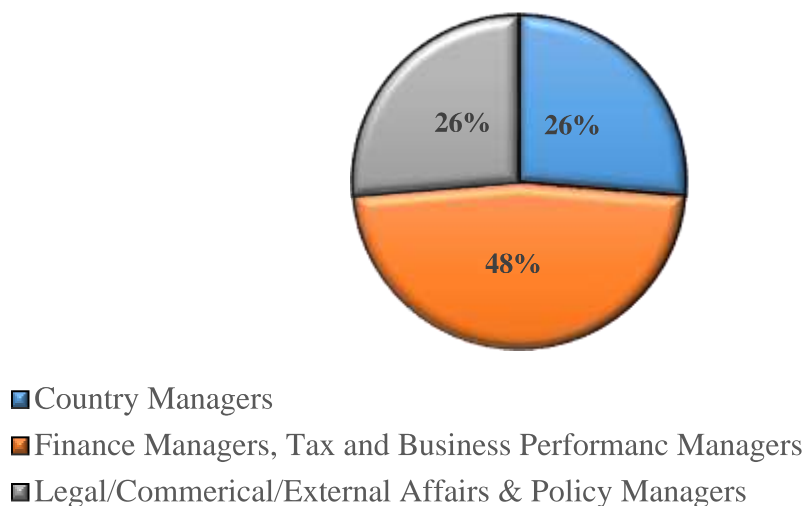
4.2 General Information

The general information of the respondents of the study are indicated in subsequent sections.

4.2.1 Job Designation and Length of Service

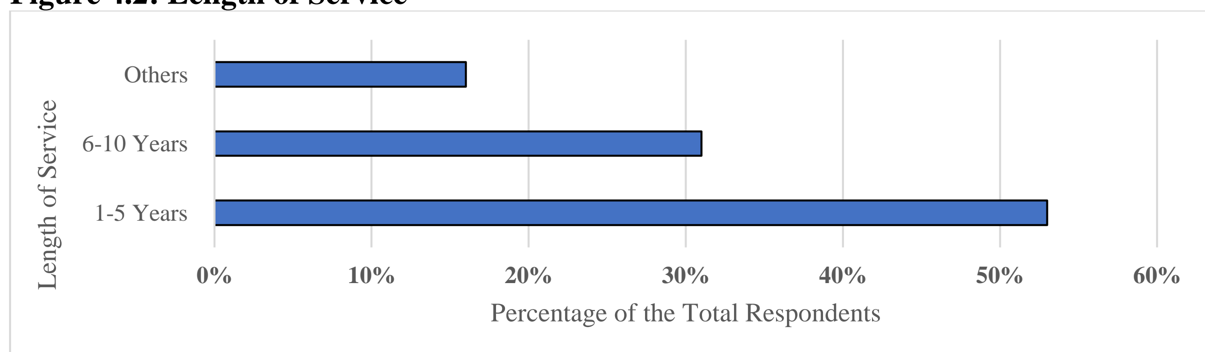
The study targeted country managers as well as mangers in the finance, tax, business performance, commercial, legal, policy and external affairs departments. Country managers constituted slightly more than a quarter of the respondents whereas the majority were from finance, tax and business performance functions. Figure 4.1. below illustrate the findings.

Figure 4.1: Job Designation



The period that respondents had worked in their respective firms are shown in Figure 4.2 and as may be seen, over 50% the of the respondents had worked for a period of one to five years, whilst 31% had worked for a period of six to ten years.

Figure 4.2: Length of Service



4.2.2 Incorporation, Parent Company Location and Foreign Participation

To determine the extent of foreign ownership and control of the firms constituting the population, it was sought to establish the country of incorporation, home country for the parent company as well as the mode of set up in Kenya. From the findings, a majority of the firms were incorporated in Netherlands whereas the home countries for the parent companies, revealed countries like Canada, France, Netherlands, United Kingdom and the United States of America. Save for one, all the rest of the firms were found to have set up in Kenya as branches with 100% foreign ownership.

The study also investigated the year that the companies had set up operations in Kenya. In view of the findings, the oldest company started operations in Kenya in 2007 and it was also apparent that a majority of the firms had been operation in Kenya for between five to ten years.

4.2.3 Average Investment Since Inception

The study sought to determine the average level of investment spent by each of the firms in Kenya in the form of foreign direct investment since inception. Table 4.2 gives breakdown of the findings and as may be noted, a majority had spent between United States Dollars one hundred to five hundred million with one having spent over United States Dollars one billion.

Table 4.2: Average Investment Since Inception

	Frequency	Percentage
Less than 100 USD Millions	2	28.5%
100-500 USD Millions	3	42.9%
500-1000 USD Millions	1	14.3%
Over 1000 USD Millions	1	14.3%

4.3 Rating of Regulatory and Fiscal Policy Requirements

Respondents were requested to rate the extent; whether low, moderate, high or very highly, to which policy requirements affected FDI in Kenya. The findings are compared and illustrated in Figure 4.3 below.

Figure 4.3: Perception of Extent Regulatory and Fiscal Policy Requirement on FDI

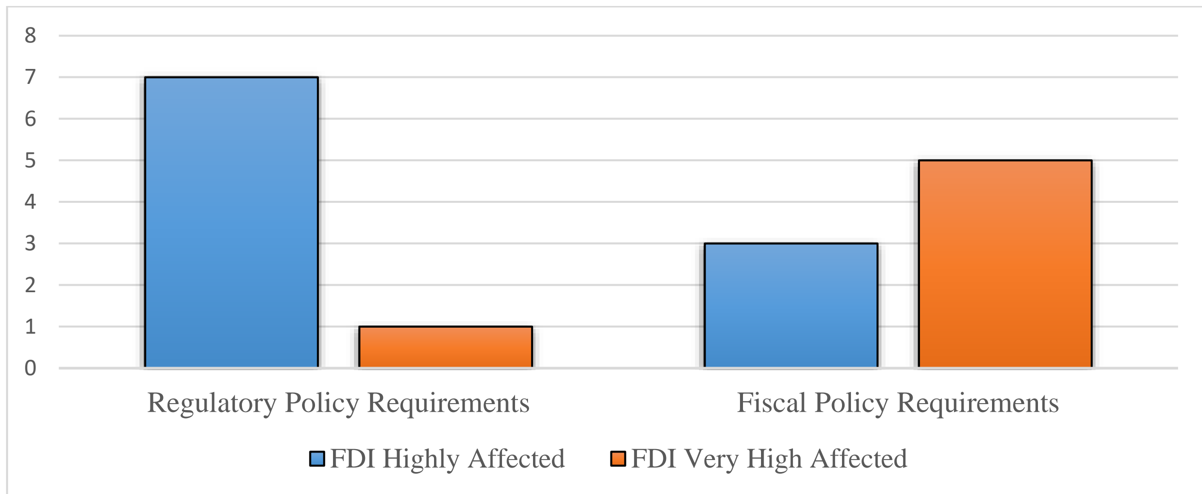


Figure 4.3 gives a rating on how regulatory and fiscal requirements influenced FDI in Kenya. 88% of the respondents perceived regulatory requirements highly affected FDI and only 12% indicated that it very highly affected FDI. Only 27% of the respondents perceived that fiscal requirements highly affected FDI whereas in contrast to regulatory requirements, 63% of the respondents perceived that fiscal requirements very highly influenced FDI.

4.4 Regulatory and Fiscal Policy Requirements and Firm Entry Decision

Several statements on key government regulatory and fiscal policy requirements were carefully identified in the research. Respondents were requested to indicate the extent of their agreement on each of these statements using a scale of 1-5, where 1-not at all, 2-low extent, 3-moderate extent, 4-large extent, 5-very large extent. Results of the mean score are in Table 4.3 below.

Table 4.3: Regulatory and Fiscal Policy Requirements and Firm Entry Decision

	Mean	**Standard. Deviation**
Entry procedural requirements (legal requirement affecting set up of the company in Kenya e.g. incorporation, licensing, etc.)	3.14	1.212
Operational and transactional requirements (legal requirements affecting the operations of business in Kenya) e.g. environmental, labour, petroleum, land access, security, import/export control, marine, local contents, competition etc.)	3.26	0.853
Production sharing contract (PSC) related payment (requirement to pay signature bonus, surface fees, training fees, etc.)	3.02	0.741
Capital allowance requirement (Deductibility of exploration or development expenditure).	3.14	0.738
Tax treaty (nonexistence double tax treaty with home country of incorporation.	2.28	0.670
Transfer pricing requirements.	3.14	0.595
Tax requirement (corporate income tax rate, value added tax rate, withholding tax rate, branch tax rate, capital gain tax rate).	3.78	0.574
Duty rates requirements (import duty, excise duty, stamp duty).	3.26	0.663
Average Mean and Standard Deviation	**3.13**	**0.756**

As indicated in Table 4.3, the most significant regulatory and fiscal policy requirements that affected entry decision were tax and duty requirements with means of 3.78 and 3.26 respectively, followed by operational and transactional regulatory requirements with a mean of 3.26. However, the existence of tax treaties with home country was least, with a mean of 2.28. Respondents were further asked for additional comments, to which a number noted that the existence of an attractive geology was a key consideration and which confirmed past studies (African Development Bank & African Union, 2003; & Some, 2013). Additionally, the stability and predictability of the fiscal, regulatory environment given the long term nature of the investment was also noted as being significant. This coincided with previous studies (Asiedu, 2013) reviewed in literature.

4.5 Regulatory and Fiscal Policy Requirements and Firm Operations in Kenya

The researcher carefully identified several statements on current requirements and how they affected business operations. Respondents were requested to indicate the extent of their agreement on each of these factors using a Likert scale of 1-5, where 1-not at all, 2-low extent, 3-moderate extent, 4-large extent, 5-very large extent. Summary is in Table 4.4 below.

Table 4.4: Regulatory and Fiscal Policy Requirements and Firm Operations in Kenya

	Mean	Standard. Deviation
The current regulatory requirement for the gas and oil sector, positively affect the operations of the company.	2.86	.722
The current regulatory requirement for the gas and oil sector, negatively affect the operations of the company.	3.44	.640
Regulatory incentives (those who know) have led to in operations of foreign companies.	1.92	.388
Rationalizing and reducing import or export related taxes in the oil and gas sector has increased foreign investment by the firm.	2.78	1.022
Policy incentives targeting the oil and gas sector, such as tax exemption has increased availability of capital for foreign investment by the company in the said sector.	2.85	.559
Government restrictions in the oil and gas sector is directly affecting the foreign direct investment by the company.	3.28	.821
Liberalization of government regulation in the sector has affected the operations of the company.	2.52	.971
There is decline of overall administration costs associated with regulatory compliance since the start of business in the country.	1.86	.833
Average Mean and Standard Deviation	**2.69**	**0.745**

As indicated in Table 4.4 above, the most significant regulatory and fiscal policy requirements that affected company operations in Kenya were regulatory requirements and government restrictions with means of 3.44 and 3.28 respectively. There was consensus that there had not been a decline in administrative regulatory compliance costs as this had the least mean of 1.86.

Unexpectedly, increased availability of capital for foreign investment following policy incentives such as tax exemptions, had a mean of 2.85. Respondents additional comments on this issue were consistent with past studies and also revelatory. These were clustered into four.

For starters, the rigidity in execution and administration of laws made operations and transactions challenging. An example cited was transfer of materials and equipment, obtaining exemptions among others. Second, incentives given in the Production Sharing Contracts were not being honoured by all arms of the Government and County Governments. In addition, taxation of the sector did not align with the oil and gas cycle and respondents observed that Government taxes were stringent and burdensome as they targeted investments and loans received from their parent companies. Fourthly, the introduction of county government requirements following introduction of devolution. Lastly, other items that respondents felt affected their operations in Kenya were political stability, security and community relations.

4.6 Growth of Foreign Direct Investment in the Sector

Several statements on growth or increase of FDI by the companies were carefully identified by the researcher. Respondents were requested to indicate the extent of their agreement on each of these statements using a Likert scale of 1-5, where 1-not at all, 2-low extent, 3-moderate extent, 4-large extent, 5-very large extent. Results of the means are summarised in Table 4.5.

Table 4.5: Foreign Direct Investment

	Mean	Standard. Deviation
There has been an increased level of equity capital into the company, which has influenced company operations or new projects since start of business in Kenya.	2.59	1.168
There has been an increased level of imports and exports by the company since start of business in Kenya	2.42	1.355
There has been an increased level of specialized expatriate labour by the company since start of business in Kenya	3.20	.710

	Mean	Standard. Deviation
There has been an increased level of local labour by the country since the start of business in the Kenya	3.27	1.190
There has been an increased level of mergers and acquisition transactions by the company, since the start of business in Kenya	1.97	.951
There has been an increased level of economic cooperation and development between Kenya and our home country	2.59	.949
There is an increased use by the company, of advanced technology (that is not available in Kenya, in its operations since start of businesses in Kenya).	4.06	.548
There is an increased level of re-invested earnings in the company since start of business in Kenya	1.79	1.221
Average Mean and Standard Deviation	**2.74**	**1.011**

As observed in Table 4.5 above, it was noted that there has been an increased level of use advanced technology, local labour and specialized expatriate labour. These ranked the highest with means of 4.06, 3.27 and 3.20 respectively. However, all the other parameters touching on issues of increased equity capital, increased mergers and acquisition, increased economic cooperation with home country and increased re-invested earnings, were very lowly ranked with means of 2.59,2.42, 1.97, 2.59 and 1.79 respectively.

In this section respondents also commented that, the downturn in the O&G sector over the past two years continued to have a detrimental impact on investment in Kenya. This confirmed similar observations made by Tims (2015) and Sunday (2016). Others noted that though mergers and acquisitions were witnessed at a parent company level, the same was not consistent with the Kenyan operations. Others also stated that with regard to their firm, the growth of FID is affected with perceived competitiveness or otherwise of Kenya's fiscal and regulatory policy compared to other countries with comparable hydrocarbon resources.

4.7 Diagnostic Tests

Many of the statistical procedures including correlation, regression and variance analysis are based on the assumption that the data follows a normal distribution (Sekran, 2003). Therefore, before carrying out inferential statistics, diagnostic tests were conducted to determine suitability of the data set. These included multicollinearity and normality tests as seen below.

4.7.1 Multicollinearity

Multicollinearity was tested using Variance of Inflation Factor (VIF). The findings are indicated in Table 4.6 below.

Table 4.6: Multicollinearity

	Collinearity Statistics	
	Tolerance	**VIF**
(Constant)		
Regulatory and Fiscal Policy Requirements (Firm Entry)	.444	2.255
Regulatory and Fiscal Policy Requirements (Firm Operations in Kenya)	.405	2.469

From the findings, the values of VIF lied between 1-10, an indication that there was no multicollinearity in the data set and was thus, suitable for regression modeling.

4.7.2 Normality

Normality test was done using Skewness and Kurtosis, this being the degree of pointedness of the distribution as compared with normal distribution. The findings are shown in Table 4.7.

Table 4.7: Normality

	N	Skewness		Kurtosis	
	Statistic	**Statistic**	**Standard. Error**	**Statistic**	**Standard. Error**
Increase of Foreign Direct Investment	8	-.697	.752	1.553	1.481
Regulatory and Fiscal Policy Requirements (Firm Entry)	8	.945	.794	-.970	1.587
Regulatory and Fiscal Policy Requirements (Firm Operations in Kenya)	8	.262	.752	-1.401	1.481

As may be seen, Table 4.7 shows values of skewness and kurtosis that ranged within +2 or-2. According to Kothari (2004), data analysis proceeds if values of skewness are within + or – 2. The data set was therefore normally distributed.

4.8 Correlation Analysis

Correlation analysis was conducted to compare the relationship between the variables; government regulatory and fiscal policy requirements and FDI in oil and gas sector in Kenya. The findings are indicated in Table 4.8

Table 4.8: Correlation Analysis

		Foreign Direct Investment	**Regulatory and Fiscal Policy Requirements (Firm Entry)**	**Regulatory and Fiscal Policy Requirements (Firm Operations in Kenya)**
Foreign Direct Investment	Pearson Correlation	1		
	Significance (2-tailed)			
Regulatory/ Fiscal Policy Requirements (Firm Entry)	Pearson Correlation	.678*	1	
	Significance (2-tailed)	.045		
Regulatory/ Fiscal Policy Requirements (Firm Operations in Kenya)	Pearson Correlation	.831*	.818	1
	Significance (2-tailed)	.005	.007	

N= 8

*. Correlation is significant at the 0.05 level (2-tailed).

From Table 4.8 above, regulatory and fiscal policy requirements(entry) and FDI was significant relationship, with r =0.678(being more than a Pearson's r of 0.5); at p=0.045 (being less than 0.05). Regulatory and fiscal policy requirements (operations) and FDI was also a significant relationship with r =0.831(being more than Pearson's r of 0.5) at p=0.005. This shows that regulations and fiscal policy directly affected FDI in the sector in Kenya.

4.9 Regression Analysis

In order to assess how regulatory and fiscal policy requirements influenced FDI in O&G sector in Kenya, regression analysis was done. The findings of the Model Summary, the Analysis of Variance (ANOVA) and the regression coefficients are indicated in the following sub-sections.

4.9.1 Model Summary

The Model Summary in Table 4.9 below gives a breakdown of the coefficient of correlation R and the coefficient of determination R square.

Table 4.9: Model Summary

Model	R	R Square	Adjusted R Square	Standard. Error of the Estimate
1	.831[a]	.691	.588	3.161

a. Predictors: (Constant), Regulatory/ Fiscal Policy Requirements (Firm Entry), Regulatory/ Fiscal Policy Requirements (Firm Operations).

From the Model Summary in Table 4.9 above, first, the coefficient of correlation R was 0.831, which is positive. This indicates that government regulatory and fiscal(tax) policy requirements have a positive influence on FDI in the O&G sector. Second, the coefficient of determination R square was 0.691, showing that 69.1% change in FDI in the O&G sector was explained by regulatory and fiscal policy requirements. Thirdly, the standard error of the estimate was 3.161 which could be relied on for a significant prediction level.

4.9.2 Analysis of Variance

An Analysis of Variance (ANOVA) was conducted at 5% level of significance. The findings are indicated in Table 4.10.

Table 4.10: Analysis of Variance

	Sum of Squares	df	Mean Square	F	Sig.
Regression	134.048	2	67.024	6.708	.030[b]
Residual	59.952	6	9.992		
Total	**194.000**	**8**			

a. Dependent Variable: Foreign Direct Investment
b. Predictors: (Constant), Regulatory/ Fiscal Policy Requirements (Firm Entry), Regulatory/ Fiscal Policy Requirements (Firm Operations).

From the ANOVA Table 4.16 above, that the F-ratio value of 6.708 with 2 and 6 degrees of freedom(df) has a probability of occurrence by chance alone of less than 0.030, being less than 0.05(5%). This shows that the overall regression model was a significant predictor of the effect of the regulatory and fiscal policy requirements on FDI in the O&G sector.

4.9.2 Regression Coefficients

The beta coefficients and the respective p values are indicated in Table 4.11.

Table 4.11: Regression Coefficients

	Unstandardized Coefficients		Standardized Coefficients		
	B	Standard. Error	Beta	t	Sig.
(Constant)	6.537	7.138		.916	.395
Regulatory/ Fiscal Policy Requirements (Firm Entry),	-.004	.398	-.004	-.010	.992
Regulatory/ Fiscal Policy Requirements (Firm Operations).	.781	.369	.835	2.116	.079

a. Dependent Variable: Foreign Direct Investment

The resultant equation therefore becomes: $\mathbf{Y = 6.537 - 0.004X_1 + 0.781X_2}$

Where **Y**= Foreign Direct Investment, $\mathbf{X_1}$= Regulatory/ Fiscal Policy Requirements (Firm Entry) and $\mathbf{X_2}$= Regulatory/ Fiscal Policy Requirements (Firm Operations).

From the findings, when all factors were held constant, FDI in the O&G sector in Kenya would be at 6.537. A unit decrease in key government regulations and fiscal policy requirements (affecting firm entry) would result into 0.004 increase in FDI in the O&G sector. A unit increase of a positive regulatory and fiscal policy environment (reducing regulations that affect firm operations), would increase FDI in the O&G sector by 0.781.

4.10 Discussion of the Findings

Having reported the findings on the data collected and analysed as part of this research, this study now turns to describe the significance of the findings and the interpretations thereof in light of the objective of the study and the literature already reviewed. The study aimed at establishing the effect of the government's regulatory and fiscal policy requirements on FDI in the O&G sector in Kenya by seeking to explore the possible relationship between the investment behaviors of foreign firms in this sector and the regulatory and fiscal requirements.

4.10.1 Discussion on General Information on the Foreign Firms in the Sector

As mentioned in the literature review, FDI is described as a cross border investments made by a resident in one country with the objective of establishing a significant level of control in an enterprise located in another country and to this end, MNCs are major players (OECD, 2008). The findings on the firms surveyed confirmed that they are all foreign owned, set up in Kenya as branches with 100% foreign participation and thus no form of joint venture with local firms. This supports the idea that since investment in the sector is capital intensive and highly risky with no guarantee of oil being discovered, local companies may not have the capacity or willingness to be involved at the onset (Piana, 2005; Asiedu,2013). Additionally, majority of the firms had spent over United States Dollars one hundred million since setting up and with no turn over to date.

This finding supports the idea that the sector is indeed capital intensive and the country benefits from such foreign direct investment; this probably contributing to the country's industry sector; which is approximately 17% of the country's GDP (Government of Kenya, 2015). The finding also supports the view that foreign firms strategically invest in this industry, cognizant that the capital requirements are a barrier to entry as looked at from the prism of Porter's five force model (Berger, 2014).

4.10.2 Discussion on Overall Perception of Regulatory and Fiscal Requirements

The findings under section 4.3 of this study, illustrated the response to what the overall perception on the extent government's regulatory and fiscal requirements have affected FDI. The response was overwhelmingly positive and was consistent with the findings under the structured sections of the instrument (Table 4.4 and Table 4.5); exploring in detail, the impact of regulatory and fiscal requirements on both the decision to enter into Kenya and the current operations of the firms.

However, of particular interest was that majority of the firms consider fiscal (tax) requirements as having a greater impact on FDI than regulatory requirements. This seems to contradict studies done, particularly in OECD countries, that found that on a whole, taxation was a relatively minor factor impacting on decisions of location of MNCS as compared to regulatory policies affecting ease of entry and of doing business (Corcoran,2012).

4.10.3 Discussion on Regulatory and Fiscal Policy Requirements and Firm Entry

In reviewing the findings on this issue, an important observation was that tax requirements and regulatory requirements for operational and transactional issues of the firms, to a large extent affected the firm's decision to invest in the country as compared to procedural requirements and existence of tax treaties with home countries. A probable explanation for the latter could be that many MNCs "shop" for favourable jurisdictions with which Kenya already has double tax treaties such as Netherlands and United Kingdom and incorporate the firms in the said jurisdiction notwithstanding that they may not be any treaties between the home country of the parent company and Kenya. It could also be inferred from the findings that Kenya has made significant progress in reviewing its procedural entry requirements and making it easier for investors to "set-up shop" (World Bank, 2010).

Content analysis of the additional commentary given by respondents on this issue, revealed the probable rationale behind this; that given the long term nature of these investments and the significant risk of failure, fiscal stability and predictability of the applicable taxes and regulations affecting the firm's operations are of greater significance than entry requirements and incentives. The propensity for government to change its fiscal policies with a view of increasing taxes, adversely impacts continued investment in the sector and also to a certain extent negates the concessions made to the investors in the Production Sharing Contracts. The capital gains tax charged at between 30%- 37.5% applied to farm in and farm out transactions, is punitive compared to 5% chargeable in other industries, yet these transactions are essential in order to attract additional investment and expertise required in various stages of the project.

It can be inferred that fiscal policy requirements will make such transactions commercially non-viable and therefore limit the ability of players in the industry to attract more financing, slowing down the growth of the sector. This finding corresponds with past studies (Karembu,2009) as well as with the findings in response to the questions on FDI and whether the respondents have witnessed increase in mergers and acquisition type transactions, this being reflective of FDI activity in a country and to which the overall response was in the negative.

4.10.4 Discussion on Regulatory and Fiscal Requirements and Firm Operations

In studying the effect to which the current regulatory and fiscal policy requirements affect the operations of the firms and their strategies, it was interesting to observe that, regulatory requirements negatively affecting operations in the sector, ranked highest and in tandem with this was the overall perception that there has been no decline in administration costs associated with regulatory compliance. These assertions were buttressed by a low value of standard deviation and further supported the comments given that, compliance with some of the regulatory requirements in place were cumbersome and tended to be punitive to the players.

The findings confirm a survey by Tannenwald (1997), that reported that, there is a negative relationship between regulatory stringency and economic activity on the part of a firm. Alhering (2004), also support this. Accordingly, there is evidence to suggest that the firms in the O&G sector reduce investments in light of regulatory stringency and costs.

4.10.5 Discussion on Growth of Foreign Direct Investment in the Sector

The results in response to this query revealed that, there was general consensus that there has been increased use of technology in Kenya since the start of operations by the firm and increased level of specialized expatriate labour. This supported what has been identified herein earlier in literature; that the sector is dependent on superior technology and expertise not easily available in host countries(Asiedu,2013). However, the level of equity capital invested or re-invested into the firms has only grown moderately and even to a low extent, probably evidentiary of the reduced funding available globally for investing in frontier exploration territories such as Kenya.

4.10.6 Further Interesting Finding

As already mentioned in this chapter, there were some unexpected results; these being contrary to expectations and studies relied on. Whilst the research found that fiscal tax requirements were seen as having impacted FDI in the sector very highly, it did not substantiate the finding that; policy incentives targeting the oil and gas sector, such as exemptions on import and export related taxes have only to a low extent, increased availability of capital for foreign investment by the firms. This finding is contrary to past studies that have identified import and export tax exemptions as key influencer of MNCs in the FDI decision making (Basu and Srinivasan,2002). A probable explanation could be that exemptions being given are not significant or that the O&G sector is unique and this issue warrants further study.

4.10.7 Discussion on the Model Summary

From correlation analysis and the model summary, besides a finding that there is an inverse relationship between government regulatory and fiscal policy requirements and FDI in the O&G sector in Kenya, the coefficient of correlation R was 0.831, which is positive. This indicates that government regulation and fiscal policy requirements have far reaching influence on FDI in O&G sector in Kenya. The coefficient of determination R square is 0.691, showing that 69.1% change in FDI in oil and gas sector is explained by government regulation and fiscal policy requirements. The remaining 30.9% could possibly be explained by other factors not considered in this study but have likely been among those addressed by others such as Gray (1997); Nyamwange, (2009); and Corcoran and Gillanders (2012) and include political stability, infrastructure, community relations, global oil prices among others.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The chapter summarizes the key findings and conclusions of the study in line with objectives. Suggested recommendations of the study for policy, theory and practice are also captured. The chapter also presents suggestions for further studies.

5.2 Summary of the Findings

The main purpose of the study was to determine the effect of the government's regulatory and fiscal policy requirements on FDI in the O&G sector in Kenya. The study relied on primary data collected using questionnaires and was analyzed descriptively and inferentially.

From the descriptive statistics, the study found that, generally, fiscal (tax) policy requirements have affected FDI in the O&G sector the most, followed by regulatory requirements affecting operational and transactional activities of the firms, in contrast to regulatory procedural requirements governing entry and set up in the country. The tax requirements in issue were found to include withholding tax applied on deemed interest for funds received by the firms in the form of loans from their parent companies, withholding tax applicable to dividends, royalties and services supplied by contractors and professionals in support of petroleum operations, value added tax imposed on services (despite incentives assured under the production sharing contracts) and capital gains tax charged is higher compared to others.

The second major finding of the study was that regulatory requirements affecting operational and transactional activities of the firms were found to touch on labour, immigration, land access, local content, competition and import and export control including disposal of materials to other firms in the same industry and the need for predictable stable regulatory and fiscal regime that is supportive of the production sharing contracts entered into the individual firms.

The third major finding was with regard to FDI. The descriptive studies indicated that investment of equity capital into the firms for purposes of increased operations or new projects has increased only by a very low extent, the level of mergers and acquisition type transactions since inception of operations, has also not increased to a large extent as expected and economic cooperation and development with home countries, in respect of the O&G sector, reflected as having experienced little to nil growth.

The diagnostic tests done fell within the required range, inferring that the data set was suitable for modelling. Correlation results indicated significant association between government regulatory and fiscal policy requirements on entry decisions and current regulatory and fiscal requirements on firms' operations and transactions on the one part and increase in foreign direct investment in the oil and gas sector.

5.3 Conclusion

The present study sought to address a literature gap and determine the effect of the government's regulatory and fiscal policy requirements on FDI particularly in the O&G sector and specifically in Kenya. From the regression results, it was revealed that the there was a significant inverse relationship between government regulatory and fiscal policy requirements and FDI in the O&G sector in the country. With a positive coefficient of correlation, it was established that the strength of the relationship is strong and that the current government regulation and fiscal policy requirements have far reaching influence on FDI in O&G sector in Kenya with over 50% change in FDI in the said sector explained by government regulatory and fiscal policy requirements and the rest possibly influenced by other factors (that were not covered in this study) such as political stability, security, infrastructure and geology.

Porter (1990) identified demand conditions, industry structure conditions, supporting industries conditions and factor conditions as the key determinants of national competitive advantage.

He also considered two variables that play a significant role in influencing these determinants, namely chance and the role of government, where the role of government involves development of polices that could influence these major determinants and enhance a country's competitive advantage. In light of this study and perspectives drawn from resource based theory and industrial organisation economics theory, Kenya has an opportunity to review its policies competitively position itself to attract investment in this sector so as to develop further.

5.4 Recommendations of the Study

Drawing from the findings in this study, the following recommendations are suggested: the regulatory and fiscal and policy impacting the O&G sector should be looked at as an entire framework appreciating the unique attributes of the sector and not selective pieces of legislation or fiscal policy instruments (Kemp & Kassim, 2006).

For starters, as the government (Treasury and Ministry of Petroleum and Mining) seek to encourage exploration and exploitation of the country's oil and gas resources, it should review the existing policy framework affecting the sector with an aim to ensure that the policy framework is designed to accommodate and support the industry so as to facilitate a win-win situation for all stakeholders. Done in a stable and transparent manner this will encourage efficient and effective exploration, appraisal and development given that Kenya's hydrocarbon geology is still not yet fully explored or de-risked. Secondly, fiscal(tax) policy requirements need to be reviewed to encourage farm-in and farm-out transactions that are necessary in attracting the required industry participants at the appropriate time in the oil and gas project lifecycle. Thirdly, to review both the regulatory and fiscal (tax) policy requirements to ensure that they do not erode the incentives given under the respective production sharing contracts whilst ensuring adequate government revenue(Amaedo,2017).

Lastly, it recommends that the top management of firms in the oil and gas industry should engage more among themselves with a view of tabling to policy proposals that will significantly improve the operational environment for their activities and result in a win-win for both the Government and the sector.

5.5 Limitations of the Study

The study relied on primary data collected using questionnaires. Some of the issued questionnaires were not returned or could not be returned within the timeframe of the study because of the stringent internal approval processes adopted by some of the firms; with some requiring approvals from their home country given the sensitivity with which these firms handle information. This reduced the response rate. Whereas the study was analysed using SPSS software, SPSS however cannot handle complex analysis especially the time series data extending into a wider span of time. Key assumption that required to be factored in, is the attractiveness of Kenya's geology.

5.6 Suggestions for Further Studies

The current study relied on primary data collected using questionnaires, future studies should use both primary and secondary data. The analysis in the current study was limited to regulatory and fiscal policy requirements as the variables and assumed that the geology was attractive. Future scholars should consider evaluating the extent to which regulatory and fiscal requirements affect in FDI in this sector in comparison to other factors that generally tend to also impact on FDI in this sector, such as the geology, political stability, security, community relations and infrastructure. It is also recommended for a study to be done to determine the extent to which import and export related taxes increased availability of capital for foreign investment by the firm's in this sector.

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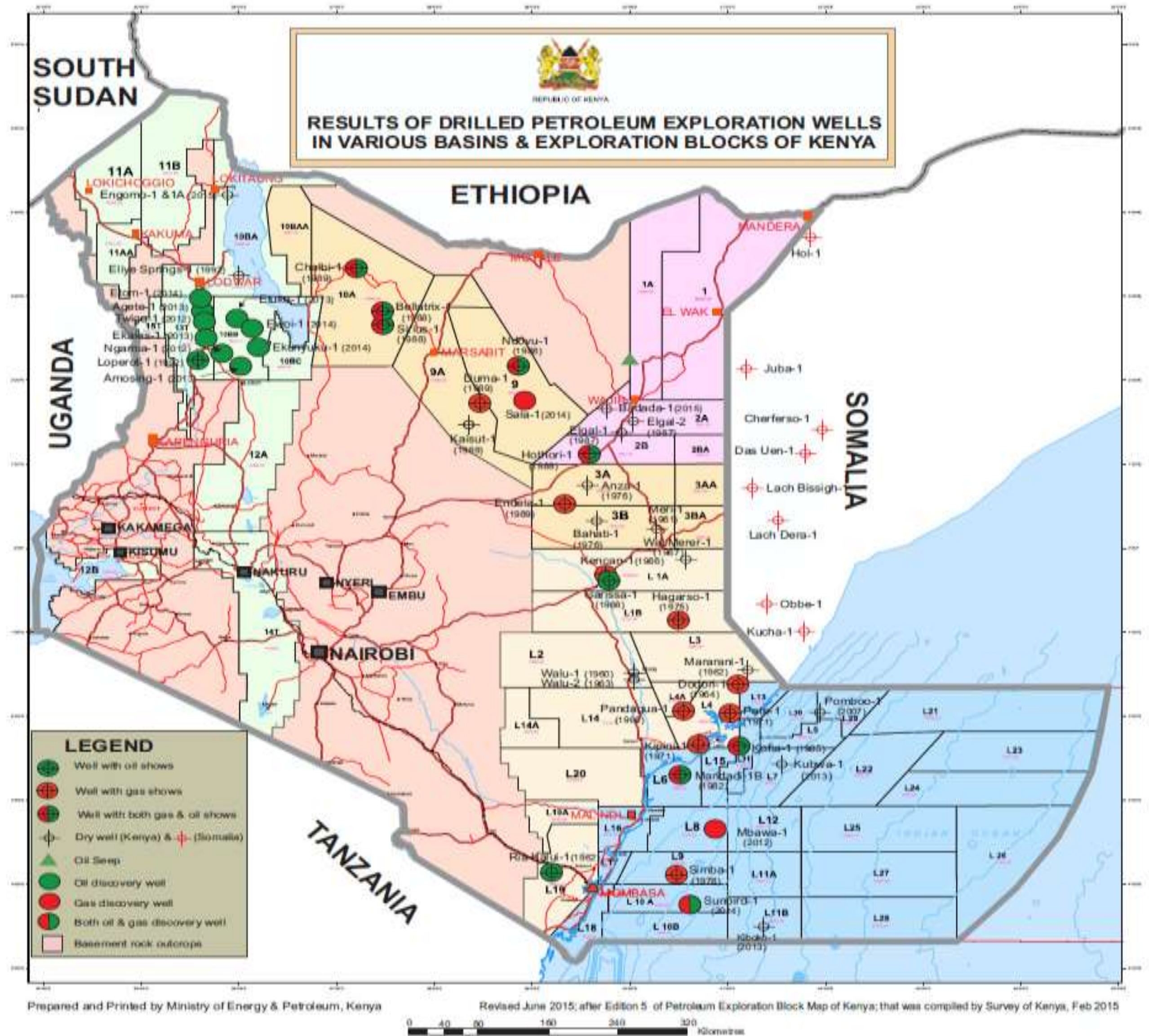
APPENDIX I: MAP OF OIL BLOCKS & LIST OF ACTIVE FOREIGN FIRMS



	Firm	Block
1.	Africa Oil Corporation	Block 9
2.	Simba Petroleum	Block 2A
3.	Shell/BG Kenya	Blocks L10A, L10B
4.	Total	Block L22
5.	Tullow Kenya	Blocks 10BAA, 10BB,12A,13T, 12B
6.	Erin Energy	L1B,L16,L27,L28
7.	ENI	Blocks L21, L23, L24
8.	Rift Energy	Blocks L19
9.	Zarara Oil & Gas	Blocks L4, L13
10.	A-Z Petroleum	Block L1A & L3
11.	Octant Energy Kenya	Block 1, L17 & L16 (Formerly operated by Afren Kenya)

Source: Ministry of Petroleum & Mining (2018)

APPENDIX II: INTRODUCTION LETTER

UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS

Telephone: 020-2059162
Telegrams: "Varsity", Nairobi
Telex: 22095 Varsity

P.O. Box 30197
Nairobi, Kenya

DATE 13th FEBRUARY 2018

TO WHOM IT MAY CONCERN

The bearer of this letter ARNOLD MAHERO

Registration No. D61/67921/2011

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

PROF. JAMES M. NJIHIA
DEAN, SCHOOL OF BUSINESS

APPENDIX III: QUESTIONNAIRE

Introduction

This questionnaire is intended for use in collecting data in pursuit of the objectives of the study titled "Influence of Government Regulatory and Fiscal Policy Requirements on Foreign Direct Investment in the Oil and Gas Sector in Kenya". It has three sections containing questions on: (i) General survey participant information; (ii) Government regulatory and fiscal policy requirements in the upstream oil and gas sector; (iii) Level and nature of foreign direct investment in the upstream oil and gas sector in Kenya. Kindly complete the questionnaire as per the instructions. Feel free to attach any other additional information you may deem useful for purposes of your feedback. Your participation is highly appreciated.

Section A: General Information

1. Name of organisation …………………………………………………………
2. What is your job designation or function in this company? (Please tick as appropriate.)

Executive Manager/Director	☐	Finance Manager/Officer	☐
Country/Business Unit Manager	☐	Legal Manager/Officer	☐
Business Development Manager	☐	Corporate Affairs/Policy Affairs Manager	☐
Commercial Manager/Officer	☐	Others (Specify):……………	
Investor Relations Manager/Officer	☐		

3. For how long have you held the position? (Please tick as appropriate.)

1-5 years	☐	Over 20 years	☐
6-10 years	☐	Other (please specify) …………………	
11-15 years	☐	………………………………………	

4. Home country of incorporation? …………………………………………………
5. Parent company home of incorporation? …………………………………………..
6. When did you set up in Kenya? ....

7. Please identify from list below, how you set up in Kenya (Please circle as appropriate):

a. Company fully incorporated in Kenya under Kenyan laws (Yes/No)

b. Company registered as a branch/place of business in Kenya (Yes/No)

c. Others? (Please explain) …………………………………………………………

8. Please describe the nature of foreign participation in the Company;

a. Foreign participation is 100………………………………………………………….

b. Foreign participation has more than 10% shareholder interest?….…

c. Others (Please explain.) …………………………………………………………

9. Using the company's annual returns as a guide, please indicate the average level of investment (in millions of dollars) that the company has invested/ directly spent in Kenya (including taxes) from inception to year end 2016?

…………………………………………………………………………………………

…………………………………………………………………………………………

Section B (1): Extent Regulatory and Fiscal Policy Requirement on FDI

10. How do you rate the extent to which the government regulatory and fiscal policy requirements have affected the foreign direct investment (tick where appropriate)

Regulatory requirements			**Fiscal (i.e. tax) requirements**	
Very high	☐		Very high	☐
High	☐		High	☐
Moderate	☐		Moderate	☐
Low	☐		Low	☐
Don't know	☐		Don't know	☐

Section B (2): Regulatory & Fiscal Policy Requirements (Firm Entry Decision)

11. The following are statements reflecting on some key government regulatory and fiscal policy requirements. Kindly indicate the extent to which these requirements affected decision to invest in the country or have affected the operations of the company:

[**1**-Not at all; **2**-Low extent; **3**-Moderate extent; **4**-Large extent; **5**-Very large extent.]

No.	Statement	1	2	3	4	5
1	**Entry procedural regulatory requirements** (i.e. legal requirements affecting set up of the company in Kenya e.g. *incorporation, tax registration, sector license i.e. obtaining PSC/Permit, incentive approvals, work permits, etc*.)					
2	**Operational & transactional regulatory requirements** (i.e. legal requirements affecting the company's operations in Kenya e.g. *environmental, labour, petroleum, land access, security, import/export controls, marine, local content, competition etc*.)					
3	**Production Sharing Contract (PSC) related payments** *(I.e. Requirements to pay signature bonus, surface fees, training fees, windfall profits, profit oil etc.*)					
4	**Capital allowance requirements** (i.e. deductibility of exploration or development expenditure)					
5	**Tax Treaty** (Non-existence of double tax treaty with home country of incorporation)					
6	**Transfer pricing requirements**					
7	**Tax Requirement** (Cooperate income tax rate, Value added tax rate, Withholding tax, Branch tax rate, Capital gains tax rates					
8	**Duty Rates** Requirements (Import duty rates, Excise duty rates, Stamp duty rates)					

Any other issue that may have affected the Company's decision to invest in Kenya or that affects your firm operations? Please state………………………………………………………………………………

Section B (3): Regulatory & fiscal Policy Requirements (Firm Operations and Transactions)

12. The following are statements reflecting on the current requirements and their impact on firm's behaviour. Kindly indicate your level of the extent at which you agree on the following statement. Using the following scale.

[**1**-Not at all; **2**-Low extent; **3**-Moderate extent; **4**-Large extent; **5**-Very large extent.]

No.	Statement	1	2	3	4	5
1	The current regulatory requirements for the oil and gas sector, positively affect the operations of the Company in the said sector?					
2	The current regulatory requirements for the oil and gas sector negatively affect the operations of the Company in the said sector?					
3	Regulatory incentives (those known to you) have led to the increase of the operations of the foreign companies?					
4	Rationalizing and reducing import or export related taxes in the oil and gas sector has increased the foreign investment by the Company in the said sector?					
5	Policy incentives targeting the oil and gas sector, such as tax exemptions has increased availability of capital for foreign investment by the Company in the said sector?					
6	Government restriction in the oil and gas sector is increasingly affecting the foreign direct investment by the Company in the said sector?					
7	Liberations of the government regulations in the sector has affected the operations of the Company?					
8	There is a decline of overall administrations costs associated with regulatory compliance since start of business in the Country?					

Any other comment you may have regarding the impact of regulatory or fiscal requirement on your Company's operations or strategic decisions? ………………………………………………………………………………………

Section C: Foreign Direct Investment

13. Below are statements describing aspects associated some aspects of foreign direct investment in the oil and gas sector in Kenya. Kindly indicate the level to which you agree with them in accordance to the following scale:

[**1**-Not at all; **2**-Low extent; **3**-Moderate extent; **4**-Large extent; **5**-Very large extent.]

No.	Statement	1	2	3	4	5
1	There has been an increased level of equity capital into the Company, which has influenced Company operations or new projects since start of business in Kenya?					
2	There has been an increased level of imports and exports by the Company since start of business in Kenya?					
3	There has been an increased level of specialised expatriate labour by the Company since start of business in Kenya?					
4	There has been an increased level of local labour by the Company since start of business in Kenya?					
5	There has been an increased level of mergers and acquisition transactions by the Company, since start of business in Kenya?					
6	There is an increased level of economic cooperation and development between Kenya and our Home Country?					
7	There is an increased use by the Company, of advanced technology (that is not available locally in Kenya, in its operations, since start of business in Kenya?					
8	There is an increased level of re-invested earnings in the Company since start of business in Kenya?					

Any other comment you may have reflective of the growth or otherwise of foreign direct investment by the company in Kenya?

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THANK YOU FOR YOUR TIME