FACTORS INFLUENCING STRATEGIES EMPLOYED BY SWEDISH TRADE COUNCIL IN PROMOTING FOREIGN DIRECT INVESTMENTS IN KENYA

BY

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STUDENT'S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university for academic credit.

Signed: ______________ Date: 15/10/2009.

Scolastica Kamau (D61/8745/2006)

The project has been presented for my approval as the appointed supervisor:

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DEDICATION

To my loving husband Kabui for believing in me and showering me with love and support that is beyond measure and my two fantastic children Weru and Nyakinyua whose love, encouragement and inspirations has seen me this far in pursuit of knowledge.

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LIST OF ABBREVIATIONS

FDI – Foreign Direct Investment

EBP – Enterprise Benchmarking Program

STC – Swedish Trade Council

UNCTAD – United Nations Conference on Trade and Development

IMF – International Monetary Fund

OECD – Organization for Economic Cooperation and Development

LDC's – Low Developing Country's

TNE's – Transnational Enterprises

WTO – World Trade Organization

ABSTRACT

This project examines the factors that influence strategies employed by Swedish Trade Council in promoting foreign direct investments in Kenya. Factors such as political and macroeconomic instability, low growth, weak infrastructure, poor governance, inhospitable regulatory environments, and ill-conceived investment promotion strategies, are identified as responsible for the poor FDI in Kenya. Developing countries actively promote FDI as it is generally recognized that FDI can make a significant contribution to economic development through the transfer of capital, technology and skills although such transfers are not automatic. However, as developing countries adopt a host of policies and strategies, including expensive incentives, to lure FDI, the success rate offers a mixed picture and is sometimes outright disappointing. In the final analysis, FDI will flow where business opportunities are the greatest and obstacles to business the smallest. While active investment promotion has proved to make a difference in Kenya, a comprehensive and consistent market-friendly development strategy adopted and implemented by a pro-active government which facilitates rather than obstructs business and is private sector oriented, promotes regional cooperation and embraces the global economy is the best guarantee that investors will find the country increasingly attractive for their investments.

The paper stresses the need for more trade and investment relations between Sweden and Kenya. It also argues Kenya should pay more attention to the improvement of relations with existing investors and offer them incentives to assist in marketing domestic investment opportunities to potential foreign investors. Consequently, concerted efforts are needed at the national, regional, and international levels in order to attract significant investment flows to Kenya and improve the prospects for sustained growth and development.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

It is generally believed that foreign direct investment (FDI) plays an important role as an accelerator promoting growth with technological transfers that creates employment in its footsteps (Aseidu, 2006). Governments have a role to try to increase trade and attract foreign direct investments. The most industrialized country in East Africa and one of the top performing countries in sub-Saharan Africa, Kenya provides an impressive array of reasons to invest in its industries. According to World Bank report 2006, the country is reported by foreign investors to have a well-developed port system with cold storage facilities and computerized port procedures, and a motivated work force. It is also a member of the East African Community (EAC) of 93 million people, where trade is envisaged to flow freely across Uganda, Tanzania and Kenya by 2013. Add to this Kenya's membership in the Common Market for Eastern and Southern Africa (COMESA), with nearly 385 million people, and it is easy to see why a number of international companies have chosen the country as a regional business hub.

The Government has implemented reforms in the legal framework for FDI in order to encourage investment. Some of these incentives include abolishing export and import licensing, except for a few items listed in the Imports, Exports and Essential Supplies Act (Chapter 502); rationalizing and reducing import tariffs; revoking all export duties and current account restrictions; freeing Kenya shilling's exchange rate; allowing residents and non-residents to open foreign currency accounts with domestic banks; and removing restrictions on borrowing by foreign as well as domestic companies.

As the world is becoming flatter exports are becoming more and more important for the Swedish economy. Sweden has maintained close relations with Kenya since independence. Swedish companies have showed increased interest in doing business with East African countries. The bilateral trade between Kenya and Sweden is fairly limited but is increasing with a number of Swedish companies establishing in the country. Embassy of Sweden, Kenya 2009 recognizes about 45 Swedish related companies represented in Kenya.

As a result of the increased interest in East Africa by Swedish companies, the Swedish Trade Council was established in Kenya in June 2007 as the regional hub for East Africa. The main purpose of STC is to promote and develop Swedish business in East Africa which is experiencing dynamic growth and on its way to developing a dynamic market economy. Other than Kenya, the office currently covers Tanzania, Uganda, Southern Sudan, Rwanda, Burundi, Ethiopia and the Democratic Republic of Congo.

1.1.1 Foreign Direct Investment Strategy

According to Kotler & Keller (2006), the ultimate form of foreign involvement is direct ownership of foreign-based assembly or manufacturing facilities. The foreign company can buy part or full interesting in a local company or build its own facilities. If the market appears large enough, foreign production facilities offer distinct advantages. First, the firm secures cost economies in the form of cheaper labour or raw material, foreign government investment incentives, and freight savings. Second, the firm strengthens its image in the host country because it creates jobs. Third, the firm develops a deeper relationship with government, customers, local suppliers, and distribution, enabling it to adapt its products better to the local environment. Fourth, the firm retains full control over its investments and therefore can develop manufacturing and marketing policies that serve its long term international objectives. Fifth, the firm assures itself access to the market in case the host country starts insisting that locally purchased goods have domestic content.

According to Kotler & Keller (2006), the main disadvantage of direct investment is that the firm exposes a large investment to risks such as blocked or devalued currencies, worsening markets, or expropriation. The firm will find it expensive to reduce or close down its operations, because the host country might require substantial severance pay to the employees.

1.1.2 Swedish Trade Council

The Swedish Trade Council was founded in 1972 and is owned in equal parts by the state and the business sector. In addition to their traditional consulting activities, they are assigned by the state to enable Swedish companies to grow internationally – among other things, through special investments in small companies, strategic sectors and emerging markets. Their joint state/business ownership also lends them credibility that opens many of the doors that would otherwise remain closed. This combination of theory and practice, of public and business sectors, is something that is entirely unique to the Swedish Trade Council. All large exporting companies have at one time been small, and nearly all of them have embarked on their international business journey on home ground. That is why their regional presence of export advisers in each county is just as important as their global presence in strategic markets worldwide

The Swedish Trade Council set up a regional office in Nairobi in June of 2007. The purpose is to promote and develop Swedish business in East Africa which is experiencing growth and on its way to developing a dynamic market economy. Other than Kenya, the office currently covers Tanzania, Uganda, Southern Sudan, Rwanda, Burundi, Ethiopia and DRC. STC helps Swedish companies to enter a new foreign market or to grow on an existing one. This may involve anything from assistance in preparing export initiatives in Sweden, to actual establishment and expansion on site. STC normally assist Swedish companies either in one or all the four stages outlined below.

The first stage of the business model is devoted to helping the company analyse his international competitiveness. They establish which markets suits the company best and what opportunities are open to him on the various markets. This often results in a comparative analysis, which is usually the best way to choose the most appropriate country. Once they agree on the market(s), they perform a market analysis to identify and map out the players, channels and trends. This enables one to determine how his competitors are currently acting and how they are likely to react to changes in their local surroundings. This stage involves one working closely with the regional Export Advisor and a trade Commissioner from the office on the relevant market. The goal here is to clarify what will be required in the areas of financing, training and, if appropriate, product/service development.

The second stage involves taking the first step into the market. They start with a business plan and their contribution here takes the form of all the specialist knowledge they possess about the market in question. Is it best to start a separate company, set up a subsidiary or purchase an existing business? Do you want to work with an importer or set up local representation on the market? Do you need to adapt the product in any way to facilitate sales? And which channels are most appropriate for reaching the customer groups you have targeted, in a way that best matches your brand? There is a whole range of questions that need answering. Their experience and market presence give you the answers needed so that they become important "building blocks" in the business plan that results from their combined efforts. This plan also contains a profitability analysis so that one can assess when his export initiative will begin to pay off.

The third stage of the business model involves putting the first two stages into action. At this point, you know which market you want to enter and how to approach it. Now it is simply a matter of doing it. Decide what form of company you want, find premises and personnel and start working. It is at this stage that the STC offers their Business Support Office function and it involves you operating from their premises and leaving much of your work to their staff. It is a cost effective way to set up operations with a low level of risk. Many Swedish companies have set up operations in this way, particularly when they wanted to test new markets. STC provides assistance with both sales interviews and recruiting processes, and after a while, the concept proved tenable and the company establishes its own presence on the market.

The fourth stage of the business model is all about monitoring the development of the market. The STC continuously monitor the development of the market to pinpoint interesting new business opportunities and they help in identifying new customer segments or sales channels, or assist in spotting opportunities in a broader product portfolio. The company involved and STC prepares an expansion analysis in which they look at the company's various opportunities to expand. STC also offers to act as the company's local business support department and to carry out the necessary activities. They can support companies to start up a partnership, cultivate customers in new segments, or prepare and carry out trade fair appearances and seminars. In this way, the company can continue to work on the market where it is already established, while simultaneously developing your business with lower risk.

1.2 Statement of the Research Problem

Kenya offers excellent investment opportunities for a range of sectors. Liberalization has made Kenya an attractive destination for foreign investments. However, Swedish companies are underrepresented in investments in emerging markets such as Kenya (Möjligheter, 2007).

However, there are still obstacles for companies in the establishing and operating phase. In 2005 Emerging Market Economies [EME] and Almaco Management Consultants Ltd conducted a research project called "Trade Facilitation Project in Kenya", commissioned by the Kenyan government. The project identified various factors as barriers of trade within Kenya and categorized them in four major groups: administrative barriers, infrastructural barriers, policy barriers and legislative barriers. The transport infrastructure is the major obstacle, especially roads, which are in bad shape even by regional standards. Governance and security are other important issues, although the Government has adopted various measures for fighting corruption and controlling crime.

In Kenya, research on factors influencing strategies in promoting FDI is very minimal. A number of studies have been carried out to document different areas on FDI in Kenya (Nazrine 2007; Musinga 1992, Mwabu 1989; Kioi 2003).

Nazrine (2007) did a study on Investor perception of the effectiveness of Kenya Investment Authority's Strategies for attracting and retaining foreign direct investments. The study also focused on establishing whether the effectiveness was related to investor characteristics.

In his study, Musinga (1992) investigated the factors that influence private investments in Kenya and estimated an investment function for Kenya based on the factors studied in order to bring into light those factors that are statistically significant in influencing FDI behaviour and which should be a focus to policy makers

Mwabu (1989) did a study on the factors that influence FDI. Using stepwise regression techniques in his analysis he found that government investment in infrastructure, deviation of GDP from the trend of the potential GDP and the previous years level of FDI were the major factors determining the flow of FDI into the country. He also found that changes in the domestic investment climate had insignificant influence on FDI.

Kioi (2003) did a study that examined the empirical relationship between net FDI flows and per capita GDP growth rates in the three East African countries for the period between 1991 and 2000. The study also examined how that relationship is affected by the financial sector development as indicated by bank development and stock market development. The study sought to determine whether FDI has significantly influenced growth and whether this relationship is equally significant for the three countries.

From all the above studies, none narrows to FDI as a strategy for enhancing cooperation between the public and business sector such as the one being used by the Swedish Trade Council which has been in existence since 1972 but set up a regional office in Nairobi in June of 2007. These studies on FDI in Kenya do not specialize on FDI as a strategy for enhancing cooperation hence leaving a gap for more research.

As such it is necessary to find out which factors have contributed to Swedish companies investing in Kenya, the barriers they have encountered and how they overcame these obstacles. Identification of these factors, barriers and solutions could provide guidelines for future entrants into the Kenyan market. In addition, studies in this field quickly become outdated since ongoing government reforms have a great impact on actual reality. As a result it is important to adapt existing knowledge to the current situations so as to make it applicable.

1.3 Research Objectives

The objective of this study is to determine the factors that influence Swedish investment into Kenya, the barriers they encounter and the solutions they have implemented. This study was guided by the following research questions formulated to aid in gathering the information regarding the research topic:

i. What types of legislation and policies attract Swedish investors in Kenya?

ii. What are the perceived barriers and or challenges?

iii. How are companies acting to overcome the obstacles?

1.4 Importance of the Study

The research will contribute to private companies and government organizations trying to assist foreign companies who want to invest Kenya. This research will hopefully enable various organizations identify which areas they need to concentrate on so as to attract more foreign direct investment. With regards to the Swedish Trade Council, the research will enable it to adequately advise Swedish companies interested in establishing in Kenya by pointing out areas that they need to look out for.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of the literature on the topic factors influencing strategies employed in promoting foreign direct investments. The chapter is structured on the basis of the research questions: types of legislation and policies that attract Swedish investors in Kenya, perceived barriers and solutions to the barriers. The aim of this literature review is to describe previously conducted research in the field and related material and also create a theoretical framework on how the analysis will be formed.

2.1.1 Conceptualizing Investment Promotion

Investment promotion is a range of different activities, many of which resemble marketing, used by governments in order to attract FDI. Investment promotion among other things also covers a wealth of activities like advertising, provision of market information, direct mailing, investment seminars or missions, organization and participation in trade exhibitions, identification of potential investors, matching future investors with local partners and investor facilitation in form of providing pre-investment, implementation and post-investment services to the investor. Usually the activities as incentives granting, screening and negotiation with foreign investors are not considered as investment promotion as such, however, some studies include them in the list. In very straightforward manner, investment promotion can be defined as "efforts by a government to communicate to foreign investors the nature of the country's investment climate, and to persuade and assist these investors to invest, or reinvest in the country." In most countries IPAs are directly responsible for investment promotion and its coordination.

Attracting FDI thus turned out to be a heavily used approach of many governments across the world to boost their economies. Many studies were devoted to the techniques how to do it. While there is hardly any universal blueprint most of them found out the necessity to improve host-countries" microeconomic and macroeconomic indicators together with the liberalization of their economy in order to succeed. Such approach, however, has not necessarily guaranteed anticipated success in attracting of FDI. This is where the concept of investment promotion stepped in. Many countries are faced with questions on why its necessary to promote a country and how to do it efficiently. Many countries wonder Why it is sometimes not enough to get the institutional, micro and macroeconomic „fundamentals" right and whether the country need a proactive and interventionist approach towards inward/ outward investments. These questions create the heart of the investment promotion debate, appearing in late 1980s when many developing countries and economies in transition tried to jump on the wave of opening up of the world economy and the growth of FDI worldwide.

2.1.2 Investment Promotion and FDI

Theory and previous research suggests that multi nationals corporations are attracted by factors related to country characteristics. These location-specific determinants are mainly political and economic fundamentals such as market size, overall political and economic stability creating perspective business environment, labor skills levels, availability of infrastructure, investment incentives, etc. Even though researchers have examined political, social, economic and policy variables trying to find a statistically significant relation with FDI, their individual importance remains open to permanent academic discussion and no single most important variable explaining FDI inflows has been isolated. While there is hardly any universal blueprint most of the studies found out the necessity to improve host-countries" macroeconomic indicators together with the liberalization of their economy in order to succeed. Another common feature of these earlier studies focused on FDI determinants is their omission of investment promotion as one of the important pull factors having impact on quantity and quality of attracted FDI. There are several points to be kept in mind while trying to describe the relationship between investment promotion and FDI inflow. First and foremost and as already shown in the literature review, investment promotion is closely associated with FDI inflows. Second, investment promotion is likely to have the greatest impact in group of countries where other factors that attract FDI (e.g. the degree of political and economic stability, nature of labor force, etc.) are most similar or close to equal. Third, and in relation to the previous point, such similar country characteristics able to attract FDI are often found in the developed industrial countries that devote great effort to getting their fundamentals right and that afterwards opt for investment promotion, which usually similarly as provision of investment incentives belongs to the last phase of FDI attraction. Morisset and Andrews validated such approach confirming that investment promotion makes more sense in countries that improved their fundamentals in the first place, because even superb investment promotion can only hardly compensate for poor investment climate.

2.2 The Concept of Strategy

According to Johnson and Scholes (2005), Strategy is the direction and scope of an organization over the long term, which achieves advantage in a changing environment through its configuration of resources and competencies with the aim of fulfilling stakeholder expectations.

Competitive Strategy

The competitive strategy literature has its origins in the late 1970s-early 1980s, closely associated with the reverse industrial organization concepts and work of Porter (1980: 1985). This "positioning" school of strategy posits that competitive strategy is the search for a favorable competitive position in an industry, the fundamental arena in which competition occurs. Competitive strategy aims to establish a profitable and sustainable position against forces that determine industry competition. The two fundamental questions underlying the choice of competitive strategy are either how attractive the industry is for long-term profitability and what factors determine the industry's attractiveness, and what determines the relative competitive position of firms within an industry.

Generic Strategies

In his book, *competitive strategy* Porter (1980) identifies three fundamental competitive strategies and lays out the required skills and resources, organizational elements and risks associated with each strategy. Overall cost leadership, Differentiation and Focus are referred to as the generic strategies. The generic strategies are not necessarily compatible with each other. Porter argued that firms that are able to succeed at multiple strategies often do so by creating separate business units for each strategy. The generic strategies each have attributes that can serve to defend against competitive forces. According to Porter (1980; 1985), the competitive school of strategy hypothesizes the external constraints to a firm's success, are determined by industry factors and socio-economic macro elements. Accordingly, industry opportunities and threats define the competitive environment with its attendant risks and potential rewards. Consequently, competitive strategy evolves from a sophisticated understanding of the structure of the industry and how it is changing. The second external factor acting as a constraint on sustainable competitive advantage according to the competitive strategy school is the socio-economic environment, including government policies, social concerns, and shifts in relative global political economy with consequent impact on the industry and individual firms.

2.3 Foreign Direct Investment

The generally recognized definition of FDI used by the United Nations Conference on Trade and Development (UNCTAD) in its World Investment Report series and based on the definitions by the Organization for Economic Cooperation and Development (OECD) and the International Monetary Fund (IMF) is an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate). FDI constitutes a long-term engagement of foreigners who make investment in fixed assets with the purpose of establishing a production capacity to make goods or produce services for sale at a profit. FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other ("host") economy.

Foreign direct investment (FDI) occurs when a firm invests directly in facilities to produce and/or market a product in a foreign country. FDI takes on two main forms; the first is a green-field investment, which involves the establishment of a wholly new operation in a foreign country. The second involves acquiring or merging with an existing firm in the foreign country. On the other hand, FDI is divided into two kinds: horizontal FDI (market-expansion investments) which is investment in the same industry abroad as a firm operates in at home; And vertical FDI (resource-seeking investments), which comprises two forms further; the first is backward vertical FDI investing an industry abroad that provides inputs for a firm's domestic production process. The second is forward vertical FDI in which an industry abroad sells the foods of a firm's domestic production processes. Foreign direct investment plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development.

The disadvantages of foreign direct investment occur mostly in case of matters related to operation, distribution of the profits made on the investment and the personnel. One of the most indirect disadvantages of foreign direct investment is that the economically backward section of the host country is always inconvenienced when the stream of foreign direct investment is negatively affected. It is normally the responsibility of the host country to limit the extent of impact that may be made by the foreign direct investment. They should be making sure that the entities that are making the foreign direct investment in their country adhere to the environmental, governance and social regulations that have been laid down in the country.

2.4 Legislation and Policies Affecting FDI

Foreign Direct Investment is playing an increasingly prominent role in the world economy, especially in developing countries, where FDI has now become the main source of development capital. While most countries have been offering assorted incentives (e.g., tax holidays) to attract more FDI, many countries continue to impose restrictions on FDI. These restrictions include the prohibition of FDI in certain industries, ceilings on the share of foreign equity (equity restrictions), controls on financial transactions between transnational enterprises and their local affiliates, minimum requirements for the use of local inputs, and restrictions on the employment of foreign personnel. Not surprisingly, both incentive and restrictive policies affect FDI flows [Clark (2000), Taylor (2000), and Asiedu and Lien (2002)]. It is therefore important to understand the factors that determine incentive and restrictive investment policies.

The intent of legislative action is supposed to facilitate economic activities, however, some elements can be found to be barriers to trade. To foreign investors, the major macroeconomic policies and indicators that matter are fiscal policies and budget deficits; monetary policies, the quality of monetary management by the central bank, their impact on domestic interest and inflation rates, and indirectly on the stability of domestic currency values; trade policies in terms of openness and liberalization under WTO rules; exchange rate policies concerning convertibility on the current and capital accounts; and debt management policies concerning both internal and external debt, the comfort levels involved in servicing both, and the risks that debt burdens pose to fiscal and/or monetary destabilization leading to a financial crisis and externally enforced structural adjustment. In all these cases foreign investors are usually more concerned about the quality of overall fiscal, monetary, exchange rate and debt management (i.e. in the quality of overall economic governance) in a particular country rather than about episodic fluctuations to which such countries are excessively vulnerable as long as such fluctuations are brought quickly under control through prudent policy and institutional management.

Foreign investors are particularly concerned with the stability and sustainability of fiscal policies in low development countries and the uncertainties/risks associated with fiscal destabilisation caused by sudden shortfalls in revenue or sudden increases in public expenditure: the level and growth of tax revenues and the dependency of such revenues on commodity prices and taxes, trade taxes, foreign aid and foreign borrowing; the structure of taxes and the long-term stability of tax rates applicable to corporate income and capital gains; tax allowances for accelerated depreciation and amortisation; excise taxes as well as taxes on imports, exports and value-addition or domestic sales; tax allowances or tax exemptions for export income; the size, sustainability and 'finance-ability' of budget deficits with investors being particularly concerned that unsustainably large budget deficits in low development countries usually presage major economic disruptions in terms of future tax rises and/or severe adjustment in curtailing public expenditures. Norberg (2002) claims that protection of property rights is central to creating a conducive environment for businesses and that it is the most fundamental piece in a capitalistic and market oriented system. Feng and Kugler (2002) conclude that policy choices at a single point affect a country's development path by impacting decisions across generations. The primary policy implication of this is that sustained economic development has political pre-requisites. It is now accepted by most development economists that an effective state is necessary for long-run economic growth and development and that political development is the key to long-run growth and attraction of investments in developing nations (Grabowski, 2006). The contrast between relatively high returns on FDI in Africa and the persistently low level of actual flows is seen as not only indicative of past policy mistakes but also suggestive of the potential rewards awaiting the region if it can improve its governance image in the eyes of international business. This is also supported by Guest (2005), who concludes that the return on investment in Africa is comparatively extremely high.

The Kenyan government has put in place elaborate reform programs which includes the Kenya Investment Promotion Act, 2004 through legislation to give the country an internationally competitive business environment in order to attract foreign direct investment. From a policy point of view, increases in the level of financial development, infrastructure development, and trade openness promote FDI. Both incentive and restrictive policies affect FDI flows [Clark (2000), Taylor (2000), and Asiedu and Lien (2002)]. Macro-economic factors are of great importance, governing individuals' and companies' decisions to invest in certain regions of the world. Factors such as market size, market growth and market access, resources and opportunities have great influence over such choices.

2.5 Perceived Barriers to FDI

FDI flows are dependent on the presence and/or absence of certain barriers. These barriers can deter FDI from entering, increase costs and increase the risks that foreign firms in low development countries have to deal with after they have entered. They influence cost estimates in project feasibility analyses and result in project possibilities in low development countries being perceived by foreign investors as unviable or sub-optimal well before serious consideration of other factors such as risk and investment climate influencing FDI entry has begun. The main barriers to FDI and indeed to domestic private investment as well in low development countries and other low-income countries fall into six broad interrelated categories which are Administrative Barriers, Information Asymmetries and Imperfections, Macroeconomic, Trade and Exchange Policy Regimes, Infrastructure Shortcomings, Constraints of Human, Social and Institutional Capital and Lack of International Competitiveness

A study of administrative barriers and other impediments to trade in Kenya which was conducted by Emerging Market Economics and Almaco Management Consultants Ltd in 2005 identified various barriers. These include administrative infrastructural, legislative and policy barriers. Identification of the current barriers especially to Swedish companies could provide guidelines for future entrants. Furthermore the studies in this field are quickly outdated since the reality is drastically changed by government reforms. A trade facilitation research project called "Study of Administrative Barriers and Other Impediments to Trade in Kenya" was conducted by Emerging Market Economics and Almaco Management Consultants Ltd in 2005. The study was done in recognition of the important role that trade facilitation could play in helping Kenya benefit from greater integration into the international trading system. In the study, 35 companies were surveyed in Kenya and they ranked their main concerns when conducting business as lack of professionalism, inefficient internal systems, inadequate consultation and information dissemination, lack of transparency, inadequate staffing levels, inadequate investment in physical equipment, inefficient use of IT, excessive documentation requirements, lack of coordination and cooperation with other trade agencies, unnecessary and time consuming physical inspections, focus on revenue maximization per shipment, high and/or unpredictable charges for services, high tariffs, cargo loss/damage, labour relations, inadequate transport infrastructure and financial constraints. (Appendix 11) They divided the obstacles in four main categories, administrative, infrastructural, policy and legislative barriers. The aim of the report was to form the basis for a co-ordinated approach to improving the trade facilitation environment in Kenya. An action plan was intended to be developed and agreed upon and the hope was that international donor community would support and finance the plan.

In a similar study conducted in 2007 businessmen in Kenya had ranked the existing obstacles as Corruption, inadequate supply of infrastructure, access to financing, tax rates, inefficient government bureaucracy, crime and theft, inflation, tax regulations, policy instability, poor work ethic in national labour force, government instability/coups, inadequately educated workforce, foreign currency regulations and restrictive labour regulations.(Appendix 1)

In the study conducted by Emerging Market Economies (2005), the most frequently identified obstacles fall into the category labelled administrative barriers. Mlambo (2005) stated that one of the major reasons for a weak investment climate in Africa lies in cumbersome administrative procedures. According to the survey the management tends to respond by implementing regulations in an overly bureaucratic manner or, where the regulations allow interpretation, subjectively interpreting the existing regulations. The subjective nature of the decision brings a strong element of risk into the transaction since it is difficult for importers to contest these decisions without being punished with substantial delays.

The second biggest identified barrier to trade also falls under the administrative barrier category, identified as "inefficient internal systems". What this primarily means is unnecessary and time consuming bureaucratic procedures. This can result in delays in decision making and dispute resolution, as one is passed from one officer to another to resolve an issue. Freight forwarders Interviewed stated that over ten steps were required for a typical import clearance transaction, and sometimes the same information can be checked by up to 4 officers.

Bureaucratic procedures in Kenya tend to leave officers with discretionary powers, which create uncertainty and unpredictability for investors, as similar issues are resolved in different ways. This uncertainty was discussed under Administrative Barriers and Other Impediments to Trade in Kenya, 2005. The threat of a delay in the clearance process due to a dispute in valuation is sometimes used to extract favours from importers in order to avoid penalty costs. This administrative ineffectiveness is conducive to an atmosphere where bribes are common. According to Okealaham and Bah (1999) corruption leads to economic inefficiency and especially emphasized is that the perception of corruption inhibits foreign direct investment

2.6 Solutions to FDI Barriers

In order to overcome some of the barriers experienced by foreign investors, the Trade Facilitation Project, an initiative of the Ministry of Trade and Industry funded by the Commonwealth Secretariat, developed through its core team of key trade facilitation stakeholders an eleven-point plan in October 2003. To overcome the challenges several measures were recommended including computerization of investment related offices, strengthening public-private sector partnerships in negotiating trading protocols, building capacity to monitor international trade, improving the investment environment and developing an export strategy.

There is need to reduce cost of doing business, simplify the regulatory environment, operationalize the 2004 Investment Promotion Act, improve governance and security, eradicate corruption and implement various Investment Policy recommendations such as the UNCTAD's Investment Policy Review of Kenya 2005. Kenya needs to build on four key strengths and opportunities: Her human resource base, which has the potential to be among the best in Africa;

Her relative level of industrialization and economic development compared to neighboring countries: Her membership to preferential trade agreements, including COMESA and the EAC; and land and climate, which offer decisive comparative advantages in certain key agricultural sectors and in tourism (Kikwai, 2005).

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter provides a discussion of the research methodology that was used in this study. It discusses the research design especially with respect to the choice of the design. It also discusses the population of study, sample and sampling techniques, data collection methods as well as data analysis and data presentation methods employed in the study.

3.2 Research design

The study was carried out through a case study design where the unit of study was the Swedish Trade Council in Nairobi. The design was most appropriate because there was need to conduct a detailed, in-depth analysis of Swedish Trade Council. According to Cooper and Schindler case studies place more emphasis on a full contextual analysis of fewer events or conditions and their interrelations. Case study research design provides very focused and valuable insights to phenomena that may otherwise be vaguely known or understood.

3.3 Data Collection Method

The study involved the collection of both primary and secondary data. To achieve this, an Interview guide was used to collect the data The study targeted the Swedish Trade Council staff members. The STC staffs were considered to be better placed in providing the data because they are involved in the day to day running of the Trade Council. The following key people were interviewed, The Trade Commissioner, Project Leader, Consultants and Associates. The interview guide was administered through mail whereby the interview guide was dropped after respondents have been explained the purpose of the study. The interviewees were given two days to familiarize themselves with the interview guide. This was followed by personal interviews that captured in-depth information and details that the researcher felt can be secured. Secondary data was obtained from the STC website, Embassy of Sweden, UN and World Bank documentations.

3.4 Data Analysis

Both the primary and secondary data was qualitative in nature. Content analysis was used to analyze qualitative data. According to Nachmias and Nachmias (1996), content analysis is a technique for making inferences by systematically and objectively identifying specified characteristics of messages and using the same to relate trends. The case used conceptual analysis by beginning with identifying research questions and choosing a sample or samples. Once chosen, the text was coded into manageable content categories. The process of coding was basically one of selective reduction. By reducing the text to categories consisting of a word, set of words or phrases, the researcher focused on words or patterns that were indicative of the research question.

CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

4.1 Introduction

The chapter highlights the findings from the interview conducted with the mangers of Swedish Trade Council. The interviewees were asked questions guided by the interview guide attached. However, due to nature of the interview, which was unstructured in nature, the findings were presented in a re.-organized but raw format. Furthermore, relevant information that was extracted from firm publications and their Website, is also presented.

4.2 Strategies used to promote Swedish Investments

The Swedish Trade Council makes it easier for Swedish companies to grow in Kenya by providing strategic advice and hands on support locally. By so doing they enable foreign ventures to proceed more quickly and more smoothly. The main strategies used to promote Swedish investments in Kenya as elicited by interviewees revolve around the services that the Swedish Trade Council offers to support Swedish Companies in Kenya. The STC has a broad experience of supporting Swedish company in the following areas: Market research, Agent/ partner search, Visiting programmes, Business set up, Recruitment services and Delegation/ Seminars and lobbying. On request STC can tailor make offers to meet the customers' demands. They offer business Support office, providing everything from office space to management service. The STC represent companies on a temporary or continuous basis and usually take an active role together with the Swedish Embassy to create a good working environment for Swedish Companies. The sectors targeted include, water and sanitation where we have companies like ITT, ClearBlue. In investments we have a company called Swedfund, PCM and in the manufacturing industry we have SSAB company. The transport industry is represented by Scania while Base camp explorer is in the tourism sector. The ICT sector is well represented by Ericsson who established Ericsson Kenya Ltd being the hub for East and Central Africa. The beauty sector is well taken care of by Oriflame cosmetics and Translation by a company called Tamarind.

4.2.1Market Research

STC conducts market research and analysis for Swedish companies that have never ventured into the region, as well as for those that have done so and are keen to expand. STC provide critical information about market potential, conditions for doing business, establishment costs, alternative locations and legal details. STC conducted a market study and visiting programme for Tamarind Translation with the aim of establishing whether there is a business interest in translation and interpretation services in Kenya. STC also conducted a market research and cost analysis for Sony Ericsson in regard to evaluating their establishment options in Kenya and East Africa. STC also did a market research for Swetrade Pharmaceuticals who are interested in introducing a water purifier to Kenya. A visiting programme was organized for the Swetrade management to meet and establish important contacts that would help them identify a possible market for their product. Most importantly, they offer recommendations on entry strategy.

4.2.2 Trade delegations and seminars

In addition to market studies, STC also organizes Trade Delegations with the Swedish Embassy to various countries in the region. The delegations are organized in close co-operation with the host government. The purpose is to promote Swedish business and industry towards foreign governments and business environment. STC organizes trade delegations and seminars that bring together all the stakeholders. Chief executives and representatives from Swedish Companies are invited to tour the country to prospect for investment opportunities. Trade delegations and seminars main aim is to highlight the market potential in Kenya. Most of the time STC target small and medium sized Swedish companies in Kenya and Sweden.

4.2.3 Business alerts

STC Nairobi is currently heading an assignment called Early Project Information. Through Business alerts, STC ensures that details about upcoming projects and tenders are distributed at an early stage to registered Swedish companies, giving them a competitive advantage over the rest. The Embassy of Sweden and the Swedish International Development Agency (SIDA) are partners in the project. Apart from Kenya, Tanzania and Uganda have now been fully integrated into the programme

4.2.4 Office Support.

Swedish Trade Council operates a Business Support office (BSO) whose aim is to provide all the required business support to the companies who either want to test the market or are looking for their own premises and resources. The STC normally hire out their personnel and also conduct recruitments for Swedish companies In addition, STC office space has turned out to be a meeting point for Swedish firms. They are currently sharing it with Swedish companies such as Ericsson, SAAB and Swedfund. As part of STC's Business Setup Services, they for instance offered their services in establishing Lundin Petroleum through recruiting the General Manager and Executive Assistant. And also searched and found office space for them

4.3 Factors Attracting Foreign Direct Investors in Kenya

One of the most important determinants of foreign direct investment is the size as well as the growth prospects of the economy of the country where the foreign direct investment is being made. It is normally assumed that if the country has a big market, it can grow quickly from an economic point of view and it is concluded that the investors would be able to make the most of their investments in that country. In case of foreign direct investments that are based on export, the dimensions of the host country are important as there are opportunities for bigger economies of scale, as well as spill-over effects. The population of a country plays an important role in attracting foreign direct investors to a country. In such cases the investors are lured by the prospects of a huge customer base. Now if the country has a high per capita income or if the citizens have reasonably good spending capabilities then it would offer the foreign direct investors with the scope of excellent performances

The interviewee agrees that Kenya has become a high-potential investment area. The economy is growing fast and a lot of opportunities are present. This has made Kenya an attractive destination for foreign investments. The Government has implemented reforms in the legal framework for FDI in order to encourage investment. Some of these incentives include abolishing export and import licensing, except for a few items listed in the Imports, Exports and Essential Supplies Act (Chapter 502); rationalizing and reducing import tariffs; revoking all export duties and current account restrictions; freeing Kenya shilling's exchange rate; allowing residents and non-residents to open foreign currency accounts with domestic banks; and removing restrictions on borrowing by foreign as well as domestic companies. Furthermore, there is the creation of Kenya

Investment Authority and Invest Kenya which promote Kenya as an area to invest in. Liberalization has made Kenya an attractive destination for foreign investments.

Other factors that are considered to make Kenya an attractive investment destination are good range of tax treaties and investment promotion and protection agreements, a pro- investment Government, business friendly regulatory reforms, large pool of skilled English speaking enterprising workers, strategic location as a regional financial, communication and transportation hub, well developed social and physical infrastructure, fully liberalized economy, preferential market access to United States of America and the E.U. and well established local and foreign sector. In addition, there are numerous opportunities for investment in Agriculture, Tourism, Building and Construction, Infrastructure, Energy, Manufacturing, Environment and Natural Resources, Money, Banking, Finance, and Information Technology.

4.4 Motives For Investing in Kenya

In the last decades of globalization, the world economy has become increasingly more integrated through international trade and foreign direct investment. One of the primary effects of the new economic environment is that firms are now more flexible in how they may produce and deliver goods and services to foreign destinations. With a small domestic market, many Swedish companies need to venture into international markets to attain sustainable growth.

The main motive for entering the Kenya market as elicited by the interviewees, included the sheer size of the market and the business opportunities for growth and profitability that it presents, particularly in the ICT industry. The companies deemed the potential for ICT development to be presenting tremendous opportunities, which have been the catalyst for implementing the direct investment decision. Interestingly, according to the interviewees, the lower cost of labour is not significant determinant for Swedish companies. Another factor that seems to have played a significant role for the companies' decision to enter Kenya was the recognition that important competitors were also eyeing up the market and about to enter or have already established their presence in the country. It follows that the motives of Foreign Direct Investors, may include market seeking and to counteract competitors' strategies and/or position themselves for future strategic growth.

Kenya is still developing and therefore foreign market seekers have access to untapped market in all sectors. Swedish Trade Council being locally established can provide Swedish firms with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. New market access is also another major reason to invest in a foreign country. At some stage, export of product or service reaches a critical mass of amount and cost where foreign production or location begins to be more cost effective. Any decision on investing is thus a combination of a number of key factors including assessment of internal resources, competitiveness, market analysis and market expectations.

4.5 Preferred Mode of Entry

The preferred mode of entry as elicited by the interviewees is establishing a local representation either through the setting up of a limited company or a branch office. Other companies also choose to enter the market through the use of agents and partners who stock their products. Various factors may account for the choice of a particular mode for entering a foreign market. For instance, according to interviewee, the choice may depend on product characteristics such as degree of differentiation, importance, age, and technological content. Certain firm characteristics such as size and resources, degree of diversification and corporate policies may also have an impact. Finally, entry mode choice by firms may also be determined by external environmental factors: host country trade and investment restrictions, host country market size, host country geographic and cultural distance, and exchange rate fluctuations.

4.6 Preferred Location.

The attractiveness of a market has been characterized in terms of its market potential and investment risk as well as resource abundance in the geographical location. Nairobi is the preferred location because it is the capital city of Kenya. It is the economic hub for East Africa. The fact that it is the only UN head quarter in Africa and hosts many regional offices for many international companies makes it more attractive. Furthermore Nairobi is where the government operates from and as such the standards of infrastructure and services are higher than in the rest of the country. The location of Swedish companies in Kenya is influenced by proximity to the regulatory authority, current and future market demand, and the presence of other foreign investment in the location. The emergent reasons for locating in a particular area or city include the presence of good infrastructure in terms of transport and communication networks as well as good port facilities that can offer opportunities for developing sea networks with other regions and countries. It is only natural that special economic zones, established commercial centers' and open cities will be preferred for foreign investment as they tend to reduce the uncertainty associated with FDI and take advantage of the privileges that these areas offer. Foreign Investors tend to favour locations with an established industrial base and well-developed physical infrastructure and other region-specific political and socio-economic factors as well as control on other firm resources.

4.7 Legislation and Policies that attract Swedish Investors in Kenya.

To foreign investors, the major macroeconomic policies and indicators that matter are: fiscal policies and budget deficits; monetary policies, the quality of monetary management by the central bank, their impact on domestic interest and inflation rates, and indirectly on the stability of domestic currency values; trade policies in terms of openness and liberalization under WTO rules; exchange rate policies concerning convertibility on the current and capital accounts; and debt management policies concerning both internal and external debt, the comfort levels involved in servicing both, and the risks that debt burdens pose to fiscal and/or monetary destabilization leading to a financial crisis and externally enforced structural adjustment.

4.8 Perceived Barriers

There was a general consensus among the interviewees that barriers to entry and operation in Kenya still exist. Prior to entry there is a complex and time consuming process of approval before the government and local authorities are satisfied in granting an entry license. The barriers can be grouped into four major groups which are: Administrative barriers, Infrastructural barriers, Policy barriers and Legislative barriers. The transport infrastructure is the major obstacle, especially roads, which are in bad shape even by regional standards. Governance and security are other important issues, although the Government has adopted various measures for fighting corruption. Most Swedish companies establishing and conducting business in Kenya will have to face issues such as corruption, inadequate infrastructure, cumbersome legislation and incomprehensible polices. Apart from these domestic obstacles, as a foreigner, there is yet one more obstacle to overcome, the cultural barrier. The Swedish and Kenyan (East-African) cultures display significant differences. That culture has an effect on business as it becomes evident when one considers that it provides its members with an implicit theory about how to behave in different situations and how to interpret others' behaviors in these situations.

Despite the attractiveness and the reforms that have been taking place in Kenya a number of impediments have also been encountered by the companies. The first issue involves the bureaucracy that is associated with administrative procedures, inefficiencies in the co-ordination of government departments, unclear or contradictory laws and the uncertainty arising thereof. In addition it seems that post-approval monitoring and evaluation mechanisms are weak. The result is again friction between the foreign investors and the interests of local investors and the host country. While a number of tax incentives are granted to foreign affiliates, there have been cases of domestic enterprises enjoying preferential treatment in terms of easy access to financial resources This causes unfair competition and market distortions and may be looked upon as an impediment to foreign investment.

4.9 Challenges facing Foreign Investors

Acquisition of work permits especially if many expatriates are required in an organization seems to be a major problem. This is because many companies would like to have expatriates as their key employees while the government does not give work permits for resources that are locally available. Cultural barriers also play a major role because of diverse ways of working. Different countries have different cultures and some practices may be acceptable to one country but are considered not only unacceptable but an insult in another country. For instance most our time management is a major challenge especially to Europeans countries to an extent that when you are booking an appointment you have to specify whether it's African or European time. The Africans are known for not keeping time. Lack of proper infrastructure in certain areas poses a challenge because it affects the operations of the company. Corruption especially when dealing with governmental bodies is evidently a challenge since it's widely known that you have to bribe to get the services done.

STC is working hand in hand with lobby groups to agitate for better services. Kenya Association of Manufacturers and other professional bodies provide information on ways of working to ensure faster processing of the required documents. Swedish Trade Council assists Swedish companies established locally in solving their problems in conjunction with the Swedish Embassy.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

Kenya has become a high-potential investment area. The economy is growing fast and a lot of opportunities are present. This has made Kenya an attractive destination for foreign investments. The Government has implemented reforms in the legal framework for FDI in order to encourage investment. Furthermore, there is the creation of Kenya Investment Authority and Invest Kenya which promote Kenya as an area to invest in. Liberalization has made Kenya an attractive destination for foreign investments.

The problems identified by the research participants indicate limitations in incentive policies that will specifically encourage FDI in all the sectors. It is highly recommended that policy makers should identify the bundle of resources, capital, technology and labour associated with encouraging FDI and develop complementary policies to enhance its total incentive package. There is a need for identifying industry-specific factors in order to encourage FDI in various sectors. The tax system is problematic, vague and difficult to understand. Quotas on imports and exports are too tight and customs procedures themselves extremely complex and time consuming. Companies have to spend vast sums of money and time to handle the voluminous amount of paper documentation.

5.2 Conclusions

Most developing countries actively promote FDI as it is generally recognized that FDI can make a significant contribution to economic development through the transfer of capital, technology and skills although such transfers are not automatic. However, as developing countries adopt a host of policies and strategies, including expensive incentives, to lure FDI, the success rate offers a mixed picture and is sometimes outright disappointing. In the final analysis, FDI will flow where business opportunities are the greatest and obstacles to business the smallest. Investors are quick to spot attractive locations in this regard without much official promotion. While active investment promotion has proved to make a difference in Kenya, a comprehensive and consistent market-friendly development strategy adopted and implemented by a pro-active government which facilitates rather than obstructs business and is private sector oriented, promotes regional cooperation and embraces the global economy is the best guarantee that investors will find the country/ locality increasingly attractive for their investments. Where they succeed, others will follow.

The seemingly preferential treatment afforded in certain cases to domestic entities may cause unfair competition and market distortions. The functioning of multinational enterprises is based on the principle of internalisation. To the extent that discriminatory practices against foreign firms exist, then the full benefits of FDI may not be realised. The government should not only eliminate such practices but also actively encourage multinational enterprise FDI by subsidizing the search costs associated with it such as information gathering and dissemination.

5.2 Limitations of the Study

This study has implications for further research in the area. Inevitably, it also suffers from some limitations that need to be acknowledged. One limitation of this study is its cross-sectional nature. Its important to note that the determinants for FDI change over time. Therefore, it will be useful to replicate the results of this study through empirical examination of justification-oriented research hypotheses and that can be developed from the results herewith. In addition, the fact that the case-study approach has been adopted means that statistical generalization and aggregate results over the whole population of Swedish investors in Kenya cannot be attained. Of course, this was not the objective. The outcomes of this case study reveal factors that can be the subject of justification-oriented research hypotheses in the context of motives, entry modes and ownership and location of Swedish businesses investing in Kenya.

5.3 Recommendations for Future Study

It is highly recommended to extend this study to the whole population of Swedish Investors in Kenya. Swedish Trade Council can provide a list of all the Swedish investors currently established in Kenya and each investor should be studied to verify the information collected from the Swedish trade Council and to get any other information that may apply to specific investors.

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APPENDICES

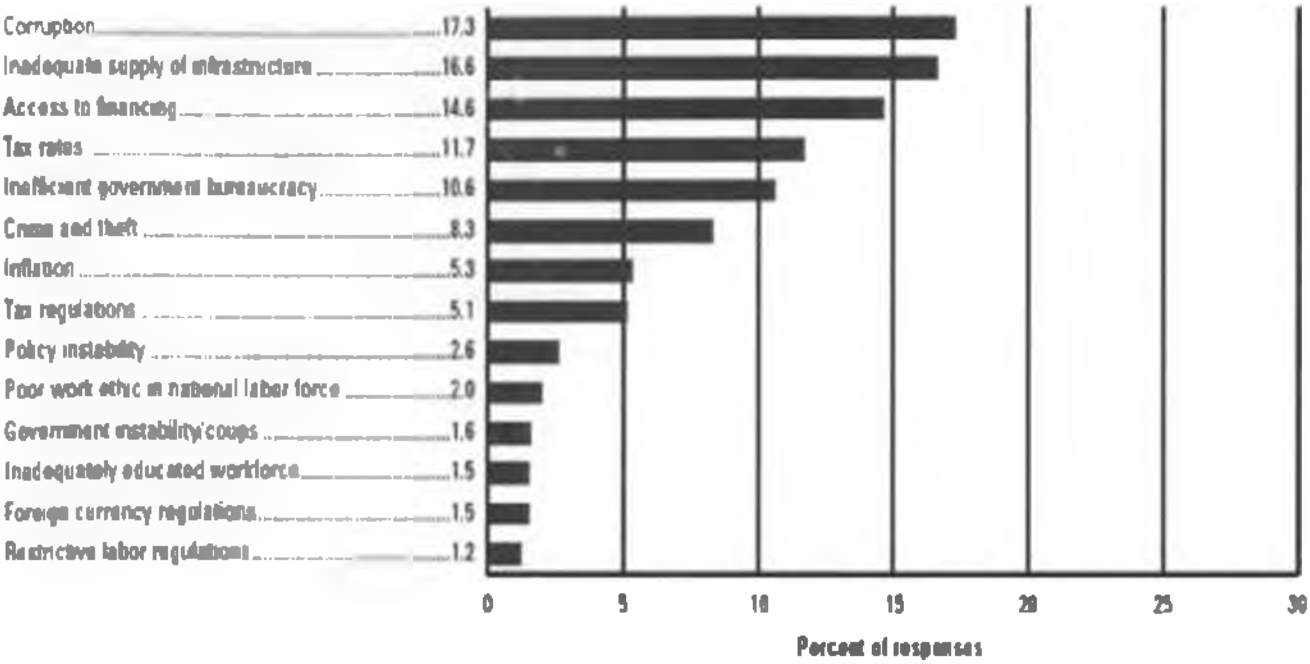
Appendix 1: Barriers of Trade

Barriers	No.	%	Rank
1. Lack of professionalism	11	64.7	1
2. Inefficient internal systems	10	58.8	2
3. Inadequate consultation and information dissemination	9	52.9	3
4. Lack of transparency	7	41.2	4
5. Inadequate staffing levels	7	41.2	4
6. Inadequate investment in physical equipment	5	29.4	6
7. Insufficient use of IT	5	29.4	6
8. Excessive documentation requirements	3	17.6	8
9. Lack of coordination and cooperation with other trade agencies	3	17.6	8
10. Unnecessary and time consuming physical inspections	2	11.8	10
11. Focus on revenue maximization per shipment	2	11.8	10
12. High and or unpredictable charges for services	2	11.8	10
13. High tariffs	2	11.8	10
14. Cargo loss damage	2	11.8	10
15. Labour relations e.g. strikes	2	11.8	10
16. Inadequate transport infrastructure	1	5.9	16
17. Financial Constraints	1	5.9	16

Source: Barriers of Trade (EME. 2005)

Appendix 11: Problematic Factors for doing Business in Kenya

The most problematic factors for doing business



Note: From a list of 14 factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

Source: Problematic factor for doing business in Kenya 2007 (Africa Competitiveness Report, 2007)

Appendix 111: Letter of Introduction

August 2008.

Dear Respondent,

RE: RESEARCH ON FACTORS INFLUENCING STRATEGIES EMPLOYED BY SWEDISH TRADE COUNCIL IN PROMOTING FDI IN KENYA.

I am a Master of Business Administration (M.B.A) student at the University of Nairobi. I am currently undertaking the above stated research project as part of the academic requirements for the award of the said degree.

I would be grateful if you could kindly spare some of your time for me to come to your office for a short interview with you. An interview guide is attached hereto for your easy reference and to enable you to prepare as necessary. The information you give shall be treated with utmost confidentiality and will be used purely for academic purpose. Findings of the study, shall upon request, be availed to you.

In case of any queries pertaining to this research project, please do not hesitate to call me on 0722608225.

Your assistance and cooperation will be highly appreciated.

Thank you in advance.

S.W.Kamau

MBA Student- Researcher

Appendix 111: Letter of Introduction

August 2008.

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In case of any queries pertaining to this research project, please do not hesitate to call me on 0722608225.

Your assistance and cooperation will be highly appreciated

Thank you in advance.

S.W.Kamau

MBA Student- Researcher

Appendix IV: Interview Guide.

1. Are you aware of the strategies used to promote foreign investments in Kenya ? Explain
2. What are the factors attracting Foreign Direct Investors in Kenya?
3. What are the motives for entering and investing in Kenya?
4. Which is the preferred location of establishment and the underlying reasons?
5. Which are the preferred modes of market entry?
6. Describe the possible hindrances to foreign investment in Kenya?
7. What types of legislation and policies attract Swedish investors in Kenya?
8. What are the perceived barriers?
9. How are companies acting to overcome the obstacles?
10. What are the major challenges facing Foreign investors?
11. Which sectors are targeted by the Foreign Direct Investors?