CONSTRAINTS TO FOREIGN DIRECT INVESTMENT INFLOWS TO KENYA: STAKEHOLDERS' PERSPECTIVE

By

Benson A. Ateng', Senior Lecturer

Department of Economics and Resource Management,

The Technical University of Kenya

Robert Arunga, Chairman

T&P Innovation and Technology Management Services (TAPITEMS) Ltd

Abstract

Foreign Direct Investments (FDIs) are considered to be important in promoting economic growth in developing countries by providing capital, technology, improvement of skills, efficiency and trade; and by providing domestic small and medium-sized enterprises with linkages and markets for the supply of goods and services. The Government of Kenya has undertaken a number of policy reforms focused on making Kenya a favourable and predictable investor destination. However, these efforts have not led to significant success in FDI inflows. Why?

We reviewed various studies and research reports that have been carried out on FDI in Kenya in order to update ourselves on the reforms that the government has implemented with regard to FDIs. We also undertook structured interviews with the private sector; government departments and agencies to get their views on policy reforms that can positively affect FDI in Kenya as well as identify/establish perceived FDI gaps that need to be addressed. We did the same with international organizations that carry out comparative global competitive rankings in order to identify policy issues/factors that explain why despite efforts by the Government to improve the business climate, global rankings of competitiveness and ease of doing business in Kenya don't seem to have improved.

From the perspectives of the stakeholders, most of the problems and challenges identified by various studies are still real even today, despite the progress made by the government in implementing reforms. Specifically, the respondents were of the view that Kenya is an expensive location for doing business (bureaucracy, cumbersome regulatory framework, insecurity, weak infrastructure, high energy costs, corruption, multiple taxation regimes, limited access to affordable finance, ICT not fully developed, and high cost of labour not matched with productivity). The stakeholders provided a number of recommendations, most of which were similar to those proposed by various studies.

The respondents suggested a number of actions/reforms to address the problems/challenges they listed as the main hindrances to FDI in Kenya. The recommendations include actions/reforms that would improve the institutional, policy and regulatory framework, infrastructure, security and political environment, and access to data and information; reduce cost of doing business; address corruption and governance issues; enhance human resources; and spur economic growth.

Keywords: FDI, competitiveness, corruption, governance, infrastructure, taxation, productivity, stakeholders

1.1 Introduction

Foreign direct investments (FDIs) are the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor[1]. They are the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. The International Monetary Fund (IMF) defines FDI as 'an investment made to acquire a lasting interest in

[1] Moosa I. A. (2002). Foreign Direct Investments: Theory, Evidence and Practice, Palgrave Macmillan. UK.

an enterprise operating in an economy other than that of the investor, the investors' purpose being to have an effective voice in the management of the enterprise ("direct investment enterprise")[2].' FDIs are considered to be important in promoting economic growth in developing countries by providing capital, technology, improvement of skills, efficiency and trade; and by providing domestic small and medium-sized enterprises with linkages and markets for the supply of goods and services. The Government of Kenya has undertaken a number of policy reforms focused on making Kenya a favourable and predictable investor destination. Examples of such reforms include the establishment of Export Processing Zones and Special Economic Zones; the improvement of core infrastructure (ports, roads, fibre optic); the review of the Public-Private Partnership (PPP) laws and the reengineering of Kenya's economic diplomacy. However, these efforts have not led to significant success in FDI inflows. In fact, FDI inflows to Kenya have been rather erratic and way below the country's potential.

The above finding influenced our decision to undertake this study. We set out to determine the main constraints to FDI inflows to Kenya from the perspective of the stakeholders. We defined the stakeholders to include key players in business, public sector and the country's development partners (international organizations).

1.2 Methodology

The study consisted of the following steps:

a. Reviewing studies and research reports that have been carried out on Foreign Direct Investment (FDI) in Kenya by various research institutions, the private sector, academia, government and bilateral and multilateral organizations in order to update ourselves on the reforms that the government has implemented with regard to FDIs.
b. Undertaking structured interviews with the private sector; government departments and Agencies to get their views on policy reforms that can positively affect FDI in Kenya as well as identifying/establishing perceived FDI gaps that need to be addressed.
c. Undertaking structured interviews with international organizations that carry out comparative global competitive rankings in order to identify policy issues/factors that explain why despite efforts by the Government to improve the business climate, global rankings of competitiveness and ease of doing business in Kenya don't seem to have improved.

We conducted structured interviews with 100 officials representing the private sector, government departments and agencies and international development organizations. The interviewees were selected from:

a. The private sector and opinion leaders to get their views on policy reforms that can positively affect FDI in Kenya as well as identify/establish perceived FDI gaps that need to be addressed from the private sector perspective;

[2] International Monetary Fund (1993). *Balance of Payments Manual 5th* Edition (BPM5), Washington, DC.

b. Relevant government departments and agencies, research institutions, and academia to get their views on the implementation of FDI policy recommendations, the impacts of such policies, and FDI challenges in the country; and identify/establish perceived gaps that need to be addressed from public sector perspective; and

c. Some of Kenya's development partners that carry out comparative global competitive rankings in order to identify policy issues/factors that explain why despite efforts by the Government to improve the business climate, global rankings of competitiveness and ease of doing business in the country don't seem to have improved.

The respondents were asked to give their views on three main issues:

a. Challenges they consider to be the main hindrance to FDI;
b. Actions they would recommend to address the challenges; and
c. 3-5 questions, which if the study would address, would be beneficial to their organization or members.

1.3 Findings and Recommendations

This section summarizes the FDI challenges and actions to address them from the perspective of the stakeholders we interviewed.

1.3.1. Challenges Identified During Consultation on FDI

The respondents gave a wide list of problems/challenges that the government needs to address in order to attract more FDI as well as domestic private investment. We have summarized the main challenges that kept coming up in virtually all the interviews under the following groupings:

a. Institutional framework;
b. Data and information;
c. Policy and regulatory framework;
d. Infrastructure;
e. Economic growth;
f. Cost of doing business;
g. Corruption and governance;
h. Human resources;
i. Security and political environment; and
j. Other challenges

The responses and comments from the stakeholders interviewed are grouped below under each of the above headings.

1.3.1.1. Institutional Framework

The respondents raised the following concerns with respect to institutional framework:

a. There is a multiplicity of independent institutions dealing with investments resulting in turf wars and causing frustrations to investors.

b. There have been difficulties in establishing a one-stop shop for facilitating investment (several attempts, directives and proposals have not borne any positive results).
c. There is weak coordination among government departments/agencies and private sector organizations
d. There is lack of a champion of FDI at the highest level.
e. Other concerns include weak capital markets, lacking transparency and riddled with insider trading, weak and non-transparent financial intermediation, deteriorating public service delivery and weak promotion activities.

1.3.1.2. Data and Information

The respondents also raised issues concerning the management of FDI data and information. Specifically the respondents were unhappy with lack of: comprehensive information on investing in Kenya; single institution with FDI inflow data; and consolidated information and data nationally and regionally (counties). As a result, collection, collation and analysis of accurate and comprehensive data are difficult. Furthermore, getting accurate data on FDI inflows in Kenya has been a major challenge because investors come through many institutions (Central Bank of Kenya, Kenya Investment Authority, Export Processing Zone Authority, Capital Markets Authority, National Stock Exchange, Commercial Banks and directly through local authorities).

1.3.1.3. Policy and Regulatory Framework

a. Poor investment policies - respondents pointed out that the FDI promotion methods were poor; raised issues with the compulsory investment certificates and the higher capital requirements. There was also concern with multiplicity of laws, regulations and licenses. Regulatory and tax regimes were also not favourable (licenses, taxes, capital allowances).

b. Regulations - respondents pointed out that there was need to rationalize the number of regulations governing FDI, through border posts reforms; taxation reforms; liberalization and competition laws aspiring to best practice as well as sectoral investment policy and strategy. Lack of trade and investment policies were also mentioned as a problem.

c. The respondents were also concerned with weak policy implementation record and lack of consistent legislative frameworks for Public-Private Partnership (PPPs) and for exploiting natural resource (oil, gas, coal, gold, titanium).

d. Unfavourable and rigid structural and regulatory regimes (e.g., cessation of 35 percent shares to local investors) this can be daunting to local investors in raising capital where the total investment is high (Lamu Port and South Sudan Ethiopia Transport, LAPSET, investment first phase requires 2 billion USD and 100 billion USD in total). Lack of consistent legislative frameworks for PPPs and for exploiting natural resource (oil, gas, coal, gold, titanium), was also identified as a problem.

e. Other issues included:

i. noninvolvement of private sector in policy dialogue, formulation, implementation and monitoring;
ii. Problems with communities and NGOs with regard to environmental matters and space for investment (for example, Sondu-Miriu, Kwale, Lamu, and Tatu City projects)
iii. Long negotiation time lags, e.g., independent power producers have been negotiating for the last 3-4 years
iv. Poor linkages between small and large scale investors.

1.3.1.4. Infrastructure
All respondents cited infrastructure (electricity, ICT, roads, water) as the main bottleneck to attracting FDI into Kenya and doing business in the country.

1.3.1.5. Economic Growth
The respondents mentioned the following two issues with respect to economic growth:
a. Sluggish GDP growth rate which affects market size and rate of return on investment
b. The engine of growth (the economic pillar in Vision 2030) is only seen on paper, for example, Medium-term Plan (2008-2012) but with no implementation (except for talk, plans and models) of the flagship projects.

1.3.1.6. Cost of Doing Business
Respondents were of the view that Kenya is an expensive location for doing business (bureaucracy, cumbersome regulatory framework, insecurity, weak infrastructure, high energy costs, corruption, multiple taxation regimes, limited access to affordable finance, ICT not fully developed, high cost of labour not matched with productivity)

1.3.1.7. Corruption and Governance
Respondents also mentioned rising corruption and poor governance as well as rent seeking in a variety of operations, as main challenges for FDI into Kenya.

1.3.1.8. Human Resources
Respondents mentioned the following issues related to human resources for FDI and business:
a. Rising cost of labour without corresponding rise in productivity
b. Low levels of skills (Human resources).
c. Lack of capacity to prepare, negotiate tender and implement PPP- projects
d. Lack of capacity to prepare and manage complex and transformative projects
e. Government and management weaknesses
f. Low technical capacity

1.3.1.9. Security and Political Environment
Respondents found unstable political environment and insecurity; perceived political risks; lack of political good will; and insecurity (criminals, judicial credibility), as key challenges.

1.3.1.10. Other Challenges

Other challenges mentioned by the respondents include; low domestic investment; low investment to GDP ratio which stands at 20% in Kenya and needs to move to 40%; reluctance by enterprises, banks and investors to report on their source of finance accurately; and negative perception abroad (post-election violence, political, economic and stereotyping)

1.4. Actions Proposed by Respondents to Address the Challenges

The respondents suggested a number of actions/reforms to address the problems/challenges they listed as the main hindrances to FDI in Kenya. These are summarized below.

1.4.1. Institutional Framework

a. Review the investment act to give more facilitation powers to Kenya Investment Authority and enable it to attain a one-stop investment status.
b. Conduct a study of the agencies dealing with investment to recommend how to merge some of them to facilitate efficiency and effectiveness in promotion, data collection and representation.
c. Implement the concept of one-stop shop through one agency or by having all regulatory agencies working under one roof, probably with Kenya Investment Authority taking the lead.
d. Strengthen Kenya Investment Authority through various reforms, capacity building and provision of adequate resources; the institution should be in the Office of the President with the President acting as the champion of investments (cf. Rwanda Investment Board championed by the president).
e. Revive the Prime Minister's Round Table with investors/private sector, under the President, and increase the frequency of meetings.
f. Strengthen economic representation in Kenyan embassies abroad with information and adequate authority and resources.
g. Create Diaspora Board/Agency to deal with investments by Kenyans who are abroad.
h. Strengthen Capital Markets Authority.
i. Establish Kenya Investment Authority satellite offices at the county level.

1.4.2. Data and Information

a. Develop and publish an investment handbook with comprehensive information to be used by promoters and prospective investors and establish a portal link with Kenya Investment Authority.
b. Consolidate and update all data relating to investments to facilitate further investment and maintenance functions of Kenya Investment Authority.
c. Establish a national institution with current data and information on investments.
d. Establish a national mechanism for reporting and recording accurately all FDI inflows.
e. Establish an institution to receive, collect and collate national and county information and data on investment.
f. Create one-stop shop for data/information, preferably Kenya National Bureau of Statistics, and facilitate institutions with enough resources and authority.

1.4.3. Policy and Regulatory Framework

a. Adopt evidence-based policy advocacy informed by intra-country studies and regular studies to monitor the impact of FDI inflows nationally and sectorally. There is also an urgent need to study and regularize investment flows nationally and within counties.
b. Enforce transparency and consistency in investment policy.
c. Review the incentives in place and move towards soft incentives.
d. Rationalize government investment and regulatory institutions.
e. Rationalize some of the investment restriction to take care of quantum and sectoral differences.
f. Strengthen PPPs.
g. Make no distinction between FDI and Domestic Investments; both contribute towards economic growth.
h. Implement effectively recommendations and policy reforms agreed with development partners such as the World Bank and IFC (reactivate stalled Bills, Acts and projects).
i. Enact the Business Regulatory Bill urgently.
j. Encourage counties to attract FDI independently in order to increase inflows.
k. Regularize and establish supportive taxation regime for investors.
l. Sensitize the communities, for example, with respect to land acquisition for investment.
m. Complete judicial reforms to reduce delays in court cases.
n. Consolidate/harmonize all the laws governing the investment terrain.
o. Carry out impact analysis of policy and regulatory reforms

1.4.4. Infrastructure

a. Improve infrastructure (energy, ICT, roads, water, port and air services).
b. Strengthen ICT platforms and reduce costs.
c. Give incentives to private sector to invest in energy and water.
d. Ensure energy reliability and affordability (while current generation and proposed energy projects may amount to 2,000MW of electricity, projects proposed under Vision 2030 will need an additional 41,000MW of electricity).

1.4.5. Economic Growth

a. Improve macroeconomic environment (economic growth, low inflation).
b. Reduce the debt burden.
c. Improve markets (size, purchasing power-- economic growth, quality).

1.4.6. Cost of Doing Business

a. Reduce cost of doing business.
b. Improve the business environment by:
    i. Implementing simple reforms recommended by Regulatory Reform Working Group (Ministry of Finance, IFC),
    ii. Implementing legislative actions (insolvency bill, company's law), and
    iii. Improving border and port clearances.
c. Work with IFC to improve investment climate.

1.4.7. Corruption and Governance

a. Reduce corruption.
b. Take decisive action on corruption.
c. Eliminate corruption or bribery
d. Improve democracy, governance (judiciary, legislative, executive).
e. Improve accountability, integrity, credibility and judicial processes.
f. Improve governance (transparency, social responsibilities, accountability, justice and priority setting).

1.4.8. Human Resources

a. Reform education to generate skills needed by industry.
b. Provide training in high level technical skills at the higher level in domestic products such as textiles (apparel) and leather (leather goods).
c. Involve industry in serious high level technical training through levy.
d. Institute strong programmes for training in project management (planning, preparation, negotiation, tendering and implementation).

1.4.9. Security and Political Environment

a. Improve security (law and order).
b. Adopt democratic practice and good governance to ensure political stability.
c. Complete reform of the police force.

1.4.10. Other Recommended Actions

a. Market Vision 2030 and Kenya comprehensively to reverse negative perceptions.
b. Strengthen economic representation in Kenya's embassies abroad with information and adequate authority and resources.

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